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Middle Class Welfare in Australia: How has the Distribution of Cash Benefits Changed Since the 1980s?

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Abstract

The purpose of this article is to examine trends in 'middle class welfare' in Australia, defined in various ways, including the extent of cash transfers going to working age families with incomes above the second decile in the distribution of family incomes, the middle 50 per cent, and the richest 20 per cent of working age families. We use nationally representative income survey data for selected years between 1982 and 2007-08. We find that while according to this definition there was an increase in 'middle class welfare' between 1982 and 2007-08, this was relatively modest, and was focused on families not far above the second decile. We conclude that difficulties associated with tighter targeting of mean tested payments in an already tightly targeted system would achieve little in terms of increased efficiency and would likely cause considerable pain.

JEL classification: I380; D310; H220

1. Introduction

The Australian social security system is the most targeted in the OECD – the poorest 20 per cent of households in Australia receive about 42 per cent of all government cash benefits, a share that is nearly twice the OECD average (24.4 per cent) or twice the share received by low-income households in the United States (24.8 per cent) (Whiteford, 2010a). For people of working age, the degree of targeting is even more marked than it is for the overall population – the poorest 20 per cent of households receive benefits that are 15 times as much as the richest 20 per cent of households, a ratio that is more than six times the OECD average and more than twice as high as the next ranked county (New Zealand) (Whiteford, 2010b).

Despite – or perhaps because of – the fact that the Australian benefit system is the most targeted in the OECD, the level of access by those on middle and higher

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incomes to welfare benefits (popularly known as 'middle class welfare') has been a controversial issue for many years (Bradbury, 1998). The introduction of tighter means tests in the first Rudd Government Budget and the expectation of further means testing has led to renewed debate about the pros and cons of universal versus targeted benefits and the government's future intentions in this area. While concerns about middle class welfare have been expressed for a long time, the volume of debate has increased in recent years, perhaps because of perceptions that the level of middle class welfare increased in the period of the Howard government between 1996 and 2007.

Debates about access to welfare by the non-poor are often emotive. The term 'middle class welfare', itself generally used as a pejorative, is often described by critics in terms such as 'shameless', 'outrageous', 'unjust' or 'pernicious'. An editorial in the *Sydney Morning Herald* of 1 April 2009 stated some of these views concisely: 'The arguments in favour of trimming middle-class welfare spending are compelling - High on the list of potential casualties are the Family Tax Benefits, parts A and B payments to help families with the cost of raising children that together cost taxpayers $18 billion. Some families almost certainly find these payments vitally important, but some others just as certainly don't need the money. The same may be true of the child-care tax rebate, which costs almost $1 billion a year, the controversial Baby Bonus, which costs almost $1.5 billion and the $320 million Medicare safety net'.

More recently, an opinion piece in the *Sydney Morning Herald* of February 11 2011 noted 'by far the biggest expense the government incurs is social security and welfare. This accounts for $115 billion out of a total estimated spending of $355 billion this year. .... The family tax benefit system alone pays out $18 billion a year, including to some families on incomes as high as $150,000. But it is not only direct payments that give <u>an unnecessary boost to the well off</u>' (emphasis added). Under the headline 'Roll back pernicious welfare state', an editorial of 4 October 2008 in the *Australian* noted that 'More than 4 million Australian families now receive more in handouts than they pay in income tax, with the income-tax-free club covering 42.2 per cent of the nation's 9.7 million families. This churning of taxpayers' money to the government through the income tax system, and its return by way of a complex system of family payments, with a vast army of bureaucrats in the middle assessing eligibility and administering the payments, desperately needs major reform'.

Underlying many of these criticisms is the notion that 'middle class welfare' is inequitable and that a higher share of government spending should be directed to the poor; but an emerging theme in these discussions is that current welfare arrangements are also inefficient. For example, Saunders (2008), who examines the distribution of both cash transfers and public services such as health care and education, argues that 'middle class welfare reflects the fact that less than half the money spent by government on social programmes is redistributed from richer to poorer families. Most of it is 'churned' as high and middle income people finance social expenditure through their taxes and then claw the money back as benefits or services'.

This article addresses aspects of this debate through an analysis of changes over time in Australia in the distribution of social security benefits to income units where the head and spouse (if any) are of working age; in the remainder of this article we call them *families* for short – this includes families without children. Specifically, we discuss changing patterns of welfare receipt and the factors associated with these changes; whether these trends really do indicate an increase in welfare payments to the middle class, and what are the implications of these trends and comparisons for potential policy reforms in Australia. As noted, we restrict our analysis to cash benefits paid to people of working age. It is worth noting that in 2007 family assistance accounted for about 45 per cent of spending on this group, with about 43 per cent of spending being on disability payments, and the balance being mainly on spending for the unemployed (OECD, 2011).[1]

The article is structured as follows. Section 2 discusses aspects of the definition of the 'middle class' and 'middle class welfare'. This is followed by a discussion of developments in family assistance in Australia over the past 30 years or so. Section 4 details trends in alternative measures of middle class welfare. The article concludes with a discussion of policy implications of these findings.

It is important to note the significant caveats that should be borne in mind in considering our results. The definition of middle class welfare that we use is restrictive, as we focus our analysis on cash payments received by families of working age, and we do not discuss receipt of services such as child care or tax expenditures, for example for private health care, or indirect subsidies such as funding for private schools. Our approach is primarily descriptive, and we present data on the changing distribution of benefits across income groups, where families are ranked by their disposable incomes. In common with Bradbury (1998), no analysis is undertaken of the shifting of taxes or benefits onto other families. We also only consider the benefits that accrue to families at one point in time. Implicitly, we adopt a counterfactual in which the ranking of families would be the same in the absence of the taxes and benefits that we discuss. This is a plausible assumption. For example, transfers are a substantial component of disposable income only for the bottom 20 per cent of working age families. For higher income families the transfers they receive are generally small as a proportion of their disposable income, and therefore unlikely to have a substantial impact on their position in the overall income distribution.

2. Defining the Middle Class

Who are the middle class? Writing about proposals to restrict access to family payments to families with income of less than $150,000 per year, Quiggin (2009) notes that the phrase 'middle class welfare' may be misleading:

> 'In most cases, the proposals under consideration will means-test access to programs that are currently universal, in a way that will exclude households in the top 20 per cent of the income distribution, or even higher up.
>
> The use of 'middle class' to refer to the best-off members of the community is so standard in Australian political discourse as to go without saying. With the possible exception of those annually listed in the *BRW* Top 200, no one in Australia considers themselves rich. One consequence is that politicians, journalists, academics and others in the policy elite routinely overestimate average incomes.' (Quiggin, 2009)

[1] Family payments extend further up the income distribution than either unemployment payments or benefits for people with disability since the income thresholds and cut-out points for these income support payments are much lower than for family payments.

