The Politics of the New Welfare State:

Social Tax Expenditures and the Second Tier of Australian Welfare

A thesis submitted for fulfilment of the requirement for the award of the degree of **Doctor of Philosophy** from **Macquarie University.**

Adam P. Stebbing
B. Soc Sci (Hons)
Department of Sociology
Macquarie University

Declaration of Originality

I hereby declare that this thesis is my own work and that to the best of my knowledge it contains no material previously published or written by any other person, nor material that has been accepted for the award of another degree of a university, or other institute of higher learning, except where due acknowledgement is made on page *ix* or in the text.

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List of Abbreviations

ABC	Australian Broadcasting Corporation
ABS	Australian Bureau of Statistics
ACA	Australian Consumers Association
ACCC	Australian Consumer and Competition Commission
ACOSS	Australian Council of Social Services
ACTU	Australian Council of Trade Unions
AHRA	Australian Health Reform Alliance
AIHW	Australian Institute of Health and Welfare
AMA	Australian Medical Association
APRA	Australian Prudential Regulatory Authority
ATO	Australian Taxation Office
AWA	Australian Workplace Agreement
BCA	Business Council of Australia
BMA	British Medical Association of Australia
BUS	Builders Union Superannuation Fund
CAI	Council of Australian Industry
CIS	Centre for Independent Studies
DOHA	Department of Health and Ageing
DRS	Doctors Reform Society
DVA	Department of Veteran Affairs
EPAC	Economic Policy Advisory Council
FSPU	Federated Storemen and Packers Union
GDP	Gross Domestic Product
GST	Goods and Services Tax
GPSA	General Practitioners Society of Australia
HILDA	Household, Income and Labour Dynamics of Australia Survey
IRC	Industrial Relations Commission
LCR	Lifetime Community Rating
LIFA	Life Insurance Federation of Australia
LUCRF	Labour Union Cooperative Retirement Fund
MLS	Medicare Levy Surcharge
NCP	National Competition Policy
NICC	National Industrial Construction Council
NMA	National Medicare Alliance
NSCE	National Superannuation Committee of Enquiry

NSW	New South Wales
OECD	Organisation for Economic Cooperation and Development
PC	Productivity Commission
PHIAC	Private Health Insurance Advisory Council
PHIIS	Private Health Insurance Incentives Scheme
PHITR	Private Health Insurance Tax Rebate
PNHS	Page National Health Scheme
PPU	Pulp and Paperworkers Union
RBL	Reasonable Benefit Limits
RSA	Retirement Savings Accounts
SSCHA	Senate Select Committee on Housing Affordability
SCS	Superannuation Co-contribution Scheme
SGS	Superannuation Guarantee Scheme
SSR	Social Security Review
STC	Super Tax Concession
STE	Social Tax Expenditure
TES	Tax Expenditures Statement
US	United States of America
WETT	Women's Economic Think Tank

Thesis Abstract

Classifying Australia as a 'targeted' welfare state overlooks the rising significance of social tax expenditures (STEs). As tax provisions that offer selective welfare benefits, STEs are increasingly relevant to Australian welfare because of their large scale, inequity and rapid growth. This thesis incorporates STEs into our understanding of the Australian welfare state by situating them within its institutional framework and explaining their political development. I explore the relevance of STEs by analysing two case studies – the tax expenditures for private health insurance and superannuation. Both cases are difficult to understand as 'evidence-based' policies because they are inequitable and expensive. Adopting a historical institutionalist framework, I show that better explanations of the cases account for the influence of politics and institutions. The private health insurance tax rebate was 'layered' onto Medicare by the Howard government to revitalise private health provision without winding back the popular universal health scheme. The superannuation tax concessions have emerged as major retirement incomes policies through processes of 'drift' associated with the extension of occupational super to the work force. The Hawke and Howard governments' reorientation of these tax concessions through 'conversion' had broad effects because of their large budgetary scale. Drawing on the case studies and broader research, I locate STEs as the second tier of the *dual welfare state* model – a less equitable but more expansive understanding of the Australian welfare state. My analysis of the political development of STEs shows that they have emerged as core second-tier institutions through two 'overlapping processes' that coincided with the winding back of the wage-earner model. STEs have grown as both an indirect consequence of developing new wage-earner institutions and a means of meeting new demands for social provision in a policy environment hostile to extending social expenditures.

Published Materials

Earlier versions of some materials presented in this thesis have been published as a journal article, occasional paper, refereed conference paper and book chapter over the course of my doctorate. These publications were jointly researched and co-authored by Dr. Ben Spies-Butcher from the Department of Sociology at Macquarie University. I first discussed the inequity, inefficiency and low visibility of tax expenditures in a co-authored piece entitled (2008) 'Reforming Australia's Hidden Welfare State: Tax expenditures as welfare for the rich', which the Centre for Policy Development published as an *Occasional Paper (No.6)*. I first presented the inequity of the superannuation tax concessions in a co-authored refereed conference paper titled (2009) 'The Upside-down Welfare of the Superannuation Tax Concessions' at the *Society for Heterodox Economists' 8th General Meeting*. I first identified social tax expenditures as the second tier of the dual welfare state model in a co-authored journal article titled (2010) 'Universal Welfare by Other Means? Social Tax Expenditures' in the *Journal of Social Policy*, Volume 39 Issue 3. And, I first discussed the social policies of the Rudd Labor government in a co-authored chapter entitled, (2010) 'Getting Value for Public Money: Superannuation, Housing and Childcare' in Davis and Lyons, *More Than Luck: Ideas Australia Needs Now.* This thesis, however, builds on this joint research rather than replicating it. The responsibility for the ideas presented here thus rest solely with the author.

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Thank you to my friends and colleagues in the Department of Sociology. I have benefited more from our social interactions and intellectual engagements than most of you probably realise, especially from my fellow travellers on, or who recently made it to the end of, the long and winding PhD path.

Finally, I want to thank the three examiners for their most constructive comments.

Of course, I take sole responsibility for any errors that remain in this thesis.

- Introduction -

A Targeted Welfare State?
Social tax expenditures and the Australian welfare state

The Australian welfare state is often understood to exemplify the ‘targeted welfare model’, with means-tested social assistance targeted at those most in need (Korpi and Palme 1998; Whiteford and Angenent 2001; Whiteford 2008; Mendes 2009). Emphasising social expenditures such as income transfers and services, this understanding overlooks the broader range of policy instruments that the state uses to entrench as well as reduce social inequality. Social tax expenditures (STEs) are included in this arsenal and are of growing significance to the Australian welfare state because of their inequity, budgetary scale and recent growth. This thesis broadens our understanding of the Australian welfare state by incorporating STEs. Adopting a two-pronged approach, I consider what the inequity of STEs implies for the Australian welfare model and explain why they recently emerged as key policy institutions. To ground this discussion, I focus on two STE case studies – the superannuation tax concessions and the private health insurance tax rebate. Drawing on these case studies and insights from previous research, my aim is to locate STEs within the political history of Australian social provision and establish them within a two-tiered model of the Australian welfare state.

STEs denote the subset of tax expenditures that provide benefits in the key areas of welfare provision. Tax expenditures are tax provisions that benefit taxpayers who belong to particular groups or undertake certain actions (Treasury 2010a: 2). The main forms of tax expenditures include: tax exemptions; tax concessions; tax deductions; tax allowances; tax rebates or offsets; rate relief; and provisions for income tax averaging (Smith 2003: 3). Tax expenditures deliver benefits in the form of a tax reduction that is often conditional on certain behaviours such as purchasing insurance. The selectivity of tax expenditures distinguishes them from general tax cuts. As the subset relating to social policy, STEs benefit their recipients – particularly wage and salary earners, property owners and individuals with retirement savings – together with private providers of social services. And, following Surrey (1973) and Howard (1997), I contend later on that STEs are 'conceptually equivalent' to social expenditures since they must be financed by diverting resources, running deficits or raising taxes.

STEs deserve greater attention from welfare state analysts because they account for a considerable slice of social provision and tend to be inequitable. These tax provisions are large in number and scale; the Treasury (2008, 2010) estimated that 74 STEs reduced tax revenue by $83.3 billion, or 8 percent of Gross Domestic Product (GDP), in 2006-07.[1] This corresponded to around 38 percent of total social expenditure in the same year (Treasury 2010).[2] The two largest categories of STEs – housing and superannuation – reduced tax revenue by $38.5 billion and $30.2 billion respectively (*ibid*: 4). Typically, STEs are also inequitable compared to Australian social expenditure, which constitute the most targeted social programs amongst the Organisation for Economic Co-operation and Development's (OECD) member countries (Australian Bureau of Statistics 2007a: 12). STEs are social provisions targeted at the non-poor because they tend to provide the highest proportional benefits to those who receive the highest income and have the greatest purchasing power. At the same time, tax expenditures – including tax concessions, tax deductions and tax rebates – often provide inequitable and sometimes regressive benefits because they invert the progressive income tax scales through their interaction with them. Because they have grown so rapidly over recent decades (see

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[1] This number was obtained by counting the tax expenditures listed under the headings for health, social security and welfare, and housing and community amenities in the *Tax Expenditure Statement 2007*, as well

[2] Total social expenditure was derived as the sum of direct social expenditure (from Treasury 2008: 13) and the total social tax expenditure (from Treasury 2010: 4). The figure from 2010 was used because it includes housing tax expenditures. These STEs, despite being the largest, were not included until 2009.

Chapter 1), STEs' inequitable distributive effects make them particularly deserving of scholarly attention.

Nonetheless, STEs remain relatively hidden social policies that avoid much of the scrutiny routinely directed at social expenditures. These policies avoid budgetary oversight, let alone comprehensive review. The Treasury's *Tax Expenditure Statement* (TES) is the main official source of data on tax expenditures, but requires no vote or formal discussion in parliament when released (Auditor General 2008: 15). More broadly, Wanna (2003: 30) contends that many tax expenditures have only been subject to scrutiny at their introduction. This low profile perhaps also explains why STEs have not featured more prominently in research on the Australian welfare state – with a few notable exceptions such as Keens and Cass (1983), Bryson (1992), and Bradbury (1998) – and why they rarely receive media attention. STEs also have a low profile since they appear to give recipients 'their own money back' rather than conferring a selective benefit from the state. At the same time, governments have little incentive to alter this arrangement because these policies provide a 'policy backdoor' to increase spending.

To incorporate STEs into our understanding of the Australian welfare state, this thesis addresses two research questions. The first question asks: how do STEs recast the Australian welfare model? The targeted model that features in recent studies (*i.e.* Whiteford 2008) offers a useful conception of social expenditure, but overlooks the role played by STEs. I propose an alternative two-tiered model of Australian social provision termed the *dual welfare state* (Stebbing and Spies-Butcher 2010). This model recasts Australian social provision by identifying STEs as a second tier that co-exists with targeted social expenditures. The second research question asks: what led to the recent emergence of STEs as core second-tier policies? Although STEs have grown recently, their long history needs to be accounted for so that the significance of this development can be appreciated. I contend that STEs have long been institutionally entrenched, but emerged recently as core second-tier policies – particularly since the gradual demise of what Castles (1985) terms the wage-earner's welfare state. Representing continuity and discontinuity with the wage-earner model, the rise of STEs is both an indirect consequence of building new forms of occupational welfare *and* the result of re-opened political space in a policy environment conducive to private social provision. The main advantage of my two-pronged approach is that it explores how STEs recast the Australian welfare model and explains the political dynamics that led to their development, rather than merely providing an ahistorical theoretical account of STEs that views these provisions as ‘rational’ outputs of ideal policymaking or a purely historical account that ignores their institutional ramifications.

I. The Context of This Thesis

This thesis responds to three challenges currently confronting Australian welfare state analysis. The first of these is growing recognition that our understanding of the Australian welfare state is in need of updating. As *the* reference point for studies of the Australian welfare state, Castles’ (1985) wage-earner’s welfare state model explains how a system of social protection developed through ‘other means’ – primarily through wage arbitration – over the first half of the twentieth century. Although the explanatory power of this model has waned since the 1970s, its legacy is evident in the relatively high minimum wage and in the residualism of the ‘targeted welfare state’ that has been widely perceived to replace it (Castles 1994; Saunders 1999; Whiteford and Angenent 2001; Bryson and Verity 2009).[3] Similarly, in the comparative literature, Australia is classified as a ‘liberal welfare regime’ (Esping-Andersen 1990, 1997) and is even seen to exemplify the ‘targeted welfare model’ (Korpi and Palme 1998).[4] The depiction of the Australian welfare state as possessing low levels of social expenditure and taxation is thus common to both Australian and comparative accounts. Although these depictions offer a valid account of the social assistance received by poorer and lower income households, it does not take stock of developments in middle class welfare or state assistance for private social provision. This thesis responds to this challenge by examining how developments relating to STEs over recent decades (in particular) have reshaped the politics and policies of Australian social provision.

The conventional understanding of the Australian welfare state also needs revising because it is incomplete. With few exceptions, welfare state analysis has focused on social expenditures, rather than the broader repertoire of policy instruments used by the state. This second challenge involves the question of how to differentiate social policy from other kinds of state activity. In his pioneering ‘social division of welfare’ thesis, Titmuss claimed that the “definition, for most purposes, of what is a ‘social service’

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[3] As discussed in *Chapter 1*, the legacy of the wage-earner model is also evident in the construction of new forms of occupational welfare, such as the Superannuation Guarantee Scheme.

[4] This view, of course, is not universally held. Castles and Mitchell (1993) challenge the classification of Australia as a liberal welfare regime and contend that it belongs to a fourth ‘radical’ world of welfare capitalism.

should take its stand on its aims; not on the administrative methods and institutional devices employed to achieve them" (1958: 42). With no universal definition, the welfare state has been viewed as including: programs that enhance the wellbeing of their recipients (Titmuss 1958); state policies that guarantee access to social rights (Marshall 1977); and, more recently, as a system of social risk management (Barr 2001; Taylor-Gooby 2004). Regardless of which conception is applied, none justifies confining social policy or the welfare state to social expenditures (Howard 1997: 5). Rather, each of these conceptions is broad enough to include a wide range of policy instruments, including but not limited to: social services; income transfers; STEs; industrial relations policies, mandatory saving schemes; income-contingent loans; social regulations; and social subsidies. Of particular interest here is Titmuss' (1958) concept of 'fiscal welfare', which represented an early attempt to include the policies now known as tax expenditures into welfare state analysis. My thesis, in responding to this challenge and situating STEs within the Australian welfare state, follows the focus of Titmuss (and others) on fiscal welfare and other non-conventional policy instruments.

The third challenge facing Australian social policy analysis is how to account for STEs in light of their rapid expansion over recent decades. In recent decades, STEs have doubled in number and as a proportion of GDP: the number of STEs listed in the TES grew from 36 to 74 between 1985-86 and 2006-07, while their estimated cost rose from 3.6 to 8 percent of GDP over the same period (Treasury 1986, 2010). STEs have thus become a major form of state assistance and seem to have the widest implications of the policy instruments excluded from the targeted welfare model.[5] Moreover, tax provisions have been introduced in every policy area of the welfare state, such as: income support; family support; childcare; support for individuals with disabilities; retirement incomes; health; and housing. But STEs also remain quite distinct from social expenditures as tax provisions that are administered by the Australian Tax Office (ATO), delivered to their recipients as tax cuts, and provide inequitable benefits. These differences pose the question of whether to include STEs within the welfare state or to analyse them separately. My response to this question is to argue that STEs are 'conceptually equivalent' to social expenditure and thus to situate these policies within the Australian welfare state.

[5] This is not to assert that STEs were insignificant before the 1980s, rather it is to state that their current scale and number, as well as their recent growth, is unprecedented.

II. The Need for Further Study

Taken together, these three challenges reveal the need for further research to address the gap in our knowledge about the Australian welfare state. The previous discussion showed that scholarly accounts offer an incomplete picture of both the Australian welfare state's institutional dynamics and political development because they overlook the increasing importance of STEs. Broadening the focus of analysis onto a wider set of policy instruments has the potential to redress the over-emphasis on social expenditure, thereby providing a more complete account of the state's impact on social inequality. My thesis contributes to closing this gap in our knowledge by situating STEs within both an account of the Australian welfare state's political development and institutional structure.

Although my primary goal is to update our understanding of the Australian welfare state, this study also addresses other scholarly needs. The potential for STEs to extend income inequality provides a further motivation for including them within welfare state analysis. The available evidence suggests that social inequality, and in particular income inequality, has grown in Australia during recent decades (Stilwell and Jordan 2007: 43). The welfare state's capacity to redress income inequality is important because inequality affects the distribution of individual opportunities and societal wellbeing. According to Wilkinson and Pickett (2009: 27), income inequality measures the hierarchical nature of a society, with material differences between individuals also reflective of the social distances between them. In their research on the 50 wealthiest countries (including Australia), they found that a range of social and health problems relating to social trust, educational achievement, life expectancy, infant mortality, mental illness and crime (amongst others) tend to occur with greater frequency in the more unequal affluent societies (*ibid*: 19-20). Wilkinson and Pickett (2009: 29) argue that their research reveals that "reducing [income] inequality is the best way of improving the quality of the social environment, and so the real quality of life, for all of us". Including STEs in welfare state analysis will thus help us understand the impact of tax expenditure based social policy on rising income inequality.

There is also a need to incorporate STEs in welfare state analysis to focus greater attention on the hidden dimensions of social policy (see Howard 1997). Ensuring that policy is held democratically accountable through independent scrutiny and investigation is a key rationale for scholarly analysis. This rationale has become more pertinent recently because of the modern state's massive scale and its increasingly labyrinthine structure. As Yeatman argues, publicly accountable policies "are oriented to the maintenance and development of public values [and] are contingent on the struggles within civil society to make them so" (1990: *xiii*). Because of their low profile and inequitable benefit structures, STEs embody the characteristics of non-accountable policy and have the potential to offer a policy backdoor for governments to direct social resources to the middle class, who are conceived of broadly as the 'non-poor' (see Goodin and Le Grand 1989). Situating STEs in the welfare state may thus improve the accountability of social policy by highlighting the development of these subterranean policies and their distributive effects on the Australian welfare model.

Another motivation for this thesis is the need for a systematic account of the role of STEs in Australian social policy. A relatively small but growing literature focuses on particular STEs and their implications for specific Australian policy domains. In her research, Segal (2004: 14) characterises the Private Health Insurance Tax Rebate (PHITR) as the 'second tier' of Australian health policy. Similarly, Jamrozik (2005: 299-300) frames the STEs for housing as middle-class welfare and social housing as residual welfare for the poor and low-income earners. This description is consistent with Yates' (2003) analysis of the housing assistance STEs provide to owner-occupiers. And, researchers including Gruen (1985: 613), Olsberg (1997: 70) and Marriot (2009: 479) conceive of retirement incomes policy as having two tiers – the age pension and super guarantee scheme. Previous studies, however, analyse STEs in particular policy domains in a piecemeal fashion rather than exploring their systemic ramifications for the Australian welfare state. Bryson's (1992: 152) analysis of fiscal welfare is an exception; although systematic, her account is brief and no longer current. This thesis builds on these previous studies by attending to broader trends in STEs, and two case studies in some detail, to enrich our understanding of the Australian welfare state.

A final rationale for this thesis is the need for comparative research. Although I concentrate on Australia, the rising significance of STEs has an international dimension. The research of Howard (1997, 2006, 2009) and Hacker (2002) into the important roles played by STEs in the United States provides further motivation for my investigation of Australia as another in the liberal welfare state cluster. Adema and Ladaique (2005: 32) have also shown that STEs are used in the welfare systems of the United Kingdom, Japan, Germany and France. Despite the cross-national significance of STEs, comparative studies of these policies are marred with methodological issues because a range of measuring techniques and accounting conventions are used in different countries (Howard 1997: 201; Adema and Ladaique 2005). Because little is known about STEs in Australia, there is more potential for important contextual factors relating to their politics, growth and use to be overlooked in comparative analysis. This thesis is thus a precursor for further comparative analysis.

III. The Contribution of This Study

My central argument is that STEs form the core of the 'second tier' of the Australian welfare state, which recasts both its institutional structure and political development. In recasting the Australian welfare model, STEs are situated in a more expansive but less equitable two-tiered model that I, with Ben Spies-Butcher, have termed the *dual welfare state* (Stebbing and Spies-Butcher 2010). The first tier consists of the targeted welfare model that pervades scholarly accounts of the Australian welfare state. Its core programs include targeted social expenditures: the age pension; Medicare (universal health insurance scheme); and, the family tax benefits. Because Australian social expenditures tend to have more generous tapers than other countries, these programs assist lower income households as well as many middle-income households (Saunders 1999: 503; Castles 2001: 32). My contribution is to describe the second tier in more detail, which comprises STEs and programs involving non-conventional policy instruments. Core second-tier programs include: the Superannuation Tax Concessions (STCs); the PHITR; and the tax exemptions for imputed rent and capital gains on the principal residence. These policies predominantly assist the middle class, including middle and high-income earners. Lower income earners receive little from these policies since they often have neither the purchasing power to afford private services nor the heavy tax liabilities to receive substantial tax discounts. High-income earners tend to receive even more from STEs than middle-income earners because they spend most on private services and receive higher tax discounts.

Expanding as core second-tier institutions, the political and institutional development of STEs has also become integral to understanding the evolution of the Australian welfare state. Having long played an established, albeit peripheral, role in Australian social provision, STEs only emerged recently as core second-tier policies. My contribution is to show how the early development of STEs and the policy environment of recent decades have assisted their establishment as core second-tier policies. The parallel development of STEs alongside the early pillars of the wage-earner model (see

Chapter 1) reinforced the emphasis of the Australian welfare state on some types of private social provision. These early STEs laid down the foundations of the second tier and established the practice of using tax provisions to subsidise services. When the policy environment shifted in recent decades, STEs presented political actors with a proven means to subsidise private social provision for the middle class. STEs have also been appealing in this policy environment because the gradual winding back of the wage-earner model re-opened middle class demands for social provision and the growing hegemony of neoliberalism continued to contain the appeal of social expenditures (as the wage-earner model also constrained social expenditure). Political actors have responded to this policy environment in two ways that have expanded STEs. Political actors have mandated private social provision – such as superannuation – that is already subsidised by STEs and thereby increased the revenue forgone required for them. And, they have created new STEs for private social provision – like the PHITR – to direct benefits to the middle class (and private providers). While both major parties have increasingly used STEs, I show that the political persuasion of policymakers has *mattered* to their design, with Liberal-National Coalition governments preferring policies that reduce complexity and Labor governments favouring reforms that reduce inequity.

IV. Approach and Organisation of This Thesis

This final section outlines the approach that I adopt to develop these arguments and then concludes with a brief overview of the following chapters. This thesis contributes to a growing literature that analyses public policy at the level of policy instruments (see Hood 1986; Salamon 1989, 2002; Lascoumes and Le Gales 2007). Policy instruments refer to the broad types of methods used in the design of particular programs (Salamon and Lund 1989: 29). For instance, the Child Care Tax Rebate is a 'program' delivered through a tax expenditure 'policy instrument'. Policy instruments present a fruitful avenue for analysis because they tend to have consistent effects on the design and outcomes of a policy (Salamon 1989: 14). This is because policy instruments are: technical and social devices that organise particular social relationships between the state and those actors that are affected, and, they reflect a particular framing of the policy problem and the means to address it (Lascoumes and Le Gales 2007: 4). By focusing on policy instruments common to different policies, such as STEs, mid-level accounts of social policy can be developed to inform better conceptions of the welfare state. This level of analysis also has the advantage of being broader in scope than studies focused on specific policies, whilst remaining more concrete than regime-level analysis.[6]

Since it is not practical to examine all 74 STEs in detail here, I have selected two case studies to illustrate the implications that these policy instruments have for the second tier and the Australian welfare state more generally. The two case studies – the STCs and PHITR – were selected as the largest STEs in two policy domains that are of central importance to all welfare states. While the STCs provide concessional tax rates for super contributions, investments and withdrawals, the PHITR offers a tax discount to consumers of private health insurance. Retirement incomes policy has formed a core pillar of the welfare state since its beginnings; as Guillemard (1983: 3) observed, "the so-called welfare state is first of all a welfare state for the elderly".[7] Health policy is the other key domain of social policy, which potentially affects all members of society over their lifetimes (Sax 1984). Reflecting their wide significance, retirement incomes and health policy are the two largest areas of social expenditure in Australia. The selection of these two case studies also reflects their distinctive policy designs; while the STCs are concessional tax rates (and exemptions), the PHITR is a tax rebate. Moreover, the two case studies provide an opportunity to examine the influence of political parties and ideologies on policy design, since both Labor and Coalition governments have recently reformed each of them. And, although not representative in a statistical sense, these two case studies illustrate broader developments in other welfare policy domains such as family support, childcare and housing.

I incorporate the two case studies into our understanding of the Australian welfare state by applying the two-pronged analysis mentioned earlier. I situate the STE case studies within the framework of the Australian welfare state by analysing their institutional contexts and distributive effects. The institutional context of STEs, as social policies that deliver financial benefits to the consumers of private services through the tax system, involves relationships with the tax system and the various sets of actors, institutions and policies relevant to their respective policy domains. By situating STEs within their institutional context, I am able to present a more complete picture of

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[6] The policy instruments approach is perceived to complement (rather than supersede) the narrower focus of studies focused on single policies and the wider scope of research on welfare states and regimes.

[7] The centrality of retirement incomes policy to the welfare state is reflective of its position in comparative welfare state research. Recently, Quadagno argued that Esping-Andersen's typology of welfare regimes was "developed to primarily explain variations in public pension arrangements" (2010: 127).

Australian welfare. The distributional effects of STEs reflect their policy design, the socio-economic positions of recipients, and, their interactions with other policies. Where appropriate, this analysis estimates the distributive effects of STEs (especially the case studies) by drawing on data sourced from the Treasury, the Australian Taxation Office (ATO) and secondary research. Identifying trends in the distributive effects of STEs allows this thesis to consider how they have transformed the Australian welfare model.

STE case studies need to be placed in their political context to inform an explanation of their emergence as core second-tier policies. In analysing the political development of the case studies, I examine the processes through which they were enacted and reformed, with particular focus on how the decisions of political actors were influenced – but not determined – by their political and institutional contexts. My aim is to update the historical account of STEs by including their development alongside that of social expenditures. To analyse the political and institutional factors that have influenced the recent expansion of STEs, I adapt a historical institutionalist approach to chart the development of the case studies. Historical institutionalism offers a dynamic framework to examine how policy development is influenced by politics and history, which are perceived to simultaneously constrain the choices available to political actors and provide resources for action. In applying this framework to the two cases, I explore how the emergence of the second tier reflects the influence of multiple factors, including: the agency of political actors; the path dependence of institutions; the influence of particular cleavages; the diffusion of political ideas; and the prevailing socio-economic context.

My analysis of the political development of the two case studies draws on a range of primary and secondary sources. When analysing the private health insurance rebate, my task is assisted by the abundance of existing research on the political history of Australian health insurance, including those authored by key policy actors. I incorporate rich material from this secondary research into my novel account of the rebate's introduction and discussion of its implications for the Australian welfare model. But, where accounts of health policy overlook tax expenditures, they are supplemented with primary analysis of policy documents. When analysing the less traversed territory of the super tax concessions, I make a new contribution to historical research as well as reinterpreting existing history and data. This research entails primary analysis of qualitative data – such as official reports, policy documents, media reports, and Hansard – and quantitative data including social surveys and official statistics.

By attending to both the political development and redistributive impacts of STEs, this thesis is able to link the politics and policy dynamics fuelling the rapid growth of tax expenditures to their distributional consequences for the Australian welfare state. My arguments about these linkages between the politics of STEs and their distributive effects unfold over eight chapters. The first two chapters provide the context for this thesis; the first places STEs within the welfare state literature, while the second explains the historical institutionalist approach that is subsequently used as a methodological framework when analysing the two case studies. Once the context of this study is established, I undertake the case study analysis. Chapters three and four focus on the PHITR. The third chapter focuses on placing the STE within its policy context and explores its distributive effects, while the fourth places the rebate for private health insurance in its political context and identifies the political and institutional factors that influenced its development. Chapters five to seven turn to the STCs. The fifth chapter locates the STCs in their policy context and examines their distributive effects, whilst the sixth and seventh chapters both trace the institutional development of these tax concessions to identify institutional and political factors that influenced their development. The eighth and final chapter draws out the similarities and differences between the two case studies, before discussing the broader implications for STEs and the Australian welfare state.

- Chapter 1 -

Fiscal Welfare and the Welfare State:
Social tax expenditures as social policy

This chapter reviews two literatures – one on the welfare state generally and the other on STEs specifically – to demonstrate that STEs remain neglected despite their increasing importance to the Australian welfare state. STEs have been neglected in conceptual accounts and Australian research. At the conceptual level, this neglect has more to do with academic convention rather than theoretical justification because influential understandings of the welfare state include STEs or can accommodate them with ease. In the Australian case, this neglect seems to reflect the understandable focus of welfare state analysis on Australia's distinctive wage-earner institutions and system of targeted social expenditures. As well as stressing the neglect of STEs in scholarly accounts, this chapter highlights the growing role that they play in Australian social provision. Because of their neglect, I outline the properties of STEs and ongoing measurement issues. To establish their importance for Australian social provision, I document the current scale of STEs and their rapid growth in recent decades. Then, to demonstrate how these policies contrast with Australia's 'targeted' social expenditures, I highlight the qualities of STEs identified by previous studies. This review chapter concludes with a proposal for an alternative dual welfare model that incorporates STEs and the targeted model of conventional accounts.

I. Social Tax Expenditures as Social Policy

STEs have been neglected by social policy scholarship because the welfare state has too often been conflated with social expenditure (Howard 1997: 5; Hacker 2005: 134). Owing most to academic convention and convenience, this neglect has not been justified either empirically or theoretically.[8] The welfare state is a contested conceptual terrain, but it is invariably defined with reference to a set of policy aims or functions rather than the policy instruments used to deliver benefits (Titmuss 1958: 42; Castles 1998: 7). Defined by policy aim or function, most general accounts of the welfare state are applied narrowly to social expenditure, but STEs are compatible with every "commonly accepted definition of the 'welfare state' and 'social policy'" (Howard 1997: 5). To demonstrate this point further, I outline three influential accounts of the welfare state – which I refer to as the social citizenship, wellbeing, and social risk perspectives – and highlight how STEs are either recognised or compatible with them. Drawing on the strengths of these perspectives, I propose a working definition of the welfare state that emphasises the increasing importance of STEs.

Two peas in a pod? STEs and the welfare state

STEs are recognised by or are compatible with three influential accounts of the welfare state. The wellbeing perspective explicitly identifies STEs as part of the welfare state. This perspective defines the welfare state as the policies aimed at enhancing human welfare and wellbeing (Gough 1979: 2). Titmuss (1958: 14) promoted the wellbeing perspective in his pioneering social division of welfare thesis and other works. He understood welfare as comprising collective interventions aimed at improving the living conditions of individuals and/or serving the interests of society (Titmuss 1958: 42).[9] Using this definition, Titmuss distinguishes between three sources of welfare: *social welfare* consisting of social expenditure programs; *fiscal welfare* delivered through STEs and other tax provisions; and, *occupational welfare* as benefits workers obtain through employment (1958: 42). While Titmuss focuses on social sources of welfare (public and private) rather than the welfare state *per se*, it flows from his definition that social expenditures, social tax expenditures and other policy instruments form elements of the welfare state provided they are state programs that seek to enhance welfare and

[8] Even in policy domains (such as health) where STEs played a central role historically, these policies have received less attention than their direct expenditure counterparts (see *Chapter 4*).

[9] Titmuss does, of course, also provide more specific accounts of welfare that emphasise altruism, dependency and social integration in different publications.

wellbeing. Despite Titmuss' (1958) early recognition of fiscal welfare, STEs have continued to receive scant attention compared to social expenditures.

Presenting a narrower view, the social citizenship perspective advanced by T.H. Marshall (and others) views welfare as amongst the citizen rights of modern democracies (Mishra 1982: 26).[10] Marshall (1977: 78) claimed that citizens of modern polities have an equal claim to civil, political and social rights. As a social right of citizenship, welfare is practically synonymous with the welfare state, as an entitlement that the state provides its citizens to enable their full participation in society (Mishra 1982: 31). By equating welfare with state social programs that provide entitlements, this perspective prioritises universal and residual welfare programs, while excluding state programs that act as adjuncts of the market as well as private sources of welfare. Marshall (1977) does not mention tax expenditures in his account, but they appear to qualify as elements of the welfare state as long as they are provided to citizens as entitlements to assist them with 'economic welfare and security'. Most STEs would not be counted as part of the welfare state from this perspective, because they are provided on a user-pays basis rather than as entitlements. However, the few STEs that target support to low-income earners (*e.g*. the Low Income Tax Offset) would qualify as welfare. This is significant because it suggests that STEs are compatible with this perspective on the welfare state provided that they have the appropriate policy aim or function.

More recently, the welfare state has been understood as a publicly financed system of social risk management (Esping-Andersen 1999: 36; De Neubourg and Weigand 2000: 407; Barr 2001: 1). Social risks entail threats or perceived threats to satisfying valued 'needs' in a social context (Esping-Andersen 1999: 37-39; De Neubourg and Weigand 2000: 407). Risks constitute social rather than individual threats when they: threaten societal wellbeing; have complex social causes that are beyond individual control; and/or collective solutions are demanded for a social issue (Esping-Andersen 1990: 37). As a system of social risk management, the welfare state entails those state institutions that manage the following categories of social risk: *class risks* encountered by particular social groups or classes; *life-course risks* whose exposure is more pronounced at particular stages of the life-course; and, *intergenerational risks* stemming from the interaction of inheritance and market forces that transmit unequal social opportunities

[10] From this perspective, citizens are typically understood to encompass members of society, rather than those individuals who possess the legal status of citizenship.

across generations (*ibid*: 40-42). STEs thus comprise part of the welfare state if they aim to assist individuals in managing class, life-course and/or intergenerational risks. Although STEs are recognised by or are at least compatible with these perspectives on the welfare state, they are rarely emphasised by the Australian research harnessing them.

Situating STEs in the welfare state: A working definition

Drawing on the strengths of these perspectives, I propose a working definition of the welfare state that can accommodate the increasing role that STEs play in social provision. This working definition understands the welfare state to involve the set of state institutions and policy instruments that manage social risks. This definition combines the emphasis of Titmuss (1958) on policy instruments, with Esping-Andersen's (1990) focus on social risks. While the wellbeing and social risk perspectives are mostly compatible, I define the welfare state with reference to social risks because of the greater analytic clarity afforded by the distinctions between class, life-course and intergenerational risks. The working definition does not, however, limit social policy to programs that provide entitlements, which make it broader than the social citizenship perspective. This definition is therefore able to provide a wide perspective on the welfare state's impact on social inequality and its roles in resource allocation.

The working definition developed here does not limit our understanding of the welfare state to redistribution from rich to poor or from high-income earning stages of the life-course to low-income earning stages. Rather, the welfare state is perceived to involve policy instruments that constrain and expand social inequality. The consequence of this is that the welfare state "is not just a mechanism that intervenes in, and possibly corrects, the structure of inequality; it is, in its own right, a system of stratification" (Esping-Andersen 1990: 23). As policies that predominantly enhance the welfare of higher income earners, STEs form important aspects of the welfare state understood as a system of social stratification. In fact, Esping-Andersen (1990: 21) extends welfare analysis beyond STEs onto the political economy of welfare, which he terms the welfare regime, in recognition that the welfare state's effects on social stratification are bound up with welfare sourced from the market and family.[11] Incorporating STEs in social policy analysis is essential, as they constitute public policies that subsidise private social provision.

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[11] Esping-Andersen (1990: 20) also notes on several occasions that STEs are of relevance to welfare analysis, but they do not feature prominently because they are excluded from the national accounts.

Further, the working definition does not limit the welfare state to policies that bestow social citizenship rights. As a social right, the welfare state comprises universal social programs that all members of society are entitled to and, to a lesser extent, residual social programs. This narrow conception is difficult to justify because it excludes policies that reinforce market principles, which have been widely adopted alongside social programs provided as a right and can be seen as functional alternatives to them (Mishra 1982: 3). This understanding is also restricted as the welfare state is viewed in isolation from other non-state interventions that have similar social and economic effects, which conceals its interrelationships with the market, family and civil society. Moreover, as Taylor-Gooby (2004: 10) contends, the welfare states of capitalist democracies (such as Australia) increasingly confront new social risks that require selective policy responses as they adversely affect particular social groups and minorities. Including policies with selective benefits not only accommodates STEs, but also has the potential to reveal the linkages between public and private sources of welfare.

Finally, the working definition does not limit the welfare state to social expenditures, but includes policies with similar aims and outcomes. That welfare is not confined to social expenditures is uncontroversial, which is clear in the wide acceptance of Titmuss' social division of welfare thesis. Revising Titmuss' framework, Rose (1981) and Sinfield (1978) have identified further sources of welfare – informal welfare offered through the household and private welfare that includes various private market sources of social provision. Castles' (1985; 1988) notion of welfare 'by other means' is perhaps the most radical extension of the principle underpinning the social division of welfare; echoing Titmuss' sentiment, Castles contends that "social policy is no less social policy for being categorised by policy-makers as something quite different" (1998: 7). In his famous account of Australia's welfare state (see the next section), Castles (1985) claims that the wage arbitration system acted as a functional equivalent to the welfare states developed in Europe. Like these accounts, the working definition defines social policies according to their aims or functions rather than the policy instruments used to confer benefits. STEs are thus included in social policy analysis providing that they seek to manage social risks. This definition is thus well suited to account for the increasing importance of STEs because it can accommodate a wide range of policy instruments that expand or contract inequality.

II. The Wage-earner's welfare state Model and Beyond

Given broader neglect, it is unsurprising that STEs have also been overlooked in scholarly accounts of the Australian welfare state. This neglect results from the emphasis that general accounts give to social expenditures. It also reflects the focus of scholarly accounts on Australia's distinctive primary-welfare institutions, including the wage-earner's welfare state (Castles 1985) and the highly targeted social expenditures stressed recently (*e.g.* Whiteford 2008; Bryson and Verity 2009). Although understandable, this emphasis has nonetheless contributed to the neglect of STEs in accounts of the Australian welfare state that track the development of the wage-earner model and its gradual demise over recent decades. The long-term, albeit subsidiary, role of STEs in the wage-earner model has received little attention. Following the winding back of the wage-earner model, recent studies have focused on social expenditures, noting how targeted social programs compensate workers for protections formerly afforded by 'other means'. What has been overlooked, however, is the growing significance of STEs to social provision as the wage-earner model has been wound back.[12] The upshot is of this is that the links between the politics of STEs, social expenditures and wage-earner institutions are yet to be fully explored. This section outlines the widely accepted understanding of the Australian welfare state's political development – from the wage-earner's welfare state to the targeted model – to highlight what is missing from recent accounts and what this thesis might contribute.

The wage-earner's welfare state

Castles' (1985) wage-earner's welfare state model has become *the* reference point for studies that chart the development of Australian social policy. This is not to deny that this model, or the broader framework of the Australian settlement (Kelly 1992), is bereft of controversy. Since explanatory models such as the wage-earner model simplify reality by their nature, it is unsurprising that disagreement persists over their usefulness.[a] The wage-earner model is used here a framework for further developing my account because it highlights how policy settings contributed to the high post-tax wages of Australian workers and the long history of occupational welfare.

The wage-earner model draws attention to the central role that occupational welfare has played in the Australian welfare state, but its focus on welfare 'through other means'

[12] The argument supporting the claim about the rising significance of STEs is provided in section III of this chapter.

did little to stimulate interest in the early roles of STEs. Established in the early twentieth century, the wage-earner's welfare state consisted of four pillars, including three economic policies – the minimum 'living' wage, controlled migration, and tariff protection – as well as the fourth pillar of residual social policy. These distinctive institutions set Australia apart from the more expansive European welfare states and the more stringent North American welfare states. The central pillar of this model was the minimum living wage, a form of occupational welfare that directed wages policy toward social policy ends (Castles 1994: 122). Castles (1985) argues that the wage-earner model acted as a functional alternative to the social expenditure usually associated with welfare states.

The minimum living wage set through the arbitration courts reflected the political clout of the labour movement. The Arbitration and Conciliation Court and the concept of a 'fair and reasonable wage' in 1904, but the minimum living wage was not formally defined until the Harvester Judgment of 1907 (Jamrozik 1994: 163). In this ruling, Justice Higgins pronounced that a fair and reasonable wage must meet "the normal needs of the average employee, regarded as a human being living in a civilised community" (Higgins 1907). To meet the 'normal needs' of the average worker, the minimum living wage was set at a level sufficient to cater for the basic needs of the then 'normal family' consisting of the male breadwinner in full-time employment, a female housewife and their three children (Castles 1985: 35). Because the Harvester Judgment set wages with consideration to the welfare of workers' families, the minimum living wage partially decoupled wages from labour productivity and business profitability. It also substantially increased the wages enjoyed by many full-time male workers and acted as a functional equivalent to the social expenditures typically associated with the welfare state.

The minimum living wage interacted with protective tariffs and controlled migration policies to form "a system of shock-absorbers designed to defend and stabilize the existing structure of economic opportunities and rewards from any rapid or excessive disturbance from exogenous forces" (Castles 1989: 32). Migration controls reinforced the minimum wage by maintaining the bargaining power of workers by limiting the size of the workforce – Castles (1994) calls this the non-racist side of the White Australia policy.[13] The tariffs protected local industry by increasing the price of imports, but also sustained the bargaining power of Australian labour by compensating employers for

[13] Of course, this is not to condone the racism of the White Australia Policy.

higher wages. As well as increasing the wages of many workers, the higher minimum wage afforded by this model also appears to have contributed to wage compression in Australia that was similar to, as recently as the 1980s, similar to that of Sweden (Saunders and Fritzell 1993: 40). The three economic policies of the wage-earner model thus enabled most male workers and their dependents to satisfy their basic needs. Alongside this system of social protection, Australia developed a residual system of social expenditure – the fourth element of the wage-earner model – that targeted limited assistance at the poor.

The wage-earner's welfare state remained the primary system of social provision for most of the twentieth century because it fostered a cross-class coalition between workers and business interests, or at least their organised representatives. This cross-class coalition was cultivated by the capacity of the wage-earner model to tie the interests of labour to capital, which it did by providing workers with higher wages and employers with industry protection (Kelly 1992: 7). Supported by this coalition, the wage-earner model received a degree of bipartisan support until at least the early 1970s. Castles (1985; 1994) argues that the durability of this model reduced demands for conventional welfare programs and allowed it to achieve outcomes not necessarily less equitable than European welfare states. This model thus explains Australia's relatively low levels of (highly redistributive) social expenditure by the 1970s despite the presence of a strong labour movement.

