

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

CHAPTER 1

Introduction: Welfare and Inequality

INTRODUCTION

In most democratic capitalist nations, the idea that the state should play a major role in protecting and advancing well-being amongst the population as a whole developed after the Second World War. This is not to deny that major policy innovations occurred before then, or that the goals of the welfare state were debated earlier either within government, or outside of it. But these earlier measures tended to be restricted to specific groups in society (particularly the aged) who were seen as being unable to fend for themselves adequately in a market economy. All this changed in the period immediately after the war, when governments acknowledged and embraced a new interventionist role which included responsibility for the attainment of economic goals like full employment and economic growth, for economic and social equality, and for the protection of those suffering economic and other misfortune.

The enthusiasm with which this new role for government was embraced varied across countries as, more significantly, did the way in which that role was translated into economic and social policies and the development of institutions to support them. But the idea that some form of welfare state was integral to the operation of what is now referred to as welfare capitalism (Esping-Andersen, 1990) has formed the basis of economic and social development for the last half century in all industrialised nations. From the outset, the welfare state comprised a framework of institutions and policies designed to enhance the welfare of citizens and reduce the various dimensions of inequality. This was to be achieved through the establishment of entitlements – access to income support, services and other provisions – which represented the social rights of citizenship, to be distinguished from the legal and political rights gained earlier

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

(Marshall, 1981). In practice, the form of these entitlements was dependent upon the breadth of vision encapsulated in the push for equality, and their scope and generosity reflected the seriousness with which governments – and the citizens who elected them – were prepared to tackle existing dimensions of inequality. At a minimum, there was broad acceptance that some part of society's resources should be allocated according to social need, rather than in accordance with individual ability to pay.

Associated with acceptance of these principles of rights and entitlements was a set of duties and responsibilities, specifically that the state should be given the power through taxation to divert resources away from the satisfaction of individual wants towards the satisfaction of social needs and that individuals would not abuse the new opportunities and benefits available to them. Those who benefited most from an economic system which flourished under the protection and support of the state were expected to contribute most to expanding the opportunities and resources available to those less fortunate than themselves. The welfare state was thus a powerful force for both equality and social cohesion in a world where market forces would otherwise have produced inequality and social unrest.

Policies which seek to achieve greater equality almost inevitably threaten the relative positions of some individuals and groups. This is true to some extent of all actions by the state, although many lead to minor redistributive effects which, being less obvious, give rise to less concern. However, state intervention generally creates or affects the interests of different groups in different ways, who then mobilise to shape interventions in the interests of the group. Where redistribution is an explicit goal of policy, as in the case of the welfare state, the development of welfare policies and programs thus reflects the playing out of these political forces mobilised by the various interest groups affected. The invisible hand of market competition could not be left to resolve the allocation of resources through the mediation of supply and demand. Instead, politics became the arena for allocating resources towards the achievement of collective social goals.

These political forces operated within the framework of a market economy, and inevitable tensions arose between the two (Esping-Andersen, 1985). On the one hand they reflected the fact that the resources allocated by the state were by and large generated by the market. In order to redistribute income, someone first has to generate

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)*Introduction: Welfare and Inequality*

3

that income. On the other hand, the policies implemented to achieve welfare goals operated within a market structure and thus influenced the operation of markets and, more importantly, changed the economic signals and incentives confronting individuals. Some have argued that the changes in behaviour induced by these changed incentives have seriously undermined the success of the welfare state (Murray, 1984). Others argue that politics has triumphed over the market and that welfare state policies have had significant positive effects, even if they are not always as strong as was hoped (Ringgen, 1987).

For the three decades up to the mid-1970s, expenditure on the welfare state rose steadily in all countries belonging to the Organisation for Economic Cooperation and Development (OECD). By 1975, expenditure on the main welfare state programs – education, health, social security and welfare services – accounted for between 15 per cent and 37 per cent of national income, as measured by gross domestic product (GDP) (OECD, 1985). Australia was towards the lower end of the spending ratio league at that time, with social expenditure accounting for just below 19 per cent of GDP. Cross-country variations in the total level of spending and in the relative importance of different social programs reflected a number of factors, including differences in age structure, in economic performance, in policy design and in ideology (George and Wilding, 1984; Castles 1987, 1990; Saunders, 1988a). However, by the late 1960s, all of the OECD countries were becoming concerned about the growth in welfare state expenditure and these concerns were heightened by the decline in economic performance which followed the first oil shock in 1973.