Evidence for this argument is found by Saunders and Wong (2011). Surveys conducted in 1999, 2006 and 2010 asked population samples to locate themselves in the overall income distribution. The question asked people to select a position on a ten-point scale that ranged from the lowest to the highest incomes, and the responses thus show the income decile of the distribution into which people feel that they (or their families) fall. All three surveys revealed that two thirds of respondents thought they were in one of the three middle deciles (four to six). In contrast, less than one per cent thought they were in the lowest income decile, and almost nobody thought that they were in the top decile (or were prepared to admit it).[2]

A further complication in defining the middle class relates to lifecycle variations in economic wellbeing. For example, some people over retirement age may appear to have relatively low cash incomes, and may feel themselves to be worse-off than they were before retirement, but may in fact be better-off than they or others realize, particularly if their financial assets as well as their incomes are taken into account. Such people may consider themselves to be in modest or even straightened circumstances, whereas in terms of effective net worth they are well above the Australian average.

Variations in family circumstances also need to be taken into account in assessing economic wellbeing and 'middle class' status. In income distribution analysis, accounting for variations in family circumstances involves adjusting family incomes by equivalence scales, which are measures of the relative needs of families of different size and composition. For example, in 2007-08, median household equivalent disposable income was $692 per week or around $36,100 per year (ABS, 2009). However, this is *disposable income per equivalent adult*. Given the equivalence scales used by the ABS, this means that a single person household with a disposable income of $36,100 would be at the median, as would a couple with disposable incomes of $54,100, and a couple with two children and incomes of $75,800. While the idea that larger households need more income than smaller households to be equally well-off is commonly accepted, it seems unlikely that households make very precise calculations in assessing their relative economic position, or if they make such adjustments these could easily vary significantly between people in broadly comparable circumstances.

These considerations suggest that defining the middle class – and therefore middle class welfare – is to some extent arbitrary. In her analysis of 'the suffering middle' in the 1980s, Harding (1997) identifies the "middle' as households falling into the third to seventh deciles. Gregory (1993) treats the middle as the middle 60 per cent of the wage distribution, i.e. excluding the highest and lowest earners. A limitation of these sorts of definitions is that by definition the size of the middle class stays the same, either the middle 50 or 60 per cent of households ranked by income. An alternative approach would be take households as middle class in relation to their ratio to the median income, for example households with equivalent disposable incomes between 75 per cent and 125 per cent of the median, which has the advantage of allowing the size of the middle class to vary over time as a result of economic and social changes.

[2] As noted by Saunders and Wong (2011), the tendency for people to think they fall into the middle of the distribution may explain why politicians are always keen to use phrases such as 'middle Australians' or 'ordinary working families' to identify those who are expected to benefit most from the policies being introduced.

None of these approaches, however, can be considered as a sociological approach to defining the middle class as they do not deal with changes in occupational status or the nature of jobs, and nor do they deal with changing social perceptions.

Nevertheless, much of the discussion of middle class welfare focuses on the income position of families receiving benefits, and policies to target benefits also necessarily focus on incomes. For the purposes of this article, rather than attempting to strictly define the middle, we adopt a flexible approach, for example by examining the 'creep' of transfer payments up (and down) the distribution of incomes over time in Australia. We restrict our analysis to families where all adults are of working age. In doing so, we avoid some of the major problems discussed above that involve comparing people at different stages in their lifecycle. However, in focusing just on working age families, we note that our definition of 'middle class' ignores aged persons. The implicit suggestion here is that working age persons compare themselves with other working age persons, but not with elderly persons, in considering their relative standard of living.

3. Cash Transfers to Families as the Defining Issue in Australian Middle Class Welfare

Even if a strict definition of 'middle class' were to be adopted, the definition of welfare that goes to the middle class is still problematic. Middle class welfare can potentially be defined as encompassing tax concessions, cash benefits and public services (Cox, 2008; Buckmaster, 2009; Bradbury, 1998). Other commentators include tax expenditures in middle class welfare, for example, superannuation tax concessions (Cox, 2008) or the health insurance rebate. In his analysis of middle class welfare, Bradbury (1998) looked at the distribution of cash benefits and government spending on health and education services as well as the superannuation tax concessions. While there are strong arguments for adopting a comprehensive approach, this article focuses primarily on the issue that has received the most attention recently – the provision of cash transfers to people of working age, particularly payments for families with children.

Cash transfers to working age people encompass payments for a wide range of contingencies, including payments for people who are unemployed, sick or disabled, or caring for someone who is sick or disabled; and payments for parents to help with the costs of raising dependent children. While the names of specific payments have changed (in some cases several times) over the past 30 years, there is a good deal of continuity in the basic architecture of the system. The current major benefits for people of working age include Newstart Allowance, Disability Support Payment, Carer's Payment and Parenting Payment, which are all targeted on individuals and families with low incomes, and are therefore usually excluded from debates about middle class welfare.

Instead, concerns about middle class welfare have usually focused on the payments for families with children, including the Baby Bonus, Child Care Benefit (and an associated Child Care Tax Rebate) and (in particular) Family Tax Benefit. These are less tightly targeted than the main income support payments. Family Tax Benefit (FTB) actually comprises two separate payments, FTB Part A (FTB-A) and FTB Part B (FTB-B). FTB-A is a payment per eligible child, and is means tested on family income, and is paid at different rates over different income ranges. Currently, families with incomes below about $45,000 are eligible for payments between $4,900 and $6,160 per child, depending on age. This amount is reduced by 20 cents in the dollar above $45,000 until it reaches the base rate of around $2,100 per child. The payment stays at the base rate until annual family income for a family with one child reaches $94,000 per year, plus $3,800 per child after the first, and then reduces by 30 cents in the dollar until it reaches zero.[3]

FTB-B is paid to families with children and only one earner (whether partnered or not). The payment is currently just over $3,900 for a family with a child under five years and $2,830 for families with children aged five to 15 years or 18 years if a full-time student. The payment does not vary with the number of children. Until 2009, FTB-B was only income-tested on the second earner's income.[4] After 2009, families with incomes of greater than $150,000 per year could no longer access this payment.

Thus, it is these two payments that have been the main focus of discussion in the middle class welfare debate. How is it that Australia has payments that go to families with incomes at this level? To answer this question it is necessary to review the development of the current system of family assistance.

4. The Development of Family Assistance in Australia

The level and means by which assistance is provided to Australian families has developed since the early 20th century, reflecting changes in social structures, the labour market, and attitudes and priorities, as well as the capacity of Australians to afford the support being provided to families (see, Whiteford, Stanton and Gray, 2001; Morehead, 2004). At different times these objectives have included contributing to the cost of bearing and raising children and redistributing resources over the lifecycle, alleviating child poverty and boosting low family earnings, promoting equity within the tax system, redistributing within families, and relieving unemployment and low income traps. Overall, the Australian system has gone further than many other countries in emphasising redistribution to low income families and in particular to mothers within families.

Taxation support for families with children was first introduced in 1915. A national system of cash assistance for children was introduced in 1941, with Child Endowment, a system of non-means-tested cash payments for the second and subsequent child in all families. There were also payments for pensioner and beneficiary families with children introduced in this period. While there were a number of important policy changes over succeeding decades, the underlying structure of the system of family payments was not altered. The most important change affecting family payments was the introduction of Family Allowance from 1976. This involved the cashing-out of the then income tax rebates for children, so that assistance was redirected from taxpayers (usually fathers) to mothers. Low-income families whose incomes had not been high enough to benefit from the tax rebates also received significantly increased assistance.

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[3] So for a family with one child under 17 years, payments stop when family income reaches $101,200, and for a family with six children the zero rate can be reached at incomes of around $162,000.

