6

The Future of Social Security

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Key points

- The social security system is one of the largest and most significant areas of government spending in Australia and similar countries. Cash payments to individuals in 2022–23 were around $135 billion, or 20 per cent of the Commonwealth budget.
- Social security is also significant to individuals, with more than 5 million people receiving income support—either pensions or allowances—in 2022.
- The Australian system differs significantly from other countries' systems, apart from New Zealand's, in that payments are flat-rate and means-tested on current income and assets, and are financed from general taxation revenue rather than from social insurance contributions. As a result, benefits are more targeted to low-income households than in any other country in the Organisation for Economic Cooperation and Development (OECD).
- The continuation of current policies as assumed by the 2021 Intergenerational Report (IGR) implies that future generations of people of working age who receive income support will receive the same real payments as currently, even though wage earners are projected to be nearly 80 per cent better off in real terms in 40 years' time.

- The result would be much higher relative poverty among people of working age receiving benefits in the future, with a single unemployed person, for example, projected to receive a payment of around 10 per cent of the average male wage (compared to around 20 per cent in 2022). Child poverty would increase very substantially.
- If deep poverty among disadvantaged working-age adults and their children is to be avoided, then spending on social security payments needs to keep pace with general improvements in population living standards, with implications for future spending and budget deficits.
- Accordingly, the 2021 IGR should have included some sensitivity analysis about possible future adjustments to social security indexation arrangements.

Introduction

The 2021 Intergenerational Report (IGR) delivers a range of good news about the future of Australian living standards. Our children and grandchildren will be living longer than us and, *on average*, they will be much better off in material terms. However, the same assumptions imply that the poorest in the future Australian community will be much poorer in relative terms.

This chapter discusses the reasons why the IGR projections imply the ongoing impoverishment of the poorest groups in the Australian community. The remainder of the introduction summarises the main trends in social security spending projected in the latest IGR. The subsequent section outlines some of the main features of the Australian social security system. This is followed by a discussion of the policy assumptions leading to the projected ongoing fall in the relative position of working-age social security recipients. The chapter concludes with a discussion of the implications of these assumed trends for the sustainability of the system.

The 2021 IGR projects that a girl born in 2061 could expect to live for 89.3 years, compared to 85.4 years for a girl born in 2021. For boys, the corresponding increase in life expectancy at birth by 2061 is from 81.4 to 86.8 years.

Australia will be a much richer country than it is now. Productivity growth is assumed to be 1.5 per cent per year on average, which would lift real Gross National Income (GNI) per person by 1.3 per cent per year, from around $77,900 in 2020–21 to $128,900 in 2060–61.

Using the assumption specified in the report, real male total average weekly earnings (MTAWE)—the benchmark currently used to index age and disability pensions and some other payments—would rise from around $80,900 now to $144,600 in 2060–61. On average, Australians—particularly those employed—will be better off in real terms by close to 79 per cent, while income support for the unemployed and related payments will not increase at all in real terms.

Nevertheless, the 2021 IGR shows that Australia faces an extended period of difficult social policy choices. Even though the IGR projects continuing deficits over the entire 40-year projection period, some of the necessary assumptions used to generate these projections involve reductions in social security spending that have very unpleasant outcomes for many of the poor.

Table 6.1 shows the projections of the composition of government spending over time. Payments to individuals (not including age pensions) are projected to reduce from 3.9 per cent of GDP to 2.7 per cent.

Table 6.1: Composition of government spending over time.

	2021–22 (% of GDP)	2060–61 (% of GDP)
Health	4.6	6.2
Payments to individuals (excluding age pension)	3.9	2.7
Age and service pensions	2.5	2.1
Defence	2.1	2.3
Education	1.9	1.2
Aged care	1.2	2.1
NDIS	0.9	1.0
Infrastructure	0.5	0.4
Interest payments	0.8	1.9
Other payments (excl. NDIS state and GST)	5.3	4.0

Note: NDIS = National Disability Insurance Scheme.

Source: Commonwealth of Australia (2021:Chart 7.4).

Table 6.2 provides a disaggregated breakdown of projected changes in spending. Spending on Family Tax Benefit is projected to more than halve; JobSeeker Payment will fall by a similar level, while Youth Allowance and Austudy will fall by nearly two-thirds.

Table 6.2: Composition of payments to individuals, 2018–19 to 2060–61.

	2018–19 (% of GDP)	2019–20 (% of GDP)	2060–61 (% of GDP)
Family Tax Benefit	0.9	0.9	0.4
Disability Support Pension	0.9	0.9	0.8
JobSeeker Payment	0.5	0.9	0.4
Child Care Subsidy	0.4	0.4	0.3
Carer Payment	0.3	0.3	0.5
Parenting Payment Single	0.2	0.3	0.2
Youth Allowance and Austudy	0.2	0.3	0.1
Paid Parental Leave	0.1	0.1	0.1
Parenting Payment Partnered	0.0	0.1	0.0

Source: Commonwealth of Australia (2021:Chart 7.5.1).

Part of these projected changes in spending reflect the demographic assumptions made in the report, with children and young people falling as a share of the population. But a more important factor is that the level of payments will fall relative to wages and GDP per capita, because they are projected to remain the same in real terms.