Although scholarly accounts on the wage-earner model have concentrated elsewhere, developments in private social provision and STEs underpinned this model. Higgins did not mention STEs in the Harvester Judgment, but he carved out a role for private social services with his admonition that the minimum living wage should cover friendly society subscriptions (Macintyre 2009: 152). The high minimum living wage also translated into higher levels of home ownership in Australia, with reduced political pressure for a more generous state-financed income stream in retirement (Castles 1997a: 104). Moreover, STEs are among the oldest social policy instruments used in Australia and, in some cases, even predate their social expenditure counterparts. For instance, super tax concessions were first introduced at the State level before age pensions in the late 1890s and the tax exemptions for private health insurance were enacted before universal health insurance. Both the State and federal governments also developed STEs to subsidise the private social services provided by the not-for-profit sector in recognition of the subsidiary role they played (Macintyre 2009: 152; Harris 2002). Considering their minor role, the lack of attention focused on the early development of STEs is understandable, but increasingly difficult to justify in light of their growing significance to Australian social provision.

From the wage-earner's welfare state to the targeted model

As the core pillars of the wage-earner model have gradually been wound back since the 1970s, research on the Australian welfare state refocused its gaze on social expenditure and largely ignored other developments such as the increasing role of STEs. The minimum wage remains high by international standards (OECD 2007b: 28), but the Hawke-Keating Labor and Howard Coalition governments deregulated the industrial relations system and decoupled it from social imperatives (*see* Mendes 2009: 104).[14] Tariffs for Australian industry have been gradually wound back, with the average tariff level falling from over 30 percent in 1970 to less than 5 percent in 2001 (Leigh 2002: 487). And, migration laws have been partially relaxed since the Whitlam government repealed the White Australia policy in 1972. Just as significantly, the currency of the wage-earner model has been undermined by a decline in home ownership, as well as social changes in both working life – such as the casualisation and feminisation of the workforce – and family life – including the spread of the modified breadwinner model and the rise of single-parent households (McClelland 2006: 247; Yates and Bradbury 2009). Nonetheless, the gradual decline of the wage-earner model is not perceived to have spelled the end of all wage-earner institutions.

The wage-earner model and its gradual demise have continued to influence the development of the Australian welfare state. While social expenditure has considerably expanded in Australia since 1970, the institutional legacy of the wage-earner model is apparent in the continued absence of the universal and social insurance schemes typical of European welfare states (Bryson and Verity 2009: 68). More directly, the winding back of the wage-earner model is viewed to have contributed to the growth of social expenditure since the 1970s. When winding back the core pillars of the wage-earner model, political actors have couched social expenditures as compensation to lower income families for economic reform – including the deregulation of the wage arbitration system (Castles 1994: 134). Nonetheless, targeted social expenditures have supplanted

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[14] There were, however, notable differences between the approaches of the two major parties. In particular, Labor governments opposed the market-driven minimum wage introduced by the Howard government through its *Work Choices* legislation.

the occupational welfare of the minimum living wage as the primary welfare institutions since the 1970s (Bryson and Verity 2009: 68).

Australia's system of targeted social expenditures has captured much scholarly attention, not least because it has expanded since the 1970s whereas the growth of other welfare states has slowed (Wilson *et al.* 2005: 103). But, while Labor and the Coalition both expanded social expenditure, the partisanship of the government has affected the agenda pursued. Reforms of the Hawke and Keating governments significantly expanded social expenditures from 11 percent to 18 percent of GDP between 1980 and 1996 (Castles 2004: 25). This growth amounted to almost double the average rise of four percent of GDP in OECD countries over the same period (*ibid*: 25). The Labor governments also targeted near universal welfare benefits – such as the aged pension and family allowances – at lower income earners by tightening the eligibility criteria and raising the benefit levels to compensate those hit hardest by economic reform, especially families with children (Mendes 2008: 33; Ziguras 2006). While Labor's re-introduction of universal health insurance – Medicare – did break with its strategy of targeting, its re-introduction also represented an attempt to compensate workers for wage restraint (Castles 1994: 133). Overall, the Hawke-Keating government's social expenditure policies combined an adherence to social justice principles, with an emphasis on program efficiency and limits on rises to expenditure (despite significant growth) (*ibid*: 134-135).

The Howard Coalition government's major reforms expanded active labour market policy and compensated families with children for economic reform.[15] But, it was unable, or perhaps unwilling, to reduce social expenditure (Mendes 2009: 108), even in a period of sustained economic growth. The Howard government increased the work activity tests for unemployed individuals through its *Work for the Dole* program introduced in 1997. The *Welfare to Work* reforms of 2006 extended pro-work incentives to single parents, those with disabilities and recent migrants (Wilson and Meagher 2007: 263). The Howard government also expanded family assistance to low and middle-income families, as part of its compensation package for the Goods and Services Tax (GST) in 2000. These reforms reduced the number of family payments from 12 to 3 – renamed the Family Tax Benefit Part A and Part B, and the Child Care Benefit – and increased their benefit rates. Subsequently, the Howard government introduced the Baby Bonus and Child Care

[15] Active labour market policies that increased the obligations of unemployed individuals were first introduced by the Keating government, but significantly transformed and expanded by the Howard government.

Rebate, which helped boost the income transfers received by families with children to 3.3 percent of GDP in 2005.[16] Less concerned with social justice principles, the Howard government's reforms sought to increase the assistance received by families – primarily breadwinner families (Apps 2006) – and the efficiency of income support.

Despite their distinct agendas, the Hawke, Keating and Howard governments transformed Australian social expenditure so that considerable social assistance to families with children went hand-in-hand with increasing conditionality in support for single parents, the unemployed and people with disabilities (*see* Mendes 2009).[17] Australian family assistance is now amongst the highest in the OECD, comparable to the 3.4 percent of GDP spent in Norway and 3.5 percent in Sweden.[18] In fact, the expansion of family assistance can be understood as functionally equivalent to the minimum living wage of the wage-earner model. Australian social expenditure and taxes remain low in comparative perspective because of the increasing tendency to target and impose conditions for social welfare (Castles 2004: 25). Australian social expenditure is now among the most targeted of OECD countries, with the highest degree of redistribution per dollar spent (Whiteford 2008). While across-the-board tax cuts introduced by the Howard government in the early 2000s have reduced this somewhat, progressive income taxes are a higher proportion of taxation in Australia than the OECD average (Warburton & Hendy 2006).[19]

The 'targeted' characterisation of the Australian welfare state receives strong support in the social policy literature. In their Australian study, Whiteford and Angenent (2001: 2) contend that Australia has a targeted welfare system that provides relatively little middle class welfare and conceivably achieves the most redistributive outcomes in the OECD. Similarly, in his comparative research, Esping-Andersen (1990) classifies Australia as a liberal welfare regime – a model typified by low levels of tax and targeted social welfare for only the poor. This account is modified by Korpi and Palme (1998: 667-668), who view Australia as the exemplar of the targeted welfare model, comprising residual programs that offer means-tested benefits to lower income earners. But, in

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[16] Data sourced from SOCX (2007a) OECD database.

[17] Medicare may seem an exception, with universal health insurance accessible and benefitting the overwhelming majority of Australians. It remains the case, however, that families with children are amongst its major recipients.

[18] Data sourced from SOCX database. Family assistance in Norway and Sweden is predominantly delivered as benefits in kind rather than income transfers.

[19] When social security payments are included, income taxes in Australia are broadly comparable with other OECD countries – however Australia does not have a significant earnings-related welfare system.

contrast to Esping-Andersen (1990), they also note that Australia's targeted social programs exclude the wealthy rather than only benefitting the poor (*ibid*: 668).[20] There is, nonetheless, much overlap between these accounts of Australian social expenditure. Both Australian and comparative accounts, however, also share a similar neglect of major recent developments in middle class welfare (although wage-earner institutions receive more attention in Australian accounts).

The middle class and welfare

This neglect has meant developments affecting the middle class have received less attention than they deserve as the wage-earner model has gradually declined. The winding back of the core economic pillars of the wage-earner model is understood to have triggered the resumption of partisan politics by unravelling the old coalition between labour and business interests (Buchanan and Watson 2000: 21). With Labor supportive of low-income earners through targeted social expenditures, the Coalition has opposed large extensions to social welfare that would expand the tax burden of the middle class. As the result of this political dynamic, the targeted model is seen to pit the interests of the middle class against labour because they fund social expenditures through their taxes but receive few benefits in return (Buckmaster 2009: 9).

What has received less attention, however, is how the gradual decline of the wage-earner model, along with broader social change, has opened up new middle class demands for social provision (Castles 1994: 137). Governments have had the choice of meeting these demands through social expenditures, STEs, regulations or some combination of these. The 'targeting' strategy employed by both Labor and Coalition governments has focused welfare on the poor and ruled out public universalism. It is therefore unsurprising that – with few exceptions such as Medicare – Labor and Coalition governments have extended support for the middle class by subsidising and regulating private social provision. This has, as Castles (1994: 136) claims, involved the creation of new wage-earner institutions – such as the Superannuation Guarantee Scheme – that benefit the middle class most (also see Stebbing and Spies-Butcher 2009). At the same time, STEs have become of growing significance to Australian social provision as

[20] This does not, however, support Korpi and Palme's (1998) contention that the targeted welfare model achieves the most redistribution proportionately, even though it does not alleviate poverty as much as other models because they have smaller budgets. This conclusion was perhaps more applicable in the 1980s when Australian social expenditure was lower, but is difficult to sustain in light of recent research that has found Australia is amongst the most redistributive welfare states (Whiteford and Angenent 2001; Whiteford 2008: 118).

governments of both major persuasions have extended these tax provisions to subsidise private social provision. These developments, which have received much less attention, are the primary focus of this thesis.

III. Accounting for Social Tax Expenditures

The neglect of STEs in both generalist accounts of the welfare state and Australian social policy studies is thus increasingly difficult to justify on either conceptual or empirical grounds. STEs are functionally equivalent to other social policy instruments with similar effects on the Budget. Although measurement issues persist, the available evidence suggests that STEs have expanded rapidly in both number and budgetary scale since the early 1980s. This rapid expansion has had ramifications for the Australian welfare model because previous studies show that STEs have typically had distributive and administrative properties that contrast with Australia's targeted social expenditures.

Conceptually equivalent?

The conceptual equivalence of STEs and social expenditure relates to a broader relationship between tax expenditures and income transfers. Pioneered by Surrey (1973: 6), the tax expenditure concept refers to selective tax provisions that direct resources at particular groups or individuals who undertake certain actions. As the introduction noted, tax expenditures may take many forms including: tax rebates or offsets; tax concessions; tax exemptions; tax allowances and tax deductions; provisions for tax deferral; income tax averaging; and rate relief (Smith 2003: 3). The recipients of tax expenditures include income earners, businesses, property owners and consumers (Treasury 2006: 41). Tax expenditures benefit their taxpayer recipients and private service providers. The selectivity of tax expenditures means that they are deviations from the tax benchmark, which refers to the underlying normative structure of the taxation system that treats similar types of taxpayers equally (Ingles *et al* 1982: 6).[21] As deviations from the tax benchmark, tax expenditures amount to a form of state allocation carried out through the tax system.

The resource allocation undertaken by tax expenditures is conceptually equivalent to the redistribution carried out by direct outlays. Surrey and McDaniel (1985: 25) regard

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[21] It should be noted here that there are multiple tax benchmarks, as different norms apply to different types of taxation. For instance, the personal income tax benchmark, which is of primary significance here considering that most welfare payments are made to individuals, corresponds to personal income tax.

tax expenditures as instantaneous cash transfers involving taxpayers who pay their full tax liability according to the tax benchmark and the state which reimburses eligible taxpayers the value of tax reductions. The revenue reimbursed by the state for tax expenditures is perceived to be conceptually equivalent to tax revenue spent on direct outlays (Surrey and McDaniel 1985: 25). Moreover, tax expenditures and direct outlays are both financed by reallocating resources from other programs, running deficits or increasing taxation (Hacker 2002: 34) and both increase the resources available to their recipients. The conceptual equivalence of tax expenditures with direct outlays is endorsed by most public finance experts, Australian government departments, and, transnational institutions such as the World Bank and Organisation for Economic Cooperation and Development (OECD).

Nevertheless, a small cluster of commentators dispute the classification of tax expenditures as a form of public spending. The most common objection, espoused by political conservatives, is that by equating the income quarantined by tax expenditures with income transfers, the concept assumes that the state has the right to collect all income as tax (Davidson 2007; Hacker 2002: 33; Howard 1997: 3). This objection is misplaced because the conceptual equivalence of tax expenditures to direct outlays relates to the preferential treatment conferred to particular taxpayers (Hacker 2002: 33). Thus, the tax expenditure concept focuses on the difference between the tax paid with or without the preferential treatment, which does not presuppose that the state has a claim to all income (Hacker 2002: 33). A less frequent objection is that the tax expenditure concept lacks analytical clarity since classifying ambiguous features of the taxation system as either part of the tax benchmark or as deviations from it rest on subjective judgements (Wildavsky 1985: 420; Howard 1997: 195; Burman 2003).[22] This objection does not rescind the conceptual equivalence of tax expenditures with income transfers either, but it highlights some methodological issues that arise when seeking to account for these policies (like many other public policies). In sum, there is relatively little controversy over the conceptual equivalence of tax expenditures with public spending. It therefore seems reasonable to argue that STEs and social expenditures share a similar relationship, being conceptually and therefore functionally equivalent.

[22] Interestingly, considering the focus of this thesis on social tax expenditures, Burman (2003: 619) contends that social tax expenditures appear in multiple tax expenditure estimates compared across different tax bases – it is the business tax expenditures and savings tax breaks that are most disputed.

Accounting for social tax expenditures

Even for those who accept their functional equivalence with social expenditure, STEs policies are difficult to measure accurately because of persistent measurement issues that relate to tax expenditures more generally. These measurement issues are examined in some detail here, since they need to be taken into account when I discuss estimates of the budgetary value of STEs in making arguments about their rapid expansion over recent decades and their unprecedented budgetary impact. These measurement issues also relate to the estimates of particular STEs that I present later on in the case study analysis.

Three measurement issues make it difficult to precisely calculate the budgetary value of tax expenditures and therefore STEs. First, the value of tax expenditures is sensitive to broader disputes over which aspects of the taxation system comprise the tax benchmark and deviations from it. As Smith (2003: 3) contends, the composition of the tax benchmark is debated because it changes over time, differences persist in different tax systems and there are ambiguous elements of the tax system that are not easily classified. To further complicate matters, there is no universally agreed method to estimate the value of tax expenditures. There are three major approaches to measuring tax expenditures: the *revenue forgone* approach calculates the amount that each tax expenditure reduces taxation revenue; the *revenue gain* approach forecasts the amount that revenue would increase if tax expenditures were repealed in relation to the amount that they reduce tax revenue and their likely effect on taxpayers' behaviour; and the *outlay equivalence* approach calculates the cost of providing an equivalent direct expenditure (Brixi *et al.* 2004: 7; Treasury 2006: 15). Each of these approaches produces different calculations.

A second difficulty in calculating tax expenditures is that they are often difficult to identify and measure as many evade conventional accounting systems. Tax expenditures often do not entail visible transactions between the state and their recipients, which means they avoid much of the oversights that applies to direct expenditures (see *Table 1.1*). Unlike direct expenditures, tax expenditures are also not listed by all Commonwealth agencies, estimated according to independent standards nor subjected to an annual audit. This lack of oversight is not a novel development, with the Economic Planning Advisory Council (EPAC) finding that several tax concessions had not been reviewed for over 45 years by the early 1980s (1986: 17). Another point of difference is that tax expenditures feature infrequently in the Budget, with many escaping regular review, reporting or monitoring. Tax expenditures are also unlikely to appear in the annual reports of government agencies or have their cost measured against estimates.

Table 1.1 Oversight Arrangements for Direct Outlays and Tax Expenditures in Australia

Oversight Arrangement	Existing Direct Outlays	Existing Tax Expenditures
Estimates Compiled according to independent standards fit for the purpose	Yes	No
Identified for all Commonwealth agencies	Yes	No
Subject to regular Budget review	Yes	Infrequently
Reported in Budget estimates	Yes, generally by outcome rather than by program.	Infrequently
Subject to Budget monitoring	Yes, by outcome.	Infrequently
Costs measured against measurements	Yes	Infrequently
Subject to annual agency reporting	Yes	Infrequently
Subject to annual audit	Yes	No

Source: Auditor General (2008: 15)

The Treasury's TES constitutes the most extensive list of tax expenditures and estimates of their budgetary cost in Australia. The TES has been compiled annually since 1985-86 and became a legislated requirement through the *Charter of Budget Honesty Act 1998* (Henry 2010: 730).[23] In 2006-07, the TES listed over 300 tax expenditures. However, the TES does not provide estimates for a significant proportion of the tax expenditures it identifies. The Auditor-General (2008: 13) also recently reported that each TES since 1995-96 has added around 10 tax expenditures that were already in place but previously unreported. The same report stated that the TES only estimated around 60 percent of the tax expenditures it lists and only two-thirds of these were based on reliable estimates (Auditor-General 2008: 13). The TES has also had limited success at boosting the profile of tax expenditures because it amounts to a list rather than a review and requires no vote in parliament when tabled (Wanna 2003: 3). In addition, the TES has been released in each of the past six years during the holiday period at the start of the

[23] As part of the Charter of Budget Honesty, it was envisaged that tax expenditures would be incorporated into the Mid-Year Economic and Fiscal Outlook (MYEFO) and be subjected to the same budgetary oversights as direct expenditures (Henry 2010: 730). This has not yet happened. Also, the Treasury has compiled the TES for each year since 1998 with the exception of 1999 when the GST was introduced.

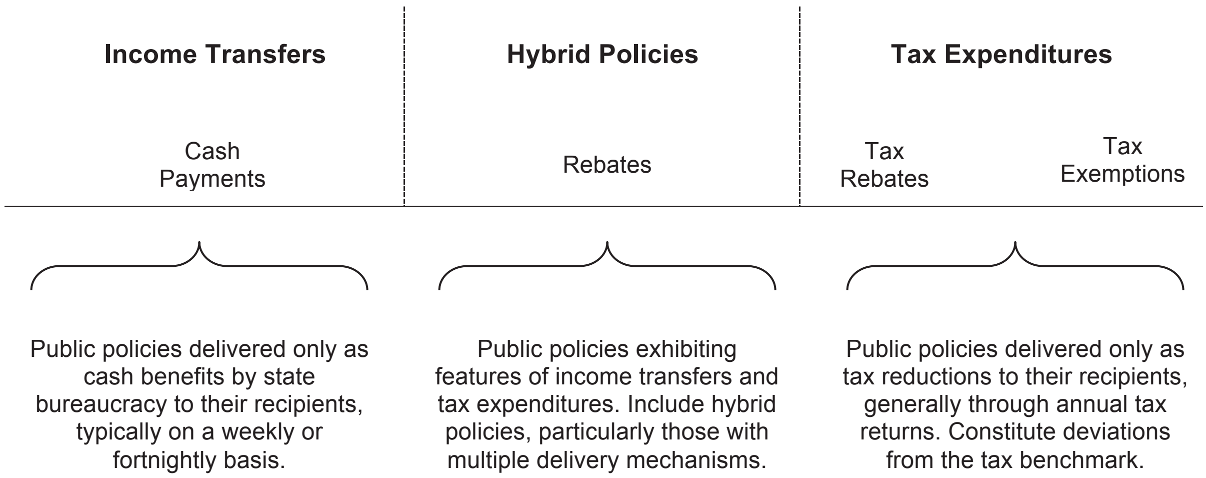
calendar year and has, not surprisingly, attracted very little media attention or public scrutiny (Spies-Butcher and Stebbing 2009: 9). It is therefore difficult to be confident of estimates derived from the TES on the scale of STEs or the rate of their growth.

A third measurement issue concerns the increasingly blurred line between tax expenditures and direct outlays, particularly income transfers. While public policies regularly fit the criteria of either income transfers or tax expenditures, there are also hybrid policies that incorporate features of both instruments. Hybrid policies may be designed with multiple delivery mechanisms or modified so that a tax expenditure or income transfer takes on characteristics typical of the other policy instrument. Because fully accounting for these hybrid policies in the TES would lead to some double counting of government activity, partial estimates of particular delivery methods of these policies appear in the reports of different agencies. For example, the Private Health Insurance Tax Rebate (PHITR) is delivered as: an upfront direct subsidy of health insurance premiums; a cash refund through Medicare; and a tax expenditure in annual tax returns. Three official agencies reported different valuations for particular elements of the PHITR in 2006-07. The Private Health Insurance Advisory Council (PHIAC 2008: 8) estimated the rebate to cost \$3.8 billion. The Australian Institute of Health and Welfare (AIHW) estimates the upfront premium subsidy and tax rebate to cost \$3.5 billion (2007a: 32). And, the Treasury (2010: 42) estimated the tax exemption to cost \$1 billion.

The measurement issues that arise when estimating tax expenditures are not unlike those associated with other policy instruments or theoretical concepts. These issues do, however, undermine any notion of an objective estimation method, which should make us receptive to using tax expenditure estimates derived from different formulations of the tax benchmark; they also highlight the importance of identifying any data sources used (Bradford 1988: 431). Nonetheless, the tax expenditure concept remains a useful tool to shed light on a hidden form of state resource allocation that might otherwise escape public attention and thereby allow policy-makers to increase public spending through the ‘policy backdoor’ with little scrutiny. In this thesis, I draw on primary data collected or estimated by the Treasury and the Australian Tax Office (ATO) both of which measure tax expenditures using the revenue forgone approach. While the revenue forgone approach is the most widely used approach, it has the tendency of over-estimating the value of tax expenditures – to some extent – because it does not take into account how changes to the incentive structure influence behaviour.

The most immediate quandary in applying the tax expenditure concept stems from hybrid policies. Should these policies be treated as income transfers, tax expenditures or a separate category for analytical purposes? The barrier separating tax expenditures from income transfers is ultimately an arbitrary one. The approach that I take here is to conceive of hybrid policies as fitting on a continuum with policies delivered only as tax expenditures at one extreme and income transfers at the other (see *Figure 1.1*). Policies are classified as tax expenditures, or STEs for that matter, provided they meet the criteria of the tax expenditure concept outlined previously or comprise hybrid policies that have been framed as tax expenditures in the policy process and/or public discourse. The latter are considered STEs for analytic purposes because they are subject to similar political processes as non-hybrid tax expenditures during their development and during reforms. However, while complicating the application of the tax expenditure concept, hybrid policies provide another rationale for incorporating STEs in the welfare state – by demonstrating their direct substitutability with income transfers.

Figure 1.1 The Continuum of Income Transfers and Tax Expenditures



Source: Stebbing and Spies-Butcher (2010: 590)

The rise of social tax expenditures

Notwithstanding these measurement issues, the available data suggests that STEs have recently expanded in both number and budgetary scale. Two further qualifications, however, must be stressed in making this claim. First, even though I focus on recent trends, I acknowledge that they feature amongst the oldest form of social assistance provided by Australian governments (Auditor General 2008: 14). Second, the focus here on recent trends reflects data limitations, because it is more difficult to ascertain the scale of STEs before the TES was compiled. EPAC's (1986) analysis suggests that tax expenditures declined in the 1970s, both in comparison to direct expenditure and as a proportion of GDP. Tax expenditures plunged from 13.1 percent of public spending in 1970–71 to 6.4 percent in 1982–83, equivalent to a drop from 3.1 to 1.9 percent of GDP over the same period (*ibid*: 9). However, EPAC's (1986) estimates are less reliable than those from the TES because they included fewer STEs. These figures also relate to tax expenditures rather than STEs *per se*, but there is little to suggest that trends in the 'social' sub-category strayed from the more general pattern.[24]

With these further qualifications in mind, the STE subset of tax expenditures appears to have rapidly grown in number and budgetary scale since the mid 1980s. STEs now feature in every key area of welfare provision (see *Table 1.2*). The number of STEs reported in the TES has more than doubled since it was first commissioned, rising from 36 to 74 between 1986 and 2007 (Treasury 1986, 2008).[25] The largest categories of STEs include those for housing ($38.5 billion), superannuation ($30.2 billion) and health ($4.5 billion). The budgetary scale of STEs was calculated for each year over this period by analysing Treasury and ABS data, and the results are presented in *Figure 1.2*. Estimates of the revenue forgone for STEs have grown rapidly from $4.9 billion in 1984-85 to $83.3 billion in 2006-07 (Treasury 1986; 2010). This is equivalent to a six-fold increase from the level of STEs in 1984-85 (adjusted for inflation) and a (more than) doubling in the proportion of STEs to GDP from 3.6 to 8.0 percent over the same period.[26] Comparing these results with estimates for social expenditure also shows that STEs have expanded rapidly as a proportion of total social spending (the sum of STEs and social expenditure), from around 16.3 percent in 1985-86 to 38.2 percent in 2006-07 (Treasury 1986, 2010). In sum, these figures establish the significance of STEs as major welfare institutions and further highlight the need to account for them in the understanding and architecture of the Australian welfare model.

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[24] The figures are for tax expenditures rather than STEs since EPAC (1986) did not disaggregate their data by policy function. A decline in STEs during the 1970s is consistent, however, with policy reform initiated during this period. Such an assessment does not rely on specific data estimates, but rather the more general documentation that indicates that reform undertaken by the Whitlam government in its final Budget response to the *Asprey Tax Review* did in fact seek to curb the number of tax expenditures. And, in response to the Henderson Poverty Report in 1975, the Fraser government replaced Family Allowances with the Child Endowment and abolished child tax concessions.

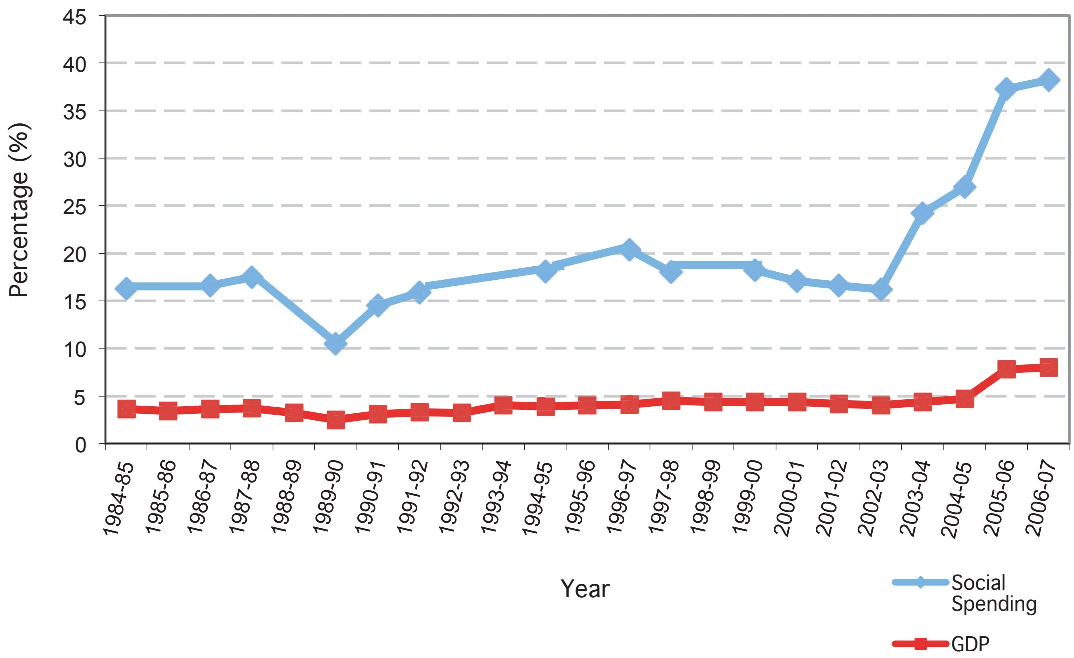
[25] STEs are listed under 'social security and welfare', 'housing and community amenities', and 'health' headings in the TES.

[26] Calculated from data from the ABS *National Current Accounts* and the Treasury's *Tax Expenditure Statements*.

Table 1.2 Tax Expenditures in Key Areas of Australian Welfare

Key Area of Welfare	Tax Expenditure
Low-income earners	Low-Income Tax Offset
Families with Children	Child Care Tax Rebate, Tax Exemption of the Family Tax Benefits
Retirement Income Support	Concessional Taxation of Superannuation
Health	Private Health Insurance Rebate
Housing	Non-taxation of Capital Gains; Non-taxation of Imputed Rent.
Individuals with Disabilities	Social Security Recipients Tax Offset

Figure 1.2 STEs as a Proportion of Total Social Spending and GDP in Australia, 1984-2007



Source: calculated from analysis of Treasury (various years) and ABS (various years)

Whilst the TES provides the most complete data, this source underestimates the budgetary scale of STEs and overestimates their rate of growth. The TES underestimates the budgetary impact of STEs because it lists – but does not cost – tax expenditures (including STEs) that are estimated to exceed several billion dollars in revenue forgone (Smith 2003: 9). The TES also does not provide estimates for hybrid policies including large social programs such as the PHITR and the Child Care Tax Rebate (CCTR). At the same time, the TES overestimates the rate at which STEs have expanded – in both number and scale – because pre-existing STEs have only recently been added to its estimates. In particular, the housing tax expenditures, which are currently the largest category of STEs (and tax expenditures), were only added to the TES as an appendix in 2009 and included in its estimates from 2010. *Figure 1.2*, however, includes estimates of the housing tax expenditures from 2003-04 (since the Treasury backdated its estimates) and shows that STEs have continued to expand since then. Although these data limitations make it difficult to be certain about the growth rate, STEs have clearly grown as a proportion of social spending and GDP since the mid-1980s.

The properties of social tax expenditures

Having established that STEs are major welfare institutions, we can now consider the implications that these policy instruments have for the Australian welfare state. As noted previously, policy instruments such as tax expenditures embody particular understandings of the policy problem and are subject to similar policy processes, which makes it highly likely that policy instruments have similar properties (Stebbing and Spies-Butcher 2009: 10). Conveying this more eloquently, Lascoume and Le Gale claim that policy instruments "structure public policy according to their own logic" (2007: 10). It is thus unsurprising that previous studies have shown that STEs tend to have distinct administrative and distributive properties when compared to social expenditure, such as their: low profile; impact on state bureaucracy; distributive effects; treatment of recipients; and the political justifications offered for their introduction.[27]

STEs, like other tax expenditures, have a low profile in the media and the legislative process compared to social expenditures. Except for some hybrid policies, STEs avoid the budgetary oversights listed in *Table 1.1* and are absent from both major official reports and forward estimates. In particular, the three *Intergenerational Reports* that the government has commissioned to project the likely budgetary impact of population ageing over coming decades do not include estimates of the STCs, even though these policies already outstrip the cost of the age pension (see *Chapter 5*). Moreover, STEs have a low profile in public debate, reflecting the low level of media coverage received by the TES and the focus of Budget coverage on large ticket items

[27] Of course, many of these properties apply to tax expenditure more broadly, but the focus here is on STEs.

rather than the more complex and often (seemingly) minor changes made to STEs.[28] The low profile of STEs shields these policies from both the public and/or political responses that routinely accompany changes in social expenditures. This means that STEs have the potential to act as a 'policy backdoor' to increase social spending with much less political attention and consequently pressure (Toder 1999: 5).

STEs also leave a much lighter imprint on state bureaucracy than social expenditures. Whether delivered as an income transfer, public subsidy, voucher or social service, new social expenditures expand state bureaucracy because government departments and welfare agencies administer them. Conversely, the government's revenue-collecting institutions administer STEs rather than public agencies (Howard 1997). In Australia, STEs are designed by the Treasury and administered by the Australian Tax Office (ATO). These policy instruments deliver benefits without transaction trails and so do not appear to expand state bureaucracy, often taking the form of undiscernible sums on recipient annual tax returns. At the same time, by subsidising private social services, STEs reduce the pressure on state bureaucracy by supporting private alternatives to public social provision. This reinforces the potential for STEs to offer policy-makers with a policy backdoor, since they provide a means of increasing state involvement in reallocating resources without expanding the agencies associated with such moves.

STEs tend to have inequitable – and sometimes regressive – benefits compared to social expenditures because they privilege the taxpayer as the unit of redistribution. At a general level, tax expenditures that exclude or reduce the level of taxable income are often regressive, as common design structures (such as flat rate tax rebates, concessions and tax exemptions) invert the progressive income tax scales (Surrey and McDaniel 1985: 103). Tax expenditures are also often inequitable because individuals only receive benefits if they have sufficient purchasing power to buy the services being subsidised (*ibid*: 103). Furthermore, the potential for tax expenditures with progressive structures to redistribute income to low-income households is hindered by the fact that eligibility is determined by individual income, which means that benefits can be received by low-income earners in high-income households. These properties of tax expenditures apply to

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28 This thesis predominantly focuses on the period up to December 2007, when Labor was re-elected to government. However, since Labor returned to office, the Henry Tax Review (2010) has focused more attention on tax expenditures and the STE subset in public debate.

STEs and mean that non-taxpayers and lower income earners are effectively excluded from receiving benefits.

Another feature of STEs that contrasts starkly with social expenditure is that they subject their recipients to low levels of surveillance. The recipients of social expenditures are subjected to extensive surveillance, which manifests in the complex forms that place the onus of proof on individuals and household members to substantiate their identity and eligibility (Henman and Marston 2008: 192). This surveillance has been intensified by recent reforms such as income management and welfare quarantining that increases the eligibility criteria and conditionality of social assistance. By contrast, the recipients of STEs encounter only random and sporadic surveillance. The ATO obligates taxpayers to keep supportive documentation for their claims, but rarely requires independent verification for eligibility to receive STEs and only undertakes sporadic audits (*ibid*: 195). Taxpayers are also unlikely to have direct contact with the state when they claim STEs, since accountants or other third parties often mediate their fiscal transactions (Baldock 1994: 105). The recipients of STEs are thus much less likely to encounter scrutiny than those of social expenditures.

These different levels of surveillance reflect distinct sets of underlying assumptions about the agency and character of the recipients of STEs and social expenditures. Welfare recipients (who receive social welfare) encounter intrusive and continuous surveillance because of concerns that social welfare provides a disincentive to undertake paid work and encourages dependency on the state (Henman and Marston 2008: 192; also see Murray 1984). As the recipients who benefit most from social welfare experience cumulative disadvantage and tend to not participate in the labour market, high levels of surveillance are deemed necessary to ensure that they remain ‘deserving’ of support (Henman and Marston: 192; Mead 1986). By contrast, the low level of surveillance directed at the recipients of fiscal welfare reflects perceptions that taxpayers ‘deserve’ incentives for their independence, neither relying on the state as the primary source of income or for services. In fact, STEs have been seen to increase choice and enhance self-reliance by providing them greater access to ‘their own money’ (Henman and Marston 2008: 192). Indeed, while receiving social welfare tends to carry a stigma, receiving STEs is typically viewed as responding positively to incentives.

These different properties of STEs and social expenditures are further reflected in the political justifications provided for them. Reflecting the political dynamics of the targeted welfare model, Australian policymakers invariably justify social expenditures on equity grounds – particularly on the demonstrable need of recipients. Social expenditures are rarely framed as economically efficient, since it is often asserted that they inflate wages and 'crowd out' the private sector (Friedman and Friedman 1980: 264; Saunders 2007: 42). From this perspective, Saunders (2007: 41) contends that state provision involves higher administrative, compliance and enforcement costs than private enterprise. Conversely, the inequity of STEs – to the extent it is acknowledged – is mostly overshadowed by the promotion of the incentives they create for private service providers and their recipients (*ibid*: 99).[29] Although subsidies constitute market intervention, they are seen as less distorting than direct outlays and social service provision, and, most notably, do not visibly expand state bureaucracy. Coupled with their capacity to promote the self-interest of their deserving recipients, the incentives attached to STEs have fuelled perceptions of them as a responsible alternative to social expenditures.

These characterisations of STEs and social expenditures do, however, simplify reality somewhat and there are occasional exceptions. Nonetheless, these characterisations highlight the design features of STEs that make them attractive to political actors. STEs have been popular with political actors as a means of extending social provision because they enjoy a low profile as policies without transaction trails that receive little attention in either the media or public debate. As state intervention tends to be measured in mostly expenditure terms, these policies have also provided a policy backdoor to public spending without appearing to do so, which has been particularly appealing in a neoliberal policy environment. The benefit structure of STEs, which typically benefit higher income earners the most, has also made them popular with political actors since they have middle class recipients who tend to receive little from social welfare (in liberal welfare states such as Australia) but whose support is important for electoral success. As Toder (1999: 5) argues, STEs have been popular with political actors because they provide a policy backdoor to benefit the middle class.

[29] Saunders (2007: 99) from the Centre for Independent Studies (CIS) does not refer to these policies as STEs, rather he calls them 'contributions opt-outs'.

IV. The Dual Welfare State: STEs as the second tier

While their scale and growth signal their importance to the Australian welfare state, STEs seem incongruous as a component of the targeted welfare model because of their inequitable – and even regressive – benefits. As inequitable policies delivered through the tax system, STEs extend state welfare to their middle class clienteles who receive few, if any, benefits from targeted social expenditures. At the same time, STEs provide little benefit to lower-income earners who pay low levels of tax or who cannot afford to purchase private social services. In catering for those who receive little from the targeted model, STEs effectively extend state-financed welfare in some form to almost all Australian citizens (and long-term residents). But, in contrast to social-democratic universalism, the STEs contribute to the development of what I with my colleague Spies-Butcher have elsewhere termed the *dual welfare state* (Stebbing and Spies-Butcher 2010). This dual welfare state model offers a more expansive but less egalitarian characterisation of the Australian welfare state, in which the state delivers benefits to the poor and non-poor using separate sets of policy instruments that support distinct welfare institutions with different eligibility conditions and distributional consequences. Rather than debunking the targeted model, my proposal is to build on it by identifying STEs as the second and less visible tier of the Australian welfare state.

How would the proposed dual welfare model understand the two tiers? The first tier entails the targeted welfare model of social expenditure that has been outlined in the social policy literature. The core of the first tier includes Medicare, the age pension and the Family Tax Benefits Part A and Part B.[30] Other programs of the first tier, such as the Newstart Allowance (the unemployment benefit) and the Disability Support Pension, have recently been subjected to reforms that have made them increasingly conditional and impose either mutual obligation or quarantines on their recipients. Overall, this tier is highly progressive, with 85 percent of the social assistance delivered as income transfers and over 50 percent of that provided as social services benefiting low-income households (those in the lowest four income deciles) in 2003-04 (ABS 2007a: 12). The second tier consists mainly of fiscal welfare, particularly STEs, and disproportionately benefits higher income earners. Because it subsidises private social provision and benefits increase with the amount of tax paid (sometimes proportionately), the second tier is effectively targeted at the middle and upper classes. Accounting for around 38 percent of

[30] Medicare is not targeted, but is included here in the first tier as most of its benefits go to lower income earners and it provides access to basic and emergency health services rather than the full range of ancillary services.

total social spending, this tier has a considerable budgetary impact though less than the first tier. And, while the first tier is becoming more conditional, the second tier continues to place minimal constraints on the behaviour of its recipients and often seeks to extend their choices.

STEs are the central policies of what I call the second tier of Australian welfare. To help validate my alternative model, a better explanation of the historical and institutional development of these tax provisions, and a deeper understanding of their contemporary dynamics, is required. To this end, I have chosen two STE case studies to bolster my arguments and the evidence in support of this alternative understanding of Australian welfare.

V. Conclusion

This chapter has argued that STEs remain neglected in social policy analysis despite their increasing policy significance. I have shown that the growth of STEs has accelerated since the gradual winding back of the wage-earner model in the 1970s and that their current scale is unprecedented. I have also shown how the ideal typical properties of STEs conflict with the principles of the targeted model and have proposed the dual welfare state model as an alternative way to view the Australian welfare state with STEs accommodated as its second tier. Questions, nonetheless, remain as to how STEs function in the dual welfare state model. The relationship between STEs and social expenditures, as well as the factors behind their political development, remain unclear. This includes the question of why political actors found STEs appealing (or at least allowed them to expand) following the decline of the wage-earner model, when most recent reforms to social expenditure have targeted benefits and increased conditionality. Exploring these questions is the task of the coming chapters focused on the case studies of the PHITR and the STCs. But first, the next chapter will first provide a framework that draws on the historical institutionalist toolkit to apply in the case study analyses.

Note

[a] The wage-earner's welfare state model as well as the 'Australian settlement' and the 'Australian way' are not without their critics. Notably, Watts criticises the wage-earner model because this model understates "the contingency of history central to historical processes" (1997: 1) and overstates the centrality of wage arbitration. But, Watts' (1997) criticisms are largely misplaced, reflecting the methodological differences of the authors. While Castles draws on a functional structuralist framework, Watts' approach is in contrast interpretive and historical (Castles 1997b: 16). Models simplify reality by their nature and, as Castles (1997b) argues, his account is not primarily historical but explanatory. In fact, Castles' model is more

historically informed than many other welfare state models and Watts (1997) offers little evidence to support his claim about wage arbitration.

The Australian settlement has also been criticised as too narrow and overly political (Stokes 2004). Broader in scope as a framework aimed at understanding Australian public policy, this model includes colonial benevolence as well as the pillars of the wage-earner model (Kelly 1992). Stokes (2004) suggests that the Australian settlement should be expanded to include no less than nine features of the policy environment (Stokes 2004: 19-20). To Kelly's five pillars, he adds state securalism, masculinism, democracy and state developmentalism (*ibid*: 20). However, as Beilharz (2008: 62) argues, further pillars overly complicate the model and wage arbitration – the central pillar of the wage-earner model – was the definitive feature of Australia's early development.

As an alternative to the wage-earner model and Australian settlement, the Australian way also has its limitations and controversies. The Australian way emphasises how the state used social regulations powers to "promote employment and growth while seeking egalitarian outcomes" (Smyth 2008: 651). This starkly contrasts with the wage-earner model, which posits that Australian wage levels were set through arbitration with the cost of living as their reference point. From this perspective, Smyth (2008: 651) argues that the wage-earner model grossly overstates the importance of wage arbitration and neglects the long history of state (and private market) involvement in social investment.

Smyth's claims about wage arbitration would be, however, more convincing had he offered an explanation for Australia's high minimum wage. A high minimum wage is viewed as the legacy of the wage-earner model because Castles (1985) posits that demands for social provision were constrained by the high wages set through wage arbitration (i.e. Stebbing and Spies-Butcher 2010). Among OECD countries for which data is available, Australia's minimum wage as a proportion of the median wage was second only to France as recently as 2005 but dropped to third in 2009 after slipping behind New Zealand (the other *Antipodean* wage-earners welfare state) (OECD 2010b). Considering France relies on labour regulations to provide security for workers (Bonoli 2003: 1018) and Australia and New Zealand on wage arbitration, these high minimum wages vindicate Castles' (1985) thesis.