[4] As the payment is intended to assist single earner families, there is an income-test on the second earner's income, with payments being reduced by 20 cents in the dollar for incomes over $4,745, and payments reducing to zero on second incomes between $18,900 and $24,300 depending on the age of the youngest child.

In the period between 1976 and 1982, Family Allowances and the additional payments for pensioner and beneficiary children were not indexed and as this was a period of high inflation, low income families in particular were adversely affected. In addition, the number of low income families had increased significantly as the result of increasing unemployment and growing lone parenthood. In 1982 the Coalition Government announced the introduction for the first time of an income-tested supplement for low-income working families. When the programme came into effect after the Federal election in 1983, this Family Income Supplement was paid to about 1.2 per cent of Australian children. However, also in the 1982-83 period the number of children in unemployed and jobless families increased significantly as a result of the recession (Whiteford, 1987).

After 1983, payments for children became much more targeted, but targeting was achieved through two processes – reducing assistance to high-income families, and extending more generous assistance to an increasing proportion of low-income families. Coverage of Family Allowances for children under 16 years of age was universal until 1987. The introduction of means testing in 1987 and tighter income and assets tests from 1994 reduced coverage to around 79 per cent of all children by the late 1990s.

On the other hand, payments to lower income families expanded considerably between the mid-1980s and the mid-2000s, particularly following Prime Minister Bob Hawke's pledge in 1987 to eliminate the need for child poverty by 1990. In December 1987, the Family Income Supplement was subsumed by Family Allowance Supplement (FAS) at higher rates and a more generous income test. Rates of Additional Pension and Benefit for children were increased correspondingly, and effectively indexed to inflation for the first time. Rates were further increased in 1989 and formal indexation provisions were introduced in 1990.

One of the most important changes was in 1993, when all of the payments for low income families in work and on benefits were integrated into a single payment called the Additional Family Payment. This was then one of the few systems of family assistance that provided integrated support for low income families in and outside the workforce, as in most other countries with systems of in-work support payments are made separately (e.g. the Earned Income Tax Credit in the USA, and working tax credits in the United Kingdom.) In addition, this meant that the principal carer in couple families – usually the mother – became entitled to payments rather than the primary benefit recipient, usually the father.

In response to the recession in the early 1990s, the Keating government further increased the generosity of family payments, and expanded access to families in the middle of the income distribution through a relaxation of the income test for unemployment payments, and the partial individualisation of payments for unemployed couples, which had the effect of increasing the number of families eligible for Additional Family Payment. In addition, the last specific support in the tax system for families with children – the dependent spouse rebate for families with children - was gradually moved into the benefit system. Once again, the partial individualisation of the benefit system shifted support towards women, as previously the benefit entitlement for the couple had been payable to primary beneficiary.

In summary, in the period of the Labor Government between 1983 and 1996 there was both a reduction in coverage of universal assistance for all families with children on the one hand, accompanied by increased coverage of assistance for low-income families and increases on the real level of child payments for these families, on the other hand. Overall, the real level of assistance for low income children roughly doubled between 1983 and 1990, with even higher real increases for those with older children and those renting privately. The number of children in families receiving income-tested payments increased from around three per cent of all children under the age of 16 years in 1965 to 43 per cent of all children by the late 1990s. About one-third of these families receiving income-tested payments were in employment (14 per cent of all families with children) and two-thirds were in families receiving income support benefits.

From 1996, Prime Minister John Howard followed a policy of further expanding payments to families whom he described as 'battlers'. The first stage was the introduction of the Family Tax Initiative in 1996-97. This provided benefits payable in cash to lower income families or through the tax system to middle to higher income families. The assistance through the tax system was provided as an increase in the tax threshold (the level of taxable income at which the first positive tax rate becomes payable), so that the assistance provided was the same for all families irrespective of their incomes. The cash assistance was the same amount of money, paid to those in receipt of the higher rate of Family Allowances. The Family Tax Payment/Assistance had two components: Part A was a small payment per child in all families, and thus similar to the Family Allowance although the income test parameters differed. Part B was a higher, payment for single income families – including sole parents – with a youngest child under five years of age. Providing payments through the tax system represented a partial reversal of policy trends since 1976, and also introduced a degree of increased complexity since the Family Tax Payments to some extent duplicated existing benefits.

In July 2000 the Australian system of assistance for families with children was again reformed as part of a broader program of reform of the taxation system, including the introduction of a Goods and Services Tax, which had a significant one-off impact on consumer price inflation in 2000. As well as increases in payment rates, these reforms alleviated the high effective marginal tax rates (EMTRs) facing many low income families with children and simplified the system in some important respects (although the GST itself ensured that the impact of the tax system extended further into the pockets of very low income families – see, Warren *et al*., 2005).

Part of the reforms involved giving families the choice of whether assistance was received through cash payments or through the tax system, thus further partially reversing the direction of reforms since 1976. These changes to family assistance were also intended to simplify payments, by amalgamating a number of different forms of assistance, and also provided higher levels of assistance, with reductions in income test withdrawal rates. The new structure was also simpler, combining 12 of the pre-existing types of assistance into three new programs: Family Tax Benefit Part A to assist with the general costs of raising children; Family Tax Benefit Part B directed to single income and sole parent families; and Child Care Benefit to assist with the costs of child care.

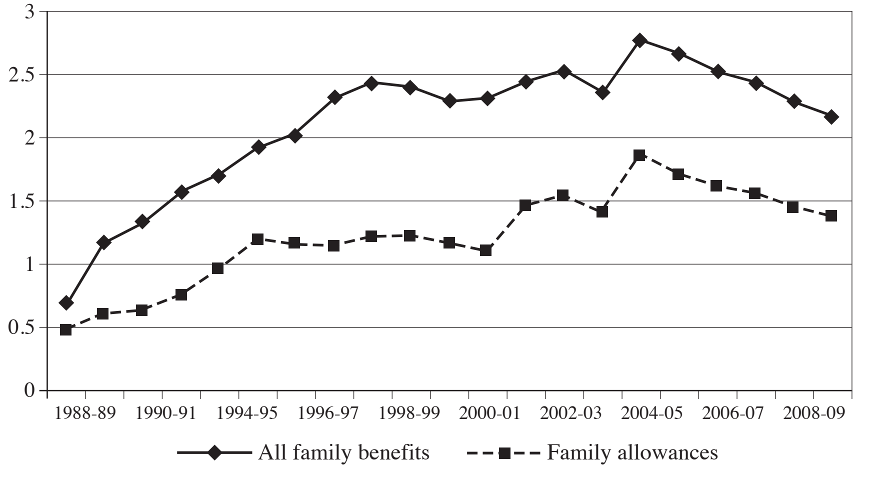
Payment through the tax system introduced a new level of complexity, because the income tax system is subject to end of year reconciliation. As a result families were required to estimate their incomes in advance, with payments made on the basis of these estimates, and overpayments being raised following the submission of end-of-year tax returns and underpayments being made up. As a result, the number of families with family payment debts increased from just over 50,000 in 1999-2000 to 670,000 in the year after the introduction of the new system (Whiteford, Mendelson and Millar, 2003). A range of subsequent initiatives attempted to deal with this problem of overpayments, including the introduction of an end of year lump sum payment of $600 per child in 2004, with the lump sum being used to offset any debts accrued during the year. Regular payment rates were also increased in the same year, and new Maternity Payment was also introduced (popularly known as the Baby Bonus). Unusually, these increases in family benefits were made as part of a broader package of income tax reductions, so that the overall package involved increases in disposable income of families at the same time as the tax cuts increased the disposable incomes of taxpayers without children.[5]