Economic downturn threatened the viability of the welfare state from two opposing directions. By reducing economic growth, the ability to fund additional welfare programs from the growth dividend virtually disappeared, while at the same time the rise in unemployment associated with lower growth placed more demands on the system. In addition, a better appreciation began to emerge of the political difficulties associated with curtailing welfare programs, even those which had outlived their usefulness. The power of the various vested interest groups was considerable, as was the strength of their resistance to change. Such interest groups included not only those who benefited from services, but also those involved in service provision who were often more highly educated, more

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

organised and better able to maintain their existing advantages even in the face of hostile governments (Goodin and Le Grand, 1987). Changes in demographic structure were also giving rise to an increased proportion of elderly people in the population, putting further upward pressure on future levels of expenditure if existing entitlements were to remain unaltered (OECD, 1985, 1988a).

All this was taking place at a time when it was becoming apparent that despite expanding welfare budgets, many of the social problems to which welfare state policies were directed were proving resilient. Poverty remained widespread, reinforced by other forms of inequality which further exacerbated the problems of disadvantage, isolation and financial stress faced daily by large numbers of people. In a climate of economic stringency, it was no longer sufficient to argue for more spending, and it became increasingly hard to extract the necessary fiscal resources through higher levels of taxation. In addition, there were concerns that the effectiveness of welfare state policies could be – and in some instances was being – undermined to various degrees by the effects on work incentives, induced dependency and other behavioural adjustments to which they gave rise. Although the research indicated that most of these effects were not large (Danziger, Haveman and Plotnick, 1981; Gruen, 1982; Saunders and Klau, 1985), there remained an uneasy feeling that some welfare state programs appeared to work only to the extent that they initially worsened the magnitude of the problems they were designed to solve.

The result was a ‘crisis of the welfare state’ in relation to the current and projected financial costs of welfare programs, to their broader economic and social costs, and as to whether or not many of those programs could actually achieve their original objectives (Gough, 1979; OECD, 1981; Mishra, 1984). Although in hindsight the extent of this crisis in the mid-1970s was exaggerated at the time, it nonetheless set the context for the development of welfare state programs throughout the OECD over the next two decades. Different countries have responded in different ways to this perceived crisis, although broad similarities exist between certain countries which have developed similar welfare state regimes (Esping-Andersen, 1990). Australia, traditionally regarded as a ‘laggard’ when it comes to the level of welfare state expenditure (Castles, 1985), has had to confront this crisis and seek to bring its welfare programs more into line with its reduced economic prospects. This has not proved to

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)*Introduction: Welfare and Inequality*

5

be easy. Indeed, it is interesting to note that the crisis of the welfare state was perceived to be most serious in those countries with the smallest welfare states, not those with the largest ones.

The fiscal crisis and economic hegemony of the 1980s have been put into perspective by the recession which began in 1990. This has focused the minds of policy-makers and the population at large back on to fundamental issues of unemployment and living standards. In those countries which were at the vanguard of moves to wind back state involvement in the 1980s, new political forces and policy paradigms emerged which questioned the fiscal and economic orthodoxies of the period. The election of President Clinton in the United States, the moves towards more moderate and compassionate policy by Prime Minister Major in Britain, and the federal re-election of the Labor Party in Australia represented a turning away from the harsh social and economic policies of the 1980s which had failed to deliver what they promised – economic prosperity in a minimalist state, market-driven, deregulated economy. The need for balance between state and market was also an important lesson to emerge from the economic and political collapse of the countries in the former Eastern bloc.

Despite these developments, Australia, like the United States and other Anglo-Saxon nations, still embodies a strong ideological commitment to liberal economic principles and to the role of market forces in economic development. The Australian welfare state has thus tended to be assigned a residual role, providing support as a last resort when other mechanisms – self-help, the market economy and the family – have broken down. Income equality, for example, has been pursued in Australia through the unique development of a ‘wage earners’ welfare state’ working through wages policy rather than through the widespread provision of generous income support measures (Castles, 1985). In contrast, in many European countries, the state generally and the welfare state in particular has been accorded a far more positive interventionist and redistributive role. State intervention has been institutionalised into the economic system on a more equal footing with the market, not relegated to a subordinate and residual role.