Just as significantly, Smyth's (2008) account of the Australian way downplays the political dynamics of how Australian social policy develops when his account is compared to the wage-earner model or the Australian settlement. While the wage-earner model emphasises the impact of politics and industrial relations institutions on the development of social provision, the Australian way highlights the influence of different interpretations of social investment. The wage-earner model's emphasis of politics is of greater relevance to Australian social provision because the long period of conservative government contributed to Australia's status as a welfare laggard up to the 1970s and the long period of Labor government underpinned the rapid growth of social expenditure in the 1980s and 1990s.

Although imperfect, the wage-earners model was selected here as a framework for understanding the development of the Australian welfare state. Over other frameworks, it has the advantage of highlighting the centrality of occupational welfare to Australian social policy development and the high post-tax wages enjoyed by Australian workers. The wage-earner model also emphasises the political dynamics of Australian social provision, which is particularly relevant to my focus on the political and institutional factors that have led to the development of an Australian dual welfare state.

- Chapter 2 -
Explaining the Emergence of the Second Tier:
A historical institutionalist approach to social tax expenditures

The previous chapter showed that social tax expenditures (STEs) have become increasingly significant to the Australian welfare state as core second-tier policies in recent decades. To address the second of the two research questions that underpin this thesis, I seek to explain the recent emergence of STEs as core second-tier policies. The rapid and recent growth of STEs, as the ensuing chapters show, is difficult to view as the product of 'evidence based' rational policy or to easily locate within scholarly understandings of the Australian welfare state. Rather, the emergence of the second tier is better understood as the product of political and institutional factors. To explain the early development and recent growth of STEs, I adopt a case study approach that reviews the circumstances that gave rise to the entrenchment and expansion of two carefully selected cases – the tax expenditures received by the consumers of private health insurance and superannuants. In analysing the development of these cases, I apply a 'historical institutionalist' approach since this approach offers a wide repertoire of conceptual tools to explain the rise of STEs. This approach also has the advantage of incorporating a wide range of explanatory factors, with particular emphasis on how the policy environment influences the choices of political actors and the sequence of historical events influences institutional development. In concluding, I sketch how this approach is applied as part of the two-pronged analysis of the case studies adopted in the following chapters.

I. Comparing the Case Studies Over Time

My thesis takes as its two case studies the tax concessions offered to superannuants and consumers of private health insurance. The two cases were selected because they are large second-tier policy institutions in core welfare domains with long histories. Selecting two case studies from uncontested areas of the welfare state has the advantage of emphasising the growing importance of STEs to the welfare state, rather than leaving my analysis open to the criticism it overstates the significance of an esoteric topic on the fringe of social policy. The case study method was selected because it has the potential to generate sophisticated explanations through the analysis of carefully selected cases. In explaining the emergence of these tax concessions, I adopt a historical *and* comparative approach: it is historical because many STEs have 'roots in the past' (Hacker 2005: 145); and, it is comparative so that factors relating to STE policy instruments can be set apart from those pertaining to a particular case.

The PHITR and the STCs are tax expenditures for health and retirement income – policy domains that form the "bedrock foundations of the welfare state" (Hacker 2002: 62). The Australian government spent more than $66 billion in social expenditures in these policy domains in 2006-07, which was just under half of its social expenditure in the same year. As the largest STEs in these domains, the PHITR and STCs cost an estimated $33.8 billion in 2006-07 and amounted to around 40 percent of the revenue forgone for STEs. When STEs and social expenditure are accounted for, the government devoted roughly 45 percent of its total social spending to these two domains.[31] Moreover, STEs for private health insurance and superannuation have a long history in Australia. The STCs were introduced with the first Commonwealth income tax in 1915, while the STEs for private health insurance operated from the 1950s to 1980s and were then re-established in 1999. These are desirable features for the cases as they allow for the identification of the political and institutional factors that led to the establishment of STEs and their recent emergence as core second-tier institutions.

[31] These figures are calculated from the Treasury's (2008) *Tax Expenditure Statement 2007*. Total social spending refers to overall spending, which includes social expenditures and social tax expenditures.

As core second-tier policies, the PHITR and STCs can also be viewed of as policy institutions. Streeck and Thelen (2005: 9) define institutions

> as *building-blocks of social order*: they represent socially sanctioned, that is collectively enforced expectations with respect to the behavior [sic] of specific categories of actors or to the performance of certain activities. Typically they involve *mutually related rights and obligations* for actors, distinguishing between appropriate and inappropriate behaviour, 'right' and 'wrong', 'possible' and 'impossible' actions and thereby organizing behaviour into predictable and reliable patterns.

From a sociological perspective, this definition is broad enough to encompass the range of formal and informal institutions – including public policies – that regularly feature as the 'object of study' (i.e. Giddens 2001).[32] Moreover, public policies often feature among the social institutions that impose most directly and exhaustively on the members of modern polities, and form the building blocks of larger institutions (Pierson 2006: 116; 1993: 596). While this is not to claim that all STEs are policy institutions, there are good reasons to claim that policies such as the PHITR and STCs meet the criteria of entrenched and relatively stable features of the policy environment. In selecting these two case studies, I chose policies with long histories that best illustrate the slow, gradual development of second-tier institutions. As such, my analytical framework needs to be sensitive to the impact of historical processes on the 'embedding' of the two policies.

There is an established research strategy in sociology and other social sciences of studying a small number of case studies in detail to generate explanations of broader social phenomena (Gerring 2006: 20). Although it is impractical to study all 74 STEs in detail here, the more compelling reason for analysing STE cases in explaining the development of the dual welfare state is that this strategy has the potential to generate a novel account of this political development. Case study analysis provides an appropriate method to identify the political and institutional factors that explain the development of the second tier because it is easier to validate causal factors that relate to a single case than multiple cases (*ibid*: 43). The focus on a small number of cases in detail does, however, mean that it will not achieve the representativeness found in statistical studies with large samples (*ibid: 43)*. Nonetheless, case study analysis is appropriate as an explanatory tool because it often has the capacity to foster creative insights "from the

[32] As Kay (2006: 13) and Pierson (2006: 116) both highlight, narrower definitions of institutions are typically used in other disciplines such as political science.

juxtaposition of contradictory and paradoxical evidence" (Eisenhardt 1989: 546). It is able to foster such insights, Eisenhardt (1989: 546) argues, because explanations are informed by evidence incorporated from multiple cases (that generally draw on multiple data sources) and the relevant literatures.

The case study research strategy adopted here is both historical and comparative. My strategy is historical because STEs – including the two case studies – have relatively long histories despite their growing significance for the Australian model in recent decades and it is well established that earlier policy decisions impact later ones (*e.g.* Pierson 2004). This long history implies that recent as well as long-term processes influenced their development. These processes that contributed to the establishment and growth of STEs – as public policies – involved the influence of: prevailing policy ideas; the partisanship of governments; the advocacy of interests; and the interactions with other policies (Hacker 2005: 145). The sequence of these developments is also important because this can reinforce or undermine the feasibility of policy options at a given time. Developments that reinforce the resilience of policies appear to be particularly relevant to STEs because "the barriers to visibility, traceability, and political control thrown up by privatised approaches may be an additional advantage for their defenders, allowing even paths of policy development that are costly or viewed as undesirable to endure" (Hacker 2002: 57).

My research strategy is also comparative in that it compares STEs in two social policy domains. Although comparative studies often focus on the cross-national level, Hacker's (2002) research on the American welfare regime demonstrates that applying a similar approach across policy domains in one country presents a fruitful avenue for analysis.[33] In fact, Hacker (2002: 65) argues single-country studies may identify subtleties that are lost when comparing countries that possess different institutions and politics. By holding many of these factors constant, this comparative approach contrasts favourably with the study of a single case study since it allows for explanatory factors that are common to policy instruments more generally to be set apart from those that pertain to particular case studies. In analysing the case studies, I embrace a comparative approach similar to Hacker's (2002) in an effort to separate those explanatory factors that relate to particular social programs from those that associated with STEs more generally.

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[33] This is not to deny the usefulness of comparative approaches. Rather, it is to highlight that national and cross-national approaches both have their uses.

II. Historical Institutionalism: The politics of STEs in time

The challenge, then, is to apply a dynamic framework capable of explaining the decisions and factors contributed to the expansion of STEs and the two cases in particular. My claim is that historical institutionalism offers such a framework because of its attention to how the choices of political actors are influenced by the constraints and resources afforded by their policy environment. To establish its relevance for this study, I outline the tenets of historical institutionalism that are likely to add explanatory power to my analysis of the political development of STEs. Then, in demonstrating how this framework will be applied to STEs, I explain how 'structured narratives' of policy development provide "an interpretative framework to further our understanding of processes and events" (Eccleston 2007: 32). Building on this further in the next section, I contend that the historical institutionalist framework provides the best available conceptual toolkit to analyse the political development of STEs.

Historical institutionalism: A brief overview

Historical institutionalism refers to a 'loose camp' of cross-disciplinary approaches that begin from the premise that politics and history *matter* to institutional development because institutions are social processes that develop in time and become distorted if removed from their temporal context (Pierson 2004: 8). The central claim of these approaches is that actors are influenced by the constraints imposed and resources afforded by their environment when building or reforming institutions (Eccleston 2007: 21). At their core, these approaches rest on the twin insights that institutional *development* over lengthy periods is generally of greater significance than an institutional *choice* made at a single point in time, and, that over time institutions can become 'embedded' and impact subsequent developments (Pierson 2004: 15). Historical institutionalist studies examine policy development by situating the actions of political actors in their context and examining how the sequence of events impact on subsequent institutional developments. This means that these approaches recognise that the factors leading to an institution's selection are not necessarily those that sustain it over time (Pierson 2004: 15; Thelen 2002: 209).

From a historical institutionalist perspective, political and institutional features of the policy environment influence the decisions of political actors through 'feedback effects' (Pierson 2004: 20). Earlier developments produce feedback effects when they impose constraints on political actors or confer them with resources when they undertake (or do not undertake) particular courses of action (Thelen 2005). As the feedback effects of these developments impact on the options available to political actors subsequently, the sequence of developments along an institutional trajectory is a vital explanatory factor in the durability or instability of policy institutions. Feedback effects may be exogenous or endogenous to the institution under investigation; exogenous processes relate to shifts in the political economy, while endogenous processes originate within an institutional regime (Eccleston 2007: 19).[34] To be sure, there is overlap between these processes when this distinction is applied, but the inclusion of endogenous processes highlights that feedbacks can be relative to particular institutions. Moreover, feedback effects may stem from materialist factors – such as other public policies and the architecture of the state – as well as ideational factors – including norms, frames and policy paradigms – or the interplay of both (*ibid*: 30, 34). And, feedback effects may have their origins in radical shifts to the policy environment or incremental changes that only slightly alter policy arrangements.

This attention to feedbacks is not, however, to downplay the impact that political actors have on institutional developments by exercising their agency. Feedback effects, after all, influence institutional development by altering the resources available to political actors when they make decisions. These effects serve to situate the agency of political actors within their political and institutional contexts, rather than claiming that these feedback effects determine their decisions. As Bell contends,

> agents and institutions are mutually constitutive and dependent variables. In this sense, institutions matter because of the ways they reflect, refract, restrain and enable human behaviour, whilst in turn, it is the behaviour of agents that reproduces institutions over time (2005: 6 in Eccleston 2007: 25).[35]

Political actors thus retain the capacity to respond to feedback effects from their policy environments in unpredictable and/or unexpected ways. According to Kay (2006: 2), this means that the choices of political actors are important to institutional development, particularly in cases where actors choose policy objectives, select policy instruments and choose the timing of action. Peters *et al.* (1999: 1277) claim that this approach cannot explain change without attention to dynamic understandings of agency and political conflict. There is thus scope in historical institutionalist approaches for political actors to

[34] Rather than the term 'political economy', Eccleston (2007: 19) refers to "broader shifts in the structural context in which institutions are situated".
[35] This quote by Stephen Bell is from an unpublished manuscript.

exercise their agency in ways that are counter to the incentives structures of their political environments (Eccleston 2007: 24).

Structured narratives

How, then, can historical institutionalism be applied to explain the development of STEs? Following Kay (2006) and Eccleston (2007), 'structured narratives' are formulated for the two chosen cases to show how political actors responded to feedback effects from their policy environment when making decisions. Neither predictive nor merely descriptive, structured narratives make sense of policy development through an explanation of how the sequence of political and institutional processes in a policy environment contribute to what Kay (2006: 58) calls a 'greater interpretive scheme'. These interpretive schemes reflect research objectives and may entail: an account of institutional development over time; an exposition on the values underpinning institutional change; or, an evaluation of whether institutions are successful or fallen short of some normative criteria (*ibid*: 58). In studies of policy development such as this one, structured narratives require that the relevant actors and sources of feedback effects are identified, that the way in which feedback effects confer resources or constraints on policy actors is made apparent, and that the sequence of policy actors' decisions and processes of development are explained coherently (Eccleston 2007: 33). As with all approaches to analysing institutional development, the key is to "avoid getting lost in the detail… [and] to focus attention on a small set of key details" (Majone 1989: 100).[36]

III. Applying Historical Institutionalism to Social Tax Expenditures

More than merely appropriate, historical institutionalism offers a comprehensive approach to analysing the political development of STEs because of its wide scope, its attention to situated agency and its focus on temporal sequencing. Especially when compared to other frameworks, historical institutionalism enables the incorporation of feedback effects from a wide range of political and institutional sources. Since these factors are incorporated into explanations as influences on policy decisions, this approach has the added advantage of situating the agency of political actors in their policy

[36] These key details are discussed in more detail below, as well as in *Chapters 4, 6 and 7*. Majone (1989: 100) identifies the key details as follows: "(a) the group of actual and potential policy actors; (b) the resources available to them under different institutional arrangements, including (c) the amount and quality of information, skills, and expertise available to the various actors; and (d) environmental factors and constraints such as existing policies, societal values, ideologies, public opinion, and cognitive paradigms".

environment rather than overstating its impact or discounting it. Moreover, this approach can account for how early policy decisions and developments affect later policy decisions because of its focus on feedback effects. To further highlight the benefits of this approach, I compare it to others where appropriate.

Policy actors, political ideas, social cleavages and institutions

The scope of historical institutionalism is particularly wide when compared to post-Marxist approaches, such as Gough (1981), that focus on class politics, and approaches that use discourse analysis, such as Elliot (2006), which focus solely on ideational factors. Historical institutionalism "requires a careful analysis not only of the ideas that drive change but also the larger social, economic and political context in which these ideas are situated" (Peters *et al.* 2005: 1297). Historical institutionalist studies have thus incorporated a wide range of political actors, as well as political and institutional factors into explanations of policy development. As public policies, the political development of STEs has involved the actors involved in the policy process. It is well established that the actors that bear most on policy processes tend to be involved in policy formation, including politicians, political parties and bureaucrats, as well as actors in civil society and the public. Because of the low profile of STEs in public debate and the media, it follows that actors from civil society and the public have had less input in their political development. This, however, does not rule out the influence of these actors altogether. The capacity of this approach to account for the influence of a wide range of actors thus makes it well suited to analysing STEs because their development has involved multiple political actors.

Historical institutionalist approaches are also able to incorporate the influence of materialist factors into explanations of policy development. The social organisation of politics into *cleavages* – social groups separated by material circumstances – is a major political source of feedback effects on policy development (Svallfors 2007: 9).[37] Classes, interests, gender, generations and ethnicities are amongst the cleavages most often associated with policy formation (*ibid*: 9). Since the major beneficiaries of STEs are the middle class and private service providers, it is reasonable to expect that these cleavages and the interests representing them have had some bearing on their political development.

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[37] These groupings mainly affect policy design by either facilitating interests, because group members tend to share similar orientations toward policy issues as they typically have similar levels of access to resources and exposure to social risks, or reinforcing social norms, since group members are likely to occupy similar positions in "networks of interaction and communication" (Svallfors 2007: 9).

Moreover, as its name suggests, this approach also focuses attention on institutions that may produce feedback effects on public policy. These institutions include the architecture of the state, electoral systems, and existing public policies (Pierson 1993: 606; Svallfors 2007: 10; Iversen and Soskice 2006). Because it affords political actors with resources and constraints to undertake different actions, the institutional context has mattered to the political development of STEs. The attention of historical institutionalism to the impact of materialist features makes it relevant to analysing the politics of STEs because their development have been influenced by cleavages and institutions, including other social policies.

Furthermore, historical institutionalism is able to account for the feedback effects of political ideas on policy development. According to Campbell (2004: 94), the kinds of ideas that may influence the decisions made by actors involved in the policy process include: *paradigms* that involve broad cognitive frameworks that prescribe the acceptable and unacceptable courses of action; *programs* that enable actors to justify a particular approach to a problem; *frames* that political actors use to 'strategically represent' their views on a program to the public (Howard 1997: 179); and *orientations* that refer to public attitudes toward any aspect of the policy process (Campbell 2004: 94; Brooks and Manza 2007: 141). STEs, as the first chapter noted, are particularly susceptible to framing because their low profile tends to conceal their features. They have also been justified through programs that point to the established practice of using tax expenditures. The ensuing analysis of the two STE cases will establish help to establish the role of paradigms and orientations. The capacity of this approach to include these explanatory factors make it appropriate to explaining STEs because the political actors involved in their development have been influenced by both political ideas and institutions.

The situated agency of political actors

Historical institutionalism places reasonable limits on individual agency compared to early functionalist accounts that understate it and rational choice theory that overstates it. Peters *et al.* argue that, "without including some dynamic conception of agency… the approach [historical institutionalism] cannot provide an adequate explanation for change" (2005: 1277). The approach adopted here situates the agency of political actors in their policy environment by focusing on how feedback affects from political and institutional sources influence policy decisions by imposing constraints or conferring resources. As Pierson (2004: 26) claims, these feedback effects limit the options available to policy actors and thereby increase the political costs of deviating from the existing institutional path. At the same time, political actors can draw on resources afforded by their policy environment to actively influence policy design.

This focus on situated agency has the capacity to reveal how political agents interacted with their policy environments when reforming STEs. It places reasonable constraints on the agency of policy makers, neither extinguishing their agency nor overstating their freedom to act. On the one hand, the agency of key political actors has impacted on developments concerning STEs. In health policy, Prime Minister John Howard's intervened to introduce the PHITR. This can be viewed as an attempt to keep the health profession on side and to build a constituency between middle and high-income earners in support of private health care. On the other hand, the capacity of public policies to build constituencies of beneficiaries has influenced decisions made by key political actors (Pierson 1993). In retirement incomes policy, the super tax concessions proved difficult to reform because they were supported by a cross-class coalition of labour and business. Because it can incorporate these interactions between agency and policy into explanatory accounts, historical institutionalism thus offers an appropriate approach to analyse the political development of STEs

Path dependence: Timing and sequence

Yet, it is the emphasis of historical institutionalism on the timing and sequence of institutional paths that make it most suitable to explaining the development of STEs. To account for the timing and sequence of policy developments, historical institutionalism has a range of conceptual tools to compare and contrast different kinds of institutional change. This reflects the recognition that institutional change "takes multiple forms, and strategies for institutional change systematically differ according to the character of institutions and the political settings in which they are situated" (Hacker 2004: 244). Historical institutionalist analyses typically adopt one of two approaches to explain institutional development, which borrowing from quantitative research, I call the *discrete* and *continuous* approaches for convenience. The *discrete* approach developed by Pierson (2004) emphasises that feedback effects tend to reinforce institutions over the longer term by 'locking-in' path dependent trajectories, which limit the prospects for change. Conversely, the *continuous* approach applied by Streeck and Thelen (2005) views institutional change as an evolutionary process that may involve incremental or abrupt processes. Because of the early development of STEs and their more recent emergence as core second-tier policies, I adopt the continuous approach since it is able to account for processes of gradual transformation and major change. To highlight its significance, I outline both approaches and explain my choice.

The discrete approach is more suited to explaining institutional continuity than change because it emphasises how feedback effects produce path dependence (Streeck and Thelen 2005: 5). In his seminal work, Pierson (1994, 2004) adapts concepts such as positive feedback and path dependence to politics from institutional economics.[38] He justifies adapting these concepts from institutional economics because of similarities between their objects of study,

> such as the prominence of collective activity in politics, the central role of formal, change-resistant institutions, the possibilities for employing political authority to magnify power asymmetries, and the great ambiguity of many political processes and outcomes [that] make this a domain of social life that is especially prone to positive feedback (Pierson 2004: 19).[39]

In fact, Pierson contends that positive feedbacks (which reinforce existing institutions) are especially marked in politics because the electoral cycle imposes a time frame for action and the strong 'status quo bias' of political institutions (Pierson 2004: 30). Cumulative positive feedbacks, also known as increasing returns, exert 'path dependence' when they reinforce the existing trajectory of institutional development by raising the cost of switching institutional paths. Despite deterministic overtones, the concepts of path dependence and positive feedbacks underscore the constraints on actors' choices rather than ruling out agency altogether and highlight both the importance of early decisions and the potentially high start-up costs of new institutions (*ibid*: 20, 26).

The discrete approach's focus on institutional resilience means that change is often considered either minor and continuous, or major and limited to critical junctures. When change is viewed as minor and continuous, path dependence tends to be perceived as constraining the extent to which developments stray from the institutional path (Campbell 2004: 13). In punctuated equilibrium models where change is limited to critical junctures, it occurs when exogenous events beyond the institution being observed overcome its path

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[38] This includes the work of Nobel Laureate Douglass North and Brian Arthur.

[39] These concepts are not, however, applied uncritically. Pierson (2004: 44) does acknowledge that the positive feedbacks that appear in research on political processes are not identical to those studied in economics and are more likely to have the following characteristics: multiple equilibria, meaning that various options are at least open to policy actors at earlier stages of institution building; contingency, with the potential for incremental reform to be significant and durable over the longer term; timing, since the sequence of a reform may impact whether it is taken up; and inertia, with established processes that lock-in particular developments having a greater impact over time.

dependence (Streeck and Thelen 2005: 1). These exogenous shocks are perceived to only temporarily undermine the institutional stasis brought on by path dependence (Thelen 2004: 212). But, in both these cases, institutional resilience typically occupies the foreground of analysis whilst change remains in the background (Thelen 2004: 29-30; Campbell 2004: 32). The focus of the discrete approach on institutional resilience means that it is of limited usefulness to explain policy change – namely, the rising significance of STEs to Australian welfare, which is the central task of this thesis.

The continuous approach dispenses with the dichotomy of institutional stability and change that underpins the discrete approach. Compared to other frameworks, this approach is more flexible than rational choice theory, which has limited capacity to deal with timing and sequence, and the discrete approach that focuses on continuity. The continuous approach is the subject of a growing literature that theorises institutional change as produced through evolutionary processes of gradual transformation (Streeck and Thelen 2005; Hacker 2004; Kay 2006; and Eccleston 2007). Institutional reproduction is thus perceived to be an ongoing process with existing arrangements subjected to ongoing negotiation (Thelen 2004: 213). This approach focuses on the ongoing constraints and resources encountered by political actors and thus emphasises their agency more than the discrete approach (*ibid*: 213). At the same time, the continuous approach can still analyse institutional stability or path dependence since they are able to incorporate feedback effects that have path dependent effects. The continuous approach thus has the potential to shine light on a wider variety of institutional changes than the discrete one. This approach can distinguish between incremental and radical forms of change, as well as continuous and discontinuous changes (Streeck and Thelen 2005: 9).

The broader scope of the continuous approach makes it well suited to analysing STEs since they have a long history but have only recently emerged as core second-tier policies. This approach's focus on processes of gradual transformation is of particular advantage because relatively minor and early policy decisions concerning STEs have been reinforced by later developments. Its emphasis on gradual transformation also makes this approach suitable to explaining recent developments in STEs, as their emergence as core second-tier policies has not involved major policy upheaval in a short time frame.

Streeck and Thelen (2005: 31), who adopt the continuous approach, distinguish between five casual mechanisms that gradually transform policy institutions (see *Table 2.1*). These mechanisms include: *displacement* that occurs when existing institutional arrangements open new space for behaviours not envisaged by designers; *layering*, which involves reorienting institutional arrangements by building new institutions onto existing policies that are organised to divergent principles; *drift*, referring to the deliberate failure to adapt a policy to a shifting policy environment; *conversion* that entails actors reorienting existing institutions toward new roles, functions or outcomes; and *exhaustion* which refers to gradual institutional breakdown (Hacker 2004: 246; Streeck and Thelen 2005; Thelen 2004: 225-226). Of these tools, the STE cases explored here have developed through the processes captured by the concepts of conversion, drift and layering. But, more broadly, this conceptual toolkit is useful in explaining the recent emergence of STEs because their development has involved processes of gradual transformation.

Nevertheless, selecting any framework involves trade-offs. Pierson (2004: 141) claims that the continuous approach tends to overstate the fluidity of institutions because of its attention to agency. However, the focus on situated agency makes this approach suitable to explaining change. Recognising this concern, my response is to consider it when analysing the cases because awareness of a fault can help to overcome it. Pierson (2004: 140) also queries the relevance and representativeness of the cases selected for institutional analyses. The cases selected in this study are relevant because they are large STEs in core welfare domains, although I concede that they may not be representative of all cases. Further, from a positivist perspective, other critics have bemoaned that this approach does not generate predictive theory (Eccleston 2007: 32). As Eccleston (2007: 32) argues, this is hardly a limitation since this approach harbours no such ambition; rather it seeks to build a historically grounded interpretative framework. Although these limits warrant consideration, they do not detract significantly from the potential for historical institutionalism to shine light on the political development of STEs.

Historical institutionalism is a suitable analytical toolkit because it provides a dynamic framework to explore the recent rise of STEs while attending to their longer history. This approach is suitable to analysing the institutional paths of STEs because these policies have been influenced by the agency that political actors (including political parties) exercise, feedback effects from both materialist and ideational factors, and, processes of gradual and abrupt change. Historical institutionalism is particularly suitable to analysing the case studies because it has the capacity to incorporate the roles played by political parties and the importance of their ideological positions, both of which are crucial in the case studies analysed in the following chapters.

Table 2.1 A Typology of Gradual Transformation

	Definition	Mechanism	Elaboration
Displacement	Slowly rising salience of subordinate relative to dominant institutions	Defection	* Institutional incoherence opening space for other behaviour * Active cultivation of a new logic of action inside existing institutional setting * Rediscovery and activation of dormant or latent institutional resources
Layering	New elements attached to existing institutions gradually change their status and structure	Differential growth	* Faster growth of new institutions created on edges of old ones * New institutional layer siphons off support for old layer * Compromise between old and new may detract from old
Drift	Neglect of institutional maintenance in spite of external change resulting in slippage in institutional practice on the ground	Deliberate neglect	* Change in institutional outcomes effected by neglect of adaptation to external change * Enactment of institution changed, but by rules remaining unchanged in the face of evolving external conditions
Conversion	Redeployment of old institutions to new purposes; new purposes attached to old structures	Redirection, reinterpretation	* Gaps between rules and enactment from: *unintended consequences *intended ambiguity *subversion *time: changing context opens up space for redeployment
Exhaustion	Gradual breakdown of institutions over time	Depletion	* Self consumption: normal working of an institution undermines its external preconditions * Decreasing returns: generalisation changes cost-benefit relations * Overextension: limits to growth

Source: Adapated from Streek and Thelen (2005: 31); Hacker (2004: 248)

Politics and policy dynamics

My choice of a historical institutionalist approach should not, however, be seen to claim that explaining the development of policy with reference to politics and history is novel. There is a well established literature that focuses on how political and historical factors have influenced the redistributive nature of social programs, the trajectory of both welfare state development and taxation policy, as well as the public-private mix of welfare regimes (*e.g*. Castles 1985; Castles and Obinger 2007; Esping-Andersen 1990, 1999; Goodin *et al.* 1999; Pierson 1994; Hacker 2002; Svallfors 2007; Steinmo 1993; Eccleston 2007). Rather, historical institutionalism offers is a dynamic conceptual toolkit to explain policy change over the short and longer term. This makes it particularly well suited to explain the institutional path of STEs from their early development as relatively minor policies to their more recent development as core second-tier policies.

IV. Historical Institutionalism and the Case Study Approach

The historical institutionalist analysis forms part of the two-pronged case study approach outlined at the outset of this study. In addition to updating our understanding of the Australian welfare state's political development, my aim in this thesis is to situate STEs in an ideal-typical model termed the *dual welfare state* (Stebbing and Spies-Butcher 2010). Each case is analysed in turn over the coming chapters. The first of these chapters is devoted to analysing the efficacy of each STE case and explaining its relationship to the policy domain to which it forms part – particularly first-tier policies. This underpins my account of the dual welfare state, since it outlines the institutional structure of a core social policy domain, while also informing the historical institutionalist analysis that follows. The second chapter – and the third in the case of the super tax concessions – provides a structured narrative of the STE cases and conducts the historical institutionalist analysis. As has been discussed in this chapter, this has the potential to account for the influence of agency, as well as political and institutional factors, on policy decisions in their historical context. More broadly, the advantage of this two-pronged approach is that it enables linkages between policy outcomes and political explanation.

The case study analysis is carried out over the next five chapters. The third and fourth chapters are concerned with the STEs for private health insurance and the PHITR – the most recent incarnation – in particular. *Chapter 3* focuses on the contemporary institutional context of the PHITR as the core second tier health policy. It locates the PHITR within a two-tiered model of the Australian health system and analyses both its efficiency and equity. Informed by this account, *Chapter 4* updates the historical account of STEs for health and provides a structured narrative of the development of the PHITR, identifying the political and institutional factors that altered its path development, over the short and long term. Then, chapters five to seven focus on the STEs for superannuation, especially the current super tax concessions. *Chapter 5* analyses the institutional context of the STCs as the major second tier retirement incomes policy, as well as analysing their equity and effectiveness. *Chapter 6* and *Chapter 7* update the history of the retirement incomes policy through a structured narrative and an explanation of the development of the STCs.

Excursus: Data sources and limitations

As noted earlier, an advantage of the case study approach is its capacity to include evidence from multiple cases, draw on multiple sources of data, and incorporate findings from the relevant research literatures. Although I already touched on the data limitations that pertain to STEs more generally, I have not yet discussed the limitations confronted, nor the data sources available when researching the two STE case studies so that they can inform the following analysis. Unsurprisingly, considering the low profile of STEs, there were significant limitations to the data available on their implications for efficiency and social equity, as well as written records to inform the political development of the policies selected for the case studies. The situation has improved more recently, especially since the release of the TES, but the distributive implications of STEs receive little attention in official reports and tend to receive much less attention in policy processes than social expenditures. While these limitations are of themselves telling of the hidden nature of STEs, they do provide potential hurdles for researchers. Where relevant, I highlight data limitations so that they can be taken into account.

Nonetheless, STEs have been subject to more scrutiny over recent decades, particularly since the TES and other publications have revealed their immense growth and scale. This scrutiny has improved the range of sources and records available on both case studies. I draw on these sources when piecing together the historical institutionalist accounts of the STE case studies, and, when analysing their social and economic impacts.

The PHITR has received much more attention in the social policy literature than the STCs because health policy has been the focus of decades of policy instability and political debate. This controversy has fuelled the abundant secondary research that I draw upon in my accounts of the political history of health insurance policy, and, the social and economic impacts of the rebate – particularly when compared to superannuation. In my analysis of the political history of private health insurance, I supplement these secondary accounts with primary analysis of official reports, policy documents, Hansard, and opinion poll data. In my analysis of the rebate's economic and social impact, I also complement a discussion of secondary sources with primary analysis of official statistics sourced from: the Australian Institute of Health and Welfare; the Australian Tax Office; the Private Health Insurance Advisory Council (PHIAC); and, Medicare Australia.

The STCs have not stimulated as much scholarly attention, reflecting their low profile, slow and gradual growth, and the comparatively mild level of political contestation over retirement incomes policy. To overcome resulting gaps in our knowledge about the political history of superannuation, and, both its social and economic impacts, my account draws more heavily on primary analysis. This has involved analysis of historical records such as: Hansard (at both the State and the Federal level); official reports; policy documents; media reports; and, reflections key policy-makers offer in their autobiographies. In my account of the impact of the STCs, I have supplemented secondary analysis with an examination of official data sourced from: the Australian Bureau of Statistics; the Australian Prudential Regulatory Authority; the Australian Tax Office; and, the Treasury.

Although data limits remain, the case study approach's strength is its capacity to use these various sources to confirm the account of STEs presented here through triangulation. The analysis presented in this thesis, however, should still be read with some caution. This thesis offers a novel explanation of the Australian welfare state's development – particularly in recent decades – and it is anticipated that this initial presentation will undergo further refinement and interpretation.

Case Study I

The Private Health Insurance Tax Rebate

The next two chapters focus on the Private Health Insurance Tax Rebate (PHITR) as a core second-tier policy of the Australian dual welfare state. Introduced by the Howard Coalition government in 1999, the PHITR offers a flat rate subsidy for private health insurance premiums. The rebate was selected as a case study because it is both the largest social tax expenditure (STE) for health services and the Commonwealth's main financial contribution to private health services. Despite its recent enactment, the PHITR is but the latest in a series of STEs for private health insurance and services used in Australian health policy since the early 1950s. Because of its scale and links with the past, the next two chapters analyse what the rebate reveals about the institutional structure and political development of the Australian dual welfare state. In doing this, the next two chapters provide an account of the rebate's emergence as the major second-tier health policy, explaining its institutional location in the Australian welfare state and social policy consequences, together with the reasons why the Howard government adopted it in preference to other policies.

Chapter 3 analyses the relationship that the PHITR has with the two-tiered health system to explore its implications for the institutional structure of the dual welfare state.

Construed as a two-tiered model, the health system combines a first tier that is publicly financed and has universal coverage, with a second tier that is financed from private sources and is accessed by consumers with means. As the core second-tier policy, the PHITR was justified by the Howard government (and advocates) as an equitable and efficient policy that reduces fiscal pressures on the first tier. These claims need to be investigated to ascertain whether the rebate can, in fact, be viewed as a 'rational policy'. A failure to justify the PHITR on equity and efficiency grounds has clear consequences: it makes it harder to explain why the rebate was adopted without recourse to an explanation sensitive to politics, policy history and institutions.

Chapter 4 turns to the question of why the Howard Coalition government decided to introduce the PHITR to assist the private health insurance industry. Applying the historical institutionalist approach foreshadowed in *Chapter 2*, I consider whether an explanation that accounts for the influence of political and institutional processes on the PHITR's development is more credible. To situate the rebate in its political and institutional contexts, I develop a 'structured narrative' of health insurance policy to show that the rebate's introduction is but the latest skirmish in an ideological debate between the major Australian political parties for over 55 years. In this debate, the PHITR represents the latest attempt by the Coalition parties to reinstate support for private health insurance as an intermediary to subsidise private health services. But, the Howard government's strategy in introducing the PHITR differed from its Coalition predecessors in that it do not seek to wind back Medicare, the universal public insurance scheme, a move that conceded significant ground to Labor. Using the historical institutionalist toolkit, I explain the development of the PHITR using the concept of 'layering' to explain how second-tier policies were built on existing first-tier institutions.

- Chapter 3 -

Value for Public Money?

The private health insurance tax rebate and the second tier of Australia's health system

The Australian health system is financed through a two-tiered insurance system (Kay 2007: 584; Duckett 2007: 50; Hussey and Anderson 2003: 226). The first and primary tier is publicly financed and collectively pools social risk, making health services universally available to citizens. The second tier privately pools social risk through private health insurance and/or private savings, which makes private health services available to consumers with means. The Private Health Insurance Tax Rebate (PHITR) is the government's main financial support for the second tier. The rebate is a hybrid policy that channels public finance through the intermediary of private health insurance to private health services. My claim is that the PHITR meets the definition of an STE for analytical purposes and this chapter shows how the policy functions in the two-tiered health system. As the Howard government argued that the rebate was fair and efficient, and reduced pressure on the public system, I scrutinise these claims. If the PHITR cannot be justified on these 'rational' policy grounds, then my task is to provide a more plausible explanation for the rebate's adoption with recourse to politics, policy history and institutions. An alternative explanation is the task of the following chapter.

I. The PHITR as a Social Tax Expenditure

The PHITR is a hybrid policy best defined as an STE for analytical purposes. The rebate provides consumers with a rebate for private health insurance premiums covering hospital and/or ancillary services with private health insurers registered under the *Private Health Insurance Act 2007* (PHIAC 2009). Introduced in 1999, the rebate initially provided a flat rate 30 percent subsidy for premiums but it was reformed in 2004 to raise the subsidy proportionately for older consumers of private health insurance. It has since been set at three levels, providing: 30 percent rebates for consumers under the age of 65 years; 35 percent rebates for those aged 65 to 69 years; and 40 percent rebates for consumers 70 years and older. At the same time, by discounting health insurance premiums, the rebate effectively subsidises the operations of the private health insurance industry by at least 30 percent (and at higher rates for older consumers). This subsidy mostly flows onto private hospitals and other private health providers through insurance transactions, but also directly assists private insurers in meeting their administrative and marketing costs. Thus, the main beneficiaries of the rebate are consumers, the private health insurance industry and private health providers.

The rebate is a hybrid policy that consumers can choose to claim in one of three ways. The rebate can be accessed as an upfront premium reduction through private health insurers; it is also claimable as a tax expenditure in the form of a tax offset on an annual tax return, or as a cash refund from Medicare when the full premium is paid upfront. Of these three delivery mechanisms, consumers (and private insurers) have shown a clear preference for receiving the rebate as an upfront premium subsidy — with 95 percent of the rebate transferred directly to private health funds as premium reductions in 2006-07 and only 5 percent claimed as a tax incentive (AIHW 2008a: 26). Why then, considering the prevailing delivery mode of the rebate, was it selected here as one of two social tax expenditure (STE) case studies? The PHITR is treated here as a STE because it meets the criteria of a hybrid policy, has the distributive effects associated with second-tier policy and was repeatedly framed as a tax expenditure in the policy process and public debate. As I have established that the STE is a hybrid policy and this chapter covers its distributive effects later on (see the fifth section), I briefly discuss how the PHITR has been framed before proceeding.

The Howard government framed the PHITR as a tax incentive for private health insurance consumers. According to Lakoff (2005: *iv*), the frames used to represent public policies reflect particular political positions and influence their reception in both public debate and the policy process.[40] Former Prime Minister Howard repeatedly referred to the rebate as a 'tax rebate' in his public addresses (Elliot 2006; Gray 2004). When discussing the role of tax concessions in his recent autobiography, Howard (2010: 492) claims that the rebate is "not a welfare payment… [It] is an incentive to take out private health insurance" and thereby change human behaviour. In the second reading speech, the health minister Michael Wooldridge emphasised that the rebate effectively meant, "for the majority of Australians, private health insurance will once again become tax deductible" (1998: 263). Moreover, the Department of Health and Ageing (DOHA) consider the rebate as "part of the overall [Goods and Services Tax] reform package, which provides a number of taxation concessions in the health sector" (1999: 9). The department also claimed that the use of tax "policy to encourage self-provision is well entrenched and accepted in Australia" (1999: 9).[41] And, a series of economic studies such as Smith (2001) have classified the PHITR as a tax expenditure. Thus, the PHITR is treated here as an STE for analytical purposes because of its design and its framing as a tax expenditure in policy debates.

II. The PHITR and the Two-tiered Health System

The PHITR forms the major social policy of the 'second tier' – comprising the Commonwealth's principal financial contribution to the private health sector. The public and private health insurance systems that comprise the two tiers of the Australian health system finance and deliver health services according to different distributive principles. Along with these different principles, these two tiers of the health system involve distinct insurance institutions, social policies, regulatory instruments, health infrastructure, and, types of health services. To inform the discussion of the PHITR as the major second tier health policy, it is first necessary to situate this rebate within an account of the two-tiered health system. In doing so, I provide an overview of the major institutional features of the two-tiered Australian health system, with particular attention on the rebate and the other policy instruments that the Commonwealth government uses in each tier to redistribute resources and manage access. Although acknowledging that responsibility for health is shared between federal and State governments, my primary focus is on Commonwealth

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[40] As noted in Chapter 2, frames are linguistic structures that imbue cognitive concepts with a particular worldview.

[41] For the present chapter, it is sufficient to note that the Howard government framed the PHITR as a tax expenditure. The next chapter discusses the government's political rationale for using the tax expenditure frame.

policies because it is was at this level of government that the PHITR and earlier STEs for health were introduced.

The universal institutions of the first tier

Health insurance systems, whether public or private, offer protection to their members from the financial risks of ill health (particularly the cost of health services) by pooling their resources (Hussey and Anderson 2003: 217). The first tier of the Australian health system collectively pools the risks of ill health, consisting of public health programs that are financed through taxation revenue. The major social programs of the first tier include the public hospital system, Medicare, health services for veterans and the Pharmaceutical Benefits Scheme (PBS). The financial and regulatory responsibilities for the first tier are shared between the Commonwealth, State, and Territory governments. The first tier delivers health services through public hospitals, private medical practice, and private retailers of pharmaceuticals. Through the financial instrument of public health insurance, the health benefits of the first tier are accessible to citizens and long-term residents on a universal basis according to the distributive principle of need.

The major social programs of the first tier provide eligible recipients with access to a wide range of health services and subsidies for health products. Medicare finances the public hospital system and the Medicare Benefits Schedule (MBS) for medical services (Duckett 2007: 50). Through Medicare, the public hospital system provides public patients with services for no cost at the point of delivery (AIHW 2008a: 3). But, unlike the second tier, it does not provide individuals with the opportunity to choose a doctor. Medicare also finances bulkbilled medical services listed on the Medicare Benefits Schedule (MBS) and contributes co-payments for non-bulkbilled medical services. The Department of Veterans Affairs provides additional support to veterans in accessing health and medical services. And the PBS subsidises medications registered with the Commonwealth.

The first tier is financed through taxes collected by all three levels of government. It accounted for $60 billion of consolidated revenue in 2006-07, with the Commonwealth supplying $36 billion, and the State and Territory governments (as well as local governments) contributing the remaining $24 billion (AIHW 2008a: xii). The Commonwealth's major financial contributions to the first tier in 2006-07 are shown in *Table 3.1*. The largest category 'direct expenditures on health services' amounted to

$22.8 billion, which was largely allocated through MBS ($13.1 billion) and the PBS ($6.6 billion). This was followed by Commonwealth grants to the States and Territories that cost $9.9 billion and were disbursed mostly through the Australian Health Care Agreements (AHCAs) negotiated with the States and Territories to fund public hospitals. A further $3.3 billion was allocated through the Commonwealth Department of Veterans Affairs. The Commonwealth mainly finances its contributions to the first tier through general tax revenue, but also through the Medicare Levy — $3.4 billion in 2006-07 — to partly cover the cost of Medicare.