Apart from increases in benefit rates, the generosity of family assistance has been enhanced by changes to income tests. Up until 1987, additional pension and additional benefit for children were withdrawn once basic benefit entitlements were extinguished, at either 50 per cent for pensioners or 100 per cent for beneficiaries. The Family Income Supplement was withdrawn at 50 cents in the dollar, from incomes a little over the cut-out point where families no longer received unemployment benefits. With the introduction of Family Allowance Supplement in 1987, the cut-out point for payments for one child increased by about 20 per cent. There were further increases in thresholds in subsequent years. In 2000 the income test withdrawal rate was reduced from 50 per cent to 30 per cent, and in 2004, the 30 per cent rate was reduced to 20 per cent between the maximum and base rates.

Figure 1 shows the overall effects of these changes on spending on family assistance in Australia in the period from 1988-89 to 2008-09. The figure separately identifies the total level of spending on families – which includes spending on child care assistance and income support payments for low income families – and spending on family allowances (including the higher rates of payments for low income families), that is what are now called Family Tax Benefits Part A and B. It is evident that spending on Family Tax Benefits and its earlier equivalents doubled from around 0.5 to 1.0 per cent of GDP between the late 1980s and the early to middle 1990s, this was followed by a period of stability (at least as a percentage of GDP), but there was another large increase in 2000 as a consequence of the compensation package for the GST. A shorter period of stability was followed by another significant increase in spending from 1.5 to 2 per cent of GDP as an effect of the 2004 increases in family benefits. Since 2005, spending has fallen consistently as a percentage of GDP, probably reflecting the strong increase in GDP and in household incomes over most of this period.

[5] Taxpayers with children also benefited from the income tax cuts of course, but since income tax cuts do not have a family dimension, the relative disposable incomes of families with children would fall compared to those without children in the absence of increases in family payments.

Figure 1 - Spending on Assistance for Families, Australia 1988-89 to 2008-09, % of GDP



Source: Data supplied by the Department of Family, Housing, Community Services and Indigenous Affairs.

Since 2000, the system of family payments (principally FTB-A and FTB-B) has been among the most generous in the OECD, although also still among the most targeted, in that nearly all payments were means-tested, albeit at a high level. In broad terms, Australian spending on family payments was around 60 per cent of the OECD average in the early 1980s, rising to around the OECD average in the early 1990s, then to around 1.5 times the average by 1996 and increasing to more than twice the average since 2000. In 1980 Australian spending in family payments ranked 16th in the OECD, but in 2007 it was the third highest (OECD, 2011).

Australia's rise in spending up the OECD ranking was during the period when income-testing restricted payments to higher income groups, so this relative increase mainly reflects the increase in assistance for lower income families and the extension of this higher assistance to a greater share of families in the bottom half of the family income distribution. To a large extent, this increased spending was the result of initiatives following Bob Hawke's famous 1987 pledge that by 1990 no Australian child would be living in poverty. This promise is now widely seen as either a broken political promise or an example of hyperbole, including by Hawke himself.[6] In fact, early assessment of the Family Package (Brownlee and King, 1989) estimated that the initial impact of these reforms in 1987 was to reduce the number of children in poverty by between 43 per cent and 47 per cent, with the poverty gap being reduced by 50 per cent to 55 per cent.

[6] 'Twenty years after pledging no Australian child would live in poverty, former Prime Minister Bob Hawke has said the comment was one of the biggest regrets of his career...'John Masanauskas and Martin Philip, 'Bob Hawke's biggest regret', *Herald Sun*, June 16 2007. http://www.heraldsun.com.au/news/national/bob-hawkes-biggest-regret/story-e6frf7l6-1111113759999

[7] Effectiveness is calculated as percentage point difference in the child poverty rate before and after taxes and transfers.

Subsequent analysis by the OECD (Whiteford and Adema, 2006) found that by 2003, benefit levels for Australian families receiving income support payments were the second highest in the OECD for lone parents and the highest for couples with children, both in absolute terms and relative to median incomes. Benefits paid to low income working families (at the minimum wage) were the highest in the OECD. Between 1985 and 2000, child poverty fell by more than any other OECD country, and Australia moved from having the 6th highest rate of child poverty to 16th. By 2005 Australia was the second most effective country in the OECD in reducing child poverty[7] (Whiteford, 2009). In summary, the family assistance changes outlined above had a very significant impact on child poverty – as they were designed to. This should be borne in mind when looking at the effects of these changes on the extent of middle class welfare.

Taxation Changes

Debates on middle class welfare cover not only the transfers that people in different parts of the income distribution receive, but usually sets this against the taxes that they pay, with the welfare element comprising the net gain after the taxes a person pays are deducted from the transfers she receives.

Since the 1980s there have been a series of income tax cuts through changes in the tax scale. It should be noted, however, that these cuts have been infrequent, and because the income tax system is not indexed, in the intervening years inflation has meant that the real value of various thresholds fell, so that income tax cuts tended to be partly offset by earlier less visible tax increases.

For example, the top income tax rate was 60 per cent in 1983-84, 47 per cent in 1995-96, and 45 per cent in 2007-08 (with a relatively small Medicare levy added in the latter two years). This top rate was payable on income above about twice the average wage in 1983-84, but this fell to 1.5 times the average wage in 1995-96 and subsequently rose to 2.6 times the average wage in 2007-08. On the other hand, between 1983-84 and 2007-08 the tax-free threshold fell from a quarter to one tenth of the average wage. However, a range of measures was introduced or expanded to offset this for pensioners and beneficiaries and low wage earners. Tax rebates for social security benefit recipients meant that those with no income apart from their allowance income were not liable for income tax, while for pensioners the tax rebates were more generous. The Low Income Tax Offset (LITO) was introduced and increased, so that while the standard tax threshold is about one-tenth of the average wage, these measures have had the effect of keeping the effective tax threshold for low income earners at slightly more than one quarter of the average wage, about the same as in 1983-84. While the LITO increases effective marginal tax rates in the income ranges over which it is withdrawn, it nonetheless protects low income earners (including many second earners – typically women – in middle and high income families) from the fall in the value of the basic tax threshold. What this means is that tax reductions in the middle and at the top of the distribution were at least partly paid for with tax increases at lower earnings levels (but not on lower earnings individuals), partly offsetting the effects of tax cuts for middle and upper income groups. In a sense, the tax threshold like family payments became targeted.

Labour Market and Family Changes

A final factor that should be borne in mind is the effect of labour market and family changes on the distribution of incomes and therefore on the apparent extent of middle class welfare. The recessions of the mid-1970s, the early 1980s and the early 1990s saw a significant increase in unemployment. The growth in lone parent families and the growth in receipt of disability payments also put upwards pressure on social security spending. While fluctuating, the proportion of the working age population receiving social security pensions and benefits increased from less than 5 per cent in the 1960s and early 1970s to 15 per cent in 1983, falling to 12 per cent by 1989 and increasing again to 19 per cent by 1997. Put another way, in the early 1970s about half the poorest decile of the working age population were mainly dependent on cash transfers but by the late 1990s virtually all of the poorest quintile were. Overall, the scope of the benefit system expanded significantly; while part of this was due to higher real payments and less restrictive income tests, partly this reflected the labour market and family changes referred to above.