An important lesson to emerge from the experience of the past two decades is that the welfare state has an important role to play in supporting and facilitating economic change. Also, while there are limits to the scope and form of welfare programs if they are to

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

be affordable and achieve their goals of equality, certainty and freedom within the framework of a market economy, previously held notions that state cutbacks are both necessary and sufficient for the achievement of economic progress have been found to be seriously misguided. Achieving the right balance between the state and the market remains the central policy concern, although economic analysis is only one of the ingredients in the mix of approaches and frameworks required to help achieve this. Increased appreciation of the complexity of the technical issues involved in the design and implementation of social policies should not be allowed to undermine the vision, aspirations and economic benefits which inspired the development of the post-war welfare state half a century ago.

This book is concerned to investigate how some of the main forces operating on the welfare state have been played out in Australia in the past two decades and what their consequences have been. The two main themes of the book concern the relationship between the welfare state and the economy, and the impact of the welfare state on inequality. A third important theme which underlies the other two is the significance of cross-country comparisons for understanding national issues. There are two dimensions to this. The international social and economic challenges facing all countries have been similar and international comparisons help to highlight this, putting domestic developments in an appropriate context. In addition, the study of overseas experience can shed new light on national policies and problems. It is possible, for example, by studying how others have coped (or not coped) with their problems to better appreciate what is required in order to deal with ours. This is occurring increasingly in the field of social policy, facilitated by international agencies like the OECD which provide scope for policy-makers to interact and learn from each other, as well as by the enormous increase in comparative social policy research.

WELFARE AND THE ECONOMY

As already indicated, any study of the welfare state must recognise the key role it plays in the economy and the nature of the links between the economy and the welfare state. This does not mean that the economics of the welfare state is all that matters. Although important, economic issues must be placed alongside an understanding of political and legal questions as well as an appreciation

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)*Introduction: Welfare and Inequality*

7

of the social forces which impinge upon collective decision-making in any comprehensive study of the welfare state. In the past, economists have been notoriously bad at acknowledging that other (non-economic) factors must also be embraced in any meaningful assessment of public policy. Crossing disciplinary boundaries inevitably involves a step into the unknown, one which the great majority of economists have been reluctant to undertake. Yet there are many fundamentally economic issues which have a major role to play in the analysis of the welfare state, particularly if they are employed in a context which recognises both the strengths and limitations of purely economic reasoning.

The arguments and analysis contained in Chapters 2 to 5 attempt to illustrate the important contribution which an economic perspective can provide to the analysis of aspects of the welfare state. Some themes – such as the role of welfare spending in affecting overall economic performance and the expenditure implications of population ageing – emerge in several places, reflecting their fundamental importance. The first of these forms the basis for the analysis of the Australian social security system which is contained in Chapter 2. Here, OECD data are used to demonstrate the lack of any simple cross-country relationship between the size of welfare (or social security) spending and the rate of economic growth. Thus the economic crisis of past decades cannot be blamed on the growth of the welfare state. This discussion is followed by a detailed analysis of the objectives of the Australian social security system and how the nature of the system has been changed by social and economic developments over recent decades. The role of labour market changes and population ageing in influencing future developments is then canvassed before the critical issue of the relationship between the structure of social security benefits and their effects on income inequality is addressed. The arguments developed here suggest that the increased targeting of benefits throughout the 1980s may not, in the longer term, lead to greater income equality as many of the proponents of targeting have claimed.

Chapter 3 begins with a detailed analysis of the growth of welfare state spending since the mid-1960s. The distinction between spending on income transfers and on the provision of community services is explained and its importance highlighted, specifically the need to distinguish between expenditure on program outputs and on program inputs. The distinction between outputs and inputs is

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

also critical in separating and thus assessing the effectiveness and efficiency of welfare programs, an issue addressed in more detail in Chapter 4. After discussing some of the factors underlying past spending growth, the role of welfare state expenditure in responding to and in turn influencing labour market changes is explored.

The welfare state plays a dual role in this context. Firstly, by providing a framework of support for all citizens, the welfare state facilitates the processes of economic and structural adjustment taking place in the market sector. Secondly, some of those structural changes – the switch towards services and the increased labour force participation of married women, for example – would have created severe labour surpluses had they not been absorbed in the expansion of welfare programs. An outline is also provided of some of the pressures on future expenditures in the Australian context in which occupational and fiscal welfare co-exist alongside the formal public welfare system. This leads to a discussion of the role of welfare privatisation as a response to the future financing pressures, an important issue which is taken up in later chapters and remains very much on the current political and policy agenda.

