This paper to the Liberal Forum concentrates on cash transfer and income redistribution. It does not deal specifically with provision of services. Three main questions arise.

- What are the issues that are important to us as liberals?
- To what extent do our social goals happen to coincide with conservative policy outcomes?
- To what value positions and what policy lines should we be giving priority?

The Present Tax/Welfare System

1.

Two systems of cash transfer operate in Australian welfare. Welfare is also provided by systems of service provision, by the welfare effects of other taxation measures (such as the reduced living standards from the imposition of indirect taxes), and by the provision of universal benefits such as health and education allowances. The traditional cash-transfer system operates through the social security apparatus. The other, the tax expenditure system, operates through the taxation apparatus. Some features of the two systems are compared in the table below.

<table>
<thead>
<tr>
<th>Social Welfare System</th>
<th>Tax Expenditure System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mainly the poor</td>
<td>Mainly the well-off</td>
</tr>
<tr>
<td>Visible/stigmatising</td>
<td>Hidden/no stigma</td>
</tr>
<tr>
<td>Costs known</td>
<td>Costs unknown</td>
</tr>
</tbody>
</table>
Social Welfare System | Tax Expenditure System
--- | ---
Beneficiaries known | Beneficiaries unknown
Majority women | Majority men
Beneficiaries | Beneficiaries
Subsistence support | Affluence enhancing
Means/income tested | Often universal
Often criticised | Seldom criticised

In 1981 women received 67 per cent of age pensions, 95 per cent of the Supporting Parent Benefit, all widows pensions, 31 per cent of invalid pensions, 30 per cent of unemployment benefits and 24 per cent of sickness benefits. Tax expenditures also have an important impact on tax revenue and, through this, on the capacity for provision of other social welfare expenditure. It was estimated that in 1973–74 in the UK, the effective tax base was more than halved by tax expenditures. Asprey estimated that in 1971–72 in Australia, deductions and rebates reduced the tax base by nearly 20 per cent and involved a loss of revenue of more than one-third of the sums actually raised.¹

2.

At present there are more than six million taxpayers and three million people dependent on welfare. In addition, most Australians receive welfare through universal benefits for substantial periods of their lives. Identifiable needs and possible beneficial interventions far exceed the ability of a society to pay. This requires a priority-setting process between competing demands. Priorities do not always demonstrate consistency with any coherent set of principles or with the pursuit of clearly articulated and accepted goals. So cover is incomplete, many in need receive no benefits, and many not in need do receive benefits.

3.

Issues important to Liberals. There are liberal issues of equity, opportunity and responsiveness to need set out already in the sections above. Liberal values include:

- the empowering of individuals
- responding to need
- minimum unmet need
- maximum independence and dignity
- maximum incentive for self-provision.

¹ CCH Australia Limited (1975).
4.
In addition, liberals need to examine the tensions between ideals of ‘needs-based’ and ‘universal’ systems of provision. Each has advantages and costs as set out below.

<table>
<thead>
<tr>
<th>Needs-Based Beneficiaries are:</th>
<th>Universal Beneficiaries are:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor</td>
<td>Poor and middle class</td>
</tr>
<tr>
<td>Inarticulate</td>
<td>Often articulate</td>
</tr>
<tr>
<td>Unorganised</td>
<td>Often organised</td>
</tr>
<tr>
<td>Powerless</td>
<td>Often powerful</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Systems are:</th>
<th>Systems are:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complex</td>
<td>Simple</td>
</tr>
<tr>
<td>Fairer</td>
<td>Less fair</td>
</tr>
<tr>
<td>Penalise self-provision</td>
<td>Reward self-provision</td>
</tr>
<tr>
<td>Cheaper</td>
<td>More expensive</td>
</tr>
</tbody>
</table>

Whenever one group of taxpayers receives an allowance, another group must pay for this with higher marginal tax rates. High marginal tax rates may influence decisions to undertake paid employment, especially for women.

Liberals believe that a welfare system should display:
- efficiency
- neutrality
- simplicity
- fairness
- acceptability.

All these features were identified by John Stone [former departmental head of Treasury] as desirable for any ‘good’ tax system.

5.
Coincidences of liberal and conservative positions. Both groups recognise the requirement to gather sufficient revenue to fund welfare expenditures. Liberals would gather sufficient revenue to meet genuine needs while conservatives seem to argue that the revenue base should be contracted and welfare outgoings reduced.
6. Both groups emphasise wealth creation—but for different reasons.