Since 1997, there has been a strong reversal in these trends. Between 1997 and 2008, the proportion of working age families whose main source of income was social security payments more than halved among those with a head aged under 24 years or a head aged 55 to 64 years, fell by a quarter for those aged 25 to 34 years and by a third or more for other age groups (Australian Bureau of Statistics, 2009). The fact that fewer very low income households were substantially reliant on benefits, while support for low income working families increased, is likely to have had impacts on the measured level of middle class welfare, as discussed below.

5. Tracing the Evolution of Middle Class Welfare in Australia

The data used in this analysis are calculated from the Survey of Household Income and Income Distribution series conducted by the Australian Bureau of Statistics at regular intervals since 1982. The surveys collect detailed information on the incomes and demographic characteristics of representative samples of Australian households. Although there have been several changes in method through the years, these data represent the most comprehensive series for examining the evolution and distribution of income in Australia over the past 30 years (Saunders and Bradbury, 2006; Austen and Redmond, 2010). In order to be consistent over time, the data refer to current weekly income; the unit assumed to share income is the "income unit" or nuclear family, with income units weighted by the number of persons they contain. Incomes are equivalised using the Modified OECD equivalence scale.[8]

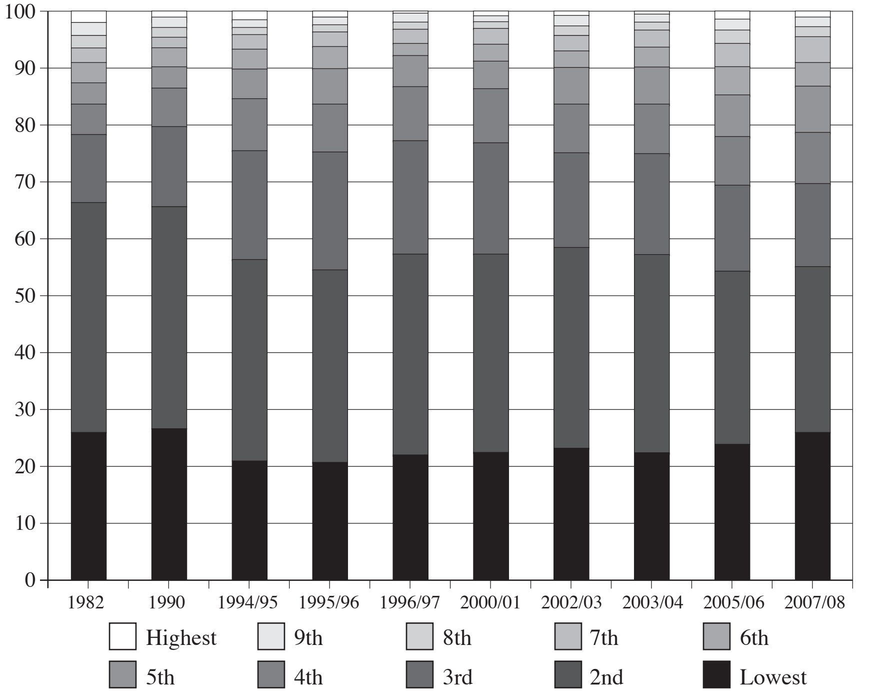
While the discussion of the transfer component of middle class welfare above focuses on the evolution of family payments, it is not possible to analyse family payments in isolation from other transfers since (as noted above) certain additions to pensions and unemployment payments evolved into family payments over the period in question. Transfers increased from around 7 per cent of total working-age family disposable income in the 1980s to peak at 9.6 per cent in 1996-97 (an increase of nearly 40 per cent) and then gradually fell back, but with a sharp decline between

[8] In addition, in order to provide consistent estimates over time, this analysis excludes the effects of improvements made to income measures in the most recent 2007-08 survey. See, ABS, 2007-08 Household Income and Income Distribution, Australia, Appendix 4, Cat. No. 6523.0.

2005-06 and 2007-08 to 6.4 per cent of family income. However, since family income was considerably higher in 2007-08 than it was in 1982 (about 64 per cent in real terms), this is a smaller share of a much greater amount.

Figure 2 shows the changing distribution of transfers in Australia since 1982; the poorest 10 per cent of households have consistently received between one-fifth and one-quarter of all transfers, while the cumulative share of the first two deciles has fallen from around 67 per cent to 55 per cent; that is the share of the second decile has fallen from 40 per cent to 30 per cent. It is worth noting that the share of transfers received by the second decile has always been considerably greater than the share received by the poorest decile, probably reflecting the fact that the poorest income decile includes people reporting business losses and who are not receiving benefits, and includes fewer families with children than in the second decile. It is also worth noting that the share of transfers going to the bottom deciles is affected by the unemployment rate, which was high up to the mid-1990s, but generally declining after that. It is also affected by compositional shifts in the demographic make-up of the decile groups, with single person families gradually slipping down the distribution over time, and couple families with children moving up.

Figure 2 - Cumulative Distribution of Transfers by Deciles of Equivalised Family Income, Population of Working Age (%)

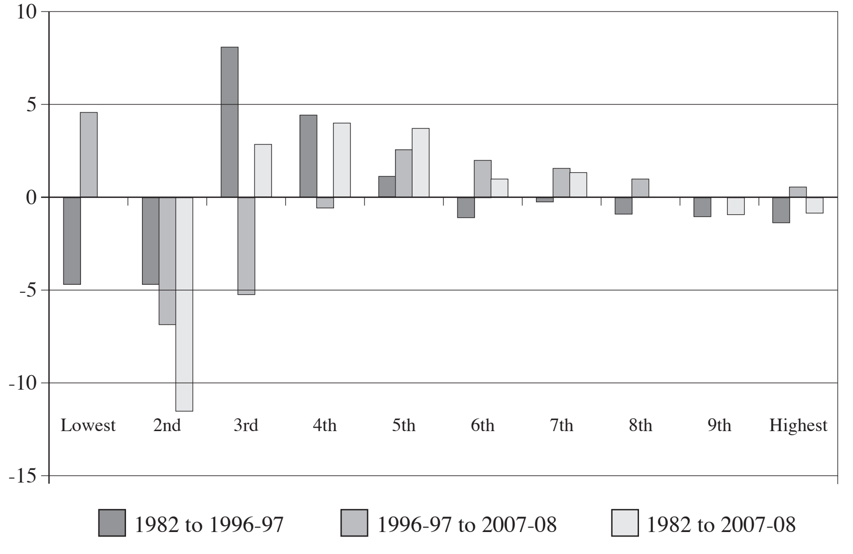


Source: ABS Survey of Household Income and Income Distribution, authors' calculations.
Note: Deciles and percentages refer to income unit income, weighted by the number of persons they contain. Incomes are equivalised using the Modified OECD scale (first adult in the family=1; other adults=0.5; children=0.3).