Table 3.1 Commonwealth Government Expenditures on the First tier in 2006-07

Expense Category	Amount ($m)
Direct Expenditure	22,852
Grants to States	9,894
Department of Veterans Affairs	3,301
Sub-total	36,047

Source: AIHW (2008a: 24)

The regulatory responsibilities for the first tier are shared between Commonwealth, State, and Territory governments. The Commonwealth is responsible for regulating the list of procedures and products available through the MBS and PBS as well as setting the rebates provided through these schemes. However, because private practice remains the dominant model of health service provision (especially for medical services), the government cannot directly set prices, instead relying on its monopsony-like purchasing powers and the common fees list negotiated with the Australian Medical Association (AMA) to influence prices indirectly. The Commonwealth also regulates the quality of pharmaceuticals listed on the PBS. The State and Territory governments play the major regulatory role in the first tier, responsible for the regulation (and in some cases operation) of public hospitals, mental health programs, community health services and ambulance services (AIHW 2008a: 3). They are also responsible for regulating the licenses and registration of doctors, and health professionals (Boxall and Buckmaster 2009: 2).

Although there is considerable overlap in the range of services provided in both tiers, they each have different case-mixes and offer services in different locations. The overlap between the two tiers is greatest for medical services, with most private services eligible for MBS rebates. There is also a wide range of hospital services provided, but public and private hospitals have different case-mixes. Accounting for around 61 percent of patient separations in 2006-07, the case-mix of public hospitals was roughly evenly split between overnight and same day separations (see *Table 3.2*). Private hospitals account for about 39 percent of patient separations, with about two thirds involving same day health separations (see *Table 3.2*). Moreover, as *Table 3.3* displays, public hospitals provided 94 percent of emergency services and 84 percent of emergency procedures in 2006-07, while private hospitals supplied 38 percent of pre-planned admittances and 64 percent of elective procedures in the same year (DOHA 2008: 36). Public hospitals are also located in both metropolitan and country areas, whereas private hospitals tend to cluster in metropolitan areas (McAuley 2004: 12). These different case mixes mean that the first tier's hospital services are typically responsible for high-risk patients and capital-intensive procedures for emergency and complex treatments (Colombo and Tapay 2003: 32; Segal 2004: 8). Nevertheless, the differences between the health services delivered in the two tiers are most evident in ancillary services, with the second tier enabling access to a wide range of allied health services and the first tier mainly limiting access to in-hospital treatment (more on this later).[42]

Table 3.2 Overnight and Same-day Separations, as a Proportion of Total Patient Separations in 2006-07

Patient Separations	Public Hospitals		Private Hospitals	
	No. (000s)	%	No. (000s)	%
Overnight separations	2,328	30.1	1,033	13.4
Same day separations	2,333	31.2	1,909	25.3
Total patient separations	4,661	61.3	2,942	38.7

Source: compiled from AIHW (2008c)

The first tier thus constitutes a universal health system that is publicly financed and regulated, delivered by public and private health providers, and that benefits citizens and long-term residents. This universal system collectively pools the risks of ill health by providing almost all members of society with access to health care on the basis of need at either no or low cost at point of delivery and requiring those same members of society, with few exceptions, to finance public health programs through their taxes. As a universal system that allocates health resources on the basis of need, the first tier confers what Marshall (1977) calls 'social citizenship rights' – which are claims that members of a society have for security and a basic standard of living to enable their participation in

[42] However, from 2004-05, Medicare has covered 5 ancillary health services for eligible patients with chronic conditions and complex needs (AIHW 2008b: 341).

social life – since individuals are entitled to access its health programs as citizens, regardless of their means or risk profile. However, while the first tier meets most primary care needs for almost all members of society by providing access to hospital and medical services, as well as pharmaceutical products, there are notable gaps in its cover in areas such as dental care and there long are long waiting periods for some elective procedures.

Table 3.3 Patient Admissions and Hospital Procedures by Urgency of Admission, 2006-07

	Public Hospital		Private Hospital	
	No. (000s)	%	No. (000s)	%
Emergency	6,741	94	423	6
Emergency Procedures	215	84	41	16
Admittances	4,700	62	2,941	38
Elective Procedures*	565	36	1,569	64

* Data for the 2007-08 financial year.

Source: compiled from DOHA (2008, 2009), ABS (2009) and PC (2009)

User-pay institutions of the second tier

The second tier privately insures against social risks associated with ill health, making health benefits available to consumers on a user-pays basis. As a shared constitutional power, both the Commonwealth and State governments are involved in the second tier. The Commonwealth finances major social programs of the second tier, including: the PHITR; Lifetime Community Rating (LCR); and the Medicare Levy Surcharge (MLS). The second tier is mostly financed through private health insurance, private savings, and Commonwealth subsidies. The Commonwealth as well as State and Territory governments regulate this tier. Private hospitals, private medical practice, and allied health service providers deliver the health services of the second tier. The insurance policies and health benefits of the second tier are available to consumers with means, which largely leaves individuals and families responsible for insuring against these risks.

The major social programs of the second tier encourage and support the take-up of private health insurance. Introduced by the Howard government in 1997, the MLS encourages the take-up of private health insurance by levying a one percent tax on middle to high-income earners without private insurance (McAuley 2005: 160). The annual income thresholds for the MLS are $50,000 for singles and at least $100,000 for families (it increases with the number of children) (Owens 1998: 186). The LCR was introduced in 2000, altering community rating (which prevents private funds from price discrimination on the basis of consumer risk profiles) to penalise younger people without continuous private cover. This policy provides an incentive for young people to take-up private health cover by increasing the cost of premiums by two percent for each year that an individual does not have private insurance when aged between 30 and 65 years (Butler 2002: 36). Crucially, the rebate encourages take-up of private health insurance through a tax incentive, supporting private health sector by subsidising insurance and services. These policies were introduced by the Howard government as a package and have cumulative effects, with the PHITR and MLS interacting to provide strong incentives encouraging private health insurance, and the LCR providing additional incentives for younger people.

The second tier accounted for almost \$33.3 billion in 2006-07 (see *Table 3.4*). Private savings, through co-payments and self-insurance, were the principal source of private funding, contributing \$15.9 billion or 48 percent of the total amount. The next two sources of private finance — private health insurance (not including the rebate) and other non-government sources such as injury insurers — each accounted for around \$6.8 billion or 20 percent of second tier funding. This was followed by the PHITR at \$3.4 billion or 10 percent of total private funding, which was financed by the Commonwealth from tax revenue or revenue forgone depending on delivery method.[43] And the Medical Expenses Tax Rebate, a tax expenditure that provides a 20 percent discount for health expenses exceeding \$1500 per taxpayer, amounted to \$381 million (AIHW 2008a: 26).[44] Commonwealth's contributions are clearly significant, but the finances of the second tier are predominantly supplied by private sources.

Regulatory responsibilities for the second tier – like the first tier – are shared between Commonwealth, State, and Territory governments. The regulatory role of State and Territory governments includes the licensing and registering private hospitals, medical practitioners and specialists, as well as allied health professionals (AIHW 2008b: 12). The Commonwealth's regulatory responsibilities for the second tier largely relate to private health insurance — private health premiums are regulated through the government's LCR policy and private insurers must be registered through the *Private*

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[43] As noted in *Chapter 1*, different agencies provide different estimates of the PHITR. The estimate here is from AIHW.

[44] The Medical Expenses Tax Rebate covers expenditures in both tiers of the health system. It is treated here as a component of the second tier, as patients are more likely to incur costs out-of-pocket costs over the threshold of \$1500 in the private health sector.

Health Insurance Act 2007. Its secondary responsibilities include the regulation of pharmaceuticals, therapeutic services and appliances produced by private health providers (AIHW 2008b: 12). Even though the Commonwealth provides 82 percent of their incomes (Gray 2004: 83), medical doctors and other health specialists enjoy significant professional and financial autonomy. Overall, the financial instruments, health products and health infrastructure of the second tier are more extensively regulated than the practice of medicine.

Table 3.4 Main Sources of the Second Tier Finance in 2006-07

Funding Source	Amount ($m)	Proportion (%)
Individuals	15,953	47.9
Private Health Insurance	6,836	20.5
Other Sources	6,673	20.0
PHITR	3,453	10.4
Medical Expenses Tax Rebate	381	1.2
Total	33,296	

Source: calculated from AIHW (2008a: 24)

As shown above, the second tier provides hospital, medical, and ancillary services and health products. Private hospitals, which deliver the bulk of their services to private patients, focus on extensive procedures and deliver a greater range of elective surgeries than public hospitals (see *Table 3.3*).[45] But, as discussed previously, they are concentrated in urban locations, and undertake fewer emergency and capital-intensive procedures. More generally, private patients can choose which doctor or specialist administers treatment (subject to their availability), and they may avoid long waiting lists in the first tier for some elective procedures. As private practice is the dominant model of medical service delivery, consumers of the second tier have access to non-bulkbilled medical and hospital services (in addition to their bulk-billed equivalents). The second tier provides consumers with a wider assortment of ancillary health services including dental, optical, physiotherapy, chiropractic and podiatric services, as well as natural therapies and subsidies for gym membership (PHIAC 2008: 68). And consumers with the means are able to access a wider range of pharmaceutical and other health products than

[45] Although public and private patients are able to access both the public and private hospital systems in some situations, the overlap between the two sectors is limited. In 2006-07, over 98 percent of patient separations in private hospitals were for private patients, whilst only 13 percent of percent of patient separations in public hospitals were for private patients.

is available in the first tier, particularly products not listed on the PBS and newer health products.

The second tier is a private health system that is publicly regulated, privately and publicly financed, delivered by private health providers (and public hospitals) and benefits consumers. However, as a privatised social insurance system, the second-tier is only accessible to individuals and families in a position to self-insure or to purchase private insurance to insure against the risks of ill health outside the first tier. In contrast to the first tier where membership is effectively compulsory because of universal access and contributions (Barr 2001: 24), the second tier is restricted to consumers with means. Although the second tier enshrines the user-pays principle and private provision, it does not, as Gray (2004: 83) argues, amount to a 'free market' of health provision because the heavy regulation of private health insurance stifles competition amongst insurers and contributions from the public purse pay the bulk of the incomes received by many groups of medical professionals.

The two-tiered health system and the Commonwealth government

The second tier plays a subsidiary role in the Australian health system because of its financial scale, accessibility of services and case-mixers of health providers of both tiers. The financial footprint of the Australian health system amounted to $94 billion in 2006-07, which at 8.7 percent of GDP was slightly below the OECD average (OECD 2009). The second tier cost about $33 billion or 35 percent of total health expenditure (AIHW 2008a: xii).[46] Further, the first tier has universal coverage, whereas the second tier is available to consumers with means. In 2006-07, the second tier covered 43 percent of the population who held private health insurance and others who self-insured (PHIAC 2009). And, while the case-mix of the first tier is focused on essential health services, the second tier provides a broad range of elective and ancillary health services.

The Commonwealth government is the largest contributor to the health system, financially supporting both tiers. The policy instruments that finance the two tiers follows the general pattern identified in this thesis: the first tier is supported by the social welfare of cash transfers and social services, and the second tier is subsidised through the fiscal welfare of STEs. As the principal source of public finance for the second tier, the PHITR

[46] The PHITR and the Medical Expenses Tax Rebate are counted as part of the second tier, even though both are financed by the Commonwealth.

flows to different recipients than first-tier programs – the consumers, insurers and private providers of health services. The government thus uses more accountable social welfare to benefit most members of Australian society, while less visible and less accountable fiscal welfare is targeted at consumers of private health insurance.

III. Two Tiers of Health: What kind of subsidiary relationship?

To better gauge the impact of the PHITR on both tiers, I consider the interactions between them. This discussion relies on Hussey and Anderson's (2004: 224) distinction between three types of subsidiary relationships that private insurance has with public insurance. *Substitutive* private insurance acts as a replacement for public insurance, when means tests exclude wealthier social groups or individuals with private insurance are able to opt-out from the public system. *Complementary* private insurance covers health services not available through the public system, allowing individuals to insure for a wider set of risks. And, *supplementary* private insurance covers health services that are also available in the public system, often extending choice or reducing waiting times. When it introduced the PHITR, the Howard government argued that private health insurance was a substitute to public hospital insurance and would thus reduce pressure on Medicare (more on this in *Chapter 4*). However, in considering the interactions of the two-tiers, I will show that the second tier actually combines elements of complementary and supplementary insurance. This role has implications for the PHITR's impact and efficacy.

Complementary and supplementary private insurance

The interactions between the two tiers of the health system are complex. On the one hand, the second tier operates as a separate social insurance system, providing consumers with access to a different range of hospital, medical and ancillary health services to Medicare. On the other hand, the public and second tiers often employ the same groups of medical professionals, purchase services and products from the same private providers, and both receive Commonwealth funding. Moreover, consumers of private health insurance and those who can afford to self-insure are not required to opt-out of the public health system. Since health staff, resources and consumers are mobile between the tiers, the first and second tiers interact in ways that mean developments in one tier impact on the other – especially when services are in short supply or in high demand in one of the tiers. This relationship, however, clearly is not substitutive private because second-tier consumers retain access to the first and contribute to it through taxes. Nor is it a supplementary relationship, since the second tier provides ancillary health services not available through the first tier. And, the second tier does not simply provide complementary insurance, as there is significant overlap – despite different specialties – in the hospital and medical services delivered, staff employed and resources mobilised by both tiers. Thus, the complexity of the interactions between tiers means that the second tier defies easy classification into any of the subsidiary relationships outlined by Hussey and Anderson (2004).

Rather, the second tier of the health system combines a system of supplementary insurance for both hospital and medical services, with complementary insurance for ancillary health services. The supplementary private insurance for hospital and medical services involves the most interaction between the two tiers because the public and private sectors deliver similar services. The second tier mostly provides supplementary medical insurance to Medicare by covering the gap payments to health services listed on the MBS through private insurance and self insurance (individual co-payments). The relationship of private hospital insurance to public hospital services provided through Medicare is more tenuous, since the case-mix of private hospitals is focused narrowly on elective procedures and same-day separations. But, private hospital insurance also meets the criteria of supplementary insurance, because the services delivered in the second tier are available in the first tier too. The interactions between the hospital and medical services offered by the two tiers noted above mean that these systems of supplementary insurance have implications for the supply, demand and thus cost of medical and hospital services in both tiers.

The supplementary character of the private insurance offered by the second tier impacts on the supply and demand of health services in the first tier because it affects the availability of services, staff and resources. The second tier increases the overall output of medical and hospital services, supplying 38 percent of hospital procedures and the 30 percent of medical services that are not bulk-billed. Hanning (2004: 330) confirms the extent of this contribution, arguing that it would cost the state an additional $1.1 billion each year if private hospital services were nationalised in Victoria alone. However, the capacity for increased activity in the second tier to relieve pressure on the first is constrained by different case mixes of the two tiers (as discussed above) and their reliance on the same pool of professional staff (Richardson and Segal 2004: 40; Pratt

2005). Hindle and McAuley (2004: 121) claim that doctors have financial incentives to work in the second tier because they get paid more for treating private patients than public ones. These incentives are amplified when patients increase demand in the second tier by using private health insurance to avoid long waiting lists for elective procedures that are in short supply in the public hospital system. At the same time, the potential for the second tier to relieve the first is further constrained by the more extensive treatment that private patients receive compared to their public counterparts for similar conditions (McAuley 2005: 168; Segal 2004). In light of these features of private provision, it is hardly surprising that Duckett's (2005: 92) research shows that an increase in private hospital activity is associated with longer waiting lists for surgery in public hospitals.

More broadly, the interaction of private supplementary insurance with the first tier has also impacted the total expenditure allocated to medical and hospital services in the health system, as the private sector limited the capacity of Medicare to constrain costs through its monopsony powers, which flows from its strong bargaining position as the sole universal insurer in the first tier. Sole universal insurers, Hussey and Anderson (2003: 226) argue, exercise greater cost controls than multiple insurer systems because of their greater purchasing power and centralised monitoring capacity over a myriad of private providers. Involving over 40 insurers, the private health insurance industry has little capacity to control costs, since the bargaining position of providers allows them to play insurers off against each other (McAuley 2005: 170). Although hospital and medical costs have increased since Medicare, the evidence suggests that the first tier has been more effective at constraining costs in the hospital sector than the second tier; while overall costs for hospitals rose 49 percent between 1984 and 1991, the costs of private hospitals expanded by 64 percent over the same period (Gray 2004: 57). The weaker capacity of the second tier to constrain costs also puts upward pressure on prices in the public sector, as health providers often set their own fees and work in both tiers. Thus, growth in private health expenditure has outflanked extensions in service provision.

However, the capacity of Medicare to reduce the uptake of private insurance was the interaction between the two tiers that received the most attention. It is of particular interest here since it was a key justification for introducing the PHITR. Advocates pointed to Medicare's role in reducing demand for private health insurance as a major factor in declining coverage between the mid 1980s and late 1990s. Private health insurance cover declined from 50 percent of the population in 1984 to 30.5 percent in

1998, representing an attrition rate of 1.4 percent per year (McAuley 2005: 159).[47] Medicare had a major hand in reducing the demand for private health insurance since it enables consumers to access to a ‘free’ alternative system of health care. This entangled Medicare and private health insurance in a feedback loop that had the cumulative effect of making private insurance more and more unaffordable (McAuley 2005: 159). As low-risk groups (such as the affluent and healthy) abandoned private cover and risk-adverse groups maintained it, private insurers increased their premiums to remain afloat, which then hastened the departure of the remaining low-risk consumers who remained and led to further spirals in premiums (Access Economics 2002: 10; Harper 2003: 16; McAuley 2005: 159).

By contrast, the second tier provides ancillary health services via complementary private insurance. Many of the ancillary services that consumers of the second tier are able to access through private health insurance or self-insurance are only receivable by public patients on a limited basis through hospital care and follow-up treatment (AIHW 2008a: 341). Other ancillary services such as gym membership or natural therapies are expensive for public patients or simply not available. The absence of public-tier equivalents for most of these health services means that there are only minor interactions between the public and second tiers, with separate sets of institutions influencing the supply, demand and cost of services in each tier. Nonetheless, ancillary health services account for a significant portion of second tier activity, totalling about $2.3 billion in 2006-07 (PHIAC 2008: 68). The Australian health system thus combines a first tier of primary hospital and medical care, with a second tier consisting of supplementary hospital and medical insurance, as well as complementary ancillary insurance.

IV. Linking Ends to Means: The PHITR and the Two-tiered Health System

Considering the complex interactions between the two tiers and the rebate’s links to the broader package of policies that support private health insurance, it is unsurprising that the capacity of the PHITR to meet the policy objectives advocated by the Howard government is contested. At first glance, the rebate seems to have met these objectives since private health insurance coverage rapidly grew following its introduction. But, on closer examination, research shows that the rebate played only a minor role in increasing private health insurance coverage and provided limited relief to first tier hospital services

[47] This also coincided with the (temporary) retrenchment of STEs for private health insurance.

despite its substantial call on the public purse. More fundamentally, the efficacy of private health insurance as an instrument to fund health services is disputed and there are doubts as to whether the second tier was threatened by declining private health insurance coverage. After outlining the policy rationale for the PHITR, both sides of the debate about the rebate's efficiency and its capacity to live up to the Howard government's stated intentions are reviewed.

The policy rationale for the PHITR

The Howard government introduced the PHITR, along with the Medicare Levy Surcharge (MLS) and Lifetime Community Rating (LCR), ostensibly to reverse the declining coverage of private health insurance apparent since Medicare's establishment in 1984. Supporting the government's claims, the Department of Health and Ageing (DOHA) (1999) argued that this policy package would rejuvenate a second tier in crisis, with benefits to the broader health system. The department claimed that the rebate would sustain the private health insurance industry by restoring cover to 32 percent of the population (DOHA 1999: 9). The department also argued that the rebate would support private health services, especially hospital services, by reducing the fiscal pressures of population ageing, expensive technological advancements and falling private cover (*ibid*: 7). Implicit to this rationale is that falling private cover undermined private services. And, the department contended that private health insurance reduced demand for public health services and related public outlays.

In supporting the government's claims, DOHA also supported the rebate on the basis that consumers of private health insurance would benefit. The department argued that the rebate would increase the affordability of private health insurance, framing it as a 'universal concession' that provided a 30 percent discount (DOHA 1999). The department also claimed that the rebate would extend consumer choice by allowing consumers to select between public and private health services. Unlike public patients, private patients may have greater input to the timing of procedures and can choose their doctor and hospital (DOHA 1999: 8). And the department argued that the rebate would boost horizontal equity and support the self-provision of health services – by compensating private patients with insurance who paid the Medicare Levy and faced out-of-pocket expenses (DOHA 1999: 7). Both sets of these claims about the benefits that the PHITR has for consumers and the health system have featured in the debate about its efficacy.

Value for Public Money? The case for the PHITR

Support for the PHITR as a rational policy measure is mainly to be found in a series of reports commissioned by the private health insurance industry or authored by senior members of associated bodies (such as Access Economics 2002; Harper 2003; Murphy *et al.* 2003; and Hanning 2004). These reports contend that the PHITR and the broader policy framework achieved most of, and in some cases surpassed, the policy objectives set by the Howard government. Advocates argue that the rebate has redressed the decline of private health insurance coverage. Advocates also contend that the rebate benefited both tiers by supporting the second tier while reducing pressure on the first. And, advocates claim that the rebate has expanded consumer choice. The role of the private health insurance industry in commissioning these reports needs to be kept in mind, but does not disqualify their claims automatically. However, these arguments fall short because they almost completely ignore the rebate's interactions with other policies and both tiers of the health system.

The main argument forwarded in support of the PHITR is that it has contained public outlays on the first tier by boosting private health insurance coverage. Following the introduction of the MLS, the rebate and LCR, private health insurance coverage grew from 31 percent of the population in 1997-98 to 45 percent in 1999-00. Proponents argue that the rebate has increased coverage by increasing the affordability of private cover for younger and healthier consumers (Harper 2003). In their report for the Australian Private Hospitals Association, Access Economics (2002: 10) attributes the rebate with boosting private insurance cover by 11 percent. Alternatively, had the rebate and LCR not been introduced, Murphy *et al.* (2003: *iii*) project that private health insurance coverage would have continued falling until only 18 percent of the population was covered by 2040 and, at this point, the viability of the private health insurance industry would be threatened. Proponents contend that the rapid growth of private health insurance coverage after the rebate's introduction surpasses the 32 percent policy goal set by the Howard government.

Advocates claim that the rebate has relieved pressure on the first tier by reducing the need for further public outlays. In their report for Medibank Private, Murphy *et al.* (2003: 27) estimate that every public dollar spent on the PHITR is offset by two dollars that it would have to spend on replacement services. The means by which Murphy *et al.* (2003) arrive at this estimate are presented in *Table 3.5*. This table shows that for every dollar private health funds collect through premiums, 83 cents is allocated to private health benefits. Of the 83 cents allocated to private health benefits, Murphy *et al.* (2003: 27) estimate that 23 cents is absorbed by the private sector. From this, they calculate that every 30 cents spent on the rebate translates into 60 cents spent on private health services. Thus, they conclude that if the rebate were removed, the government would incur a bill double the amount saved in replacement public health expenditure (Murphy *et al.* 2003: 27). While not discussing how this estimate was derived, Harper (2003: 6) used a similar estimate to show that that the $2.1 billion spent on the rebate saved the public hospital system $4.3 billion. In arguing that the PHITR reduces the call on the public purse, advocates claim that the rebate allocates public money efficiently.

Table 3.5 Estimate of How Every Dollar Collected as Private Health Premiums was Allocated in 2006-07

	Amount ($)	Proportion (%)
Premium	1.00	100
Private health benefits	0.83	83
Administration	0.09	9
Other costs	0.08	8
Rebate	0.30	30

Source: Murphy et al. (2003: 27)

Supporters also make equity and efficiency claims for the rebate. Access Economics (2002: 20) state that the PHITR is the most effective policy available to improve the affordability of private health insurance. The same report argues that the flat-rate tax rebate is preferable on equity grounds to a tax deduction for premiums because it provides an equal rate of discount to consumers rather than inverting the progressive income tax scales (*ibid*: 20). The report further contends that the rebate was an efficient policy option because it is a universal concession available to all consumers of private health insurance and mainly delivered as a premium discount, thereby avoiding the administrative costs of means testing and paying the rebate to individual consumers (*ibid*: 20). Another claim in the report is that the rebate is a more effective policy than direct benefits to service providers or insurers, since it empowers consumers to make choices and pursue their self-interest in the health market, and maximises the chances of achieving optimal outcomes (*ibid*: 19-20).

Similar support for the rebate highlights gains in horizontal equity and consumer choice. Access Economics (2002: 2) assert that individuals seek more health care choices as their incomes rise. As noted above, private health insurance extends the choices of those with private health insurance; supplementary hospital and medical insurance makes both choice of doctor and hospital more affordable, whereas complementary ancillary insurance extends choice by providing access health services not available through the first tier. Proponents contend that the rebate facilitates greater choice over the "who, when, where and what of health care" (Access Economics 2002: 18) for consumers in exchange for greater self-provision. Murphy *et al.* emphasise that the rebate amounts to "a modest government contribution to meeting the health costs of the [privately] insured, compared with the [privately] uninsured" (2003: 31). At the same time, proponents argue that the rebate boosts horizontal equity by compensating consumers of private health services who still have to contribute to Medicare through their taxes.

At first glance, these arguments suggest that the PHITR has met the objectives set by the government. However, on closer inspection, these research reports have a narrow focus because they attribute the growth in private health insurance coverage since 1999 solely to the PHITR and calculate the public savings based on this assumption. This narrow focus means that they overstate the efficacy of the rebate because they miss the impact of other policies and the different case-mixes of the tiers. Murphy *et al.* (2003), Harper (2003), and Access Economics (2002) do not account for the interaction effects of the MLS tax penalty on private health insurance coverage, nor do they consider whether the rebate may have negative effects on the supply of public services. Moreover, the reports commissioned by the private health insurance industry tend to assume that declining private health insurance led to a decline in private hospital separations, but provide no evidence to support this. I am not suggesting that these reports are intentionally misleading – their narrow focus and assumptions may stem from the terms of reference set by the commissioning organisations. The implications of these potential shortcomings are considered below.

Poor value for public money? The case against the PHITR

The case against the PHITR has been promulgated through a stream of reports and peer-reviewed articles since its introduction. This research challenges the rebate's capacity to meet the policy objectives envisaged for it by the Howard government. In challenging the efficiency of the rebate, this research variously claims that the PHITR: made only a minor contribution to the growth in private health insurance coverage;

channels less than half of the funds allocated to it to the private hospital system; and may have actually increased the pressure on Medicare. More fundamentally, critics of the rebate claim that private health insurance is an inefficient mechanism through which to fund private health services and show that the second tier was not threatened by the decline in private health insurance coverage during the 1980s and 1990s (Deeble 2003; McAuley 2005; Segal 2004). In this section, I argue that the existing evidence supports the contention that the PHITR is an inefficient policy, and highlight questionable assumptions that underpin arguments in favour of the rebate. Rather than relieving pressure on the public system, the PHITR's main effect has been to entrench the second tier.

Critics challenge the role the rebate played in increasing private health coverage, pointing instead to its joint impact with the MLS and LCR. Noting that private health insurance coverage only increased from 30 percent to 32 percent from December 1998 to March 2000, Butler (2002: 38) declares that the *Run for Cover* campaign orchestrated by the government in the lead-up to the introduction of the LCR was the catalyst for the rapid growth because it rose from 32 to 43 percent between 1998 and 2002 (see *Table 3.7*). This leads Butler to argue that the growth in the rebate's cost represented "an *effect* rather than a *cause* of increased demand for private health insurance" (2002: 38). Through regression analysis, Palangkaraya and Yong (2007) disaggregate the effects of the MLS and LCR on the growth of private health coverage between 1995 and 2001. Although it is difficult to disaggregate the impact of particular policies, the LCR is estimated to account for 22 to 32 percent of the coverage increase and the MLS is estimated to have increased coverage by 34 percent (*ibid*: 1370, 1372). This implies that the maximum contribution of the rebate was between 34 and 44 percent of the increase in private cover, or that it encouraged between 3.7 and 4.9 percent of the population to take-up private insurance. However, this figure overstates the impact of rebate because it assumes that policy changes accounted for the entire growth in private health insurance coverage without considering the effects of extrinsic factors such as the prosperity that accompanies sustained economic growth, which stimulates the provision of private services. Still, both accounts indicate that the rebate had a much more modest impact on private health insurance coverage than assumed by its advocates.

Critics also challenge the rebate's efficiency as a means to sustain private hospitals. McAuley (2005) contends that private hospitals receive no more than half of the funds spent on the rebate. As *Table 3.6* shows, the rebate allocated only $1.2 billion or around 35 percent of its benefits to private hospital admissions in 2006-07. The rebate also subsidises medical procedures and prostheses for private patients, but the share of these funds (if any) that flow to private hospitals remains unknown. But, even in the unlikely event that private health funds only paid out medical benefits and prostheses for services in private hospitals, the upper limit on the value of the total subsidies for the private hospital sector is just over half of the rebate's $3.4 billion budget cost. So, by subsidising the broader operations of health insurers, the rebate also channels public finance to pay for ancillary benefits (most of which are unavailable in the first tier), administration and marketing (McAuley 2005: 167). Private insurers also incur significantly higher administrative costs than Medicare; in 2002-03, for example, the administrative costs accounted for 10.8 percent of their budgets, while Medicare spent 4.8 percent of its budget on administration (including tax collection) (*ibid*: 169). While these higher administrative costs challenge the efficiency of private insurers, the rebate's relatively low support for private hospitals invalidates the assumption made by Murphy *et al.* (2003) that they receive all benefits paid out by private insurers.

Table 3.6 Major Expenses of Private Health Insurers and Rebate in 2006-07

Expense Category	Gross ($m)	PHITR ($m)	Net ($m)*
Public Hospitals	456	137	319
Private Hospitals	4,058	1,217	2,841
Medical Benefits	1,047	314	733
Prostheses	928	279	649
Ancillary Benefits	2,393	718	1,675

* This the amount paid by private health insurance funds on each of these benefits after the rebate is taken into account (i.e. it is the Gross column minus the PHITR column).

Source: PHIAC (2008: 67)

Critics further argue that, far from relieving pressure on the first tier, the rebate appears to have increased the strain on public hospital and medical services. By funnelling resources to private health insurers and increasing their membership (to a limited extent), the rebate potentially erodes the monopsony-like powers that Medicare is able to exercise as the sole universal insurer in the national health market. In a mixed economy of health, private insurers have less purchasing power than a sole universal insurer because they purchase fewer services and have fewer members (Hussey and Anderson 2004). This is particularly pertinent for Australia, with Colombo and Tapay finding in their report for the OECD that Australian private insurers have "not effectively engaged in cost controls. They seem to have limited tools and few incentives to promote cost-efficient care, and there are margins for some funds to improve administrative efficiency" (2003: 39). The higher prices paid by private insurers for health services also undermines the purchasing power of the public sector because, as noted above, public and private insurers draw on services and resources from the same providers. The evidence indicates that the expansion in private health insurance – which the rebate contributed to – may have eroded the monopsony powers of Medicare, as total health expenditure grew at a faster rate after 1999 than in the preceding eight years (Gray 2004: 57).[48]

The rebate, critics argue, contributed to inflationary pressures faced by the public hospital system because it is a demand-side measure that does not address supply issues. The PHITR stimulates demand for private hospital services by reducing their cost for the sizeable minority with private health insurance (Duckett 2005: 87). But, the rebate does not increase the supply of the health resources drawn on to deliver private hospital services – such as hospital staff, capital equipment and medical specialists – that have a relatively fixed supply in the short to medium term and are often mobile between both tiers of the health system (*ibid*: 87). By stimulating demand without tackling supply, the rebate has increased the purchasing power of private health insurers to employ specialists and purchase the resources used in both tiers. This increases competition between the tiers for hospital resources, which is likely to inflate the cost of the staff and relevant resources that both public and private hospitals draw upon (*ibid*: 88). And, to the extent that the greater purchasing power of the private insurers increases the procedures carried out in private hospitals, the rebate may encourage the flow of medical personnel from the first to the second tier since they tend to get paid more for procedures on private patients (*ibid*). The rebate's inflationary effects call its effectiveness into question.

Though not directly increasing the pressure on public hospitals, the rebate's capacity to relieve pressure on this system is thwarted by the case mix of private hospitals and their urban geographical concentration. With comparatively fewer resources at their disposal, private hospitals largely focus on elective surgeries because they are generally more profitable and require less capital investment (Segal 2004: 8). Public hospitals are thus left bearing most of the responsibility for high-risk patients who require high-cost emergency and/or complex procedures – particularly in metropolitan areas (Colombo and

[48] Other factors such as technological innovation and increased utilisation of health services may also have contributed to rising costs. But, the utilisation of private hospital services was also expanding in the 8 years leading up to the introduction of the PHITR.

Tapay 2003: 32; Segal 2004: 8). Dawkins *et al. (*2004: *ii*) found that patients with private health insurance tended to admit to public hospitals for complex and/or complex procedures and private hospitals for less-complex and less-urgent procedures. The same research also found that doctors preferred to admit their patients – regardless of their insurance status – to public hospitals if they required complex procedures (Dawkins *et al.* 2004: *i*). Thus, it is unsurprising that the increased coverage in private health insurance appears to have only slightly decreased hospital waiting lists for semi-urgent procedures and that the waiting lists for urgent procedures has actually increased (*ibid*: *ii*). This also suggests that rather than increasing horizontal equity, the rebate serves to assist private patients with material means to avoid longer queues in the public system (Hindle and McAuley 2004: 121).

Because critics have placed the rebate in its broader policy context and traced its implications for both tiers of the health system, these criticisms provide a convincing rebuttal to claims that the PHITR met the policy goals laid down by the government. Consider the PHITR's limited role in boosting the coverage of private health insurance, estimated to be no more than 5 percent of the population. The government effectively spent around $705 million on the rebate for every one percent increase in the proportion of the population with private health insurance. Put another way, only $389 million of the $3.4 billion allocated through the rebate in 2006-07 was directed at consumers who would have not otherwise taken out cover. Advocates have also grossly overstated the rebate's capacity to relieve pressure on the public hospital system. When it is taken into account that only half the funds collected by private insurers are spent on private hospital services, Murphy *et al.*'s (2004) estimate that each dollar spent on the rebate saves the government two dollars in replacement expenditure is halved. This revision would still vastly exaggerate the contribution of private insurance, as it does not account for the case-mix of private hospitals, their concentration in metropolitan areas, or the rebates inflationary effects. The rebate's cost ineffectiveness leaves little doubt that it provides poor value for public money.

Nonetheless, the more fundamental criticisms of the rebate relate to the limitations of private health insurance as a health-financing instrument and evidence suggesting that the decline in private health insurance coverage did not threaten the second tier – or at least the private hospital services that served as the major focus of advocates' arguments. According to Arrow's (1963) influential account, private health insurance has limitations as a means to finance health services because the uncertainty caused by the imperfect nature of the information available to patients, health providers and private insurers make the market susceptible to failure. This uncertainty underpins what Hacker (2002: 181) terms the 'three central dilemmas' of medical finance: agency, moral hazard, and, adverse selection. Pertaining to the relationship between patient and medical specialist, the *agency* dilemma relates to the risk of inappropriate treatment or over-servicing because the patient has to entrust medical specialists with decision-making powers (*ibid*: 181).[49] The other dilemmas relate to the operation of (private) insurance; *moral hazard* occurs when consumers overuse health services because of the discount received through insurance at point of purchase or when providers believe that insurers can pass on their costs to members, while *adverse selection* occurs when the financial viability of insurance is threatened by the prevalence of individuals with serious health risks and/or a greater call on health services (Hacker 2002: 182; McAuley 2005: 164, 170). Although health insurance (public or private) is prone to moral hazard and adverse selection, private insurance is particularly susceptible to market failures because universal public insurers can offset the risk of moral hazard with their monopsony powers and do not encounter adverse selection to the same extent because they cover the entire population (McAuley 2005: 165, 170).[50]

The three dilemmas of agency, moral hazard and adverse selection undermine the efficiency of private health insurance by eroding its cost effectiveness. Since the rebate's cost is proportional to the price of private health insurance premiums, its call on the Budget should increase roughly in line with growth in the coverage of private health insurance. *Table 3.7* compares the government's expenditure on the STEs for private health insurance with the proportion of the population covered by private health insurance. While private health coverage levels have remained stable at around 43 percent of the population since 1999-00, the cost of the rebate has more than doubled from $1.6 billion in 1999-00 to $3.4 billion in 2006-07.[51] That this largely reflects the rising cost of private health insurance premiums is confirmed by the Australian Consumer Association (2005), which reports that the average premium rose by 70 percent

[49] The agency dilemma also casts doubt on the capacity of the rebate to meaningfully extend consumer choice, as there is not a great deal of variety in private insurers and most important medical decisions (choices) are made by specialist staff (McAuley 2005: 168).

[50] Butler's (2002) research suggests that adverse selection is occurring in Australia, because private funds have lost members in the 30 to 55 age-group, which has increased the average age of their membership. This is significant because McAuley (2005) finds that at age 60 and above, the benefits individuals draw from private insurers outweighs their contributions.

[51] These figures are not adjusted for inflation.

(or 37 percent when adjusted for inflation) between 1996 and 2005. The absence of a clear relationship between the rebate's cost and private health insurance coverage suggests that Australian private health insurance confronts the three dilemmas outlined previously. [52] In any event, the continual rise in the rebate's budgetary cost raises serious questions about its cost-effectiveness and its long-term sustainability as a Budget measure.

Table 3.7 The Rising Budgetary Cost of the PHITR and the Stable Coverage of Private Health Insurance

Year	Expenditure on PHITR ($m)	% of Population with PHI cover
1998-99	963*	30.8*
1999-00	1,576	43.0
2000-01	2,031	44.9
2001-02	2,118	44.3
2002-03	2,306	43.5
2003-04	2,516	42.9
2004-05	2,827	42.7
2005-06	3,177	42.7
2006-07	3,453	43.5

*Not PHITR, but Tax Credit from PHIIS reforms.

Source: AIHW (2008a: 24); PHIAC (2009)

The PHITR's cost does not appear justified by the threat that declining private health insurance posed to the Australian health system. Although proponents of the rebate regularly assert that a strong link exists between private health insurance coverage and the provision of private hospital services (i.e. Access Economics 2002, Harper 2003 etc.), this assumption is rarely subject to scrutiny. A closer examination shows that the decline in private health insurance after Medicare's establishment did not radically alter the second tier's share of health services and that private hospital utilisation increased. As Deeble (2003: 4) notes, private health insurance roughly maintained its share of health financing in the ten years following the introduction of Medicare; in 1984-85, private health insurance contributed 10.8 percent of total health financing, whereas in 1996-97 it was 10.0 percent. This also coincided with growth in total private hospital admissions, from 26 percent of total hospital admissions in 1984-85 to 33 percent in 1996-97. The growth of private hospital services after Medicare's introduction undermines the link between private insurance and private health sector activity, and points to the significance

[52] See McAuley (2005) for a more detailed discussion.

of self-insurance. As self-insurance peaked in 1998-99 and dropped to about 15 percent in 2002-03, McAuley (2005: 173) contends that the rebate discourages individuals from self-insuring.

Table 3.8 Proportion of Australian Population with Private Health Insurance

Year	Basic Table	Supplementary Table	Total Hospital Insurance
1982	36.6	31.3	67.9
1984	20.4	29.6	50.0
1986	14.6	34.2	48.8
1988	8.5	38.5	47.0
1990	5.5	39.0	44.5
1992	4.1	36.9	41.0
1994	2.8	34.4	37.2

Source: Segal (2004: 5)

Moreover, Segal (2004: 4) argues that the fall in overall membership rates of private health insurance threatened neither tier because this decline concealed underlying changes to the types of premiums available for purchase. Consumers had the choice of purchasing either basic table or supplementary table private health insurance until 1996 when insurers chose to no longer offer basic cover.[53] The proportion of Australians with basic table insurance fell from 36.6 percent in 1982 to 2.8 percent in 1994, while coverage of supplementary insurance increased from 31.3 to 34.4 percent over the same period (see *Table 3.8*). Because individuals needed to have private insurance to be able to claim Commonwealth hospital subsidies from 1981, Segal (2004: 4) contends that when Medicare was introduced the proportion of the population with private health insurance was much higher than it would otherwise have been. She claims that once Medicare was re-established, many individuals who had purchased private health insurance to ensure that they received public hospital benefits dropped their cover since they no longer required it (*ibid*: 4). From this perspective, the decline of basic table insurance did not threaten the second tier (or by extension the first tier), rather it simply represented the adjustment of consumers to the growing entrenchment of Medicare. In fact, Segal (2004: 5) claims that the level of supplementary table insurance (43.5 percent) is without precedent. In light of the PHITR's limited capacity to meet its policy objectives and the questionable basis for its introduction, the rebate's main effect has been to entrench

[53] Interestingly, as Macintosh (2007) shows, private insurers have started to offer basic table insurance again because of the tax incentives produced by the rebate and MLS (see below).

private health insurance as the major source of second tier finance and to significantly subsidise the private health care sector with taxpayer funds.

V. 'Not for the Poor': The distributive implications of the PHITR

Having shown how the PHITR has expanded and entrenched the second tier of the health system, I turn to consider its broader implications for equity in the Australian dual welfare model. The welfare state is intrinsically bound up with questions about the equity of resource allocation and social risk management, which raises the questions: who benefits from the PHITR and what kind of protection do they receive? The rebate's distributive effects reflect the consumer profile of private health insurance, the range of health services financed by private insurers, and its interaction with other aspects of the health system – particularly the MLS. An examination of these factors leaves little doubt that the rebate is highly inequitable. The rebate benefits higher income earners while providing little or no benefit to lower income earners. Organised according to the user pays principle, the rebate assists many private health insurance consumers to bypass long waiting lists for elective health services in the first tier and to utilise ancillary benefits not otherwise subsidised by the government. At the same time, the rebate helps to provide other high-income earners with a route to avoid tax owed through the MLS by purchasing cheap private health insurance and choosing to admit as a public hospital patient.

The distributive effects of the PHITR

The rebate's distributive effects reflect the consumer profile of private health insurance and the value of the benefits received. This can be established by drawing on data from *Taxation Statistics 2006-07* and relating these details back to previous research where appropriate. Published annually by the Australian Tax Office (ATO), *Taxation Statistics* releases aggregate data collated from tax returns received before the November following the end of the relevant financial year. The 2006-07 edition presents data from 11.8 million tax returns. Two qualifications about my use of *Taxation Statistics 2006-07* data are required. The first is that the data are organised according to the unit of the income tax system – individuals – rather than the household, which is the usual unit of analysis in studies of distributive effects because household measurements give a clearer indication of the resources available to individuals. To address this problem, my results are compared with recent household level data presented by Denniss (2005). The second qualification is that data on the rebate covers the 5 percent of recipients who claim it as a tax offset. There is no contrary evidence, but the data may not be representative of the larger group that claim the rebate as a premium reduction for which data is unavailable. Nonetheless, *Taxation Statistics* provides accurate data because it is collated from legal documents and has wide coverage.