In Chapter 4, an international perspective is used to address questions associated with the efficiency and effectiveness of social policies. The analysis begins by investigating changes in the level and composition of government expenditures in OECD countries in the 1980s, focusing on the changing role of social expenditure during the post-war expansion of the welfare state. This is followed by a discussion of how economic, demographic and labour market changes, in association with the changed emphasis given to economic dimensions of public policies, have influenced the social policy context in the 1980s. The concepts of the efficiency and effectiveness of social policies are then discussed and a range of policy developments throughout the OECD, as well as comparative evidence on the impact of income support policies, are used to highlight their significance.

Chapter 5 returns to some of these themes, examining economic rationalism and its impact on welfare state policies. Key features of economic and social developments during the 1980s are described, focusing on the size of the public sector and overall economic performance, and providing an overview of trends in income inequality and poverty in Australia in the 1980s. Although this analysis focuses on the Australian experience, comparisons with

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)*Introduction: Welfare and Inequality*

9

other OECD countries place that experience in a broader international context. This precedes a discussion of the concept of economic rationalism, focusing on how economic theorising has been used in the design of public policies, and some of the limitations of conventional economic theorising itself. Finally, the changing role of economic incentives and market-type mechanisms in the welfare state in the new age of deregulation and encouragement of an enterprise economy is highlighted using examples from both Australia and overseas.

WELFARE AND INEQUALITY

The remaining four chapters address issues relating to the impact of the welfare state on inequality. A major objective of all welfare state programs is to reduce the degree of inequality of access, opportunity, or outcome relative to that resulting from the operation of a market economy. The impact of welfare programs on all dimensions of inequality is thus a crucial determinant of their effectiveness. In undertaking such an exercise, two points need to be emphasised at the outset. The first involves the distinction between the impact of welfare state interventions on inequality and their success in achieving their underlying objectives. The main dimension of inequality assessed here relates to the distribution of income. Virtually all welfare programs affect the extent of income inequality, yet only some have this as their main objective. To identify the (income) redistributive effects of welfare programs is thus different from measuring program effectiveness, which compares a program's outcomes with its objectives. It is possible, for example, to estimate the effects on income inequality of government subsidies to the provision of education or health care. But it would be unwise to base any judgement regarding the success of these programs solely on these effects, because the aims of both programs are not primarily concerned with income distribution as such.

A second point which arises in any analysis of the effects of policy (and other influences) on inequality concerns the importance of the counterfactual. The degree of inequality prevailing at any particular point in time is observable. It is dependent upon a host of factors, including the state of the economy, the current demographic and industrial structure, the outcome of market processes and the effects of past and present government interventions in those processes.

Cambridge University Press

978-0-521-45594-7 - Welfare and Inequality: National and International Perspectives on the Australian Welfare State

Peter Saunders

Excerpt

[More information](#)

However, in order to assess the extent to which each of these factors has influenced the existing distribution, it is necessary to estimate what would have happened to inequality if each of those factors, in turn, had not evolved as they actually did. The redistributive effect of progressive income taxes, for example, can be assessed by assuming that the same amount of revenue had been raised by a (distributionally neutral) proportional tax, and comparing the income distributions which result in each case. This alternative scenario, against which the current situation is compared is referred to as the counterfactual.

The nature of the counterfactual will clearly have implications for the results of any such exercise and the assumptions underlying it are thus critical. If, for example, a proportional income tax were to replace the existing progressive system, tax incentives would change and so too would labour market behaviour and hence the level and distribution of income derived from work. Such reasoning suggests that without making detailed assumptions about the nature of these changes, or in the absence of information which would allow the magnitude and pattern of such responses to be estimated, it is extremely difficult to estimate the redistributive consequences of the policies currently in existence. This highlights the more general point made earlier, that individuals adjust their behaviour – sometimes in unexpected and subtle ways – in response to the introduction of government policies, which makes it difficult to unravel the full effects of those policies. Estimates of redistributive impact, like other consequences of policy, are thus complicated to derive and, as a result, should always be interpreted with care.

Chapter 6, on the social wage, has an important strategic role to play in the book because it serves as a link between the discussion of trends in aggregate social expenditures contained in the four chapters that precede it and the more detailed analysis of inequality which follows in Chapters 7 to 9. The social wage has received particular prominence in Australia since 1983 because of the role attributed to it in successive versions of the Prices and Wages Accord. The initial Accord documents (and subsequent revisions thereof) recognised the role of the benefits to individuals and families associated with social expenditures in enhancing living standards and influencing their distribution in the community. This served to highlight the fact that government programs provide benefits