Figure 3 shows changes in the share of transfers received by different decile groups, first for the period of the Hawke-Keating governments (1982 to 1996-97) and then for the period of the Howard Government (1996-97 to 2007-08) and then for the two periods as a whole.

For the lowest decile, the loss of transfer share under the Labor government was offset in the period of the Coalition government, producing no net change overall. The share of the second decile fell in both periods, so that overall this group saw the largest decline of their share overall. It must be emphasised, however, that these are shares of changing levels of transfers and increasing household incomes, so it should not be thought that the second decile has been made absolutely worse off by these changes. In fact, the absolute level of transfers received by the second decile has risen slightly, as the rise in household incomes was sufficient to more than offset the falling share of this group.

Figure 3 - Change in Share of Transfers Received by Different Decile Groups, 1982 to 2007-08

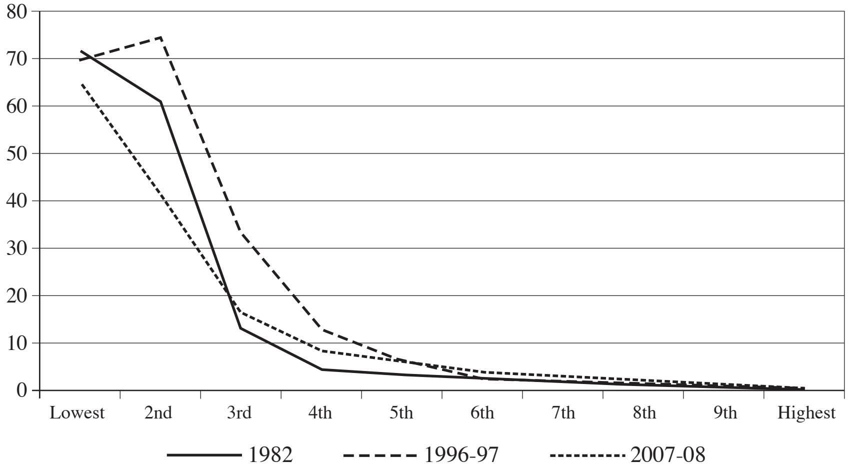


Source: ABS Survey of Household Income and Income Distribution, authors' calculations.

In the Hawke-Keating period, it was the third and fourth deciles that saw the largest increases in their share of transfers. This could be expected as the Prices and Incomes Accord of the period was designed to use improvements in the 'social wage', including higher income support for families, as a trade-off for wage restraint, with the main beneficiaries being lower-paid working families (Harding, 1982, 1994; Whiteford, 1994). The share of these deciles fell in the period of the Howard government, and it was the 5th to the 8th deciles whose share of transfers increased the most. While the increase for each of these deciles was not as great as the increase for the poorest decile, cumulatively these deciles benefited more.

The richest two deciles saw a fall in their share of transfers under the Labor government, consistent with the income-testing of family allowances. This was slightly offset under the Howard government, but only to a minor extent. As noted above, however, the interpretation of trends under the Coalition government is substantially complicated by the fact that reliance on income support among the population of working age fell very substantially in this period. In a sense, transfers were being 'taken away' from lower income groups because their private incomes were increasing significantly. This is in contrast to the period of the Labor government, when increased transfers were paid in order to offset wage restraint.

Figure 4 - Transfers as a Share of Disposable Income by Deciles of Equivalised Family Income, Population of Working Age (%), 1982, 1996-97 and 2007-08



Source: ABS Survey of Household Income and Income Distribution, authors' calculations.

Figure 4 shows cash benefits as a percentage of the disposable income of working age families in 1982, 1996-97 and 2007-08. For the poorest decile, benefits have generally accounted for around 70 per cent of their disposable incomes for most of this period, but falling to less than 65 per cent in 2007-08. For the second decile, benefits increased from 61 per cent of disposable income in 1982 to more than 70 per cent in 1996-97. It subsequently declined very significantly to 42 per cent by 2007-08. The third decile saw the largest increase from less than 20 per cent in 1982, but then increasing to 30 per cent or more for most of the rest of the decade. Once again, there was a significant fall back to less than 20 per cent in 2007-08. The 4th to 7th deciles have seen smaller absolute increases in the role of benefits, but so far they seem to have been sustained. The low share of transfers in the 8th decile has been broadly stable, while in the top two income groups, receipt of benefits has fallen over the whole period and stayed lower than in the 1980s, consistent with the effects of income-testing of family payments. In summary, it is clear that much of the upward shift in benefit receipt was concentrated in the third decile (though this has recently fallen back) and to a lesser extent in the fourth decile.

Table 1 provides a range of summary measures relating to taxes and transfers relevant to an assessment of trends in the extent of middle class welfare. The top row of the table shows that despite the range of tax changes referred to above, income taxes were remarkably stable as a share of family income between 1982 and 2003-04. There was a slight fall in the period before 2001, reflecting the introduction of the GST – income taxes fell, but at the same time indirect taxes rose, but these are not taken into account in these calculations. However, the period since 2003-04 has seen a sustained fall in income taxes as a share of family income, to just under 25 per cent and then 23 per cent. The concentration coefficient on the second row of the table shows that the progressivity of taxes increased somewhat between 1982 and 1995-96, was stable until 2000-01, and then fell before increasing again in the final survey year.

Table 1 - Alternative Measures of Middle Class Welfare, Working Age Families, 1982 to 2007-08

	1982	*1990*	*1994-95*	*1995-96*	*1996-97*	*2000-01*	*2002-03*	*2003-04*	*2005-06*	*2007-08*
Taxes as % of disposable income	26.2	26.9	26.6	26.3	26.3	25.3	26.6	26.1	24.7	22.6
Concentration coefficient of taxes	0.51	0.52	0.52	0.54	0.53	0.53	0.52	0.51	0.49	0.54
Transfers as % of disposable income	6.9	7.2	9.4	9.5	9.6	8.7	8.2	8.4	8.0	6.4
Concentration coefficient of transfers	-0.54	-0.57	-0.52	-0.52	-0.55	-0.55	-0.53	-0.53	-0.48	-0.50
Middle class welfare 1	17.7	17.3	21.9	22.4	21.1	21.5	22.9	23.7	27.9	27.9
Middle class welfare 2	12.4	9.6	10.2	10.2	7.9	8.8	10	9.8	14.7	13.2
Upper class welfare	3.8	2.7	2.7	2.1	1.6	1.5	2.1	1.5	2.8	2.2

Source: ABS Survey of Household Income and Income Distribution, authors' calculations.
Notes: The concentration coefficient for taxes/transfers is calculated in the same way as the Gini coefficient, but families are ranked by disposable income and not by taxes paid or transfers received. A more negative concentration coefficient for transfers implies greater progressivity (lower income groups get a higher share), but larger coefficients for taxes imply greater progressivity, since taxes are deducted from income. The first measure of middle class welfare is the share of transfers received by families above the third decile and below the 8th decile (the middle 50 per cent of families). The second measure of middle class welfare is the share of transfers received by families above the median. Upper class welfare is the share of transfers received by the richest 20 per cent of the population.

The fourth row of the table shows that the concentration coefficient for transfers also remained broadly stable over this period of more than 25 years; while there appears to have been a fall in progressivity between 2003-04 and 2005-06, this was subsequently reversed.