The distributive effects of the PHITR are assessed by analysing the data that *Taxation Statistics 2006-07* offers on annual individual taxable income, private health insurance coverage, and the value of the benefit received from the rebate when claimed as a tax offset.[54] *Figure 3.1* displays the proportion of tax payers in each income bracket who have taken up private health insurance. As coverage rises with income, the table shows that individuals with private health insurance tend to have higher incomes. In 2006-07, only 35 percent of individuals with an annual income under $25,000 (earning below the minimum full-time wage) held private health insurance, while 65 percent of average income earners (earning $55,000 to $60,000) purchased private health insurance. This compares to more than 85 percent of individuals with incomes of $80,000 or above purchasing private cover, and, at the very top of the income range, 94 percent of the top 3 percent of income earners held private health insurance in the same year. These results are consistent with Denniss (2005), who found that households with high-incomes were much more likely to purchase private health insurance. From a survey of more than 56,000 respondents aged over 14 years in 2003 and 2004, Denniss (2005: 23) found that only 24 percent of households with annual incomes below $25,000 purchased private health insurance, while 69 percent of households with incomes over $100,000 took out private cover. Both my analysis of the *Taxation Statistics* data and Denniss' (2005) data suggest that the rebate is inequitable because membership is concentrated amongst higher income groups.

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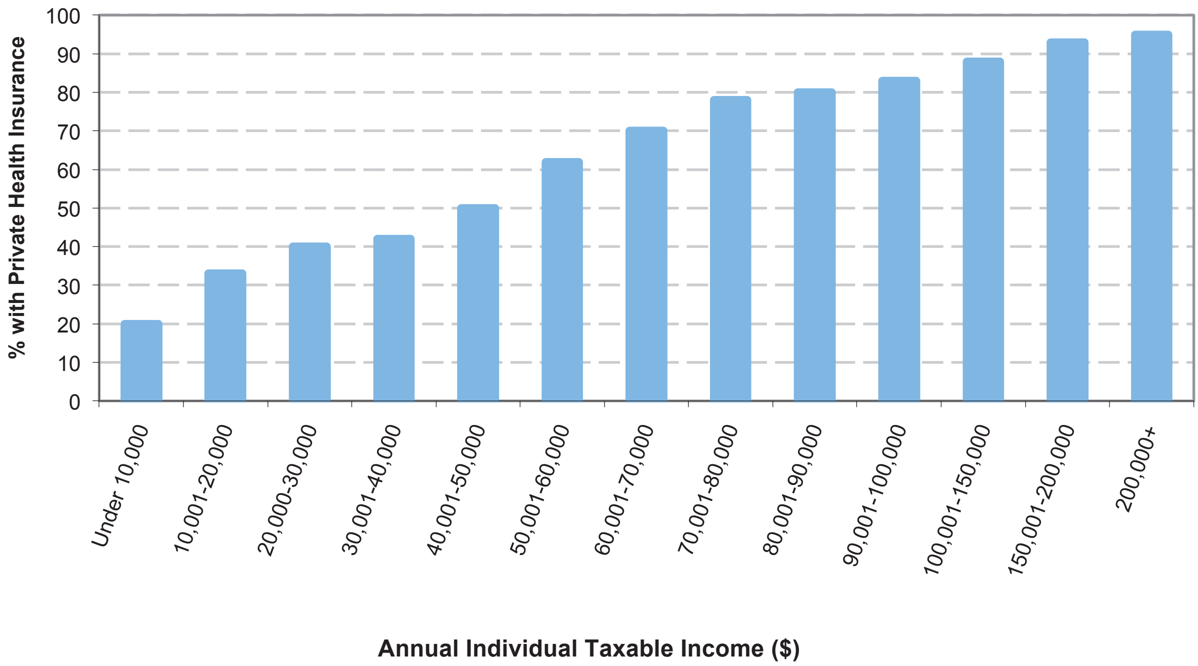
[54] Non-tax payers are excluded from this analysis.

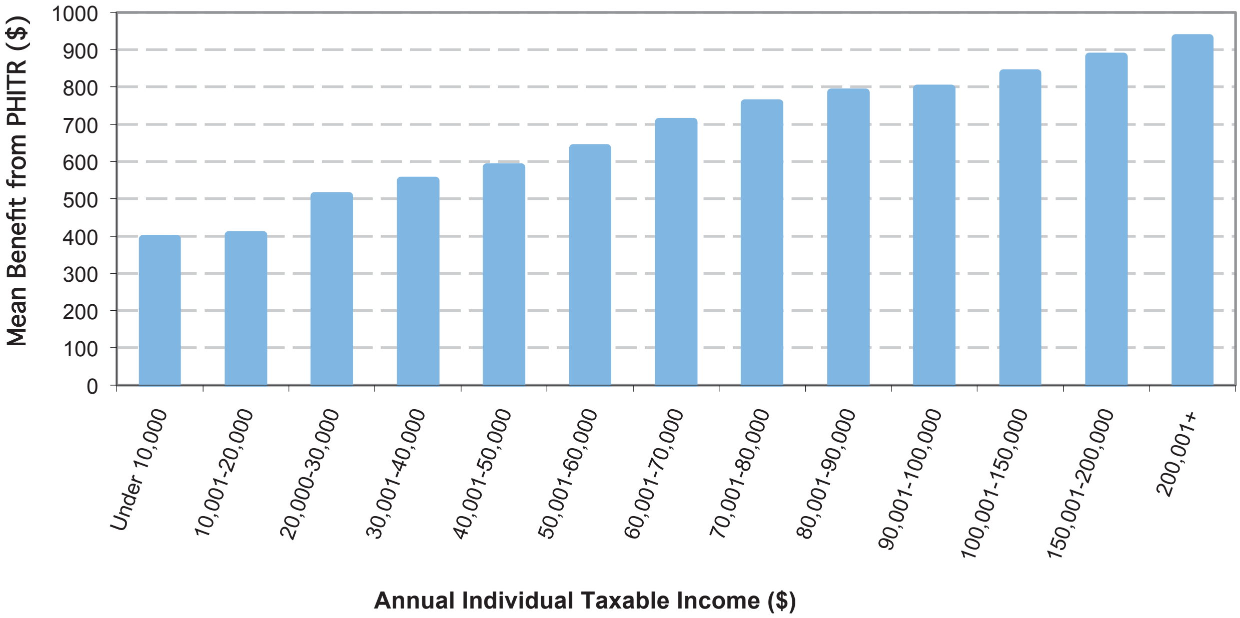
Figure 3.1 The Coverage of Private Health Insurance by Taxable Income 2006-07



Source: compiled from ATO (2009)

The rebate is doubly inequitable because it also provides higher income earners with a larger benefit than that received by low-income earners. *Figure 3.2* compares the annual income received by tax payers with the benefit they glean from the PHITR (if they claim it as a tax offset). While the average benefit from the rebate was less than $500 for those earning an annual income below $25,000, individuals earning roughly the average level of individual income received about $650 on average in 2006-07. In contrast, individuals earning more than $80,000 per year received more than $830 on average from the rebate and the highest income earners on over $150,000 received a mean benefit of $900 (both in the same year). These results, which support and update the Smith's findings (2001), are hardly surprising considering that higher income earners are able to afford more expensive premiums due to their greater purchasing power and thus receive more from the rebate.

Figure 3.2 Mean Benefit Received from the PHITR by Taxable Income 2006-07



Source: compiled from ATO (2009)

As the PHITR is a flat-rate rebate that subsidises private health insurers' entire operations, its distributive effects also relate to the kinds of health services that it makes available to private patients – particularly those services not available in the first tier such as complementary ancillary health services and some supplementary private hospital services. According to the Private Health Insurance Advisory Council (PHIAC), the largest expense of private health insurance funds in 2006-07 was outlays for supplementary private hospital benefits amounting to $6.7 billion. Of this amount, $4 billion was allocated for services to acute patients in private hospitals and $447 million accrued to acute private patients in public hospitals (PHIAC 2008: 67). Calculated as a 30 percent subsidy of these outlays, the rebate channelled $2.2 billion of public funds to procedures for private patients, including $134 million for treatments to private patients in public hospitals. [55] In light of the above discussion, the bulk of the public finance provided through the rebate to private hospital patients is likely to have assisted higher-income earners to avoid long public hospital queues for elective surgeries, to choose their doctor and to access better patient accommodation.

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[55] This understates the contribution of the PHITR to the private health insurance industry, as it provided a 35 percent discount for individuals over 65 years and a 40 percent rebate for those over 40 percent in 2006-07.

Table 3.9 Implied 30 Percent Contributions of PHITR for Ancillary Health Services, 2006-07[56]

Service Type	Benefits paid by Private Health Insurance Funds ($million)	Implied Subsidy from PHITR at 30% of Benefit ($million)
Dental	1,234.0	370.2
Optical	390.4	117.1
Physiotherapy	185.4	55.6
Chiropractic	172.0	51.6
Pharmacy	66.8	20.0
Podiatry	65.1	19.5
Natural Therapy	45.5	13.6
Acupuncture	28.1	8.4
Ambulance	25.9	7.8
Prostheses	24.3	7.3
Psychology	20.2	6.1
Hearing Aid	16.3	4.5
Preventative Health Services	11.8	3.5
Speech Therapy	10.5	3.1
Osteopathic	7.9	2.4
Occupational Therapy	6.1	1.8
Dietetics	4.3	1.3
Other	78.2	23.5
Total	2,392.8	717.8

Source: compiled from PHIAC (2008: 68)

As the rebate also subsidises complementary private insurance for ancillary health services, it finances at least 30 percent of the benefits that the consumers of private health insurance receive for these services that are not available through the first tier and often beyond the means of low-income earners. In 2006-07, private health insurance funds paid out $2.3 billion on ancillary health benefits, of which around $727 million were financed by the rebate (PHIAC 2008: 68). As *Table 3.9* shows, the largest subsidies provided by government revenue through the rebate were $370 million for dental services, $117 million for optical services, $56 million for physiotherapy and $52 million for chiropractic services. These subsidies are clearly inequitable because they support those who have the best capacity to pay, while providing no benefit to low-income earners who must rely on the public system.

[56] See also Segal (2004: 12) for 2002-03 data.

The rebate, the surcharge and the tax loophole

The PHITR's distributive impact is also shaped by its interaction with the MLS, the other policy incentive to take out private health insurance. In tandem, the interaction of the rebate with the MLS provides many higher income earners with strong incentives to take out private health insurance; even though the rebate discounts private health insurance premiums, the MLS levies an additional tax on higher-income earners without private cover. For many single-person households earning over $50,000 and couples or families who earn over $100,000, the cost of cheap private health insurance subsidised by the rebate was less than the tax penalty incurred by the MLS (Hamilton and Dennis 2002: 6).[57] This encourages a form of 'double-dipping' because individuals can avoid the MLS by taking out cheap private cover and still accessing public hospitals as public patients (Hamilton and Denniss 2002: 7).

Macintosh (2007) recently estimated the tax revenue lost from the tax loophole produced by the interaction of the rebate and the MLS. Using unpublished data from the ABS's *National Health Survey 2004-05* and premium information collected from private insurers, he estimates that over 94,000 households – including single, families, and couples – take out private health insurance to avoid the MLS tax penalty. Macintosh's (2007) preliminary results are presented in *Table 3.10*, which is organised by household type and displays both the type of cover and the average (household) income of those that seek to use private health insurance to minimise their tax liability. It shows that these households were more likely to be singles or family households than couples and had incomes over $90,000 on average, which placed them in the top ten percent of income-earners. In *Table 3.11*, Macintosh's (2007) estimates of the MLS avoided by taking out cheap hospital cover for different household types are compared with the amount that this reduces tax revenue. This table shows that the tax avoided by all household types was, on average, greater than the cost of cheap private hospital insurance at around $400 and $600 in 2004-05 – especially when the discount provided by the rebate is taken into account (Macintosh 2007: 1). When those with basic forms of hospital and ancillary insurance are also taken into account, Macintosh estimates that the total budgetary impact of the rebate and MLS reduced tax revenue by $230 million. Not only does the extent of 'double-dipping' cast further doubt on the capacity of the rebate to relieve the first tier, the rebate's interaction with the MLS provides little, if any, overall benefit to the health system.

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[57] The thresholds were lifted in 2008 by the Rudd government.

Table 3.10 Consumers who Purchase Private Health Insurance due to the Tax Loophole in 2004-05

Household Type	Hospital Cover Only (‘000)	Hospital Cover Only Mean Y ($‘000)	Hospital & Ancillary, or Ancillary (‘000)	Hospital & Ancillary, or Ancillary Mean Y ($‘000)	Private Health Insurance (‘000)	Private Health Insurance Mean Y ($‘000)
Singles	40.8	81.2	119.5	97.9	160.9	93.6
Family/Sole Parent	39.6	147.8	130.6	142.0	170.1	143.3
Couple	13.7	156.0	34.3	157.3	48.7	156.8

Source: Macintosh (2007: 10)

Table 3.11 Budgetary Cost of Private Health Insurance Tax Loophole (for consumers with hospital insurance only) in 2004-05

Household Type	Hospital Cover Only (‘000)	Average Value of MLS Avoided ($)	Revenue Loss ($’000)
Singles	40.8	812	33,130
Family/Sole Parent	39.6	1 478	58,529
Couple	13.7	1 560	21,372
Total	94.1	-	113,030

Source: Macintosh (2007: 11)

Conclusion: Substitutive insurance for a supplementary system?

The PHITR is the largest tax expenditure for health and subsidises insurance premiums for the sizeable minority of the population with private health cover. The rebate has entrenched the role of private health insurance in the subsidiary second tier, channelling more than $3.4 billion of public funds to its supplementary and complementary insurance systems that extend private provision. The evidence suggests that the rebate has not met the policy goals outlined by the Howard government – particularly its ability to relieve pressure on the first tier – and the basis for its introduction is at best questionable. The capacity of the rebate to relieve the first tier through the indirect vehicle of private health insurance assumes the existence of a substitutive relationship when, at best, supplementary and complementary relationships exist. The rebate (along with the MLS and LCR) is thus a mechanism that entrenches the second tier without relieving pressure on – in fact, it may actually detract from – the first tier.

At the same time, the rebate is the major ‘second tier’ social policy for health in the Australian dual welfare state. The social policies for the two tiers of the health system conform to the pattern typical of the dual welfare state model: the instruments of social welfare support the universally-accessible first tier; whereas the consumers, private insurers and private service providers of the second tier receive support through the instruments of fiscal welfare. A major feature of the rebate is that it is highly inequitable and disproportionately assists higher-income earners to: avoid long waiting lists for elective surgery in public hospitals; access a range of ancillary health services not available through the first tier; and/or avoid tax. Lower income earners typically do not benefit from the rebate since they are less able to afford private health insurance and have much more limited bargaining power. As the major second tier policy for health, the PHITR institutionalises inequality in the Australian health system.

Inefficient and inequitable, the rebate does not conform to the equitable social expenditures associated with the Australian welfare model. Moreover, as more efficient and equitable policy options were at its disposal to support private hospitals and the public system, the Howard government's decision to introduce the rebate cannot be viewed as a rational policy choice or even an optimal solution. Direct subsidies for private hospital services offered a proven and more efficient means than the rebate to support private hospitals because these would not subsidise the broader operations of private health insurers unrelated to providing these services. The direct investment of a further $3.4 billion (the amount spent on the rebate) into public hospitals offered an alternative policy option to support public hospitals (McAuley 2005). Because of the first tier's universal coverage, this policy option is fairer as well as more direct than the rebate. Yet, despite its limitations, ballooning cost and available alternatives, the rebate has received bipartisan support since its restoration in 1999. This raises the question: how did a policy as inequitable and inefficient as the PHITR become institutionalised? In the next chapter, I offer an alternative explanation that accounts for the political and institutional factors for the Howard government's decision in favour of this expensive second-tier policy.

- Chapter 4 -

The Struggle Over Health Insurance:

The Private Health Insurance Tax Rebate and the politics of Australian health insurance

Following five decades of instability involving six radical reforms to Australian health policy, the Howard Coalition government reintroduced the Private Health Insurance Tax Rebate (PHITR) as part of its reforms to revitalise the second tier. Framed in response to declining private health insurance coverage, the government argued that the PHITR would redress the threat this posed to the health system's economic viability. However, the rebate provides an inefficient and inequitable means of enhancing the health system's viability, so an alternative explanation for its introduction is required. Drawing on the historical institutionalist approach outlined in the second chapter, I set out a more credible explanation for the rebate's reintroduction by the Howard government. The government's decision to restore a tax rebate for private health insurance reflected long-held ideological commitments of the Coalition parties. But, it differed from its Coalition predecessors by preserving Medicare, in a move that conceded significant ground to Labor. To situate this decision within its context, I develop a structured narrative of Australian health insurance policy, with special attention to previous uses of social tax expenditures (STEs). Then, I present an alternative explanation of the decision to reintroduce the PHITR that applies the concept of 'layering' to account for the influence of politics, policy history and institutions.

Perhaps reflecting the extent of contestation, Australian health policy has a more extensive documentary history than other domains. Researchers including Crichton (1990) and Gray (2004) have written political histories of health policy. Scotton (with Macdonald 1993) and Sax (1984, 1992) provide academic accounts of health policy informed by direct involvement in policy formation. Wooldridge's (1991) masters' thesis on health policy in the Fraser years offers insights, as he was later health minister when the PHITR was enacted in 1999. Further inputs come from former prime ministers such as Whitlam (1985) and Howard (2010) in comments on health policy in their political memoirs. These sources, as well as official documents and other academic studies, have established the contours of health policy debates and the viewpoints of major actors.[58] Despite their central importance, STEs have often received only peripheral attention in these studies compared with Coalition support for private health insurance. My contribution here is to use these sources to piece together a structured narrative of Australian health policy that highlights the role of STEs and then to analyse the political and institutional paths that led to the PHITR.

I. Australian Health Insurance Policy: A Structured Narrative

The Howard government's decision to restore STEs to support the second tier through the PHITR is but a recent development in the long and often turbulent political conflict over health policy. Harking back to the turn of the twentieth century, this conflict arose from competing models of health policy. The Labor party committed to universal tax-funded public health services (almost) from its beginnings, whereas the forerunners to the Liberal and National parties have supported private health care for those able to afford it and targeted public provision only for the poor (Gray 1996: 590). This has seen Labor favour policies that built first-tier institutions while the Coalition parties (and their predecessors) enacted policies to maintain, even strengthen, the second tier. From the 1950s until the mid 1990s, partisan disputes over health policy manifested in radical reform to health insurance policy each time government changed hands. Liberal-National Coalition governments pursued policies to foster private health insurance, while Labor governments introduced universal health insurance schemes. Adopting a different strategy to its immediate predecessors, the Howard government revitalised the second tier with incremental reform to private health insurance, but left Labor's universal health insurance scheme Medicare largely intact. To better understand the impact of the longer

[58] The wealth of secondary data and the long historical period covered in this chapter reduce the need for further primary research.

history of STEs and policy instability on the choice of the rebate, this structured narrative of health insurance policy identifies key influences on the Howard government's decision.

This structured narrative primarily focuses on developments in health insurance because the type of health insurance advocated has long served as the main point of contention between Labor and Coalition policy-makers. This focus on health insurance has had the consequence of centring policy debate on the financing of health rather than on health outcomes (Gray 2004: 78). As the primary policy instruments that financially support the second tier, STEs have formed a major part of Coalition health policy but have not featured centrally in recent accounts of Australian health policy. Rather, previous studies have either given limited attention to STEs for health (i.e. Sax 1984; Scotton and Macdonald 1993) or generated separate histories (i.e. Smith 2001). To fill this gap in our knowledge, my intent is to draw attention to the role that STEs have played in Australian health policy. Reflecting this focus on STEs, the structured narrative is concerned mainly with developments in Commonwealth health policy – whether involving the instruments of social welfare, fiscal welfare or social regulations – since it is the only level of government to introduce STEs for health and is the major financer of the health system. Taken together, these features of the structured narrative make it well placed to identify the factors behind the government's decision to restore support for the second tier through the PHITR.

From Federation to the 1950s: Social insurance versus a universal health service

Well before political debates centred on competing health insurance schemes, the major parties clashed over the extent of public hospital provision. Following Federation, the Labor party committed to providing universal tax-funded public hospitals, whereas the predecessors to the Liberal and National parties supported residual public hospital services and private hospital services for the middle class (Gray 1996: 590). These competing approaches remained as ideological differences between the parties with little practical effect, because the Commonwealth government possessed limited constitutional powers for health. However, these divergent approaches to health became increasingly pronounced over the early decades of the twentieth century as the government expanded its role in the health sector.[59] In 1921, the Commonwealth Department of Health was established and largely focused on quarantine issues (Whitlam 1985: 329). In 1926, the

[59] References are to the Commonwealth level of government in this chapter unless otherwise noted.

Bruce government established a Royal Commission that enquired into health insurance, alongside other forms of social insurance. And, in 1930, the Labor party added a national public health service to its policy platform (*ibid*: 334).

The Lyons United Australia government, rather than Labor, first enacted national health insurance in 1938 as part of its *National Health and Pensions Insurance Act* (Sax 1984: 12; see *Chapter 6*).[60] Modelled on British social insurance, the government's national health insurance scheme proposed to cover workers for medical services with joint funding from the government, employers and compulsory contributions from workers (*ibid*: 39). The contributory scheme proposed by the Lyons government was limited in coverage; it did not cover workers' dependants or non-workers, and means tests sought to exclude the top 15 percent of income earners (Scotton and Macdonald 1993: 7). Despite being passing through parliament, Lyons' contributory scheme was never implemented because of concerted political resistance from the British Medical Association of Australia (BMA) – the chief professional body for medical doctors – the friendly societies, Labor and State governments (Kewley 1973: 161; Scotton and McDonald 1993: 7).[61] The opposition of the BMA was particularly crucial because its refusal to agree to conditions for medical services forced the government to defer the scheme until September 1938, and its continued resistance contributed to the government's later decision to repeal the *National Health and Pensions Insurance Act* on 16 June 1939 (Sax 1984: 47). At the same time, the contributory scheme mobilised the BMA politically, as opposition to the scheme galvanised State branches into coordinated federal action (Hunter 1980: 193). The contributory scheme was not reintroduced later, with the government's attention diverted by the onset of the Second World War (Sax 1984: 47).[62]

Labor's return to office with Curtin as prime minister in 1941 refocused health policy on the universal health services (*ibid*: 51). Nonetheless, the government's attempts to implement its policies were, like the Lyons government before it, stymied by the opposition of the BMA and medical profession. The Curtin government first attempted to establish a national health scheme in 1943, which, though opposed by the BMA, failed

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[60] The United Australia Party was the immediate precursor to the Liberal Party.

[61] The BMA initially supported the contributory health insurance scheme, along with the friendly societies and trade unions. But, after the BMA negotiating team tragically died in an air crash, the replacement negotiating team reinvestigated the issues and decided to oppose the scheme (Crichton 1990: 36).

[62] But, Robert Menzies, who became prime minister after Lyons' death in mid-1939, unsuccessfully tried to revive the contributory scheme in August 1939 (Sax 1984: 47).

because the minority government's *Joint Committee on Social Security* found that the Commonwealth lacked the constitutional power (Crichton 1990: 38).[63] After Curtin was re-elected with a sizeable parliamentary majority in 1943, Labor pressed to establish the Pharmaceutical Benefits Scheme (PBS) through the *Pharmaceutical Benefits Act 1944* to provide patients with prescribed medicines registered with the Department of Health at no cost (Sax 1984: 53). The first PBS was short lived, with the Victorian attorney general – acting on behalf of the Medical Society of Victoria – successfully challenging its constitutional validity in the High Court in 1945 (Scotton and Macdonald 1993: 8). The Curtin government also trialled a salaried-doctors service in capital cities in 1945, but this scheme was discontinued when relations deteriorated with the BMA (*ibid*: 52). Nonetheless, the government had more success at expanding the Commonwealth's revenue base through which to fund welfare programs; it established the National Welfare Fund to divert £30 million, or one quarter of total revenue from personal income tax, each year from July 1943 to fund welfare programs including health services after the war ended (Kewley 1973: 234).

Succeeding Curtin in 1945, Chifley's government continued its predecessor's efforts, expanding public health care. It had a major success when it introduced the Hospital Benefits Scheme (HBS) at the end of that year, thereby establishing the first Australian scheme that provided free treatment to public patients in public hospitals (at point of delivery). Enacted through the *Hospital Benefits Act 1945*, the HBS involved the Commonwealth providing the States with grants from the National Welfare Fund to finance free treatment for public patients in public wards and to provide subsidies for patients treated in private wards (Kewley 1973: 354). Initially, the non-Labor States opposed the HBS and refused to cooperate, but, by March 1946, every State had entered into Hospital Benefit Agreements with the Commonwealth to allow the scheme to operate nationally so as to avoid the political fallout from denying 'free' public hospital care to their constituencies (Scotton and Macdonald 1993: 8). This development represented the beginnings of the current health system's first tier.

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[63] The *Joint Committee on Social Security* found that the Commonwealth lacked the constitutional power to provide income transfers other than the unemployment benefit and aged pension. The Curtin government attempted to extend the Commonwealth's power to establish a national health scheme through the *Post War and Democratic Rights* referendum of 1944, which failed to garner the necessary support (Crichton 1990: 39).

Meanwhile, in response to the High Court ruling on the PBS and other constitutional limits, the Chifley government held a referendum at the 1946 election to extend the Commonwealth's legislative powers for social security to allow it to establish hospital benefits, medical services and pharmaceutical benefits (*ibid*: 8). This successful referendum enacted the *Constitution Alteration (Social Services) Act*, which inserted Section 51 (*xxiiiA*) into the Australian Constitution:

> The provision of maternity allowances, widows' pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental services (but not so as to authorize any form of civil conscription), benefits to students and family allowances (Australian Government 2005).

The referendum had a profound impact on the trajectory of health policy by inserting what has become known as the 'civil conscription' clause into the Constitution. Referring to the text "but not so as to authorise any form of civil conscription", the clause was an amendment secured by Shadow Attorney-General Robert Menzies, on behalf of BMA president Henry Newland, in return for the Opposition's support (Scotton and Macdonald 1993: 7). The Chifley government agreed to the amendment because bipartisan support improves the likelihood of referenda passing the stringent requirement that an overall majority of votes in a majority of States is received.[64] Because the Constitution can only be altered through further referenda, the civil conscription clause has become an important and durable political institution.

Ironically, the referendum extended the legislative powers of the Commonwealth, but the civil conscription clause was consistently used by the BMA to curb further reform by Chifley's government. Chifley passed a second *Pharmaceutical Benefits Act* through parliament in June 1947 that required doctors to use official prescription forms. As the BMA refused to comply with the PBS because of concerns it infringed on professional autonomy, the government amended the scheme so that doctors were legally bound to use these forms (Sax 1984: 58). At the same time, Chifley proceeded with the *National Health Service Act 1948* to authorise the state to directly provide: medical and dental services; funding and grants for hospital development; and the provision of education for health personnel (*ibid*: 58).

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[64] Only eight of 44 proposed referenda have passed since federation (Australian Parliamentary Library 2003).

The BMA vehemently opposed both reform packages, viewing the national health service and the PBS as affronts to professional autonomy and attempts to socialise medicine (*ibid*: 59). In response, the BMA challenged the legality of the Chifley government's reforms in the High Court in 1949, arguing that the PBS and national health service were unconstitutional. Siding with the BMA, the High Court ruled that the civil conscription clause offered the medical profession protection from mandatory salaried service, undertaking specific postings and performing compulsory tasks (*ibid*: 55). The High Court's interpretation of the civil conscription clause has prevented the establishment of a national health service (along British lines) in Australia. That Chifley's attempt marked the first and only Australian attempt to implement a national health service is testament to the civil conscription clause's institutional durability as part of the Constitution and set the scene for continued government involvement in the private health sector.

By 1950, governments of both major parties had failed to establish their preferred national health schemes during their stints in office. Although legislation for both their preferred schemes passed through parliament, Lyons' contributory social insurance scheme and Chifley's national health service were implemented. The health policy failure of the Labor and United Australia parties mainly stemmed from institutional barriers and political opposition. The institutional barriers – particularly the Commonwealth's limited constitutional powers for health – constrained the ability of either government to compel the medical profession to comply with its legislation. These barriers were especially pronounced for Labor's health service, with its implementation blocked by the High Court interpretation of the civil conscription clause.[65] BMA opposition to both national schemes proved highly effective because it was able to present a unified voice for the medical profession and organise at the national level, which was especially vital in light of the government's constitutional limits. These policy failures meant that health care was largely provided through 'free' public hospital services, services received through membership of not-for-profit friendly societies, and user pays private practice. Moreover, in response to these failed attempts to introduce national social insurance and the national

[65] The Curtin reforms (and perhaps the Lyons proposals) were not prohibited by the Constitution *per se*, but by the inability of the Commonwealth to enact the laws because it was not granted extensive legislative powers for health. And since the civil conscription clause was interpreted as preventing the establishment of a national health service, the Chifley government faced the prospect of passing another referendum to introduce its scheme.

health services, Coalition and Labor policy-makers (respectively) removed these policy options from their platforms and turned their attention to alternatives.[66]

Building the second-tier's foundations: Menzies' support for private health insurance

The next period of Coalition government proved to be an equally formative stage in the institutional development of both the current health system and, centrally, second tier health policy. After winning the 1949 election, the Menzies Coalition government's radical reforms redirected health policy to focus on private health insurance. Named after Health Minister Earl Page, the Page National Health Scheme (PNHS) that formed the centrepiece of the government's health policy promoted the voluntary take-up of private health insurance for not-for-profit funds for those assumed able to afford it and set up the pensioner health service as a residual public system. The PNHS increased the social regulation of – and introduced financial subsidies for – private sector health services, including the first set of STEs for health and private health insurance. At the same time, the government ended free public hospital services for public patients by amending Chifley's HBS. The overall thrust of the Page Scheme was to expand the role of private health insurance while rolling back direct public provision. Over the 19 years of Coalition government that followed the Page Scheme, private health insurance became entrenched as a major source of health finance. Even though it was eventually supplanted by universal health insurance, the Page Scheme's legacy is evident in the institutionalisation of private practice as the dominant model of medical service provision together with the entrenchment of STEs for private health insurance.

The PNHS combined direct subsidies, STEs, social regulation and a residual public program. Almost identical to Chifley's earlier plan, the Page scheme included a PBS that supplied individuals with prescribed medicines listed on an official register at no direct cost from approved pharmacists (Sax 1984: 61). The scheme also involved direct subsidies for both hospital services that were offered through the HBS and a wide range of medical services provided by doctors through a new Medical Benefits Scheme (Kewley 1975: 361). Receipt of these subsidies for hospital and medical services was tied to private health insurance membership (*ibid*: 361). These subsidies were also designed so that the total benefit from the government and private insurance did not exceed 90 percent of doctors' fees to discourage overuse of health services (*ibid*: 361). The Page

[66] Under Menzies the Liberal party moved swiftly away from national social insurance, whereas Labor's policy platform took much longer to change during its long period in Opposition.

scheme provided further incentives to take up private health insurance through STEs for hospital and medical insurance (*ibid*: 55, 361). Alongside its encouragement of private health insurance, the scheme further regulated the private health insurance industry. It required private insurers to: register with the Health Minister; limit their membership categories to either individuals or families; limit the types of premiums to basic and supplementary table insurance; and mandate the principle of 'community rating' that forbade price discrimination on the basis of age, health or value of claims (Mackey 1994; Productivity Commission 1997: 33). And, the scheme's final element, the Pensioner Medical Service, offered pensioners (as well as spouses and dependents) free pharmaceuticals as well as hospital and medical services (Kewley 1973: 67).

Notably, the STEs in the PNHS included tax deductions for private hospital and medical insurance premiums as well as the tax exemption of medical expenses under £150 (Smith 2001: 246). By exempting premiums from tax, the tax deductions for private health insurance inverted the progressive income tax scales. In 1952-53, around the time the PNHS was established, the marginal income tax rate ranged from 0 to 75 percent (see *Table 4.1*). The tax deductions inverted this progressive tax scale: those with annual incomes under £104 received no discount whilst those earning over £10,000 effectively received a 75 percent discount. Moreover, the average worker earned an annual income of £723 and thus received a 20 percent subsidy on their private health insurance through the tax deduction, whereas individuals had to receive an income around 14 times that of the average worker to receive the full 75 percent subsidy.[67] The regressivity of these STEs was atypical of Australian social policy and it is most unlikely that a direct expenditure program with a similar regressive structure would have been introduced. In fact, this degree of regressivity was not replicated in later STEs for private health insurance.

The Menzies government avoided fierce opposition directed at previous health reform proposals by directly consulting with key organisations representative of the main (and some minor) players in the health sector and gradually implementing its program. The government consulted widely with the BMA, the Pharmacy Guild, private health insurers, and the friendly societies (Sax 1984: 59). As a BMA member who opposed socialised medicine, Health Minister Page was instrumental in securing the cooperation of the BMA who had played the major role in defeating previous schemes (Kewley 1973:

[67] The average income was calculated by multiplying average weekly income in ABS (1955) by 52 weeks.

507; Hunter 1980: 194).[68] While in Opposition during the late 1940s, Page ensured that the BMA supported Liberal policy by involving representatives in policy formation and taking steps to assure the profession that the scheme was not a precursor to socialised medicine (Gray 1984: 2; Sax 1984: 61). The government avoided resistance by delaying the scheme until 1953, because it did not secure a Senate majority until 1951 (Sax 1984: 61). Before the PNHS was consolidated under the *National Health Act 1953*, the health programs of the PNHS were initially established using the Chifley government's *National Health Service Act 1948-49* (which had not been repealed) and the *Hospital Benefits Act 1951* (Kewley 1973: 341, 355). The success of the Menzies government's strategy is evident in the lack of controversy surroundings its introduction.

Table 4.1 Marginal Tax Rates for Individuals in 1952-53

Taxable Income (£)*	Marginal Tax Rate (%)
0-100	0
101-150	3
151-200	5
201-250	7
251-300	9
301-400	11
401-500	13
501-600	16
601-700	18
700-800	20
801-900	22
901-1,000	23
1,001-1,200	27
1,201-1,400	30
1,401-1,600	33
1,601-1,800	37
1,801-2,000	40
2,001-2,400	43
2,401-2,800	47
2,801-3,200	50
3,201-3,600	53
3,601-4,000	57
4,001-4,400	60
4,401-5,000	63
5,001-6,000	67
6,001-8,000	70
8,001-10,000	73
10,000+	75

* Incomes of £104 and below were not subject to tax.
Source: calculated from Gunn and O'Neill (1953: 355)

68 Earl Page was a long-term ally of the BMA. As Treasurer in 1928, Page assisted the BMA in securing majority representation on a Royal Commission on Health (Hunter 1980: 194). In the early 1930s, Page acted on behalf of the AMA to secure concessions from the Lyons Government (Hunter 1980: 194).

By the time that Labor returned to office in the 1970s, the PNHS had entrenched private practice as the dominant model of health service delivery and private health insurance as the principal risk-managing institutions of the health system. While establishing second-tier policy institutions, the Page scheme did not embody a 'free market' alternative to the Chifley health scheme, because its primary focus was on *limiting* state control of the health sector rather than extending market principles (Gillespie 1991: 256). As the common thread linking together elements of the Page scheme, this policy goal was evident in the reforms that removed the public alternative – namely, the alteration of the HBS and the tying of the subsidies to private insurance. It was also evident in the reforms that increased the affordability of private cover, such as the STEs and the principle of community rating.[69] The consolidation of the scheme is evident in the rapid growth in private health insurance coverage from 40 to 70 percent of the population between 1953 and 1960 (Scotton and Macdonald 1993: 12).

Along with the civil conscription clause, the entrenchment of the Page Scheme put in place significant institutional barriers to any attempts to introduce the public funding model Labor had long planned, since implementing a national health service required both a referendum and radical reform to the existing national health scheme (which was favoured by organised medicine). It is thus unsurprising that future Labor governments found radical reform so difficult once the Page scheme was entrenched. As the initial health scheme to establish (private) health insurance as the primary risk-managing device, the Page scheme has also been blamed for focusing Australian health policy on health financing and curative medicine rather than on preventative health measures. The reason for this is the tendency for health insurance to "institutionalise unplanned, private medical practice and… [to entrench] hospital-focused, technology-driven, curative medical services" (Gray 2004: 80).

Incremental reform of second tier policy: Gorton's response to Nimmo

Before Labor returned to office in 1972, the PNHS's problems became evident. In fact, within months of Gorton becoming Liberal prime minister in early 1968, these problems were scrutinised by two separate official enquiries into health and hospital care, one appointed by the governor-general and the other undertaken by a Senate Select Committee led jointly by Labor and the Democratic Labor party (DLP). In an attempt to

[69] Free treatment for non-pensioners in public hospitals ended in all states except Queensland where the state government assumed responsibility for funding public hospitals (Scotton and Macdonald 1993: 12).

reclaim the agenda, Gorton established the Commonwealth Committee of Inquiry into Health Insurance chaired by Justice Nimmo (Scotton and Macdonald 1993: 26). Yet, when it was released in March 1969, the committee's Nimmo report upheld many of the criticisms directed at the PNHS by the scheme's detractors. These criticisms included the scheme's excessive complexity and fragmentation (with more than 110 medical benefit funds competing for customers) as well as its administrative inefficiency (with insurers spending 20 percent of their turnover on operating costs) (Kewley 1973: 504). The committee also voiced concern about the unaffordability of private health insurance for low-income earners, noting that 17 percent of the population was not covered, and noted that the inadequacy of benefits required consumers to make large co-payments (*ibid*: 504).

Gorton's government attempted to address mounting criticisms directed at the PNHS, particularly those in the Nimmo Report, through substantive but minor reforms to second-tier policy. In October 1969, the government extended the safety net (of the Pensioner Health Scheme) to cover families receiving the minimum wage, the unemployed and migrants in their first two months after arrival (Sax 1984: 88). The government then attempted to reduce the operating costs of private insurers by negotiating a common fees list for 1200 health and medical procedures with the Australian Medical Association (AMA) in early 1970 (Sax 1984: 91).[70] This list proved to be an important policy innovation that was maintained by Labor. And, later in 1970, the government bolstered the benefits received by patients through amendments to the Health Benefits Scheme, which reduced the maximum gap payments to $5 for 300 procedures and tightened regulation of the health insurance industry (Scotton and Macdonald 1993: 38).[71] Despite addressing several shortcomings that had been identified in the Page scheme's 15 years of operation, the Gorton government's incremental reforms left its main elements intact.

The government's health reforms, however, were widely derided as inadequate. Critics charged that the reforms did not address the issue of how to update or enforce the common fees list, which the Committee highlighted (Scotton and Macdonald 1993: 37). Critics also claimed that the Nimmo report was inadequate because the Committee's

[70] The BMA was renamed the AMA in 1962.

[71] Gap payments refer to the remaining cost of health treatments incurred by patients after government subsidies and health insurance benefits are taken into account.

terms of reference excluded it from assessing the financial viability of the PNHS (Kewley 1973: 503). This was of concern since the cost of the scheme has tripled from £27 million to £85 million between 1954 and 1964 (*ibid*: 250). And, critics raised concerns about the inequity of the scheme, especially the support the STEs for private health insurance afforded high-income earners (*ibid*: 503).[72] These concerns led to wide perceptions that Gorton's reforms were inadequate, which, in turn, made health policy an election issue in 1969 and 1972. These perceptions also made it easier for Labor to advocate radical reform.

The political struggle for the first tier: Whitlam's Medibank

After 23 years of opposition, Whitlam's victory at the 1972 election returned Labor to government, immediately redirecting health policy toward universalism and the first tier. In the short three-year period of the Whitlam government, Labor built the formative institutions of the first tier. The new government set about enacting universal health insurance, which had featured prominently in both the 1969 and 1972 election campaigns, often appearing in Whitlam's speeches (Kewley 1973: 506). The publicly financed universal health insurance scheme that became Medibank provided all citizens and permanent residents with medical, hospital and pharmaceutical benefits (Sax 1984: 108). Implementing Medibank was a mammoth undertaking because of the scheme's institutional scale and political opposition from the AMA, as well as the Liberal and Country parties, which was all the more important because the government lacked a Senate majority. Nevertheless, Whitlam overcame these hurdles in a fierce political battle and established Medibank on 1 July 1975.

Introducing Medibank required radical reform of both the PNHS's hospital and medical benefits scheme. Restoring the main elements of Chifley's HBS, Medibank offered universal access to 'free' treatment for public patients in public hospitals (Scotton and Macdonald 1993: 108). The government did this by reforming the HBS so that it was financed jointly with the States, with the Commonwealth agreeing to meet half the costs of this. Medibank also offered subsidies to cover 85 percent of the cost for medical and hospital procedures that appeared on the common fees list, with the maximum gap payment of $5 retained (Sax 1984: 108). The common fees list introduced by the Gorton

[72] In 1968-69, the tax expenditures for health care amounted to $48.8 million for tax deductions of the premiums of hospital and medical benefits, as well as a further $116 million in revenue forgone for the medical expenses tax rebate (Kewley 1973: 503). These figures are not directly comparable to *Table 4.2* because a decimal currency was introduced in 1966.

government was maintained by the Medibank scheme because it had established a mechanism to negotiate standard costs of health procedures with the AMA.[73] To operate Medibank, the government established the Health Insurance Commission (HIC), an independent statutory authority, to develop and operate a computerised national insurance database to administer the scheme (Scotton and Macdonald 1993: 109). Medicare was financed through taxes because the Senate refused to pass proposals to introduce a 1.25 percent levy and repeal STEs for private health insurance (*ibid*: 109). Thus, STEs for private health insurance were left intact (*ibid*: 32).

The initial impetus for Medibank came from Whitlam, who as Opposition leader in 1968, encouraged two health economists from the Melbourne Institute – John Deeble and Richard Scotton – to develop a universal health insurance scheme. This request stemmed from Whitlam's interest in developing a universal policy alternative to a national health service, which had been stymied by the civil conscription clause. In his words,

> The ALP would have liked to reproduce the national health service which the Attlee Government had created as the most substantial and enduring of British Labour's reforms. Such a service, however, was precluded by the ban on civil conscription in the 1946 referendum. Instead the [Labor] Party turned its attention to developing a system whereby the Federal government would pay patients' fees directly to doctors (Whitlam 1985: 332).