7. Both groups believe in the encouragement of incentive and self-provision—but for different reasons.

8. Both groups acknowledge the vulnerability of poorer groups to changes in indirect taxation; liberals believe that those dependent on welfare should be fully compensated for any such changes.

9. Both agree that poverty traps should be eliminated, perhaps by trading off the income test and making all cash payments taxable. The key is to reduce the effective marginal tax rates that are the essence of any poverty trap.

Liberal Priorities

1. Remove poverty traps. This might be done by removing income tests while making cash transfers taxable or by maintaining income tests and reducing effective marginal tax rates by other combinations of adjustments.

2. Separate consideration for retirement income policy in view of its ‘superannuation’ function. We should seek universal ‘basic’ super cover, including a contributory universal taxable benefit for those not in private schemes, and still provide a supplementary benefit for those who qualify on need.

3. Needs-based benefits for those whose need is potentially temporary, ensuring that poverty traps are dealt with.

4. Consider Commonwealth withdrawal from certain service provision functions that are more properly the area of state sovereignty and responsibility.
Prime Tasks

We need to determine:

- whether we seek some ‘needs-based’ or some ‘universal’ system of welfare, or whether some mixture of the two is inevitable, and what mechanism is best suited to give effect to the desired goal
- the proper responsibilities of different levels of government, the proper policy responses to the federal system of government and to the Constitution
- the desirable balance of cash provision or the provision of services in or benefits in kind.

Priority Areas

Priority areas include:

**Retirement income policy.** This is especially difficult in view of the stands taken on assets testing and on capital gains tax. There are three basic elements to any income support scheme not based on insurance principles nor related to earning:

- the maximum level of entitlement
- the withdrawal rate as extra income is earned
- the cut-off point at which entitlement ceases.

Any two of these elements determines the third. Because of the interrelationship of the elements there are inherent conflicts between:

- providing adequate income support for those with no private income
- ensuring reasonable levels of incentive for self-help
- maintaining costs of any scheme within reasonable limits.

**Taxation and wealth creation.** In addition to the welfare interactions identified below, we believe as liberals in the interdependence of the tax system and the creation and encouragement of the incentive to create wealth by the population. In that sense the tax/welfare interactions need to be seen as part of an integrated package that recognises also the central importance of wealth creation as a prerequisite to any system of welfare.

**Tax/welfare problems.** The tax system enters the welfare field when it provides tax concessions or rebates for certain social expenditures. Such favoured taxation treatment is an expression of certain value positions which have found
favour with governments—e.g. value placed on education, on home ownership, on ‘family’. Additionally, certain new initiatives in the tax area, for example BBIT [Babcock & Brown Infrastructure Trust], will cause real income losses for poorer people and for welfare beneficiaries. So any scheme will need an extensive system of compensatory payments included. Taxation of welfare benefits is one way to achieve fairness because it will reduce the net benefit of payments to those with significant other income. On the other hand, taxation of welfare benefits is one factor, along with high withdrawal rates of benefits, of the emergence and extent of ‘poverty traps’ in welfare. John Stone has identified certain criteria which are desirable in a ‘good’ taxation system. These include: certain characteristics are mutually antagonistic, for example, considerations of horizontal and vertical equity often do not sit well together.

**Welfare-tax problems.** Welfare affects the tax system because of the size of the welfare subventions and the revenue requirements that they generate. Taxation of welfare payments is required to satisfy certain equity requirements. Yet the taxation of benefits is one of the prime causes of the emergence of poverty traps. Liberals need to resolve the dilemma of different values which suggest different approaches to the taxation of benefits and to the acceptance of ‘need’ or ‘universalism’ as a basis for welfare provision.

What is clear is that it is not possible to design a new tax system without

- clarification of the values that should underlie it
- recognition of the mutual interdependence of taxation and welfare considerations in the final tax/welfare systems that emerge.²

We do not have a system that has done these things. Therefore the threshold tasks identified above are the first and most important jobs lying before us. Their achievement must precede any detailed consideration of this or that benefit or tax measure.

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² See Podger et al. (1980).
This text is taken from *A Dissident Liberal: The Political Writings of Peter Baume*, by Peter Baume, edited by John Wanna and Marija Taflaga, published 2015 by ANU Press, The Australian National University, Canberra, Australia.