The first measure of middle class welfare is the share of transfers received by families between the 30th and the 80th percentile points (the middle 50 per cent of families). This measure shows an overall increase in middle class welfare, with a significant upwards jump in the early 1990s, and another upwards jump since 2003-04. The second measure of middle class welfare is the share of transfers received by families above the median, the top 50 per cent of the working age population. This measure shows a reduction in middle class welfare in the middle of the 1990s, and an increase afterwards, but middle class welfare is only a little higher at the end of the period than it was at the beginning.

Upper class welfare is the share of transfers received by the richest 20 per cent of the population. This shows a halving in the period of the Labor government and an increase under the Coalition, but still being lower at the end of the period than at the beginning. The differences between these results highlights the fact that the precise definition of the middle class is quite important: if the middle class is taken to include people in the fourth and fifth deciles – better off than the poor, but lower than the median, then middle class welfare has increased. In contrast, if these deciles just below the median are excluded but the richest 20 per cent of families are included, then middle class welfare has been stable overall.

Table 2 shows the proportion in each income decile who are estimated to pay no net income tax – that is their income tax bill (if any) is less than or equal to the amount of public transfers that they receive, so that overall, they register a tax-transfer 'gain' (the table presents no information on the size of this gain). In 1982, 100 per cent of families in the lowest income decile paid no net tax, as did 86 per cent of families in the second decile, but fewer than a fifth of families in the third decile. In the remaining deciles the vast majority of families are calculated as paying some net tax. There was a notable upwards shift in the proportion of families paying no net tax between 1982 and 1990, from 19 to 30 per cent in the third decile, and from five to 11 per cent in the fourth decile. Equally, however, there was a downwards shift in the proportion paying no net tax in the bottom two deciles. Therefore, if the rise in the proportion of families in the third and fourth deciles paying no net tax can be seen as indicative of the rise of (lower) middle class welfare, the reduction in the proportion of families in the bottom two deciles paying no net tax can be seen as indicative of the spreading of tax burdens. Put another way, both higher income families and lower income families 'paid' for the spread of middle class welfare during the 1980s.

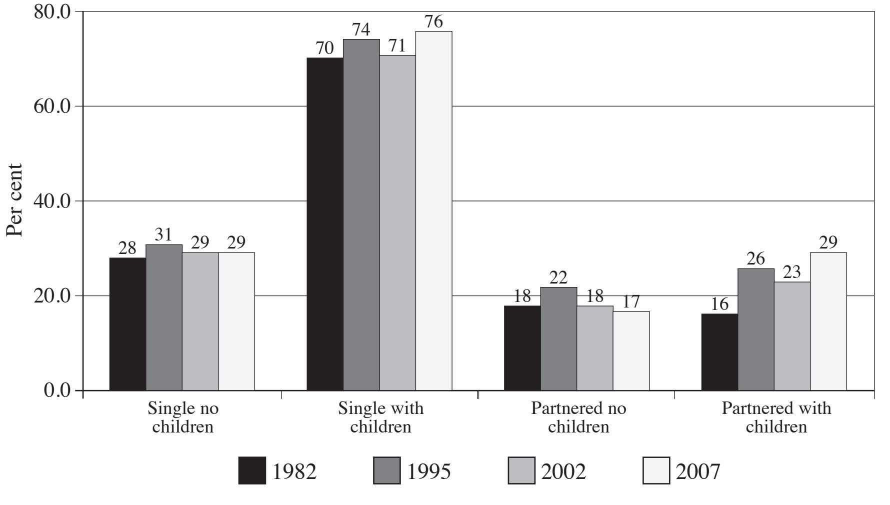
Table 2 shows that after 1990, the proportion of families in the middle deciles who paid no net tax grew significantly – more than doubling to a quarter of families in the fourth decile and a tenth in the fifth decile in 1994-95. The growth in middle class welfare (here defined as the proportion of families above the bottom two deciles paying no net tax) continued under the Howard government, associated not only with increases in transfers to families as described above, but also by decreases in income tax rates. By 2007-08, almost half of families in the third decile, a quarter in the fourth decile and 16 per cent in the fifth decile are calculated as paying no net tax. In the remaining deciles the proportion paying no net tax remained relatively small, although it should be emphasized that the binary nature of the indicator on table 3 does not reveal how positive tax burdens may have changed in the top (or the bottom) deciles.

Table 2 - Families Paying No net Tax, by Equivalised Family Income Decile, 1982 to 2007-08

	1982	*1990*	*1994 -95*	*1995 -96*	*1996 -97*	*2000 -01*	*2002 -03*	*2003 -04*	*2005 -06*	*2007 -08*
Lowest	100.0	92.9	87.8	95.6	94.3	90.8	87.4	86.4	89.7	95.2
2nd	86.4	73.8	81.4	81.3	84.9	82.4	80.5	79.8	75.8	77.9
3rd	18.7	30.6	51.0	59.1	54.4	53.7	47.6	50.2	46.2	47.2
4th	5.3	11.3	25.5	22.3	23.5	26.4	18.9	20.7	23.3	24.3
5th	3.0	4.2	10.9	13.3	11.3	8.9	11.9	12.1	11.9	16.0
6th	2.7	2.9	5.6	6.0	3.4	5.3	4.1	5.1	5.5	6.5
7th	1.3	1.2	1.9	2.8	2.5	3.8	2.1	2.9	2.0	4.9
8th	0.5	0.8	1.3	1.3	1.5	1.3	2.9	1.7	1.3	2.6
9th	0.4	0.9	0.2	0.7	0.8	0.6	1.0	0.7	1.5	0.8
Highest	0.3	0.3	0.7	0.0	0.3	0.1	0.3	0.7	0.5	1.0
Total	21.9	22.0	26.7	28.3	27.7	27.4	25.7	26.0	25.8	27.7

Source: ABS Survey of Household Income and Income Distribution, authors' calculations.
Notes: Net tax is calculated as the amount of public cash transfers received, minus the amount of income taxes paid by all family members. A family is defined as paying no net tax if this is equal to or less than zero.

Figure 5 - Families Paying no Tax, by Family Type (%)



Source: ABS Survey of Household Income and Income Distribution, authors' calculations.
Notes: For definition of families paying no net tax, see notes to table 2.

Figure 5 shows the proportion of families paying no net tax between 1982 and 2007 by family type. The proportion of single person families and couple families with no children paying no net tax did not change greatly throughout the period under examination. The proportion of single person families with children paying no net tax, already high in 1982, did not increase greatly in the years to 2007; although this small change needs to be set against steadily rising labour force participation and market incomes among this group: in the absence of increased generosity of family payments, the proportion paying no net tax might have actually decreased. But the biggest gains were experienced by partnered couple families with children (among whom labour market participation and market incomes also increased over this period – as evidenced by rising proportions of mothers working). Only 16 per cent of this group paid no net tax in 1982, compared with 29 per cent in 2007-08. Appropriately enough, it has been about this group more than any other that the 'middle class welfare debate' in Australia has focused.