The scheme resulting from this unusually close relationship between a major political party and academics was modelled on Canada's universal health insurance scheme established in 1966, which comprised a federal hospital scheme called Medicare and provincial medical schemes (Scotton and Macdonald 1993: 23). When presenting the major features of their scheme, Scotton and Deeble argued that universal health insurance would save $20 million of public funds (if the STEs were removed) and that any short-term budgetary outlay would be outweighed by the benefits of universality, collective pooling and improved equity (Kewley 1973: 506). Two months after its release, Whitlam added the universal health insurance scheme to Labor's policy platform where it remained at Labor's re-election (Scotton and Macdonald 1993: 26).

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[73] Although the common fees list had not been particularly successful at meeting its twin objectives of constraining costs and reducing out-of-pocket expenses, it was maintained as part of Medibank because the negotiation of standardised fees with the AMA had hitherto not been possible. Ironically, the common fees list has proven more suited to the universal health insurance schemes of Labor governments where the monopsony powers of a single insurer have greater potential to constrain costs and reduce out-of-pocket expenses than in a multiple-insurer market.

The Whitlam government's implementation of Medibank consumed considerable resources and political capital, taking almost three years. The Minister for Social Security Bill Hayden was responsible for implementing Medibank. In December 1972, within days of being sworn in, Hayden created the Health Insurance Planning Committee (HIPC) comprising Deeble, Scotton, Daniels (the director-general for the Department of Social Security) and Ray Williams to develop Medicare (*ibid*: 73). After the HIPC tabled its Green paper, the Labor cabinet approved formation of the HIC in May 1973 and Scotton was appointed its chairman (*ibid*: 73). In hindsight, the decision to create the HIC before the legislation for Medibank passed through parliament was critical in enabling the scheme's implementation by 1975. The Commission had to be built from scratch; it entailed "a large national organisation, using advanced and untested computer systems, to enrol 13 million beneficiaries and to process an estimated 90,000 claims each day" (Scotton and Macdonald 1993: 75). This was no small feat considering the technology of the day.

Whilst the institutions for Medibank were being built, the Whitlam government encountered fierce political opposition from the AMA and Coalition in passing the legislation for the scheme. The cooperation and intimacy typical of the AMA's negotiations with Coalition governments gave way to hostile confrontation and resistance (Hunter 1980: 195). Once again, the peak organisation of the medical profession feared that Medibank would be an affront to the professional autonomy of doctors and it resorted to familiar tactics. Over four months in 1972, the AMA campaign against Medibank "distributed some 1,600 publicity kits, issued more than 400 aggressive advertisements to the press, [commissioned] 250 thirty-second commercials per week, and 5,000 radio commercials on each of fourteen stations, …[gave hundreds] of addresses… to community organisations… [and there] was repeated countercosting of the government scheme" (Hunter 1980: 195). With irony, Sax (1984: 109) claims that despite the AMA's vehement resistance, the medical profession stood to gain much from Medibank because the universal scheme would eliminate both bad patient debts and the need to see poor patients on an honorary basis.

With the Coalition parties in disarray after losing the 1972 election, the AMA led the opposition to Medibank (Scotton and Macdonald 1993: 96). But, as Labor did not hold a Senate majority, the Coalition delayed the establishment of the payment and administrative framework of Medibank. At the bills' second defeat, Whitlam called a double-dissolution election but was returned to office without a Senate majority. After the two Medibank bills were defeated in the Senate a third time, Whitlam called the first and (to date) only joint sitting of the two houses of parliament on 6-7 August 1974 (*ibid*: 17). The Medibank bills passed with 95 votes to 92 (*ibid*: 127). However, the Coalition blocked further legislation for Medibank in the Senate (*ibid*: 289).

Medibank's establishment marked a watershed in Australian health policy, with Labor circumventing the civil conscription clause to institutionalise universal health services.[74] But, the scheme had unresolved funding issues because the government had failed to pass its savings measures and it relied on the AMA's voluntary adherence to the common fees list. These issues remained unresolved when the governor-general dismissed Whitlam four months after Medibank was introduced. Nonetheless, the establishment of Medibank also shifted health policy debates onto the merits of two health insurance schemes – the universal insurance model of Medibank versus the private insurance model of the PNHS. Medibank also "facilitated the relatively painless introduction of Medicare some years later and continues to shape current debates on health care organisation and funding" (Scotton and Macdonald 1993: 267).

Restoring the second tier? Fraser's retrenchment of Medibank

After Whitlam's dismissal, Fraser's election in late 1975 returned the Coalition to government with large majorities in both houses of parliament. Despite promising to retain Medibank and encountering none of the legislative hurdles that plagued Whitlam, the Fraser government's eight-year term in office marked the most turbulent period in the history of health insurance policy.[75] With no fewer than five reforms, the government eventually privatised Medibank and restored the major elements of the PNHS. This decision retrenched core first-tier institutions and reinstated the primacy of the second tier. Previous studies have examined Fraser's health policies at length (see Gray 1984; Sax 1984; Wooldridge 1991; Scotton and Macdonald 1993), so my focus here is on Fraser reforms with a lasting impact on the institutional path of health policy.

Medibank II, Fraser's first set of reforms, were significant because they began the process of eroding Medibank's universality and established Medibank Private, which

[74] Medibank circumvented the Constitution's civil conscription clause, by retaining private practice as the dominant model of health service delivery.

[75] Fraser promised during the 1975 election campaign that, "We will maintain Medibank and ensure the standard of care does not decline" and "I have said repeatedly that essential programs in health, education and urban development will be maintained. Medibank will be maintained" (Duckett 1979: 233).

ensured the HIC was maintained. Coming into operation in October 1976, the Medibank II reforms introduced a 2.5 percent levy on taxable income to partly pay for Medibank, an opt-out scheme from this levy for individuals with private health cover, and established Medibank Private – a private health fund operated by the HIC – to operate alongside public insurance (Sax 1984: 129; Duckett 1979: 234). These reforms also retrenched the STEs for private health insurance (Sax 1984: 129). While the other elements of the package aimed to share health financing between public and private sources, Fraser established Medibank Private to counter perceptions that the reforms reneged on his pledge to retain the scheme; in his words, Medibank Private "had more to do with the commitment to maintain Medibank than with anything else" (Fraser in Wooldridge 1991: 18). Nonetheless, Medibank II retained universal cover because individuals were compelled to choose public or private insurance (*ibid*: 130).

Despite Fraser's efforts, Medibank II was criticised because it increased the health costs of socially disadvantaged groups and reduced the effective incomes of workers. The Australian Council of Trade Unions (ACTU) under the leadership of Bob Hawke (later Labor prime minister), the Australian Council of Social Services (ACOSS) and the Doctor's Reform Society (DRS) campaigned against the reforms.[76] This opposition culminated in the Medibank strike on 12 July 1976 co-ordinated by the ACTU, which represented the first general strike in Australian history and was estimated to have involved more than one third of the workforce (Duckett 1979: 238). Although this opposition raised public awareness and appears to have cemented Hawke's commitment to universal health insurance, the Fraser government enacted the Medibank II reforms with relative ease due to its parliamentary majority.

Fraser enacted three further reforms by 1980 with only minor long-term impacts on health policy. In May 1976, Fraser declared the hospital cost-sharing agreements with the States invalid and negotiated new arrangements called Identified Health Grants (IHGs) (Gray 1984: 5). Largely a cost-cutting measure, the IHGs put further limits on the Commonwealth's financial liabilities for public hospitals (Palmer 1979: 114). The government proceeded to enact the Medibank III package in late 1978, which is widely perceived to have increased public expenditure to trim inflation because the Consumer Price Index (CPI) was sensitive to out-of-pocket health expenses (Sax 1984: 153; Gray 1984: 6). Medibank III expanded support for public hospital and medical services;

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[76] ACOSS is the main welfare lobby, while the DRS is an association of doctors who support public health.

introduced new medical benefits for socially-disadvantaged groups (including non-pensioners) that covered 75 percent of the scheduled fee, and provided medical benefits for others covering 40 percent of scheduled fees with a maximum gap of $20 (Sax 1984: 155).[77]

In 1979, the government introduced a fourth reform package known as Medibank IV that sought, once again, to limit public health outlays. Medibank IV means-tested the 40 percent public subsidy for medical services, so that it was only available to assist disadvantaged groups with health services with scheduled fees of more than $20 (*ibid*: 159). This means test reduced public health expenditure, but made private insurance more expensive since it had to cover a wider range of health services (Gray 1984: 6).[78] After Medibank IV attracted widespread reform from private insurers, the AMA and the backbench, Fraser sought to neutralise the issue by appointing the Commission of Inquiry into the Efficiency and Administration of Hospitals headed by J.A. Jamison (Sax 1984: 165).

Inspired by the Jamison report, Fraser's fifth set of reforms in 1981 dispensed with Medibank and restored the main elements of the PNHS, which had a lasting impact on health policy debates. The Fraser government enacted this reform package in the *Health Acts Amendment Act 1981*, which involved: tying receipt of Commonwealth benefits to basic table private insurance; reducing Commonwealth benefits to 30 percent for medical fees; increasing the benefit paid from basic medical insurance to 85 percent of scheduled fees with a maximum gap of $10; and, introducing a flat rate 32 percent tax rebate for basic health insurance with registered health funds (Sax 1984: 170-171). Although not regressive like earlier STEs, the tax rebate was still inequitable because it advantaged high-income earners most, who could afford more expensive health premiums. With 71 percent of the population taking out private cover, the 1981 reforms were highly successful at encouraging the take-up of private health insurance (Buckmaster and Davidson 2006: 11). Although the scheme restored the major elements of the PNHS, it did not resolve any of the problems that had led to the earlier scheme's failures, with 430,000 people remaining uninsured in 1981 (Sax 1984: 173). By 1981, Medibank was

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[77] As noted earlier, medical benefits for pensioners that covered 85 percent of the scheduled fees with a maximum gap of $5.

[78] Within a year of the Medibank IV reforms, the cost private health insurance rose by between 18 and 42 percent, and private health insurance coverage dropped by 10 percent in the year to March 1980 (Gray 1984: 7).

reduced to the sole publicly operated private health fund – albeit the most popular – in the Australian health insurance market (Buckmaster and Davidson 2006: 11).

Fraser's retrenchment of Medibank is an unparalleled event, marking the only successful attempt by a government in a rich democracy to dismantle universal health insurance. Although unprecedented, the government privatised Medibank with ease. This was possible because the scheme had operated for only a short time before the Coalition took office, which meant that private insurers retained their operational capacity, and the government had a large parliamentary majority (Gray 1984: 15). As well as easing the passage of the reforms, this large majority made it more difficult for the Coalition to ignore pressure from traditional allies such as the AMA and potentially easier to overlook the support Medibank received from the public, the ACTU, ACOSS and DRS (*ibid*: 15). Just as importantly, the government's strategy of constantly reforming health policy minimised resistance by eroding Medibank incrementally and gradually restoring the main elements of the PNHS (Gray 1984), including a new STE for private health insurance. Constant change during the Fraser years – coupled with the linking of health policy reform to broader economic objectives – suggests that the retrenchment of Medibank may not have been a co-ordinated strategy. As members of the former government including Fraser have argued, it reflected a lack of policy vision (Wooldridge 1991: 45-56). Nonetheless, the privatisation of Medibank left the Liberal party open to the criticism that it broke its election pledge to retain it.

Entrenching the first tier: The Hawke government's Medicare scheme

The Hawke government's election in March 1983 returned Labor to office with a commitment to reinstate a universal health insurance scheme, which now bore the name Medicare. On its second attempt, Labor enjoyed more success at establishing universal health insurance as the core first-tier institution. Although bearing a striking semblance to Medibank, Medicare was not a carbon copy of its forerunner and reflected a different set of policy priorities. Like Medibank, Labor's proposals for Medicare elicited hostility from the AMA, the medical profession more broadly, and Coalition parties. Compared to Medibank, however, Medicare was subject to a timid campaign and the Hawke government found it easier to enact because it secured the Democrats' (a centrist party) support in the Senate. From February 1984, Medicare remained the foundational first-tier health policy over 13 years of Labor rule. But, Medicare did not end the ideological struggle over health policy, nor was the scheme without vulnerability.

Even though Medicare was established soon after its return to office, Labor's commitment to universal health insurance was not guaranteed after Medibank's demise. In fact, Labor hesitated to commit to universal health insurance after Whitlam's defeat because of concerns that Medibank had fuelled public perceptions of Labor's economic irresponsibility (Palmer 1989: 332). Indeed, it was only after the Fraser government's widely derided Medibank IV scheme that Labor recommitted to universal health insurance; between 1979 and 1982, Labor proposed a series of schemes resembling Medibank II until, in mid 1982, it adopted the Hayden Health Plan (named after Bill Hayden – former health minister and then Opposition leader) that followed the principles of Medibank. In addition to social justice concerns, Labor re-committed to universal health insurance because it was able to use the scheme as a bargaining chip when negotiating the Price and Incomes Accord with the ACTU in 1982. In these negotiations, the government offered Medicare as the major extension to the social wage in return for wage restraint needed to quell inflation (Palmer 1989: 333). Medicare was also attractive to the government because of the aforementioned potential of a tax-funded health scheme to lower the CPI (*ibid*: 333). In addition to these social and economic reasons, the electoral popularity of the scheme – particularly among those left without insurance after Fraser's 1981 reforms – gave Labor a political rationale for its re-introduction (Sax 1984: 173).

Medicare, like Medibank, consisted of a single universal insurance fund operated by the HIC (renamed Medicare Australia) and financed from taxes. The scheme provided public patients with free health services in public hospitals at the time of treatment and offered private patients a flat rate benefit of 75 percent of the scheduled fee (Gray 2004: 30). Medicare also supplied medical benefits for services provided by doctors outside hospitals, reimbursing patients 85 percent of the scheduled fee (*ibid*: 30). In addition, when patient accumulated gap payments amounted to more than $150 in a financial year, Medicare offered benefits equal to 100 percent of the scheduled fee (Palmer 1989: 335). And, the scheme provided direct assistance to the private health sector. Private patients received a private-bed subsidy from Medicare equivalent to that received by public patients in the public system (Spies-Butcher 2001: 63). Support for private health insurers included the creation of a reinsurance pool (set at a fixed amount) to be allocated to funds whose members had higher risk profiles (*ibid*: 63).

Notwithstanding its many similarities, Medicare differed from its predecessor in that it was financed more along the lines envisaged by Scotton and Deeble (1968) and in how the agreements with the States were negotiated. The Hawke government was able to implement a one percent levy on taxable income to partially finance Medicare, which had been proposed but not implemented by the Whitlam government. The Medicare Levy was only levied on individuals with annual taxable incomes over $6708 and $13 312 for couples with two dependent children, and its upper limit was set at $700 (Palmer 1989: 334). The government also repealed the 32 percent tax rebate in July 1983 to partly finance Medicare (as proposed by Scotton and Deeble) and prohibited private cover for out-of-hospital medical services (Dugdale 2008: 117; Productivity Commission 1997: 160).[79] And, the government replaced the IHGs with new Australian Health Care Agreements (AHCAs) to be negotiated with State and Territory government every five years from 1988 (*ibid*: 109). The AHCAs defined the role of the States and Territory governments in the universal health scheme and in return disbursed funds to each government through annual block grants (*ibid*: 115).

Medicare was implemented expeditiously and encountered only minor political resistance – particularly compared to the tumultuous path of Medibank. While Labor lacked a Senate majority, the government passed the *Health Legislation Amendment Act 1983* that established Medicare through a deal secured with the Australian Democrats, who had recently come to hold the balance of power (Crichton 1990: 110; Gray 1991: 151). The government also encountered little resistance from the States when reaching hospital agreements with the States (Gray 1991: 151). This lack of resistance reflected the existence of Labor governments in four of the six States and the efforts Health Minister Neal Blewett made in negotiating with the non-Labor States of Queensland and Tasmania, and the fact that the government chose to update Fraser's IHG agreements rather than renegotiate them altogether (Crichton 1990: 114).[80] However, the maintenance of the HIC by the Fraser government to operate Medibank Private was the most significant factor that underpinned the ease at which the Hawke government established Medicare. Hawke's government thus never faced the logistical challenge of

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[79] The Hawke government maintained the medical expenses tax rebate that provided a 30 percent tax concession for individuals who spent more than $2000 on medical expenses in the financial year (Smith 2001: 246). Also, private insurers were excluded from basic insurance transactions to prevent a repeat of the 1975 situation, where private insurers were able to take over from Medibank almost as soon as there was a change of government (Crichton 1990: 114).

[80] This was particularly the case in negotiations with Queensland (a non-Labor State), where the Hawke government was required to address concerns that its existing universal hospital scheme would be taken into account (Crichton 1990: 115).

building a national database from scratch; instead, the database was renamed Medicare Australia and updated to reflect demographic changes in the Fraser years.

Nonetheless, Medicare was opposed by the familiar coalition of the AMA and Opposition. The political opposition to Medicare culminated in the NSW Doctor's Dispute, the 18-month conflict between 1984 and 1985 that counterpoised the Commonwealth and State Labor governments against the medical profession and their organised representatives such as the AMA, the Australian Society of Orthopaedic Surgeons (ASOS) and other specialist groups (Gray 1990: 228). Stemming from professional concerns about the contraction of the private health sector in NSW and the consequences for the earnings of specialists, as well as the familiar concern that Labor was socialising medicine, the catalyst for the dispute was Section 17 of the *Health Insurance Act 1983*. The medical profession was concerned that this clause gave the Commonwealth health minister the capacity to limit fees charged for procedures delivered in public hospitals to those on the Medicare schedule (Spies-Butcher 2001: 65).[81] In NSW, tensions between the medical profession and the government escalated further when the State government passed complementary legislation in late 1983 that allowed it to limit the fees that Visiting Medical Officers (VMOs) could charge in public and private hospitals (Gray 1990: 229).

Attempting to diffuse the hostilities between the medical profession and both governments, Blewett established an *Inquiry into the Rights of Private Practice in Public Hospitals* and deferred Section 17 (Gray 1990: 239). Dissatisfied with these measures, the AMA threatened a week-long national strike in April 1984 (*ibid*: 239). To avert industrial action, Blewett entered negotiations on behalf of the government and offered concessions in April 1984 to avoid the national strike (Gray 1984). Nonetheless, the dispute continued at State level for the balance of 1984 and in early 1985, culminating in 1500 specialists resigning their positions at its height in February 1985 (Gray 1984: 238). It was not until April 1985 that the dispute was finally resolved, when Hawke and Wran (the NSW Premier) agreed to unequivocally rule out socialised medicine, repeal most of the contested legislation, and yield significant compromises to private practice (Spies-Butcher 2001: 68). Despite these concessions, the dispute had little long-term impact on Medicare's operation, as it had erupted after the scheme's introduction and was confined

[81] The contraction of the private sector was particularly evident in NSW due to an over-supply of surgeons (Gray 1990: 239).

mostly to NSW; in addition, the concessions to end the dispute did not undermine the universality of Medicare (*ibid*: 68).

Medicare was subject to mostly minor reform during the remaining years of the Hawke government. In 1985, gap insurance for private hospitals was introduced and the upper limit for the Medicare Levy was abolished (Palmer 1989: 334). A further reform in 1986 repealed the private hospital subsidy of 14 percent, which made private health insurance premiums more expensive, since it required funds to increase their benefits by 8 percent (AIHW 1996: 16). And, in 1987, the government raised the Medicare levy to 1.25 percent (Crichton 1990: 125). The most substantial proposal to reform came in the final days of the Hawke government in the 1991-92 Budget. Introduced during a period of fiscal constraint and ideological resistance to government expansion, Medicare did not command unswerving loyalty from all Labor members (Gray 1996: 595). In the Budget, the Health Minister Brian Howe (who replaced Blewett in early 1991) imposed co-payments of $2.50 for visits to general practitioners (GPs) – including bulk-billed medical services (*ibid*: 595). While eroding Medicare's universality, these modest co-payments were designed to discourage over-servicing and reduce public outlays (Leeder 1999: 36).

Notwithstanding the co-payments, the Hawke government retained the main features of Medicare for its tenure, reflecting the electoral popularity of the scheme and the stability afforded by both the long period of uninterrupted Labor government and the tenure of Blewett as Health Minister from 1983 to 1990. This established Medicare as the core-tier of the health system because it also retrenched the main forms of public financial assistance provided to private health insurers, including the removal of both the STEs for private health insurance and subsidies for private provision. However, Medicare still had its vulnerabilities, as the co-payments announced by Howe demonstrated. More broadly, the government had not specified the role of the second tier or private health insurance more specifically in the new environment, which meant that a decline in private coverage remained open to multiple framings. And, Medicare remained vulnerable to suffering a similar fate as Medibank, as an opt-out scheme could end its universality or its benefits could be means-tested like other targeted Australian social expenditures.

Keating's reform of the second tier

Paul Keating's elevation to the prime ministership in 1991 saw the universality of Medicare restored, but refocused health policy on the second tier. In what became a major and persistent reframing of the policy problem, the government argued that it was necessary to increase private health insurance coverage to relieve pressure on Medicare. Reflecting a rare moment of bipartisanship in health policy, the government sought to expand the role of private health insurance by using its regulatory powers in a series of reforms aimed at increasing coverage and competition. But Keating stopped short of providing financial support to private insurers through tax expenditures or other means, despite calls from the industry for a tax rebate to redress falling membership (Mackey 1994).[82]

The co-payments for Medicare that Howe announced at the 1991-92 Budget were short-lived. These co-payments were unpopular with the public, Labor backbenchers and the ACTU, as well as welfare and women's groups (Gray 1996: 595). In light of their unpopularity, Keating repealed the co-payments in his early days as prime minister, concerned that they would erode Labor's support (Leeder 1999: 36). Labor's unexpected victory at the 1993 election, which reflected support for Medicare (see below), vindicated Keating's views (Spies-Butcher 2001). Removing co-payments for Medicare also helped to shore up support for Keating's leadership amongst backbenchers and the ACTU, whose support he relied on (Gray 1996: 595). In any case, this limited co-payments to a brief interlude and meant that Medicare effectively operated uninterrupted over 13 years of Labor government.

After the 1993 election, Graham Richardson, like his immediate predecessor Howe, voiced concerns about rising health costs. In a discussion paper *Reform of Private Health Insurance* that transformed the health policy discourse, Richardson (1993:1) reframed the decline in private health insurance (see *Table 3.8*) as threatening the first tier's viability – especially the public hospital sector – by arguing that Medicare had been predicated on 40 percent of the population maintaining their private insurance membership. He attributed the decline of private health insurance coverage to: the existence of a public alternative; the early 1990s recession; a lack of competitiveness in the private health sector; and, the inadequacy of benefits afforded by private cover (Richardson 1993: 5).

[82] As noted below, Keating did propose rebates for private health insurance at the 1996 election, but this appears to have been a move to match Coalition pledges, and as he lost office they were never implemented.

Exuding many similarities with *Fightback!* (see below), Richardson proposed to address the decline by reintroducing both STEs for private health insurance and gap medical insurance, as well as increasing the Medicare Levy for higher income-earners (Gray 1996: 596). However, despite being examined by a Departmental taskforce and Caucus working group, Richardson's proposals were shelved when he unexpectedly resigned from politics in March 1994 (*ibid*: 596).

Replacing Richardson, Health Minister Carmen Lawrence enacted two sets of reform through the *Health Legislation (Private Health Insurance Reform) Amendment Act 1995*, which is known as the Lawrence Legislation. The first involved restructuring the policies of private insurers to allow them to target new groups of consumers; basic and supplementary table insurance were replaced with one form of hospital insurance that was available at four levels, while the number of membership categories was also expanded to include single parents and couples (Segal 2004: 6; AIHW 1998: 254).[83] The second reform overhauled the regulatory framework for private health insurance by introducing Applicable Benefit Arrangements (ABAs), contractual agreements that provided private insurers with a mechanism to directly negotiate prices for medical services with doctors and hospital services (Australian Parliamentary Library 2002). By allowing private funds to directly negotiate prices with health service providers, it was expected that ABAs would increase competition in the private sector and reduce costs. Launched in April 1995, ABAs gradually replaced the basic and supplementary insurance tables that were phased out by July 1997 (Mackey 1994).

More broadly, the government extended the *Trade Practices Act 1974* to the private health sector as part of its National Competition Policy (NCP). Following the Hilmer Report's release in 1993, Keating implemented the NCP by reforming the *Trade Practices Act 1974* to curb anti-competitive market behaviour (Leaf 1997: 277). But, this reform did not apply to doctors (as professionals) because the Act was reformed using the 'corporations power' of the Constitution. To circumvent these limits, the government applied the NCP to the health sector by negotiating parallel regulations for all professionals with each State and Territory government (*ibid*: 277). The NCP has made the Australian Consumer and Competition Commission (ACCC) responsible for managing the prices for health services and ensuring adequate competition, thereby

[83] Three of the new levels of hospital insurance covered what was previously supplementary table insurance, while the fourth provided insurance for private patients in public hospitals. The four membership categories were: singles, couples, single-parent families and families.

prohibiting the AMA from undertaking price-fixing, preventing common fees lists from being binding, and reducing entry requirements to prevent artificially low numbers of professionals from inflating incomes (Spies-Butcher 2001: 77). By extending market principles to the private health sector in this manner, the NCP has clearly weakened the organisational capacity of the medical profession to fix and inflate prices.

Keating's restoration of Medicare meant that co-payments were but a brief episode over the 13 years of uninterrupted Labor government, which further entrenched first-tier policy institutions. Yet, his government's primary health policy goal was to expand private health insurance coverage by extending market principles to both the private health sector and private health insurance industry. This involved adopting a strategy arguably more attuned with market principles than STEs (or subsidies), with the government using regulations to extend consumer choice and competition. In justifying this policy focus, the Keating government shifted health policy discourse by arguing that declining private insurance coverage threatened Medicare. But, as coverage continued to fall after these regulatory changes, the government's arguments gave credence to STEs – which were demanded by private health insurers and proposed by the Coalition.

Restoring the balance? Howard's second tier policies for private health insurance

Despite earlier promising to dismantle Medicare, the Coalition returned to office with the Howard government's election in 1996 on an election promise to retain the scheme (Elliot 2005: 3). The Howard government stood apart from previous Coalition governments by retaining Labor's public health scheme during its 11-year term. But, the government neglected major reform of Medicare, leaving it alone until this became untenable during its third term in the early 2000s. Like its Coalition predecessors, the government refocused health policy on the second tier. Drawing on Labor's framing of the policy problem, Howard argued that the government's reforms of private health insurance – including the PHITR – were necessary to relieve fiscal pressure on the first tier.

The Coalition vehemently opposed Medicare when in Opposition between 1983 and 1996, including when Howard was first Liberal leader (Elliot 2005: 3). The *Fightback!* package, launched by later Liberal leader John Hewson in 1993, provided the most detailed account of Liberal policy over this period. This package included a plan to residualise Medicare using means tests and additional levies, and, to promote private cover with tax credits and gap insurance (Liberal Party of Australia 1991: 51; see *Table 4.2*). Opposition to Medicare, however, proved an electoral liability and, along with the unpopular Goods and Service Tax (GST), cost the Coalition the 'unlosable' election of 1993 (Bean 1993: 154). This ultimately led to the launch of *A Healthy Future* in 1996, when Opposition leader Howard declared that he had 'changed his mind' and that a future Coalition government would retain Medicare "in its entirety" (Howard in Elliot 2006: 136). A pragmatic decision to neutralise an electoral liability, Howard's announcement was accompanied by proposals to encourage the take-up private health insurance, so as to 'restore the balance' between the health system's two tiers and thereby relieve pressure on the public hospital system (Elliot 2006: 138).

In office, Howard and his government increased the incentives to take-up private cover with three sets of reform enacted between 1996 and 2001. During this period, Health Minister Michael Wooldridge directed health policy mainly from his department, with the confidence of the prime minister (Podger 2009: 48). Introduced through the *Private Health Insurance Incentives Act 1997*, the government's first reforms resembled the *Fightback!* proposals, involving a 'carrot and stick' promotion of private cover. The carrot consisted of the Private Health Insurance Incentive Scheme (PHIIS), an income-tested subsidy for those earning less than $70,000 annually with private health cover (Owens 1998: 186).[84] The stick comprised the Medicare Levy Surcharge (MLS), which levied an additional 1% of income tax on higher income earners without private health insurance (McAuley 2005: 160). The surcharge applied to singles with annual incomes over $50,000 and families with annual incomes over $100,000 without private health insurance (Owens 1998: 186). By offering financial rewards and penalties, this policy package aimed to boost private health insurance coverage and encourage better off people to see the private sector as the solution to their health needs. Having limited success, this first reform package reduced the decline of decline in private health insurance, but private coverage continued to fall at an annual rate of 2 percent and premiums continued to rise (DOHA 1999: 7).

After the PHIIS's failure to arrest decline, Howard enlisted the Productivity Commission to inquire into further measures to boost private health insurance coverage (Hall 1999: 102). This inquiry was explicitly limited to the private health insurance

[84] The PHIIS granted a rebate of $125 for singles with an annual income under $35,000, a rebate of $250 for couples earning a combined annual income under $70,000, and a rebate of $450 for families with annual incomes under $70,000 (Owens 1998: 186).

industry, leaving broader structural issues confronting the health system beyond its narrow scope (Hall 1999: 102). However, in its report, the Productivity Commission asserted that the health system had "inherent and unresolved tensions, the most fundamental being the unstable interaction between private health insurance and the public system" (1997: *xxxix*). The Commission's report also recommended against further incremental reform because it would complicate an already complex system and advocated broader systemic reform (*ibid*: *xxxix*). And, the Commission suggested that the government take further measures to increase competition and affordability in the private health insurance industry, with particular emphasis on combating adverse selection by introducing Lifetime Community Rating (LCR) to enable insurers to penalise those who took-up insurance later in life (*ibid*: *xli*).

Dissatisfied with the PHIIS, the AMA and private insurers lobbied the government for further assistance to redress declining coverage. The AMA went so far as to declare the PHIIS a 'disaster' shortly following the release of the Productivity Commission's report and its president Kerryn Phelps called on the government to means test the public hospital services offered by Medicare (Gray 2004: 36). Although Wooldridge was both a medical doctor and former AMA member, communications broke down between the AMA and health department during this period. The AMA responded by directly approaching Howard, who was sympathetic and willing to become involved with an election looming (*ibid*: 36). At the same time, private insurers lobbied the government for financial support rather than the regulatory reform advocated by the Productivity Commission (Podger 2009: 106). This presented the Howard government with a situation where an independent inquiry's proposals clashed with the demands of its traditional allies in the health sector.

Siding with traditional allies, the Howard government responded by announcing in the lead up to the 1998 election that it would introduce the PHITR – a decision that this chapter seeks to explain – as part of the GST compensation package.[85] Along with Wooldridge, Howard (2010: 307) took a personal interest in the development of the rebate and claims in his recent political memoirs that the policy was introduced at his 'insistence'. That the PHITR was almost identical to Fraser's 32 percent rebate is unsurprising considering that Howard was Treasurer in the Fraser government and that

[85] The decision to introduce further financial subsidies went against the Productivity Commission's recommendations, but this is not to say that the government ignored the commission's advice altogether (see next paragraph).

Wooldridge's Masters thesis (Wooldridge 1991) studied health policy under Fraser. At its launch, Wooldridge claimed that the new rebate would enhance security and offer individuals both greater control and choice (Elliot 2006: 139). Attached to the GST, the PHITR received little attention because of the controversy surrounding the introduction of a consumption tax (Hall 1999: 103). The government was able to enact the rebate through the *Private Health Insurance Incentives Act 1998* with little resistance. Although Labor and the minor parties opposed the rebate, the bill was passed with the support of an independent Senator (*ibid*: 103). Commencing on 1 January 1999, the PHITR reinstated tax subsidies for private health insurance that Hawke removed in 1984. The rebate rapidly grew to $3.4 billion by 2007, making it the major second tier policy and largest health STE.

The government's third health reform to private health insurance – which was arguably the most successful at increasing coverage (see *Chapter 3*) – was to establish Lifetime Community Rating (LCR), as recommended by the Productivity Commission. From 1 July 2000, LCR increased the cost of private health insurance premiums by two percent for each year that an individual aged over 30 years and less than 65 years did not have continuous health cover (Butler 2002: 36). LCR marked a compromise between community rating and risk rating, by penalising those who took out private cover only when they were older and more at risk of ill health (McAuley 2005: 160). Announced in July 1999, LCR was not retrospective and gave individuals 11 months to take-up private insurance without incurring this penalty. During this period the Howard government funded an aggressive publicity campaign *Run for Cover*, which gave the impression "that the government could not provide universal access to an adequate standard of hospital care through Medicare and that the only way to ensure personal coverage was to take private insurance now" (Deeble 2003: 5). While LCR is widely viewed as the main catalyst for increasing private health insurance coverage to about 45 percent of the population in the early 2000s, much of its success, according to Deeble (2003: 6), is attributable to the 'fear factor' evoked by *Run for Cover*.

Although not directly altering Medicare, Howard's early health reforms were controversial and many feared they were precursors to privatising Medicare through the backdoor (Gray 2004: 74). These fears were given further currency in 1998, when Minister Wooldridge inserted the clause into the AHCAs requiring State governments "to recognise and support the significant role that the private sector plays in the provision of health services in Australia and the right of Australians to choose private health care" (Hall 1999: 102). Labor and the minor parties in the Senate led the formal opposition to Howard's reforms, which were also opposed by the ACTU, ACOSS, and associations of pro-public health medical doctors such as the Doctor's Reform Society (DRS), as well as other community sector organisations and consumer groups (Gray 2004: 74). Working together, these groups formed the National Medicare Alliance to lobby for the allocation of new resources to the public health sector (*ibid*: 75). And, of particular interest here, the PHITR received muted opposition from key government departments, including the Department of Social Security that voiced concerns about the rebate's equity and the Treasury that was concerned about its inefficiency. Yet, this opposition did not prevent passage of the legislation for these reforms, as the government secured the support of a key Independent Senator who held the balance of power (Hall 1999: 103).

Howard's reform of the first tier: Privatisation through the backdoor?

The government's inaction on Medicare eventually became a political issue midway through its third term in 2002 in the face of declining bulk-billing rates. Bulk-billing through Medicare peaked at 72.3 percent of medical services in 1999 before falling to 66.5 percent in late 2003 (Gray 2004: 42).[86] This decline was more pronounced for general practitioner services, which reached 81 percent in 1997 before falling to 66.5 percent in 2003 (*ibid*: 42). At the same time, out-of-pocket patient contributions for medical services continued to rise, from around $13 per service in 1996-97 to over $18 in 2001-02 (Elliot 2002: 7). In response to the concern that this generated, Howard initially attempted to reframe policy discourse by insisting that bulk-billing was not intended to be universal, but later qualified this by reaffirming his commitment to universality and claiming that it did not require all health services to be bulk-billed (Gray 2004: 42-43).

The government responded more formally by announcing the *Fairer Medicare* package in mid 2003 that proposed to increase health spending by $917 million by topping-up the Medicare rebate from $1 to $6.30 (depending on location) for doctors who bulk-billed those with concessional Health Care Cards (*ibid*: 45). The package also proposed to enable doctors to bulk-bill and continue to charge co-payments for services, as well as re-introducing private health insurance for medical services (Elliot 2005: 5). Taken together, these reforms provided doctors with incentives to limit bulk-billing to

[86] This figure is not comparable to later years after the Howard government altered the bulk-billing arrangements.

concession card holders and charging all others co-payments (Gray 2004: 46). This proposed package had the potential to increase bulk-billing rates, but it did so by redefining bulk-billing as a public co-payment for health services, which eroded Medicare's universality (*ibid*: 45).

The *Fairer Medicare* package failed to receive support in the Senate, with the Democrats and Greens joining Labor to block its passage and referring the reforms to a Senate Select Committee on Medicare (*ibid*: 75). Reporting in October 2003, the Senate Select Committee was highly critical of *Fairer Medicare* and argued that the package would lead to further declines in bulk-billing (*ibid*: 12). The Coalition parties and private insurers were the only groups to actively support the reforms. The major medical associations (such as the AMA and DRS) opposed the scheme, as did the new Australian Health Reform Alliance comprising 22 health and consumer organisations. The public also opposed the reforms, with opinion polls suggesting that they received support from less than 20 percent of voters (*ibid*: 73, 75, 76).

Confronted with a highly unpopular reform package and no means of securing Senate support for it, the government altered the *Fairer Medicare* package, relaunching it as *Medicare Plus* in late 2003. In a move that illustrates Howard's direct involvement in health policy, the prime minister rather than the new Health Minister Tony Abbott announced *Medicare Plus* in November 2003. At a cost of $2.4 billion, this new package extended the co-payments to provide further incentives to bulk-bill concession cardholders with children under 16 years old. It also introduced safety nets for medical expenses that committed the government to paying 80 percent of doctors fees over certain levels – $500 for concession card holders and $1,000 for all others (*ibid*: 49). And, the new reform package dispensed with the proposals for private medical insurance.

Medicare Plus received the same treatment as its predecessor in the Senate; the package was referred to the Senate Select Committee on Medicare, which, when reporting in February 2004, also cast doubt on its ability to increase bulk-billing (*ibid*: 50). Unable to win over the Labor, Democrats or Greens Senators, Abbott negotiated concessions with the four independent Senators that allowed *Medicare Plus* to pass. These concessions included setting the Medicare co-payment at the flat-rate of $5 for concession cardholders and children and lowering the safety nets to $300 for concession cardholders and $750 for all others (*ibid*: 50).[87] Although *Medicare Plus* invested a further $2.4 billion in public health, the policy package directly addressed neither of the problems capturing public concern – the falling rates of bulk-billing and increasing patient co-payments (*ibid*: 50). Moreover, these reforms institutionalised patient co-payments by allowing doctors to bulk-bill while charging more than 85 percent of the scheduled fee.[88] This not only undermined the capacity of Medicare to constrain costs, but it also eroded its universality as a scheme (without ending it) that made health services freely available to public patients (Elliot 2005: 5).

Medicare Plus was the government's most substantial health reform in its final years and it mainly concerned itself with other policy areas in its fourth term. The PHITR was, nonetheless, incrementally reformed in 2005. The government raised the rebate to 35 percent for those aged 65 to 69 years, and, to 40 percent for those aged 70 years and older (McAuley 2005: 161). This reform made private cover more affordable to those in older age groups because of concerns among private insurers that coverage had started to decline after the peak accompanying the introduction of LCR. Providing further support for people in these age groups is likely to have appealed to policy-makers because these groups form a loyal Coalition constituency (see Singh 2009).

The PHITR and Howard's revitalisation of the second tier

Although requiring no reform to the health system, the Howard government's retention of Medicare shifted Liberal health policy into new territory because Menzies and Fraser had privatised the universal health schemes set up by their Labor predecessors. Nevertheless, the government's reform of private health insurance and *Medicare Plus* package clearly refocused Australian health policy onto the second tier. In fact, Medicare's retention is likely to have enabled the Howard government to reform private health insurance without encountering the resistance that retrenching universal health insurance would have stirred (Elliot 2006: 13). As the major subsidy of private health insurance included amongst these reforms, the PHITR's restoration continued the Liberal party's preferences for tax expenditures to encourage private health insurance over direct public provision. At the same time, the rebate's restoration made Hawke's retrenchment

[87] A higher co-payment of $7.50 was paid to doctors who bulk-billed their patients in rural areas and Tasmania (Gray 2004: 50).

[88] So whilst bulk-billing rates increased significantly after the *Medicare Plus* package, it did so by extending the definition of bulk-billing. The package also did not put limits on patient co-payments nor did it seek to limit them.

of a similar STE a relatively brief and anomalous interlude in the history of Australian health policy.[89] Despite the dubious economic case for it (see *Chapter 3*), the rebate has become an entrenched policy institution that benefited over 40 percent of the population and received the unwavering support of the government over 8 years before the Coalition lost office. A sign of this entrenchment was the Labor party's pledge to retain the rebate at the 2007 election. Having tracked major developments in health policy to the end of the Howard years, the next section discusses the feedbacks that influenced the introduction of the PHITR.

II. The Impact of Ideas, Institutions and Public Opinion on Second-Tier Health Policy

My structured narrative shows that the Howard government's introduction of the PHITR is a recent development in the long struggle between the major political parties over the instruments of health policy. The PHITR is but the latest in a series of STEs that Coalition governments have introduced to subsidise the second tier institutions of private health insurance as a central element of their health policy. These STEs have been the major second tier policy – at least in terms of budgetary impact – since the 1950s and have remained so, save for the interlude of the Hawke-Keating years. In contrast, the Howard government's retention of the first-tier program Medicare when restoring STEs and other assistance for private health insurance was at odds with prior Coalition governments that had retrenched first-tier institutions after taking office. Why did the Howard government decide to retain the first-tier institutions of Medicare when refocusing health policy on the second tier through the rebate and other measures? In this section, I use the concept of 'layering' to show that the government pragmatically maintained Medicare while refocusing health policy onto the second tier through the PHITR. In doing this, I show how the policy feedback effects of ideas, institutions and public opinion influenced the government's decision by preserving Medicare and increasing the appeal of using a tax expenditure.