The Australian social security system in context

'Social Security and Welfare' (Commonwealth of Australia 2022) is the largest single component of Commonwealth government spending. It is estimated to cost $221.7 billion in 2022–23, or 35.3 per cent of total budget expenses. Of that amount, around $135 billion or more than 20 per cent of the budget involves cash payments to individuals, including pensions, allowances, family payments and child care assistance, which, if separated out, would still be the largest single component of Commonwealth spending.

These income support payments (Department of Social Services 2022) are currently made to more than 5 million persons, just over 2.6 million people of working age and 2.5 million people of pension age. There are also 1.4 million families with 2.7 million children receiving Family Tax Benefit, of whom around 800,000 families are in work and not receiving income support payments. So, in total, there are currently more than 9 million adults and children in Australia receiving some form of financial support through the social security system.

And these are point-in-time figures; the Household Income and Labour Dynamics in Australia (HILDA) longitudinal survey (Melbourne Institute 2012) estimates that between 2001 and 2009 nearly two-thirds of Australian households of working age contained someone who had received an income support payment in this period—not including age pensions or family benefits. This reflects the fact that over the course of time, many people will experience unfavourable contingencies, including retrenchment from their job, personal illness or injury or illness and injury of a close family member, or the breakdown of a relationship, leading to a loss of income and the need to claim income support. Income support receipt was defined as having received payments for at least one week in the year, and on an individual basis this meant that about one-third of working-age individuals received income support in 2009. However, about 10 per cent of individuals received more than half of their income over the financial year from benefits, and 5 per cent received more than 90 per cent of their annual income from income support (Melbourne Institute 2012:40). Even smaller proportions were substantially reliant on income support for the full nine-year period, with only 1.2 per cent of the working-age population receiving 90 per cent or more of their income from benefits every year. What this emphasises is that the Australian social security system effectively provides insurance against risks for a much larger proportion of the population than is commonly understood, but at the same time it is essential for the long-term support of a much smaller, but extremely disadvantaged minority.

According to the Australian Bureau of Statistics Income Survey in 2017–18 (ABS 2019), more than 70 per cent of spending on social security benefits went to the poorest 40 per cent of households, accounting for roughly half of their disposable income. For the poorest 20 per cent of Australian households, social security payments provide more than 70 per cent of their income.

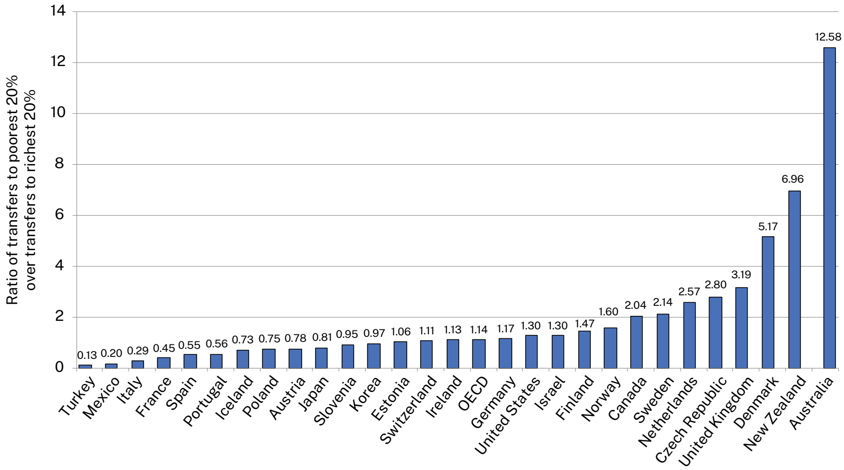

Figure 6.1: Australia's social-security system is more targeted to the poor than any other OECD country. Ratio of transfers received by poorest 20 per cent to those received by richest 20 per cent of households, 2012.

Source: Calculated from Causa et al. (2014).

Overall, the Australian social security system is more targeted to low-income groups than any other benefit system in the Organisation for Economic Cooperation and Development (OECD 2008, 2014). As shown in Figure 6.1, for most OECD countries, the poorest 20 per cent of the population receive about the same amount of social security cash payments as the richest 20 per cent.[1] In Australia, the poorest 20 per cent receive more than 12 times as much in social security benefits as the richest 20 per cent, reflecting the fact that we rely on income and asset-testing more than any other high-income country.

The high level of targeting of social security transfers also means that across-the-board cuts in social security spending in Australia would increase inequality and relative poverty to a greater extent than in any other OECD country (Causa et al. 2014).

This poses a real dilemma to any government considering 'budget repair'—it is difficult to cut the largest single component of Commonwealth spending without disadvantaging the poorest in the Australian community.

1 It should be noted that these systems are still redistributive to the poor, as the share of market income received by the lowest income group is much less than the share received by higher income groups.

Poverty will continue to increase if current policies are continued

The 2021 IGR, like most previous IGRs, assumes the continuation of existing policies for the indexation of working-age payments and family payments. But continuation of existing indexation policies means that people receiving many working-age payments will not receive any benefit from the increase in living standards projected in the report.