6. Discussion

This article has shown that the distribution of benefit payments to people of working age has changed in important ways over the past twenty-five to thirty years. In 1982 just before the election of the Hawke Labor Government about two-thirds of all spending on benefits to people of working age went to the poorest 20 per cent of the population; by 1996-97 when they left office this had been reduced to 57 per cent. By 2007-08 when the coalition government lost office this had reduced marginally to 55 per cent. While this is a substantial reduction in the share of benefits going to the poorest 20 per cent, virtually all of this shift in resources went to the next three deciles, that is to families with incomes below the median. So in 1982 the bottom half of working-age individuals and families received just under 88 per cent of all benefits, and in 2007-08 they received just under 87 per cent of all benefits. It is true that there was a reduction in the share of transfers going to the bottom half of the income distribution under the Coalition government from 92 per cent in 1996-97 to 87 per cent at the end of the period and there was also a reduction in the level of spending in this period from 9.6 per cent to 6.4 per cent of family disposable income, but this also reflects a reduction in receipt of welfare payments among lower earners because of stronger increases in earnings at the bottom of the income distribution.

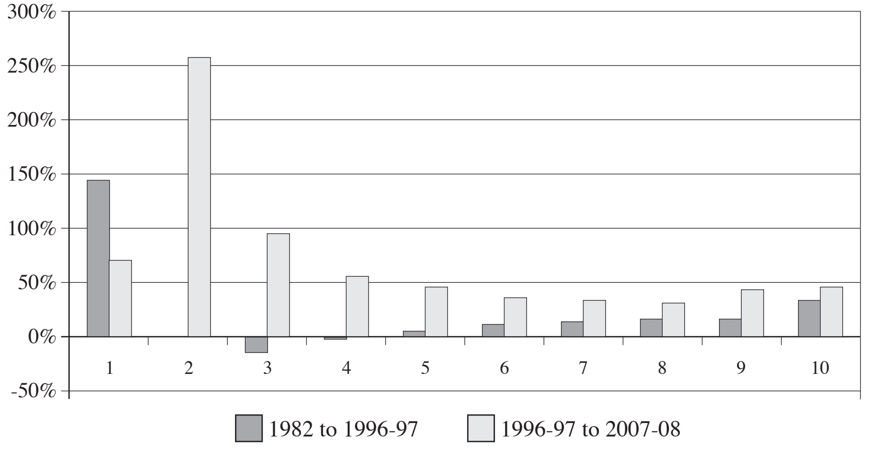
This is illustrated in figure 6, which shows the proportional change in earnings in the two periods of different governments. Excluding the first decile, it is apparent that real earnings fell or rose very weakly in deciles two to five in the period 1982 to 1996-97, while in the period 1996-97 to 2007-08 real earnings rose very strongly in the bottom half of the income distribution.

Care should be taken in interpreting these figures.[9] The proportional increases are much greater in the bottom half of the income distribution because earnings are much lower at low income levels. For example, the 250 per cent increase in the earnings of the second decile was an increase from $44 a week to $158 per week, while the 47 per cent increase for the richest decile was an increase from $1,375 per week to $2,010 per week, in absolute terms a gain about six times higher. Nevertheless,

[9] The other caveat relates to the identification of the periods of government. For example, the Hawke government was elected in March 1983 in a period of rapidly rising unemployment, from an average of 6.1 per cent for the 1981-82 year for which the income data were collected to 10.1 per cent (seasonally adjusted) in March 1983. Using 1981-82 as the starting year makes the Hawke government responsible for the unemployment they inherited (and which was one of the reasons for their election). On the other hand, the preceding Fraser government also introduced tax cuts and increases in Family Allowances as well as the new Family Income Supplement, but these did not come into effect until after they lost office.

the gains in the bottom half of the distribution will have a much greater impact on benefit entitlements, because these include the income ranges where income support entitlements are withdrawn. In summary, the change in the distribution of benefits is not only a result of any reduced targeting to lower income groups, but because the hours of work of these groups fell in the first period due to higher unemployment and rose in the second period because of reduced unemployment.

Figure 6 - Percentage Change in Real Earnings by Income Decile, 1982 to 1996-97 and 1996-97 to 2007-08



Source: ABS Survey of Household Income and Income Distribution, authors' calculations.
Notes: The figures show the percentage change in combined average earnings of men and women by decile. Figures do not include self-employment earnings or unearned income.

Interpretation of these trends also depends on the type of middle class welfare receipt that one is concerned about. As noted, overall what appears to have happened over the period since 1982 is that benefit spending has become less targeted on the poorest 20 per cent of the population but has been shared more widely with individuals and families below the median. Persons in these income ranges may not be poor, but it is difficult to characterise them as rich; in fact, if one disregards the point that most Australians see themselves as middle class, one would be tempted to describe this group as 'working class' or as 'battlers'.

In relation to family payments the main reasons for the extension of support have been the real increases in the rates of payments for low income groups and the reduction in the withdrawal rates on benefits for children – from either 50 per cent or 100 per cent in the 1980s to 20 per cent currently. These changes have pushed the cut-out points for family assistance much further up the income distribution. While a full analysis of trends in child poverty is beyond the scope of this article, earlier discussion suggests that Australia has been extremely effective at reducing child poverty and also has a system in which work pays for lower income families for children.

This raises the question of what would be the appropriate policy responses to reduce the extent of middle class welfare, should one consider this a major problem, either for equity or efficiency reasons. Broadly speaking there are two possible ways to reduce middle class welfare – governments can cut benefit levels or impose tighter income tests on payments. Governments have generally been reluctant to explicitly cut benefit levels, although in the period of the Fraser government most benefits for children were not indexed against inflation and because this was a period of relatively high inflation payments fell significantly in real terms. In the 2009-10 Budget the government held the thresholds for income-testing the lower rate of Family Tax Benefit Part B and the Baby Bonus fixed in nominal terms, and changed from wage to price indexation for FTBA. In the longer run, these initiatives will reduce benefit levels relative to what they would otherwise have been, but the effect is likely to be small for some years.

In relation to tighter income-testing, in the 2008-09 Budget, the Government restricted access to Family Tax Benefit Part B by making families where the main income earner has an income of $150,000 a year or over ineligible for payments. This ‘sudden death’ approach to income-testing produces a sharp discontinuity – a family with an income just below the threshold would be eligible for the full benefit, but a family just over this threshold would lose the full amount and suffer a drop in disposable income. This approach is easy to implement, however, and there are very few families with incomes at this level so it is unlikely to have a major impact on incentives to work. Following the same approach at lower income levels is less attractive because the greater concentrations of families at lower income levels means that higher budget savings could be achieved, but at the potential cost of stronger effects on behaviour.

Reducing the withdrawal rate from less than ‘sudden death’ to some rate less than 100 per cent means that to achieve the same budgetary savings, the threshold income level at which any income test cuts in needs to be lower. In addition, this also raises concerns about high effective marginal tax rates (EMTRs); but another mainstay of policy discussion in Australia is the desirability of reducing, not increasing EMTRS. Any consideration of options to reduce middle class welfare in Australia therefore needs to seriously consider the trade-off between desired benefit levels and higher EMTRs. To the extent that middle class welfare has increased in Australia over the past quarter century, this has largely been the result of deliberate policy choices to provide more generous assistance to families with incomes below the median and to improve their work incentives at the same time. Correspondingly, any significant reduction in middle class welfare will require a reversal of at least one aspect of this policy approach.

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