The institutional entrenchment of the first tier

The Howard government's decision to retain Medicare and largely leave the first tier alone signalled a major departure of its health policy from earlier Coalition

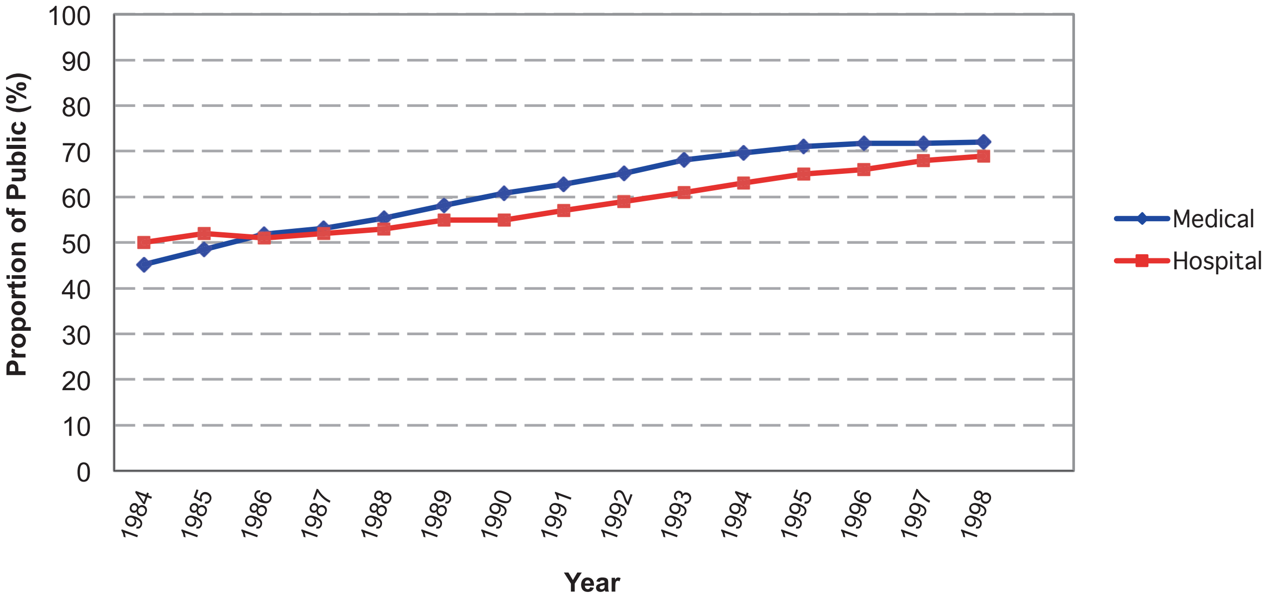
[89] The Fraser government retrenched the tax exemptions for private health insurance, but replaced them with an opt-out scheme and reintroduced them before leaving office.

governments. Menzies retrenched the Chifley government's HBS, reducing the first tier to a residual public hospital program. Similarly, even after pledging to retain Medibank at the 1975 election, the Fraser government wound back the universality of the scheme and limited it to a residual program. Both governments tied public assistance for health to holding private health insurance for those not eligible for the public program. In Opposition during the 1980s and early 1990s, Howard and the Liberal party floated similar proposals (most notably in the *Fightback!* package) until the 1996 election. Despite similarities between its circumstances and the Fraser years, the Howard government refocused health policy but not through measures that directly impinged on first-tier universality – at least in its first two terms in office. In the following discussion, my argument is that the Coalition parties' policy reversal represented a pragmatic response to Medicare's institutional entrenchment, which made retrenching the scheme politically untenable. Medicare's entrenchment, in turn, was itself the product of four reinforcing feedback effects, namely: the stability of the first tier as the primary health system; the scheme's electoral popularity; policy learning from Fraser's retrenchment of Medibank; and the AMA's declining influence.

Medicare's institutional entrenchment was a result of its constant operation as the primary health system for 13 years of Labor government.[90] In contrast, the first-tier schemes of Chifley and Whitlam that the Coalition retrenched only operated for about 4 years and 4 months (respectively) before government changed hands. The consolidation of Medicare occurred in the Hawke and Keating years since it became the primary financer of medical and hospital services (see *Figure 4.1*). Medicare came to finance 72 percent of medical services and 66 percent of hospital services by 1996. At the same time, the primary role of Medicare was reinforced by the drop in private health insurance coverage from 68 to 37 percent of the population between 1984 and 1994 (see *Table 3.8*). The expansion of Medicare in the decade after its development entrenched the first-tier in a primary role because the majority of the population stood to directly benefit from the scheme and it informed their expectations – both of which Pierson (2001: 421) argues makes social programs resistant to retrenchment.

[90] Neal Blewett's seven-year tenure as health minister in Medicare's formative years provided a further source of entrenchment because the shuffling of a quick succession of ministers into the portfolio heightened instability in the Fraser years (Wooldridge 1991).

Figure 4.1 Proportion of Medical and Hospital Services Financed through Medicare, 1984-98

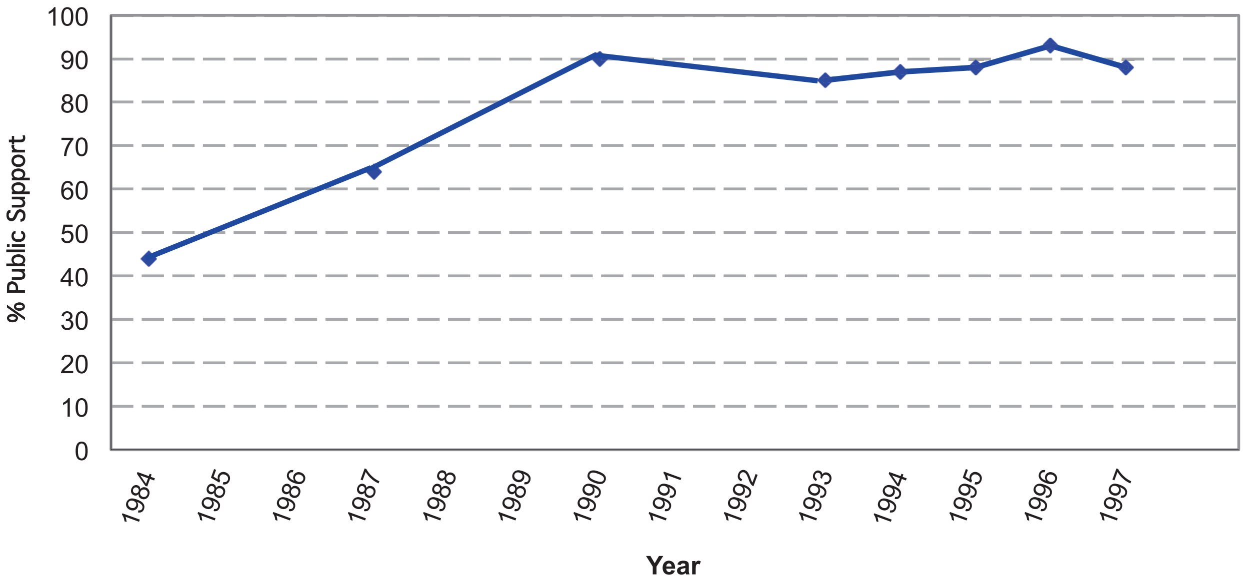


Source: DOHA (2008)

The electoral popularity of Medicare provides a second and closely related source of feedback contributing to its consolidation. Medicare built a broad constituency over its first 10 years, which emerged as a political barrier to its retrenchment (see Pierson 2001). Initially, support for Medicare was divided along party lines. In April 1984, a Gallup Poll found that although the scheme received support from 55 percent of all voters, 77 percent of Labor voters and only 31 percent of Coalition voters favouring Medicare. However, research commissioned by Medicare Australia found that public satisfaction with Medicare rose from 44 percent in 1983 to 90 percent in 1990, dropping slightly to 85 percent in 1993 before peaking at 93 percent in 1996 (see *Figure 4.2*).[91] Because satisfaction with Medicare does not necessarily equate to support for the scheme, the two data sources are not directly comparable. Nevertheless, the high levels of public satisfaction with Medicare, in tandem with high utilisation rates and the declining coverage of private health insurance, suggests that the scheme built a broad constituency crossing party and social class lines.

[91] Rather than public satisfaction with Medicare, the 1983 figure represents consumer satisfaction with the HIC's administration of Medibank Private.

Figure 4.2 Public Satisfaction with Medicare, 1984 - 1996



Source: compiled from Medicare and HIC Annual Reports

Moreover, Bean's (1994: 155) analysis of the 1993 election suggests that support for Medicare was crucial for Labor's victory. In his analysis of the 1993 Australian Election Study, Bean contends that "health care had the largest impact on the overall balance of party support because the distribution of opinion was more heavily skewed [towards Labor policy] on this issue than on any of the others" (1994: 154). He further claimed that the Coalition would have won the election had the two major parties received similar support for their health policies. This provides the strongest indication that Medicare's popularity translated into electoral support that had the potential to alter the results of close elections.

The electoral consequences of Medicare's popularity was not lost on the Coalition parties, with Andrew Robb – present Shadow Minister for Finance and long-term Liberal strategist – recently conceding that internal polling showed that *Fightback!'s* health policies were a source of public alarm (Kelly 2009: 51). The Coalition had expected to win the 1993 election because Labor had a slim majority in the House of Representatives, Prime Minister Keating was unpopular with voters, and, poor economic conditions marked by recession and high unemployment had damaged the government's economic record (Bean 1994: 135-136). After unexpectedly losing, the Coalition curtailed its electoral liabilities by shelving the polarising GST proposal and the unpopular plan to residualise Medicare (*ibid*: 154). Medicare's popularity proved such a political threat that

Howard – long-time Medicare critic – promised to retain the scheme at his health policy launch at the 1996 election. When Howard sought re-election in 1998, the Coalition did not seek radical reform as its attention was occupied with the GST (McAllister and Bean 2000: 388).

Medicare's electoral support becomes clearer when compared with earlier health policies. Back in 1968 – the time of the Nimmo report and Whitlam's commitment to universal health insurance – a Gallup poll taken in February found 53 percent of voters favoured the PNHS.[92] This level of public support was similar to that received by Medibank before it was implemented: a Gallup poll taken in 1973 showed that around 51 percent of voters supported the scheme. At the peak of its popularity in June 1975, Medibank briefly received support from 59 percent of voters, but this support was more divided along party lines and short lived (Gallup 1975).[93] Fraser's health schemes elicited the lowest support; Gallup polls suggest that his government's 1981 reforms were his most popular (supported by 42 percent of voters) while Medibank IV was the least popular (favoured by only 18 percent of voters).[94] Although undertaken irregularly, these polls suggest that the health schemes of previous governments received less voter support than Medicare, with the exception of Medibank at its peak, and that they did not receive sustained support by a majority of voters. Howard thus faced an unprecedentedly popular public scheme when he took office in 1996.

The Howard government's decision to retain Medicare stems from the Coalition's learning following Fraser's failures. Fraser's gradual retrenchment of Medibank left him open to the criticism he had broken a promise to keep it (Wooldridge 1991: 45). His health policies also did little to resolve the problems of rising out-of-pocket patient expenses and gaps in coverage. Returning to office for the first time since Fraser lost in 1983, the Howard government appeared keen not to repeat the Coalition's unpopular decision to retrench universal health insurance. Because Howard promised to retain Medicare 'in its entirety', radical reform would have left him open to the criticisms directed at Fraser. Such a move would have damaged Howard's credibility given that he

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[92] I draw on data from Gallup opinion polls in this discussion given the lack of more reliable data from other sources. My particular interest in voter attitudes to public and private health insurance leads me to focus only on polls from 1968.

[93] Whereas the 1968 poll found that support for universal health insurance and the PNHS relatively evenly divided between voters from the major parties, the 1975 poll found that 81 percent of Labor voters and 41 percent of Coalition voters favoured Medibank (Gallup 1968, 1975).

[94] Fraser's health policies were consistently unpopular. The Medibank II and III reforms received support from only 34 and 32 percent of voters respectively (Gallup 1976; 1978).

personally committed to Medicare at the Coalition's health policy launch in 1996 and the scepticism that followed in view of his vocal opposition in the 1980s. That Howard and the Coalition parties learned from the Fraser years is apparent in their cautious approach to reforming the first tier. The Coalition largely let Medicare *drift* until 2003 and then, under pressure, altered the bulk-billing arrangements that increased public funding and cosmetically extended universality while increasing co-payments.[95]

The clearest evidence that the Coalition 'learned' from Fraser's retrenchment of Medibank is provided by Health Minister Wooldridge Master's thesis on health policy in the Fraser years (written before joining cabinet) and his strategy as minister. In his thesis, Wooldridge (1991: 45-47) argued that Fraser's health policies failed because they were short-term and inconsistent. As well as reflecting the quick succession of relatively junior ministers in the portfolio, Wooldridge (1991: 45) claimed that policy failings stemmed from the division of labour between the Department of Health, which was responsible for administering policy, and the Department of Prime Minister and Cabinet that designed health policy. The problem with this arrangement, he argues, was two-fold – this process did not allow for sufficient expert input into policy design and it did not make decision-makers accountable over the longer term (*ibid*: 45). According to Department Secretary Andrew Podger (2009: 48), Wooldridge sought not to repeat Fraser's failings by running the health policy agenda from the department and limiting input from central agencies. Podger (2009: 48) claims that Wooldridge was largely successful at controlling the agenda. In the case of Medicare, Wooldridge publicly supported the scheme as Opposition spokesperson for health and later as Health Minister (Iglehart 2001: 146; Gray 2004). Consistent with his public pronouncements, Wooldridge did not seek to radically reform Medicare and his relatively long tenure (as minister) provided another source of stability.

The AMA's declining political influence also contributed to the government's decision to retain Medicare. From around the early 1930s until at least the implementation of Medibank, the AMA (formerly BMA) enjoyed hegemonic status as *the* representative organisation of the medical profession.[96] In part reflective of this

[95] As noted above, by allowing doctors to bulk-bill and charge a co-payment, Howard's reforms of 2003 increased the proportion of services that were bulk-billed, but decreased the proportion that were funded solely by the government.

[96] To use the nomenclature of Alford (1975), Hunter (1980), and Duckett (1984), the AMA were the major representative organisation of the 'professional monopolist' structural interest.

hegemonic status, AMA's organisational structure enhanced its capacity to mobilise resources and present a unified voice on behalf of the medical profession. Meeting the criteria of what Rhodes and Marsh (1992: 186) call a *policy community*, the AMA formed a highly integrated and hierarchical policy network of practising doctors who held similar values and interests, and who retained membership over the longer-term.[97] The AMA's hierarchical and federal structure, which mirrors the state and federal levels of government that are responsible for health policy, allowed it to co-ordinate members at both levels of government when necessary. AMA influence as a professional policy community was evident in its successful opposition to Lyons' social insurance scheme, Curtin's PBS, Chifley's national health service and Whitlam's Medibank – schemes that united medical doctors against intrusions into professional autonomy.

However, the emergence of a greater number of voices in the health sector – particularly after Medicare's establishment – has eroded the hegemony the AMA enjoyed as a policy community. Paradoxically, the association's fierce campaign against Medibank created divisions in the medical profession and inspired the creation of alternative organisations. These voices harked from the political left, such as the Doctor's Reform Society (DRS) that supported universal health, and the political right, including the General Practitioners Society of Australia (GPSA) to defend private enterprise medicine from the 'creeping socialism' allowed by the AMA's acceptance of publicly financed subsidies (Hunter 1984: 975).[98] Although a significant majority of the medical profession remain with the AMA, the existence of alternative voices and Keating's extension to the *Trade Practices Act* that prevented the AMA from undertaking uncompetitive behaviour also undermined the association's capacity to organise and present a unified voice.

At the same time, the AMA's influence has waned because of the greater roles of other interests in the health sector since Medicare's introduction. Partly encouraged by the government through the Consumer's Health Forum of Australia (CHF) in 1987, pro-Medicare interests such as the women's health and indigenous rights movements have become increasingly effective at lobbying (Short 1998: 145). The labour movement has also consistently defended universal health insurance as a social right of workers –

[97] Rhodes and Marsh (1992: 186) define policy communities as highly integrated and hierarchical policy networks with limited numbers of members that represent a dominant economic or professional interest. The AMA clearly meets this criterion.
[98] GPSA is now the Private Doctors of Australia (PDA).

notably under the leadership of Bob Hawke in the mid-1970s when even Labor was non-committal to the scheme (Sax 1984). And, activist community groups and unions formed the NMA and AHRA to lobby Howard after he became prime minister in 1996 (Gray 2004: 75). These alternative voices have provided a counter-balance to the AMA and their influence is evident in its increasingly ambivalent attitude towards Medicare in recent years – occasionally indicating support and at other times calling for retrenchment (*ibid*: 77).

The institutional entrenchment of Medicare, as the major first-tier program, was the product of these inter-locking feedbacks. The public's growing reliance on the scheme reinforced Medicare's unrivalled popularity. As Mettler and Soss observe, the "political thoughts and actions… [of the public are moulded] by broad policy environments and influenced by direct encounters with specific public programs" (2004: 56). Similarly, the success of the policy contributed to the formation of pro-Medicare associations and alliances. Fraser's broken promise regarding Medibank and the policy failure of his alternatives bolstered the appeal of retaining the Medicare. Moreover, the AMA was both less able and willing to speak out against universal health insurance by 1996 because it had to compete with other health interests, Medicare was electorally popular and relied upon by a majority of the public, and the scheme obtained bipartisan support. By limiting support for reform, these feedbacks meant that a radical overhaul of Medicare – including the option of retrenchment – would have had high political costs, so high in fact that it closed off certain avenues such as the primacy of the private health insurance option historically favoured by the Coalition.

Re-building the second tier

As well as retaining Medicare, the Howard government refocused health policy onto the second tier with incremental reform to assist the private health insurance industry. These reforms represented remarkable continuity with earlier Coalition governments (see *Table 4.2*). Like the policies of Menzies and Fraser, the Howard government's reforms directed funds to the second tier using STEs for private insurance premiums, regulatory incentives for private cover, and targeted assistance for the poor.[99] Nonetheless, the government's policies shared most with the *Fightback!* proposals,

[99] LCR may appear to undermine community rating, but it is consistent with earlier schemes as it adds 'good risks' to the risk pool by offering young healthy people an extra incentive to buy private cover.

implementing the package's major elements except for means-testing Medicare. So, within two terms, the Coalition had replaced a tax credit with the PHITR, altered community rating, introduced a surcharge for high-income earners without private cover, and, established private insurance for out-of-hospital co-payments. The Howard government thus implemented much of the Coalition's preferred health policy. In the following discussion, I argue that the government's strategy – and its success – reflected the impact of feedbacks from its policy environment.

Table 4.2 Continuity in Liberal Party Health Policy 1953-2001*

	Page National Health Scheme	Fraser Reforms 1981*	Fightback! Proposals 1991*	PHIIS 1996	Howard's Reforms 1998-2001
Tax expenditures	Tax deductions for PHI premiums; medical expenses tax rebate	Tax rebate of 32 cents in the dollar for PHI premiums	PHI tax credit for low income earners	PHI tax credit for low income earners	Tax rebate of 30 cents in the dollar for PHI premiums
Premium Price-fixing	Community Rating	Community Rating	Community Rating	Community Rating	Lifetime community rating
Hospital Subsidies	Hospital benefits tied to PHI membership	Hospital benefits tied to PHI membership			
Gap-cover			Gap-cover for out-of-hospital services		Gap-cover for out-of-hospital services
Tax penalty for high-income earners		Income tax surcharge (2.5 %) for those without PHI**	Income tax surcharge for high income earners without PHI	MLS: an income tax surcharge for high income earners without PHI	MLS: an income tax surcharge for high income earners without PHI
Means-tested public assistance	Restriction of public assistance for pensioners and their families	Restriction of bulk-billing to concession card holders and the poor	Restriction of bulk-billing to concession card holders and low-income earners		Increase public co-payment for concession card holders

* Also see Elliot (2005: 5).

** Introduced as part of Medibank II reforms in 1976. Included here as it demonstrates continuity in Liberal policy.

Liberal ideology was perhaps the most significant source of feedback effects on the health policies of the Howard government (Gray 2004; Elliot 2005: 8). As Sax (1984: 87) claims, Liberals favour incentives for private health insurance because the compulsory nature of universal health schemes stifle individual freedom and capabilities. The Liberal party entrenched what Titmuss (1968) called the 'residual model' in its health policies.[100] Associated with a brand of liberalism that supports temporary and targeted social programs, the residual model has its basis in an understanding of the individual as a moral agent who obtains desirable outcomes for both the individual and society through independent choices driven by conscience (Brett 2003: 9). State intervention is only justifiable from this perspective when the family and market – considered the two 'natural' sources of needs – falter because it prevents acts of conscience by compelling individuals to assist unknown others (Titmuss 1976: 33). Reflecting this, residual health policy offers minimal protection from health risks to the poor, while requiring the middle class to rely on the market (*ibid*: 30).

Menzies' and Fraser's health policies, as well as the *Fightback!* proposals, exemplified the residual model by encouraging the take-up of private health insurance for all who could afford it, while limiting access to public provision to the poor through means-testing. Similarly, the Howard government's health policies (see *Table 4.2*) aimed to increase private health insurance coverage and reduce the role of the first tier. With the exception of retaining Medicare, which did not require legislative change, the Howard government's health policies that rejuvenated the second tier – most notably the PHITR – represent ideological continuity with earlier Coalition governments. Note that this ideological position is manifested in Howard's (2010: 487, 489) framing of the PHITR as an incentive to extend the 'Liberal principle of choice' rather than middle-class welfare. Although not claiming that Coalition health policy has been static (*Table 4.2* displays several changes in emphasis), the Liberal party's embrace of the residual model explains why Coalition governments consistently prioritise the second tier using instruments such as the rebate that places choice in the hands of consumers and subsidises private industry.

[100] In contrast, Labor adhered to what Titmuss (1976) termed the institutional redistributive model. The institutional redistributive model is based on the principle of universalism, which posits that programs offering protection from social risks should be accessible to all members of society on the basis of need (*ibid*: 31). This model holds the state responsible for social provision because the family and the market have neither the will nor the ability to provide these services universally (Titmuss 1968: 129). It also considers individuals to possess social rights as citizens, which guarantees them the dignified standard of living required for social participation.

Liberal preference for the residual model in health policy and policies such as the PHITR was reinforced by neoliberal policy ideas from the late 1970s. Also known as 'economic rationalism' in Australia, neoliberalism "proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade" (Harvey, 2005: 2). It was termed neo-liberalism – literally the new liberalism – because it revived neo-classical economic ideas about the efficacy of the market mechanism in co-ordinating self-interested individuals. This ideology provides its proponents with a justification for radical reform to reduce state 'interference' in the market through policies that cut taxes, subsidies and tariffs, use regulation to foster markets, encourage paid employment, retrench existing social policy programs and privatise public services. Rather than emerging from pressures from below, neoliberalism became hegemonic through elite advocacy, finding support from political leaders in both major parties, senior bureaucrats (particularly in Treasury), and leaders of finance and business (Pusey 2010: 127).

Although an influence on the public policies of both Labor and Liberal governments since the 1980s, neoliberalism had a more pronounced impact on the Howard government's policies because it reinforced long-held Liberal beliefs, particularly its core tenet of individualism. For most of the Liberal party's existence, the individualism it has advocated has been closely associated with values of independence, self-reliance, and social responsibility that were, in turn, grounded in Protestantism and the liberal citizenship tradition (Brett 2003: 177). Brett (2003: 177) argues that this understanding of individualism placed little emphasis on the values of freedom and choice. This thinking clearly informed the design of the PNHS, which sought to limit the role of the public sector without seeking to extend market principles (Gillespie 1991: 256). From the late 1970s, however, the Liberal party response to the rising hegemony of neoliberalism as a mode of discourse has been to recast its conception of individualism as the self-interested actor of neo-classical economic theory, thereby bringing consumer choice and market principles to the fore and marginalising the earlier precepts of independence and social responsibility (Brett 2003: 178).

The Howard government's embrace of neoliberalism offered new grounds for second-tier health policies, particularly those offering incentives to self-provide like the rebate. The link between the PHIIS and these ideas was relatively explicit since it appeared in *Fightback!*, which is often viewed as the Liberal's most neoliberal manifesto. Introduced alongside the GST, the PHITR was also related to neoliberal ideas as it removed the means test of the pre-existing tax incentives to extend choice and increase private provision (see *Chapter 3*). Like the tax credits before it, the rebate also subsidised non-government organisations (not-for-profit and for-profit), which had to compete for consumers. And, compared with policy alternatives such as extending Medicare or enacting other programs to support the private sector such as industry subsidies and bed-day subsidies for private hospitals, the rebate and tax credits required minimal bureaucracy. The Coalition's preference for policies that revitalised private health insurance, particularly the PHITR, was buoyed by the policies' capacity to carry forward the reformist spirit of neoliberalism.

In addition to the PHITR's ideological appeal, the Howard government was motivated by pressure from its traditional allies in the health sector – the AMA and private insurers – which have forged close ties with the Coalition because of the alignment of their interests and Liberal ideology. The AMA has long enjoyed an active relationship with the Coalition through its involvement in policy formation, its resistance to Labor policy, and through its members such as Page, Nelson and Wooldridge serving as Liberal health ministers. Although the AMA has less capacity to attack Medicare, it is still capable of defending the medical profession's interests. The relationship between private insurers and the Coalition also has deep roots, with the PNHS and Fraser's 1981 scheme expanding private health insurance coverage to unprecedented levels. The AMA and private insurers had some success in lobbying Keating for financial support at the 1996 election campaign, but Labor did not restore the STEs while in office. In contrast, the Howard government enacted the PHIIS within a year of taking office (Gray 2004: 36). Moreover, after it became clear that the PHIIS had not produced the desired outcome, the AMA employed a strategy made possible through its close ties with the Coalition to secure further support for private insurance in the form of the PHITR. The organisation dealt with the prime minister, sidelined the Department of Health that opposed the rebate, threatened a national campaign about the failure of the PHIIS with an election looming, and called for Medicare to be means-tested, thereby allowing the rebate to become a 'fall back' position.[101] The influence of the AMA and private health insurers was evident in the Howard government's choice in enacting the rebate before the LCR, which had been recommended by the Productivity Commission.

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[101] This is not to say that this was a deliberate strategy on the AMA's part.

As well as benefiting the traditional allies of the Coalition, the rebate appealed to the government because it benefits its core constituency of middle class voters (Gray 2004: 91). The rebate disproportionately benefits middle and higher income earners since these groups are more likely to hold private health insurance and can afford to purchase more expensive premiums. The major dynamic underlying the preferences of Australian voters, Singh (2009: 428) argues, is socio-economic status, with middle and higher income voters much more likely to vote for the Coalition parties. The rebate can be viewed as a policy measure that unites the interests of middle and higher income earners – the Coalition's core electorate – because both these groups are its principal financial beneficiaries. It appears that Howard was attempting to build a constituency of middle and high-income earners in support of the rebate, much like Medicare had done for Labor's constituency. DOHA (1999: 12) argued in support of the flat-rate structure of the PHITR, arguing that it was required to encourage higher income earners to take-out private health insurance and that it was reasonable that they should retain some level of public support. Aware that regressive policies that benefit middle and higher income earners (particularly those that do not benefit low-income earners) are unlikely to appeal to the broader electorate, the government was careful not to draw too much attention to this and framed the rebate as a 'universal concession'.

As the Howard government's decision to introduce the PHITR was influenced by political and institutional feedbacks, so too was the success of the political strategy that it employed. The success of the government's strategy in revitalising the second tier was ironically bolstered by its decision not to retrench Medicare. The retention of Medicare countered opponents' claims that the rebate and other second-tier reforms reflected a desire to dismantle the first tier. That the government did not appear to retrench the first tier was important not only because of Medicare's electoral popularity, but because it lacked a Senate majority. In the event Labor and Democrat Senators still opposed the rebate, which meant that the government had to rely on support from Harradine, the Independent Senator, who Howard (2010: 313) refers to (in retrospect) as 'the great unknown'. Whilst Harradine supported the PHITR, it is unclear whether his support would have been so forthcoming had it been accompanied with a plan to dismantle Medicare, considering his concerns about the equity of the GST (see Howard 2010: 313).

Just as significantly, the Keating government's re-framing of the health policy problem from 1993 onwards contributed to the Howard government's success in extending the second tier. As consecutive Health Ministers, Richardson and Lawrence framed declining private health insurance as a threat to Medicare's viability and the policy problem that most required government action. Richardson (1993) was first to frame declining private health insurance coverage as a threat to the public hospital system and proposed STEs resembling those of *Fightback!* to subsidise private health insurance. Reflecting similar concerns, the Lawrence Legislation extended regulation in the hope of increasing private health insurance coverage. And, in an unprecedented move, Keating brought Labor even closer to the Coalition, declaring that if re-elected in 1996 his government would introduce targeted rebates for private health insurance. Considering Labor's support for Medicare and general tepidity towards private health insurance, the Keating government's framing of the health policy problem in this way, and commitment to STEs, gave the conservatives' proposals to address the same problem in the same way greater legitimacy.[102]

When launching Coalition health policy in 1996, Howard used Richardson's arguments to highlight bipartisan concern about declining private health insurance membership. He claimed:

> The proportion of the Australia population covered by private health insurance has fallen from 61 percent in 1983 to a little over 35 per cent now, and it is estimated that unless something is done that process will go on at the rate of about 2 per cent a year. It's worth remembering that the former Labor Health Minister, Graham Richardson, said that once you fell below 40 per cent you were starting to put an unacceptable strain on Medicare and the public hospital system. So… every time you lose 2 per cent of people out of private health insurance it puts an increased demand on public hospitals of about 322,000 bed days every 14 months. For those reasons we are going to provide an incentive through the taxation system… It is our goal… that with the implementation of this policy that we should by the year 2000 have a coverage of about 40 percent of the population in private health insurance.[103]

When arguing his case, Howard could also point to Keating's promise to introduce tax rebates in 1996 and the failure of his government's regulatory changes to redress declining coverage. Wooldridge (1997b) also blamed Labor's rejection of Richardson's proposals as a reason for declining cover. But, Howard and Wooldridge did not merely borrow Labor's frame, rather they actively extended it in arguing that declining coverage would threaten both tiers of the health system and that only the policies proposed by the

[102] Especially since the threat that declining private health insurance coverage posed to Medicare appears to be tentative at best (see *Chapter 3*).
[103] Wooldridge made a similar reference to the need to raise private health insurance levels to those identified by Richardson during an interview for *Lateline* during the 1996 election campaign (ABC 1996).

Coalition could 'restore the balance', which implied that the first tier had become over-extended (Elliot 2006). Whilst this frame was used to justify the PHIIS, the 'restoring the balance' rhetoric was also used more broadly to argue for further reform such as the PHITR after the first reforms failed to have their desired effect.

Howard also framed the PHITR as a tax rebate so it appeared to signal a return to past (and proven) tax expenditures for private cover. During the periods that the PNHS's tax deductions and Fraser's tax rebate for private health cover operated, private health insurance coverage (as noted before) peaked at about 70 percent of the population. When private coverage fell following the introduction of Medicare and removal of STEs for private health insurance, private insurers and the AMA lobbied both the Keating and Howard governments to restore financial assistance in the form of tax incentives that had been associated with high coverage previously. Moreover, the Howard government's move to establish the PHIIS meant that STEs had formed an entrenched feature of Australian health policy, with the exception of the Hawke and Keating years. As noted in *Chapter 3*, part of DOHA's justification for the rebate was that "the use of "taxation policy to encourage self-provision is well entrenched and accepted in Australia" (1999: 9). This appears to have been especially important to Howard because he claims that STEs were welfare payments and argues that counting programs such as the PHITR as spending programs for financial purposes is inappropriate (Howard 2010: 292, 539). Thus, framing the rebate as a STE allowed the government to argue that it was restoring a tried and tested policy.

In short, political ideology had the most bearing on the Howard government's health policy despite its pragmatic decision to retain Medicare. In Gray's (2004: 90) words, "the only reasonable explanation of the policy course taken by the Howard government is that it is motivated by ideological concerns – concerns that fit firmly within Liberal party tradition and conform closely to the thrust of Coalition policy before the 1996 'change of mind' on Medicare". The rebate was consistent with this earlier ideological thrust of Coalition health policy because it sought to increase both consumer incentives and the resources available to the second tier (like previous STEs for health). But, the Liberal party's support for the PHITR was reinforced by the rising hegemony of neoliberalism, the potential to benefit a core constituency and the demands of both the AMA and private insurers for financial support. The Coalition's focus on the second tier contributed to the ease with which the rebate was re-established. By retaining Medicare using a proven policy instrument and its Labor predecessors framing of the health policy problem, the Coalition chose an approach to rejuvenate the second tier that limited potential electoral backlash.

III. The Private Health Insurance Tax Rebate as Institutional Layering

The Howard government's political strategy to health policy exemplified 'layering'. Layering, as *Chapter 2* notes, involves political actors building new policies onto existing arrangements to reorientate policy toward new principles, typically when it is untenable to undertake direct reform (Thelen 2004: 225; Streeck and Thelen 2005: 23). Rather than altering existing policies, the government refocused health policy on the second tier by 'layering' new institutions including the PHITR (and other policies) onto the popular Medicare scheme. My contention is that the rebate's re-introduction by the Howard government represented a 'second-best' strategy for the Coalition parties to direct resources away from an institutionally embedded Medicare and build the capacity of the private health insurance industry. Because this explanation differs from that offered by Kay (2007) who also conceives of the rebate's re-introduction as institutional layering, I review his arguments and highlight the main points of difference.

A second best strategy: Building new institutions without replacing the old

The Howard government layered second-tier health policies, such as the PHITR, onto an entrenched first tier. Signalling a major policy reversal, Howard (1996: 9) himself notes, "over the years people have grown to support it [Medicare]. It gives them a sense of security and it now has our total support". But, retaining Medicare still left the Coalition with considerable scope to pursue its policy agenda – rather than replacing Medicare with policies to subsidise private health insurance, the government chose to build an additional layer of health policy, with the PHITR as its major financial policy (Gray 2004: 34). As noted above, the government found the rebate appealing because it fostered consumer choice, facilitated private social provision and benefitted a core constituency. However, the tax expenditure design of the PHITR appears to have aided its establishment, since it is highly unlikely that a social expenditure program that mostly benefitted higher income earners would have received such little scrutiny. Thus, the government responded to institutional constraints by not retrenching Medicare, while its ideological beliefs lay behind its aversion to expanding public social expenditure on health (Elliot 2006: 136).

Nonetheless, the Howard government's layering of the PHITR onto the first tier still represented a 'second best' strategy. Howard and his government were more ambivalent to Medicare than the support they offered at the 1996 election suggested. The Howard government showed little concern over dwindling bulk-billing rates through Medicare until it became a political issue and even less alarm over the Commonwealth's declining contribution to public hospitals (to 41 percent of the total) during its time in office. At the 2001 election, Howard seemed to reassert his opposition to Medicare by claiming "the introduction of Medibank in the 1970s has been a 'cardinal mistake'" (Gray 2004: 91). Further, both the *Fairer Medicare* proposals and *Medicare Plus* sponsored by the government eroded Medicare's universality by refining it to mean access to Medicare rebates (Gray 2004: 43). And, the unwavering support of the Coalition for the PHITR despite its substantial cost for relatively little return suggests fostering the private sector's role was the top priority. There can thus be little doubt that the Coalition's preferred health policy would have been to residualise Medicare as *Fightback!* and *Fairer Medicare* proposed. It is also difficult to conceive of the rebate, and the broader package to which it belonged, as anything other than an ideologically motivated strategy to increase private provision through the path of least resistance and a political measure to reward both a core constituency and traditional allies in the health sector.

Kay's alternative explanation: A synthetic policy paradigm?

Kay (2007: 579) uses the concept of layering to justify a different explanation to that offered here. He contends that the Howard government's decision to introduce the rebate signified the adoption of a synthetic policy paradigm by both Labor and the Coalition following the 1993 election. While also understanding the Australian health system as two layers, Kay (2007: 585) depicts the PNHS as the initial layer that institutionalised the insurance principle and fee-for-service, and Medicare as the second layer that established tax-financed universal public insurance. After Medicare's establishment, he argues that there was tension between the two layers as they competed for the same resources and reflected partisan ideological divisions (*ibid*: 583, 586).

Kay (2007: 584) argues that the major parties' ideological differences over health policy subsided in the mid 1990s and was replaced with a compromise in the 'universalism with choice' policy paradigm. As its name suggests, this paradigm combines the principle of universalism inherent in Labor health policy with the value of choice underpinning Coalition health policies (*ibid*: 584). He stipulates that bipartisan support for this synthetic policy paradigm was embodied in the Keating government's reforms undertaken to redress the decline of private health insurance and the Howard government's PHIIS, the PHITR and LCR (*ibid*: 588).[104] Because of this paradigm shift, Kay (2007: 581) claims that the PHITR and Howard's other incremental reforms to private health insurance reflected ideological convergence and an attempt to operate both layers as parallel elements of a single health system – he rejects the view that the PHITR formed part of a neoliberal strategy to residualise Medicare.

While there is substantial overlap between Kay's account and the one presented here, the main difference has to do with the influence of neoliberalism on Coalition health policy. In contrast to Kay, I argue that Howard's STEs for private health insurance were linked to broader neoliberal reforms and that there is little evidence to support the proposition that the Howard government adopted a 'universalism plus choice' policy paradigm. The Howard government's reforms to private health insurance were explicitly linked to neoliberal reforms. While the PHIIS featured prominently in *Fightback!,* the PHITR was included in the GST compensation package. Moreover, Kay (2007) does not unequivocally rule out that the rebate reflected neoliberal ambitions since his focus is on endogenous processes concerning the health system and he says little about exogenous factors such as the rising hegemony of neoliberalism. Because of its relation to neoliberal reforms and the fact that neoliberalism and Liberal ideology reinforce each other, I argue that it is more plausible that neoliberalism was a key factor that influenced the Howard government's health policy.

Moreover, rather than supporting a 'universal plus choice' policy paradigm, a closer scrutiny of the Howard government's 'restoring the balance' rhetoric and reform to Medicare suggests that it was a framing device. Building on the Keating government's framing, the Howard government recast its policies as 'restoring the balance' in the health system; as Wooldridge (1997a) asserted,

> A strong public and private health sector standing side by side is vital to the future of the health system for all Australians. I want to keep Medicare in place as it is today, one of the best and most affordable universal health systems in the world. This can only be done if the drop-out rate from health insurance is stopped, and the balance between the public and private systems is restored.

[104] Keating's proposals at the 1996 election to introduce means-tested rebates for private health insurance premiums could be offered as further evidence of Kay's (2007) arguments but he does not mention them. His arguments are more suited to explaining Labor's health policy when it left office, rather than the Howard government's approach.

Implicit to this framing was that "the best (and) only way to save Medicare was for those who could afford to take out private health insurance do so" (Elliot 2006: 136), which further infers that universal health insurance should be 'saved' for those unable to afford private cover. However, while a clever political move, the 'restoring the balance' frame was too rudimentary to represent a policy paradigm shift because it did not present a conception of what an ideal 'balance' between Medicare and private health insurance entailed (Hall 1999: 103). The frame also lacked detail about the role of private health insurance and the benefits of increasing coverage (*ibid*: 103). Moreover, Kay (2007) does not comment on Labor's opposition to the rebate in the Senate, how both bulk-billing and contribution to public hospitals declined in the Howard's first two terms, nor does he mention how *Medicare Plus* eroded the scheme's universality by reconfiguring bulk-billing (although he mentions that record bulking-billing followed these reforms). Thus, I claim that the government's rhetoric should not be taken at face value and that a more feasible explanation for the 'restoring the balance' frame is that it was a pragmatic approach that enabled the government to retain major elements of *Fightback!*.

IV. Conclusion: The PHITR and Second Tier Politics

Health policy is less 'settled' than retirement incomes policy because of the ideological struggle that has gripped the major parties for over five decades. However, apart from the Hawke-Keating years, STEs for private health insurance have largely been mainstay second-tier policy institutions since Menzies. The Coalition's decision to layer tax incentives and then the rebate onto Medicare (after an election in which Labor had committed to similar tax credits) reflects the entrenchment of STEs as second-tier health policies, the legacy of Liberal party ideology and the conducive policy environment – particularly the influence of neoliberalism.

The Howard government's PHITR represented continuity with the STEs for private health insurance of previous Liberal governments, while the preservation of Medicare set it apart. Inheriting a popular first tier institution, the government conceded policy ground to Labor rather than deal with the political consequences of retrenching it. But, the government did recapture some ground by layering second-tier policies, including the PHITR, onto Medicare. Benefitting a significant (and affluent) minority, the rebate and other second-tier policies built a new constituency of middle and high-income earner beneficiaries that supported private health care. The influence of this constituency is evident in the bipartisan support that the rebate came to enjoy over the next 8 years of

Coalition rule as it became institutionally entrenched.[105] With the previous chapter ruling out a 'rational' policy justification for the PHITR, this chapter has shown the Howard government's political motivations offer a more compelling rationale for the inequitable rebate's return.

[105] This seems to support Hacker's (2002) contention that STEs become more easily entrenched than direct spending programs because of their low visibility.

Case Study II
The Superannuation Tax Concessions

The next three chapters focus on the implications that the superannuation tax concessions (STCs) have for the political and institutional development of the Australian welfare state's second tier. At the Commonwealth level, STCs have subsidised all three points of the superannuation income stream – when individuals contribute to funds, earn interest on investments, and withdraw benefits – since they were introduced as part of the 1915 income tax. Although among Australia's oldest fiscal policies, STCs only emerged recently as core second-tier policies. The STCs were selected as a case study for this thesis because they are one of the largest categories of STEs and are estimated to have a larger impact on the Budget than the age pension. To examine their implications for the second tier, I analyse the institutional design of the STCs and track their political development. Over the next three chapters, the STCs are examined as second-tier retirement incomes policies, with attention given to their social policy consequences as well as both the political and institutional factors that have influenced their institutional path.

Chapter 5 situates the super tax concessions within a two-tiered conception of the Australian retirement incomes system. In a manner similar to health policy, retirement incomes policy can also be understood as a two-tiered system, involving a first tier that is targeted at those with low independent retirement income and a second tier that provides private retirement incomes on a user-pays basis. Advocates have defended the STCs because of their capacity to boost retirement incomes, reduce the fiscal pressures of population ageing and expand national savings. With the budgetary cost of the STCs now outflanking that of the age pension, their efficiency and equity has broad implications for retirement incomes policy and the welfare state more generally. As with the Private Health Insurance Tax Rebate, if the STCs cannot be justified (in their current form) on equity or efficiency grounds, it is difficult to defend these concessions as 'rational policies'. Rather it suggests that an explanation that accounts for politics, policy history and institutions is more appropriate.

Chapters 6 and *7* examine how the STCs became entrenched second-tier policies over recent decades despite their modest beginnings. As in the fourth chapter, I apply the historical institutionalist framework to explore whether an explanation that accounts for the influence political and institutional factors provides a more reasonable explanation of the STCs' development. In accounting for the political and institutional contexts of the STCs, I develop a structured narrative of retirement incomes policy to highlight that these tax concessions have a long history – operating at the State level before Federation – before their relatively recent emergence as major second-tier policies. Drawing on the conceptual toolkit outlined in the second chapter, I then explain recent developments involving the STCs using the concepts of 'drift' and 'conversion' to explain their exploding budgetary cost over recent decades.

- Chapter 5 -

The Devil's in the Detail:

The superannuation tax concessions and the second tier of Australia's retirement income system

The Australian retirement incomes system, similar to the health system, is a mixed economy that can be understood as a two-tiered system of social risk management. The first tier consists of social welfare and is financed directly by the government, collectively pooling the social risk of income insecurity in old age for the overwhelming majority of retirees. Involving fiscal welfare, occupational welfare and social regulation, the second tier offers private insurance against the risk of income insecurity through private investments in super (other private savings) to consumers with means. The super tax concessions (STCs) are the main form of public financial assistance to the second tier.[106] I locate these concessions within the two-tiered retirement incomes system and discuss the interactions between the two tiers. As their estimated budgetary cost outstrips that of the age pension, the equity and effectiveness of the STCs has broad implications for retirement incomes policy and the welfare state. If these tax concessions cannot be

[106] The term private superannuation is used here for non-government superannuation in order to distinguish it from national superannuation and the age pension. The social regulation (i.e. SGS) and STEs make it problematic to classify non-government superannuation as private market super.

defended on 'rational' policy grounds, it suggests that an explanation that draws on the political history and institutions would offer a more credible account of their emergence as second-tier institutions. This is my task in the next two chapters.