As noted above, pension payments—for the aged, people with disability and their carers—are indexed to the CPI and benchmarked to MTAWE. As shown in Figure 6.2 below, a single pensioner will see a slight reduction in the value of their total payments relative to MTAWE—from 31.1 per cent to 29.7 per cent—because the Energy Supplement of $14.10 per fortnight is not indexed. However, payments for the unemployed, low-income parents and people with barriers to work, as well as payments for children in low-income families, are indexed to the CPI.

What this means is that while the average worker is projected to be 79 per cent better off in real terms by the middle of the twenty-first century, the unemployed will be relatively worse off. A single person relying on JobSeeker would see their payment fall from just 20.7 per cent of MTAWE currently to around 11.4 per cent in 2060–61.

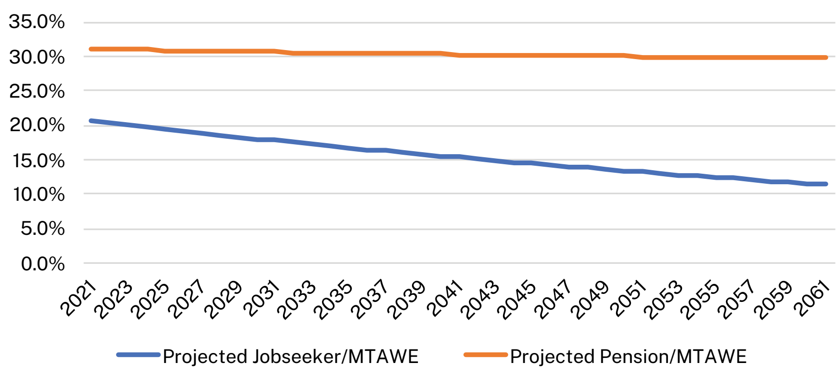

Figure 6.2: Projected pension and allowance payments for single adult as percentage of MTAWE, 2021 to 2061.

Source: Author's calculations.

The gap between allowances for the unemployed and pensions will continue to grow. Currently a person receiving JobSeeker Payment has a disposable income around two-thirds that of a full-rate pensioner. The IGR projections imply that by 2061 a job-seeker will receive less than 40 per cent of the pension level. Given that the current level of JobSeeker Payment is already recognised as inadequate (Whiteford 2012), we could ask whether these projected future levels of payments would be socially acceptable in the much richer country that Australia is likely to be.

It is also worth noting that the report assumes that the unemployment rate stays at around 4.5 per cent over most of the projection period, as did previous IGRs, but with the ongoing impoverishment of those who experience it and the potential halving of support for some of the most vulnerable unemployed.

The then Labor government's 2009–10 budget changed the indexation of Family Tax Benefits from wages to prices (Redmond et al. 2011). Under the same assumptions shown above, Family Tax Benefit Part A for the lowest-income families would also nearly halve relative to wages over the period up to the middle of the century. This might lead to an increase in the depth of child poverty (Whiteford 2014). The lower level of these payments will also reduce the share of families able to receive family payments, which have already fallen to little more than half of all families with children since the 1990s (Whiteford 2019), and disadvantages those with children in the tax transfer system relative to those without children.

Conclusions — What is sustainable?

If the implicit distributional outcomes of these spending trends are unacceptable in a society as rich as Australia—and in the even richer society we are projected to become—we need to recognise that these projected falls in expenditures may not happen. This means that the IGR may actually be underestimating the scale of the budgetary challenges ahead. Accordingly, the IGR should have included some sensitivity analysis about possible adjustments to existing social security indexation policies.

Is Australia's social security system sustainable over time?

The 2021 IGR defines sustainability as follows:

> Fiscal sustainability is important for maintaining macroeconomic stability, reducing economic vulnerabilities and improving economic performance. Fiscal sustainability is the government's ability to manage its finances so it can meet its spending commitments, now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation. (Commonwealth of Australia 2021:xvi)

However, fiscal sustainability is only one part of the story. Glennerster (2010:689) argues:

> The challenges the world will face in the next half century are going to be partly the same but partly very different from the past five decades …
>
> - Will their populations continue to vote the higher taxes required to support older and more demanding populations? This is a question of fiscal sustainability.
> - Are their present bureaucratic structures capable of adapting to fast changing consumer expectations? Will other political priorities overtake social policy—climate change, population movement or responding to global economic crises? These are questions of political sustainability.
> - In trying to respond to such concerns, will these institutions retain a commitment to the needs of the poorest and to enhancing social solidarity? This is a question of moral sustainability.

Moral or social sustainability is an essential part of the debate Australia needs to have about the future of spending and taxation. The projected deficits in the report also reflect the assumption that the projected Commonwealth tax-to-GDP ratio stays constant at 23.9 per cent of GDP from 2020–21 onwards.

In addition to having an open and serious public discussion of how to target Australia's social spending better, we need to look at the revenue requirements necessary to fund social and government spending more broadly. As Stewart (2015) has argued: 'Since federation, the Australian community has made broad choices about government expenditures, redistribution and taxes. It's time to do it again.'

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