I. The Superannuation Tax Concessions: An Overview

Tax expenditures currently apply to all three points of the superannuation income stream: when individuals make contributions; when they earn interest on super investments; and when their super matures (for a summary see *Table 5.1*). The tax concessions for super contributions are particularly complex. Super contributions are taxed at the concessional rate of 15 percent when employers make contributions on behalf of their employees as part of their obligations under the Superannuation Guarantee Scheme (SGS) or through salary-sacrificing arrangements, and when those who are self-employed make personal super contributions. These tax concessions set the maximum applicable tax rate on these types of super contributions at 15 percent – regardless of the marginal tax rate that would otherwise apply – up to a predefined annual contributions cap. In 2007-08, this annual cap was set at $150,000 for individuals aged under 50 years, with contributions over this level attracting the relevant marginal tax rate. There is also a tax concession for super contributions made on behalf of a low-income spouse who earned less than $10,800 per annum, which allows individuals to claim an 18 percent tax offset on up to $3,000 of contributions. When spouses earn over this amount, this tax offset is tapered so that the $3,000 contributions limit is reduced by one dollar for every dollar that a spouse earns over $10,800 until it phases out completely at $13 800.

The tax concessions for super investment earnings and super benefits are less complex. The concessional tax rate of 15 percent also applies for interest earned on super investments. The tax treatment of super benefits depends upon the age at which individuals access super. Super benefits are tax-exempt for individuals aged over 60 years, regardless of whether they are accessed as a lump-sum payment or annuity. For individuals aged between 55 and 60 years, super benefits are taxed at the concessional tax rate of 15 percent, while super benefits accessed by individuals below preservation age (in special circumstances) are taxed at the concessional tax rate of 20 percent. These multi-layered tax arrangements for superannuation are complex and contribute to the difficulties in grasping their overall economic and social impacts. In this chapter, the acronym STC refers to the 15 percent concessional tax rates on super contributions and investments, as well as the tax exemption of super benefits. My focus is limited to these three tax concessions because they have the largest budgetary impact and have long formed second-tier policies (whereas the others were added recently).

Table 5.1 The Concessional Taxation of Superannuation, 2007-08

Stage of the Super Income Stream	Tax Concessions/Benefits
Contributions	Concessional Tax Rate of 15 percent for compulsory contributions Concessional Tax Rate of 15 percent for salary sacrificed into super up to capped amount Concessional Tax Rate of 15 percent for self-employed individuals 18 percent Superannuation Spouse Contribution Tax Offset for up to $3000 in contributions made on behalf of a low-income spouse (who earns less than $13800) to a super fund (maximum value is $540).
Investment Earnings	Concessional Tax Rate of 15 percent on earnings from super investments.
Super Benefits	Tax exemption for super benefits received as a lump-sum or annuity paid to individuals who are 60 years or older. Concessional Tax Rate of 15 percent for super benefits received by individuals who have reached preservation age but are less than 60 years old. Concessional Tax Rate of 20 percent for super benefits received by individuals under preservation age.

Source: compiled from ATO (2009a; 2009b)

II. The Super Tax Concessions and Two-tiers of Retirement Incomes

The superannuation tax concessions are both a major second-tier social policy and the main financial contribution made by the Commonwealth to private retirement incomes provision. This chapter does not draw on the three-pillar model common in the social policy literature because it overlooks tax expenditures for superannuation. Rather, I present a two-tiered model of the retirement incomes system to illustrate the dual pattern of the social policies in Australia's mixed economy of welfare. Like the health system, the two tiers of the retirement incomes system involve distinct insurance systems, social policies, sectors of the economy, financial benefits, and are organised according to different distributive principles. This two-tiered understanding of retirement incomes policy has the advantage of highlighting the role of non-conventional policy instruments such as the Superannuation Guarantee and the STCs. After comparing the two-tiered and three-pillar models, I trace the main features of the two-tiered retirement incomes system and situate the role of STCs within this framework.[107]

[107] My focus is on the Commonwealth level of government, as the States do not provide retirement incomes for the general public.

Two-tiers or three pillars? The institutions of the Australian retirement income system

The two-tiered model of the Australian retirement incomes system devised for this chapter is distinct from, but compatible with, the three-pillar model used by the World Bank (1994). In this context, the term 'pillar' is a metaphor referring to the institutional sources of social transfers that comprise the non-market incomes of individuals or households over the life course (Rein 1994 in Borowski 2005: 46). The first pillar involves the flat rate and means-tested age pension financed out of taxes. The second pillar consists of employer and employee contributions to occupational super (World Bank 1994: 15). And, the third pillar consists of voluntary personal savings that typically take the form of housing and other savings (*ibid*: 15). There are, however, disagreements over the number of pillars, with Yates and Bradbury (2009) viewing housing as a separate fourth (and 'crumbling') pillar in its own right. As the most widely used conceptual models in the social policy literature, the three and four pillar characterisations are useful in highlighting the potential income sources available to retirees.[108]

For my purposes, the Australian retirement incomes system can be characterised as a two-tiered system so that the super tax concessions can be located within the dual welfare state framework. In this formulation, the first tier of the retirement incomes system collectivises the social risk of income insecurity by providing social welfare. These programs generally take the form of social welfare, such as the age pension and other means-tested subsidies, are publicly funded and deliver benefits according to perceptions of need. The second tier includes those institutions that privately insure against the social risk of income insecurity in retirement, involving private sources of retirement income including occupational welfare (such as superannuation from compulsory and voluntary contributions). Although funded mainly from private sources and delivering benefits that reflect an individual's purchasing power, second-tier institutions are mandated and regulated by the state, as well as being generously subsidised through fiscal welfare. This two-tiered conception of the retirement incomes system does not invalidate the three (or four) pillar model, but it does have a different focus. Rather than focusing on distinct sources of income that are not necessarily related to one another, the two-tiered model distinguishes between two sets of institutions that have particular relationships with the state, economy and households.

[108] The World Bank (2005: 1) has subsequently moved on to use a five-pillar model, but the earlier three and four pillar depictions are still most widely used in Australian studies.

Targeted to exclude the rich: The first tier's institutions

Since full 'retirement' requires that individuals do not derive incomes from the labour market, financial dependency on the retirement incomes system is a common experience for older people. As they form part of an 'incomes' system, the two tiers of this system mainly deliver benefits through financial policy instruments such as lump-sum cash payments, income streams, and STEs. The first tier collectively pools the social risk of income insecurity in retirement for eligible retirees, principally through cash transfers funded on a non-contributory basis out of general tax revenue. Its main social programs are: the age pension (and pension supplement); the age service pension; the pension bonus scheme; rent assistance; and concessions funded by the Commonwealth as well as the State and Territory governments. The Commonwealth is the primary financer and regulator of the first tier, but the States and Territories have come to play an increasing role in funding pensioner concessions. Centrelink and the ATO administer delivery of the first tier's financial benefits and STEs (respectively). Unlike the health system (see *Chapter 3*), the first tier is widely available to those of retirement age, but not on a universal basis. Instead, eligibility is determined through means tests to deny access to those with considerable means.

The first tier's main social programs – particularly the age pension – is the primary income source for a majority of retirees and provide at least some benefit to around 1.9 million retirees or 75 percent of the eligible age group (AIHW 2007b: 93). The core of the first tier, the age pension provides retired men aged over 65 years and women over 63.5 years with an indexed income of 25 percent of average male weekly earnings (*ibid*: 94).[109] The age service pension is set at the same rate, but is available to veterans (and eligible partners) from age 60 (Department of Veteran Affairs 2010: 3-4). In 2006-07, the full-rate of the age pension amounted to \$499.70 for singles and \$417.20 for each member of a retired couple per fortnight (AIHW 2007b: 93). Eligibility for the age pension is determined through income and assets tests. In 2007, the income test applies to singles earning over \$128 and couples earning above \$228 per fortnight, while the asset test applies to singles with assets valued at more than \$161 500 and couples with combined assets worth over \$229,000 (Centrelink 2007: 20-21). Assets subjected to the age pension's means test include "cash, money in bank accounts, shares, managed investments, superannuation and rollover funds, [other] properties, and the value of

[109] Reforms announced in the Rudd government's 2009-10 Budget increased the rate of the age pension to 27 percent of male average weekly earnings to be indexed annually.

businesses, motor vehicles, boats and caravans" (*ibid*: 3). Notably, the primary residence is excluded from the assets test. Income and assets over these amounts are subject to taper rates. These means tests are clearly designed to include all but the wealthiest retirees, which is evident in the high proportion of retirees receiving some benefit.

Additional payments and concessions supplement the age pension. The pension supplement, paid as compensation for the increased living costs since the GST's introduction, raises the benefit received by eligible age pensioners by 4 percent. The pension bonus scheme is a tax exempt lump-sum payment that is paid at retirement to individuals aged 65 years and over who choose to forgo retirement and continue paid employment when they eventually retire – the benefit accrued relates to the period that retirement is delayed (AIHW 2007b: 94). Rent assistance is available to many recipients of the pension and is calculated with reference to household composition and rent costs, providing up to $107.20 per fortnight to pensioners who do not own their homes (*ibid*: 190; Warren 2008: 2). In 2007, telephone and utility allowances provide age pensioners with annual bonuses of $88 and $500 (same rate for singles and couples) to help meet the cost of these services (Harmer 2008: 73). Pensioner health cards entitle those who meet the eligibility criteria to further concessions for the PBS and gap payments for bulk-billed GP services, as well as the Seniors Concession Allowance (AIHW 2007b: 93). And the States provide age pensioners with concessions for travel on public transport, motor vehicle registration fees, and for both property and water rates (*ibid*: 93).

The first tier is financed out of the Commonwealth's tax revenue (except for the aforementioned State concessions). In 2006-07, the Commonwealth spent more than $26 billion on first-tier social welfare programs. Presenting official data from the Harmer Pension Review and the Department of Families, Community Services and Indigenous Affairs (FACSIA), *Table 5.2* shows how this expenditure was allocated. Costing almost $22.6 billion in 2006-07, the age pension is the most expensive first tier program in the Australian government's Budget. A further $2.9 billion was spent on the Age Service Pension. The pension bonus scheme cost $444 million, and the utilities, 'seniors concession', and telephone allowances accounted for $147 million, $65 million and $12 million respectively.[110]

[110] This is only the cost for the federal government. It does not include the substantial costs borne by State and local governments.

Although not universally accessible, the first tier pools risk by providing financial assistance according to the principle of need through public institutions that are funded collectively through taxes. As financial support is allocated on the basis of need, the first tier bestows on recipients the 'social right' to a minimum standard of living regardless of their market position or personal contributions. This does not mean that first-tier programs produce an acceptable standard of living: questions about their sufficiency have emerged from multiple sources (and inspired the Harmer review commissioned by the Rudd government in 2008).

Table 5.2 Commonwealth Government Expenditures on the First tier in 2006-07

Expense Category	Amount ($m)
Age Pension*	22 598
Age Service Pension	2 949
Pension Bonus Scheme	444
Utilities Allowance	147
Seniors Concession Allowance	65
Telephone Allowance	12
Sub-Total	26 215

* Pension Supplement included

Source: Harmer (2009: 64); FACSIA (2007: 425)

Increasing with income and means: The second tier of retirement incomes policy

The second tier provides private insurance for the social risk of income insecurity, offering retirees access to incomes and resources from private sources according to their capacity to save and invest before retirement. Second-tier retirement incomes are mainly financed through private super as lump-sum payments or private pensions. Private super is, in turn, jointly financed by mandatory contributions from individuals and employers, voluntary individual contributions, as well as the STCs. The government's main second-tier policies relate to private super, such as: the SGS; the STCs; and, the Superannuation Co-contribution Scheme (SCS). While also regulating private super, the Commonwealth does so only lightly. To a greater extent than the health system, the retirement income system's second tier benefits higher income earners and wealthier individuals. Although individuals can claim first-tier benefits if they meet the means tests, the risks of second-tier investments are borne by individuals despite the relatively high levels of public investment.

Core second-tier policies expand private super by mandating contributions to super funds and offering individuals incentives to invest. Australia's system of mandatory super contributions is also known as occupational super because it makes contributions compulsory for almost all workers (see *Chapters 6* and *7*). Outlined in *Table 5.1*, the STCs provide individuals with incentives to make voluntary contributions to super and, by reducing the amount of tax on super benefits, increase their end benefits. The SCS offers a further incentive for lower income earners to make voluntary super contributions. In 2006-07, this scheme contributed $1.50 for each dollar voluntarily invested in a super fund by individuals earning up to $28,000 a year, to a maximum super co-contribution of $1 500. This scheme is also tapered, with the maximum contribution reduced by 5 cents for every dollar earned over $28,000 until it phases out altogether (also for 2006-07).

Second-tier retirement incomes are financed through private super, the STCs and, to a lesser extent, other forms of private savings.[111] *Table 5.3* lists the main sources of finance for the private super sector in 2006-07. Amounting to $163 billion, contributions are the largest addition to private super, with employers contributing $67 billion and members investing $96 billion.[112] Primarily made by members and employers, contributions were made to four kinds of funds: industry super funds administered by a joint board of business and union representatives on behalf of members; retail super funds operated as commercial businesses; employer-operated super funds; and, self-managed super.

Although the SGS channels much of these contributions into private super, it does not appear in *Table 5.3* because it is a regulatory instrument and does not directly call on public financers. This means that although the SGS is the core second-tier policy, its largest impact on the Budget is indirect through the STCs that apply to the contributions it mandates. The private super industry's other principal source of finance is from investment returns, which earned the sector net investment income of $158 billion on the $911 billion assets held.[113] The SCS contributed significantly less at $1.67 billion. In

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[111] As the focus here is on retirement incomes, housing assets are not included here unless they are drawn on for income.

[112] This outcome reverses the usual pattern where employer contributions amount to more than member contributions. However, the *Simplified Super* reforms of 2006-07 included a transitory arrangement whereby individuals could make contributions up to $1 million and incur no tax up to 1 July 2007. Please see *Chapter 6* for more details. From 2007-08 onwards, employer contributions have once again outstripped member contributions.

[113] Since 2007-08, the assets held by the super industry have topped $1 trillion.

total, the financial footprint of private superannuation amounted to $324 billion, which was equivalent to around 35 percent of GDP in 2006-07.

Table 5.3 Main Sources of Second Tier Finance in 2006-07

Funding Source	Amount ($m)
Super Contributions	163,550
Employer Contributions	67,092
Member Contributions	96,458
Super Assets (Total)	910,901
Net Super Investment Income	158,854
Super Co-Contribution Scheme	1,618
Super Tax Concessions	30,379
Total Super Finance*	**324,022**

* This is the sum of the super contributions, net super investment income and the SCS.
Source: Compiled from APRA (2009: 35) and Treasury (2009: 10)

Private superannuation is also financed indirectly through the super tax concessions outlined above. These tax concessions are difficult to identify in the three-pillar model as public subsidies for private benefits, but are classified as part of the second tier along with the SGS. As *Table 5.3* shows, the super tax concessions effectively contributed more than $30 billion of revenue forgone to private super funds in 2006-07, which is roughly 35 percent greater than the budget of the age pension.[114] In the *Tax Expenditure Statement* (TES), the Treasury provides estimates for the tax concessions for super contributions and super fund earnings (see *Table 5.4*), but not the tax exemption for super benefits that is counted as part of the tax benchmark (so this tax is not counted twice). Of the STEs applying to super contributions, the tax concessions for employer contributions are the largest category at $11.4 billion of revenue forgone. This was followed by the tax concession for certain super contributions (mainly the self-employed), which accounted for $810 million, the tax exemption of the SCS ($540 million), and the spouse contribution tax offset ($15 million). For the STEs for super investments, the largest categories were the tax concessions for super fund earnings at $15.9 billion and the capital gains tax discount for certain super fund assets at 1.7 billion. Taken together, the super tax concessions listed in the TES amounted to the Commonwealth's largest financial contribution to the retirement income system's second tier.

[114] This is a rough estimate because revenue forgone and direct expenditure are not directly equivalent. The only category of STEs, or tax expenditures for that matter, that cost more revenue forgone than the super tax concessions are the STEs for housing (which first appeared in an appendix of the 2009 TES and were included within the overall estimates in 2010).

The Commonwealth also regulates private superannuation. The main regulatory instrument for super contributions is the SGS, which obliges employers, with few exceptions, to contribute on behalf of employees (Nielson 2009: 14). The 'Choice of Super Fund' legislation of 2006 provides another layer of regulation to limit the range of investment options that employees can choose to direct their occupational super, except for those with defined benefit super and employees with entitlements under Australian Workplace Agreements (AWAs) (*ibid*: 16).[115] These options include: complying super funds; retirement savings accounts; and, funds that meet the criteria of super accounts under the SGS legislation (*ibid*: 16). The Commonwealth also regulates the access that individuals have to their super assets, by ensuring that super investments are 'vested' (remain the property of those who hold the account), 'portable' (can be transferred from one fund to another), and are 'preserved' until individuals reach at least 55 years of age (Olsberg 1997: 78; Warren 2008: 17). And, the Commonwealth regulates the terms under which superannuation can be withdrawn before preservation age, such as in case of sickness or hardship, and the distribution of remaining super benefits at an individual's death (Nielson 2009). Notwithstanding these regulations, the superannuation industry is regulated relatively lightly, with few limits placed on the performance of super funds, how those funds are invested or what level of benefits they must provide.

Table 5.4 Estimates of Revenue Forgone for the Major Super Tax Concessions in 2006-07

Funding Source	Revenue Forgone ($m)
STEs for super contributions	
Tax Concession of Employer Contributions	11,450
Tax Concession for Certain Contributions	810
Exemption of Co-Contribution Scheme	540
Spouse Contribution Tax Offset	15
STEs for super investments	
Tax Concession of Super Fund Earnings	15,900
Capital Gains Tax Discount for Super Funds	1,700
Total Super Tax Concessions*	**30,379**

* This is not the sum of the STEs listed in this table, but the total revenue forgone for the super tax concessions listed in the TES.
Source: Compiled from Treasury (2009: 139-151)

[115] AWAs have been subsequently abolished.

Other kinds of private savings – such as investments in shares, managed funds and housing – which retirees may also draw upon as income tend to generate returns that are more irregular and thus play a lesser role than either the age pension or private super in the make-up of retirees' weekly incomes.[116] These types of saving are often difficult to account for as 'retirement income' because they can accrue at all stages of an individual's working life and/or satisfy ends other than boosting retirement incomes – which makes it hard to ascertain how these investments contribute to the second tier. Consider the example of housing. As Castles (1998) and Yates and Bradbury (2009) both point out, private housing is a cornerstone of the Australian retirement incomes system as it diminishes the need for higher welfare payments for those who have retired. Home ownership among retirees is higher in Australia than in other OECD countries taking part in the Luxembourg Income and Wealth Studies, with 80 percent of retirees owning their homes (AIHW 2007b: 96; Yates and Bradbury 2009: 5). But, more broadly, home ownership occurs at many stages of the life course and imparts many advantages – including a reduced need for welfare at whatever period housing is acquired. Because of these difficulties, the contributions that these other types of private saving (and the tax expenditures that apply to them) make to the second tier are not discussed here.

The roles of government in a two-tiered retirement income system

Both tiers comprise substantial components of the retirement incomes system. The first tier forms the primary system of risk management accessible to the majority of retirees to protect them from poverty and income insecurity. In 2006, around 75 percent of those aged over 65 years drew on the age pension or service age pension for income, with 46.5 percent drawing the full rate of the pension and 28.5 percent receiving a partial pension (AIHWb 2007: 93). Of those drawing the pension, about 46 percent of its recipients rely on it for 90 percent (or more) of their incomes while it contributes more than half the income of a further 24 percent (ABS 2007a: 41). Moreover, these coverage rates are unlikely to change much even when the SGS matures. The Treasury projects that around 74 percent of the population aged over 65 years will receive some level of the age pension in 2050, with 45.3 percent likely to access the full pension and 28.3 percent expected to receive a partial pension (Harmer 2009: 9). Nevertheless, the second tier covers a significant proportion of the labour force and has a much larger financial footprint than the first tier. In 2006, 90 percent of those in the labour force had some level

[116] While the housing tax expenditures are not the focus here for the reasons noted in this paragraph, it is likely that the tax exemption of imputed rent (which is taxed in other countries) may act as a hidden income stream for many retirees.

of superannuation savings (Nielson and Harris 2008). And, as noted above, the private super industry accounts for a sizeable share of Australian financial activity – a trend that is likely to continue as the SGS matures. So, whilst neither tier has universal coverage, most retirees are likely to insure against the risks of poverty and income insecurity through the pension on its own or combined with super.

The policy instruments that the Commonwealth uses to channel funds to the two tiers closely follow the broader pattern observed in this thesis. Similar to the health system, the social welfare policies of the first-tier benefit low-income earners and the fiscal welfare policies of the second deliver benefits that increase with the size of contributions made. In contrast to health policy, however, the government also mandates second-tier occupational welfare – in the form of the SGS – although it should be noted that employers pay the super contributions. The first tier is largely comprised by social welfare provided through income transfers, such as the age pension, whilst the second tier is subsidised through the fiscal welfare of tax expenditures and mandated by compulsory occupational welfare.

III. Substitutive, Complementary or Supplementary Tiers?

Having outlined the main features of the retirement incomes system and policy, I discuss how the two tiers interact with each other to better gauge the implications that the STCs for this system. In this discussion, I draw again on the distinctions that Hussey and Anderson (2004) make between substitutive, complementary and supplementary forms of private insurance.[117] Although Hussey and Anderson (2004) develop their distinctions for health insurance systems, they are applicable to public and private insurance systems more broadly and are therefore applied here to the age pension and private super. Similar to private health insurance, private super is often argued to act a substitute to the age pension. After a closer inspection of the interactions between the two tiers, however, I contend that the second tier combines elements of substitutive and supplementary insurance.

Supplementary and substitutive private insurance

The second tier of the retirement incomes system is subsidiary to the first tier. The first tier's age pension benefits most retirees, whereas second-tier super, if held at all,

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[117] To recap, *substitutive* private insurance acts as a replacement for public insurance. *Complementary* private insurance covers services not available through the public system. And, *supplementary* private insurance covers services that are also available in the public system.

provides a supplementary retirement income. In some cases, retirees with second-tier savings have collected super as a lump-sum payment, and either spend it or place it in investments excluded from the age pension's means tests (such as the primary residence). For the minority of retirees who are excluded from the pension through its means tests, income derived from the second tier acts as a substitute for public programs. Moreover, as the first tier is publicly financed and the second tier is subsidised at a similar level through tax expenditures, both tiers have a significant impact on state revenue and draw on finance that could be spent on the other tier's programs. This means that developments in one tier have implications for the other, since individuals often have access to both and they receive similar levels of funding from the public purse. The multiple interactions between the retirement income system's first and second tiers make it a close but imperfect match with Hussey and Anderson's (2004) relationships. Compared with the health system where the two tiers provided insurance for distinct kinds of medical and hospital services, the retirement income system's second tier is not complementary insurance since it provides income security and hopefully, allows retirees to live comfortably.

The multiple interactions between the tiers of the retirement income system make it a close, but nonetheless imperfect, match with Hussey and Anderson's (2004) relationships. The second tier is a substitutive system of private insurance since individuals are excluded from the first tier when their income or assets – often from superannuation – reach a specified threshold that they then must solely rely on. However, the second tier is not exclusively substitutive since it provides an income supplement to the age pension for many retirees, particularly the 28.5 percent of those aged 65 or older who received a partial pension. Reflecting these relationships, the second tier is viewed here as combining substitutive and supplementary systems of private insurance. Whether retirees access supplementary or substitutive private insurance largely depends on the level of retirement savings and/or assets they (and their households) hold, because the latter determines the rate of the pension received and their capacity to rely on second-tier savings.

Interactions of a supplementary and substitutive system

As either supplementary or substitutive private insurance, the second tier provides some benefit to most retirees. It provides supplementary private insurance to those who receive the majority of their income from the first tier's pensions and a minority from private sources. Presenting data from the ABS (2007a), *Table 5.5* shows the contribution of the age pension to the gross income of households with members 65 years and over in 2003-04. This table shows that the age pension was the primary income source for about 70 percent of households with members of retirement age in 2003-04 and that single older people are highly reliant on public provision. The second tier offers substitutive private insurance for those retirees who draw upon it as their primary source of income and receive little or no benefit from the first tier. *Table 5.5* suggests that around 15 percent of those aged more than 65 years in 2002-03 derived at least one percent but less than half of their gross income from the age pension, with couples more likely to have private income. This table also reveals that the age pension comprises between 0 and 1 percent of the gross income for only 15 percent of those over 65 years (but many of this group may work as the ABS does not identify retired and non-retired persons). Nonetheless, for current retirees, the second tier provides supplementary private insurance for a sizeable minority and substitutive private insurance for only a small minority.

Table 5.5 Contribution of Age Pension and Age Service Pension to Gross Individual Income for those aged 65 years or over by Household type, 2003-04*

% of Gross Individual Income	Couples (%)	Sole Person (%)	All Households (%)
0 – 1	16	14	15
1 – 19	5	4	5
20 – 49	11	6	10
50 – 89	26	20	24
90+	41	55	46

* This is the from the most recent publication of Government Benefits, Taxes and Household Income
Source: Compiled from ABS (2007a: 41)

The main interaction between the two tiers concerns the supplementary insurance provided by private super. Supplementary insurance from private super boosts the incomes of 70 percent of those at retirement age without directly increasing the demands on the public purse. The capacity for private super to perform these functions relates to both the coverage and holdings of retirees and near-retirees. Men are more likely to have super than women. Wilkins *et al.* (2009: 125) found that around 82 percent of men and 75 percent of women held super in 2006. Calculated using data from Wilkins *et al.* (2009) and Kelly (2009), *Table 5.6* displays estimates of the income that men and women at or near retirement age can expect to draw from their current super holdings if they lived to average life expectancy and took their investments as an income stream.[118] As the table shows, men of retirement age tend to hold more super than women in the same age group. *Table 5.6* shows that only half of men aged 65 years or older (who have not retired) have super holdings equivalent to more than an extra $8 270 of retirement income per annum (assuming average life expectancy). Conversely, only half of women in the same age group have super investments equivalent to a supplement to their retirement income of $2 325 per annum in 2006. This pattern also holds for those aged 55 to 64 years, with men having access to super assets equivalent to $6 486 per year of retirement (also assuming average life expectancy) and women holding super equivalent to $2 325 per year of retirement in 2006. Even if these income levels are extrapolated for couples, the superannuation holdings of most pensioners are likely to provide only a modest top-up to the age pension, with limited potential to reduce demands on the first tier.

A further interaction between the two tiers involves the provision of substitutive insurance through private super. As a substitute to the age pension, private superannuation plays a direct role in reducing demand for the age pension by providing an alternative source of income, particularly for those with means. Despite playing a major role in public debate over super, it remains the case that only a small but significant minority of retirees – ranging from 15 to 30 percent of those of retirement age – draw on super as primary income. This is unlikely to change in coming decades, with the recent Harmer Pension Review highlighting that the SGS is projected to offset the cost of the age pension by only 6 percent when it matures. From Treasury modelling, Harmer (2009: 9-10) also notes that around 75 percent of retirees are expected to claim the age pension in 2050. Of this group, 28 percent (of retirees) should qualify for the full-rate and 47 percent a partial pension. The remaining 26 percent are expected to draw on private sources of income such as super (although they may receive the pension in later years of retirement). So, when the SGS matures, the provision of substitutive insurance through private super is unlikely to cover a higher proportion of the retired population and replace the age pension. It should also be noted that if retirees rundown their assets and spend income until it drops below the respective means test, they can qualify for the age pension.

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[118] Of course, this does not count interest, further contributions or late retirement.

Table 5.6 Expected Average Yearly Income from Private Superannuation, 2006

	Super Holdings Median ($)	Current Life expectancy at 65 years (years)	Expected Average Yearly Income from Super Savings Median ($)
Men			
55-64 years	120,000	18.5	6,486
65 years +	153,000	18.5	8,270
Women			
55-64 years	55,000	21.5	2,558
65 years +	50,000	21.5	2,325

Source: Calculated from Wilkins et al. *(2009: 125) and Kelly (2009: 14)*

The interactions between the two tiers are complicated by the primary residence's exclusion from the assets test of the age pension. By exempting the family home regardless of its value, this clause accentuates the already significant advantages of home ownership in retirement by allowing retirees to amass considerable wealth that might otherwise block access to the age pension. The other main benefits of home ownership at retirement include not having to pay rent and holding an asset whose equity can be accessed through downsizing or reverse equity mortgages (Henry 2008: 28). Retirees taking out reverse mortgages receive further tax concessions: the first $40,000 of lump-sum payments is exempt from the age pension's asset test; and, payments received as an income stream are deductible for purposes of the income test (*ibid*: 28). Benefits of home ownership are partly counter-balanced by public rent assistance and the higher assets test threshold for non-home owners. But, since the assets test's threshold is only raised by $124,500 for non-home owners, this policy exacerbates the undervaluation of the primary residence and thus provides an incentive to invest in housing (*ibid*: 28).

The interactions between the two tiers are also complicated by the structure of the super fund accounts held by individuals. The structure of these accounts depends on the benefits that retirees receive from their super investments. In Australia, super is invested mostly in two types of schemes: defined benefit schemes provide an annuity or private pension; and, defined contribution or accumulation schemes typically provide lump-sum payments. *Table 5.7* displays the responses of men and women to a survey question about the type of super scheme their contributions were invested in. The table shows that most men and women have defined contribution scheme (64 and 57 percent respectively), a relatively small proportion of men and women (around 11 percent) have defined benefit schemes, and a significant minority are unaware of the kind of fund they have (Wilkins *et* *al* 2009: 126). It also reveals that for those nearing retirement age (55 years and older), men are more likely to have defined benefit schemes (a majority of men and women have defined contribution schemes) and women are less likely to know what type of scheme they have. The relatively small proportion of Australians with defined benefit schemes is supported by research undertaken by APRA and is unsurprising as the SGS mandates contributions to accumulation funds for most workers.[119] The prevalence of defined contribution schemes, coupled with the relatively low level of super held by most retirees, also explains why super benefits are mainly received as lump-sums – basically because retirees do not have the means to draw or purchase income streams.

The prevalence of lump-sum super benefits further complicates the interactions between the two tiers of the retirement incomes system. Through comparisons of household debt and super holdings at retirement and the years leading up to it, Kelly *et al*. (2004: 8) note that in households with at least one person aged 50-69 years in the workforce, the average super balance was $170,000 and mean household debt was $85,500 in 2002 (Kelly *et al.* 2004). For households where people aged 50-69 years had retired, the average super balance was $93,000 and household debt was $22,700 in 2002 (*ibid*). Because of this difference and higher rates of home ownership amongst retired people, Kelly *et al*. (2004) claim that retirees appear to be drawing on their super to pay off debt obtained while in the labour force, rather than using it as intended to provide retirement income. This difference seems to stem from, as FitzGerald (2007: 33) argues, the incentive to amass larger debt flowing from expectations of future super benefits. Moreover, even if super is not expended on housing or debt, regulations do not prevent it being spent in ways not envisaged. As Disney (2007: 3) argues, the “lax rules about withdrawals of [super] benefits provide undue encouragement for the savings to be expended at the onset of retirement, or passed on to relatives for tax avoidance purposes, rather than used for ongoing retirement needs”. Because of the many ways that lump-sum super payments can be used, the interactions between the two tiers as second-tier savings may only offer supplementary or substitutive insurance for a brief sojourn before retirees end up drawing on the first tier.

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[119] The HILDA data is used here over APRA data, since APRA organises it data according to firms that offer accumulation, defined benefit and hybrid accounts (that offer both types of schemes) rather than members.

Table 5.7 Structure of Super Accounts Held by Men and Women, 2006*

	Defined Benefit Fund	Defined Contribution Fund	Don't Know
Men			
55-64 years	14.4	67.3	18.3
65 years +	16.8	67.6	15.6
15-65+ years	11.3	64.0	24.7
Women			
55-64 years	9.9	67.0	23.1
65 years +	13.3	64.6	22.0
15-65+ years	11.7	57.3	31.0

* This table presents population-weighted data from the HILDA survey.

Source: Wilkins et al. *(2009: 126)*

The second tier thus acts as a substitute to the first tier for a relatively small minority of retirees and a supplement to the first tier for the bulk of the Australian population. These interactions are, however, complicated by the exemption of the primary residence from the age pension's asset test and the predominance of lump-sum super benefits, which enables retirees to channel their assets toward ends other than retirement incomes and then draw the full rate of the age pension. In a similar way to the health system, the second tier of retirement incomes policy has a relatively small role in providing substitutive insurance limits the capacity of private super and by implication the super tax concessions have done little to relieve pressure on the first tier – this is examined further in the next section.

III. Ends and Means: Tax concessions, superannuation & retirement income

Because of their large scale and complexity, it is unsurprising that the STCs are a source of some controversy (although not widespread) and that questions focus on their effectiveness as retirement incomes policy and economic policy. In part, this controversy stems from the range of policy goals that governments have assigned to private super and by extension the STCs since the 1980s. These goals include: lowering inflationary pressures; increasing retirement incomes; offsetting the budgetary costs of population ageing; and, advancing national savings. Apart from boosting national savings, these goals remain chief amongst the justifications espoused for the STCs. With private super covering over 90 percent of workers and super assets reaching $1.1 trillion, the STCs appear to have been successful at meeting these goals. A closer examination of the STCs, however, casts serious doubt on their capacity to reach these goals and that, even when compared with the PHITR, they offer poor value for public money.

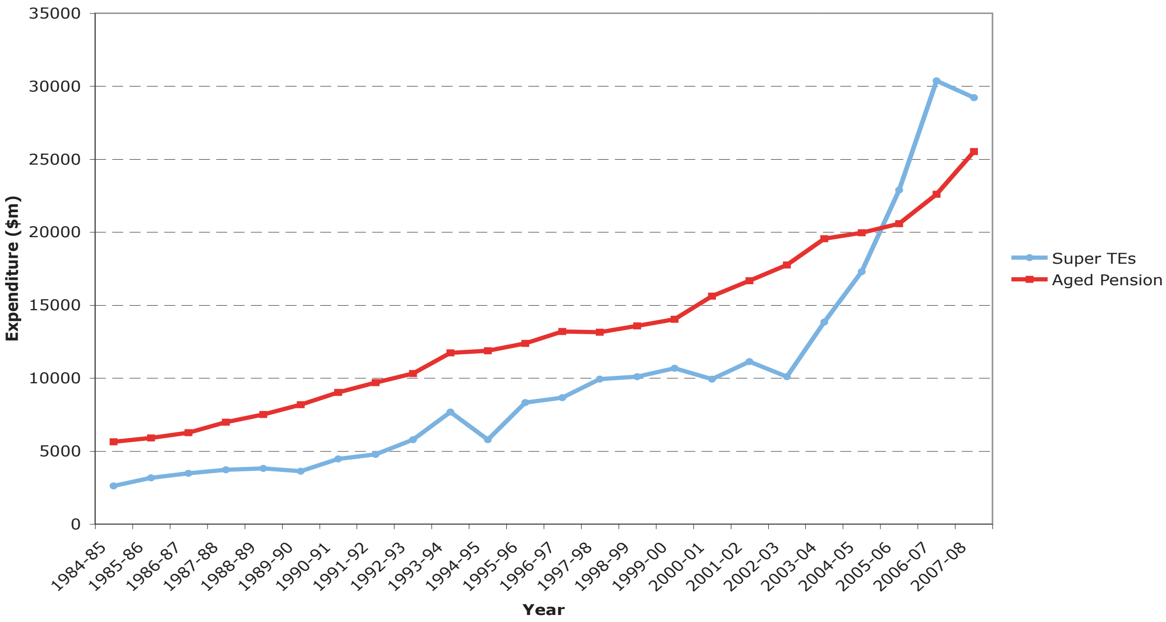
The rise and rise of the Superannuation Tax Concessions

As the financial cost of the STCs bears on their efficiency, this section reports on recent trends in their cost to the Budget and compares their growth to that of the age pension. The STCs for contributions and investment earnings cost the government $30.4 billion of revenue forgone in 2006-07, which is equivalent to about 11 percent of public spending and about 2 percent of GDP (Treasury 2009: 13).[120] As *Figure 5.1* shows, these STCs cost the Budget around 34 percent more than the age pension in 2006-07, which cost $22.6 billion. This marked only the second year that the STCs were estimated to have a larger financial footprint than the age pension. Despite falling during the Global Financial Crisis as pro-cyclical policies, the current scale of the STCs is unprecedented and the Treasury (2009; 2010) projects that they will continue growing with private super over the long term.

The unprecedented scale of the STCs reflects their rapid expansion over the past 25 years, especially since the SGS was established at 9 percent of earnings in 2002. From 1983-84 to 2006-07, the super tax concessions have surged from $2.1 billion to a much larger $30.4 billion (see *Figure 5.1*). The super tax concessions increased by more than 400 percent in 'real' terms (adjusted for inflation) over the past 25 years. They have also almost tripled as a proportion of total public spending from 4 percent in 1984-85 to about 11 percent in 2006-07 and have grown from 1.3 percent of GDP in 1984-85 to 1.9 percent in 2006-07. Indicative of this remarkable rate of increase, the cost of the super tax concessions outstripped that of the age pension during a period in which the latter also expanded significantly, from $5.6 billion in 1984-85 to $30.3 billion in 2006-07 – an increase of 77 percent adjusted for inflation. This means that the growth of super tax concessions has outpaced the rate of increase to the age pension by almost four fold.

[120] Total public spending is comprised of direct public spending and tax expenditures listed in the *Tax Expenditure Statement*.

Figure 5.1 Expenditure on the STCs overtakes that for the Age Pension between 1984 and 2008*



* Age pension figures from 1984-85 to 1989-90 also include age widows pensions and rent assistance.
Source: compiled from Treasury (various years) TES; ABS (various years) Year Book

The budgetary scale of the STCs, however, has not increased at a uniform rate. As *Figure 5.1* shows, the rise of superannuation tax concessions coincided with policy changes and favourable investment conditions. With the exception of 1994-95 and 2002-03, the tax concessions have consistently expanded since the SGS was introduced. *Figure 5.1* also shows that the growth of the super tax concessions has been particularly marked since the early 2000s. This coincided with policy changes such as the rise of the SGS to 9 percent in 2002 and reforms to the STCs that reduced the tax paid by high-income earners on super contributions and benefits between 2002 and 2006 (see *Chapter 7*). The growth of the STEs also reflected the favourable investment conditions of the early 2000s and the rise of super fund holdings to over $1 trillion. The immense scale of the STCs – to the point where they now outflank the age pension – highlights the need to question whether they provide an efficient means to increase retirement incomes, offset the cost of population ageing, and/or boost national savings.

The STCs, retirement incomes and household wealth

Although the available evidence suggests that the STCs – through private super – have been at least partly successful at increasing retirement incomes, the link between the super tax concessions and retirement income is at best tenuous and definitely not as straightforward as often assumed. This tenuous nature of this link is accentuated by significant data limitations pertaining to the STCs, including: the absence of transaction trails; their lack of coverage in major social surveys; the lack of disaggregation at either the individual or household level in the TES (which focuses on their aggregate cost); and, their absence from the Treasury's *Intergenerational Reports*. To complicate the link between the tax concessions and retirement incomes further, the STCs benefit recipients over their working lives when they contribute to super funds and earn interest on their investments. This makes it difficult to measure the contributions that the super tax concessions make to the final super benefits received by individuals, let alone households, at retirement.

Moreover, even if it were possible to calculate the contribution that STCs make to final super benefits, the current policy mix does little to ensure that private super, and therefore the super tax concessions, are directed at retirement incomes. In fact, the existing regulations for the super industry place few restrictions on how super benefits can be spent by retirees. As noted previously, the capacity of private super to boost retirement incomes is constrained by the relatively low level of super assets held by the current cohort of retirees and the prevalence of lump-sum super payments, which are often directed at reducing household debt or purchasing one-off luxury items that contribute little to long-term income. There is much potential for super savings to be spent in this way in Australia because the age pension can be claimed from age 65 years (for men) and the preservation age for super is 55 years. This gap appears to provide some retirees with an incentive to disburse their super assets before they are subjected to the age pension's means tests (Disney 2007: 22).

At the same time, lump-sum super benefits that are spent paying on mortgages or housing upgrades may increase household wealth, but not boost retirement income. Reverse equity mortgages allow retirees to access income from housing assets that they own, as a lump-sum or an income stream. This industry is in its infancy in Australia, with only 1.4 percent of individuals aged more than 60 years holding a reverse mortgage. In 2007, the reverse mortgage market accounted for $2 billion, comprising 33 700 mortgages with an average value of $59,000 (Henry 2008: 28). Although it is difficult to ascertain what the STCs contribute to retirement incomes, there is little evidence to suggest that private super substantially boosts income security in retirement.

Nevertheless, the Treasury's Retirement Income Modelling Taskforce concluded that the super tax concessions have made private super an attractive investment option. Rothman (2000: 2) claims that the STCs boost private retirement incomes by providing incentives to invest in super and offsetting the cost of sequestering super away until preservation age. Along with the co-contribution scheme for low-income earners, Bingham and Rothman (2005: 20) argue that the tax discount provided by the STCs offer incentives to make voluntary contributions to super rather than other investments. This is particularly true for high-income earners whose pay the top marginal tax rate and thus stand to earn 40 percent more by investing in super (because of these concessions) – even one year from retirement (*ibid*: 6). That STCs make private super an attractive option for high-income earners is confirmed by Henry (2008: 22), who notes that Treasury estimates that the top 5 percent of income earners received more than 37 percent of these concessions in 2005-06. This amounts to roughly $10 billion of revenue forgone. Whilst highlighting their inequity, the concentration of STC benefits amongst higher income earners suggests that they mainly provide incentives to invest in super to this group.

There is also evidence that private super, and by implication the STCs, have increased household resources available to retirees. Through an analysis of HILDA data, Connolly finds that the SGS increases voluntary super contributions and household wealth, "with an extra dollar in their compulsory pension accounts adding between 70 and 90 cents to household wealth" (2007: 22). Although Connolly (2007) does not specifically consider the impact of the super tax concessions on household wealth, they are likely to contribute to this by encouraging investment in super and increasing the proportion of invested funds preserved as super. These results have to be viewed, however, with consideration to other potential processes that have increased household wealth, such as: the rapid growth of Australian housing prices, increased rates of household debt, and as noted previously limits to the linkages between super, household wealth and retirement income.

Whilst STCs appear to encourage high-income earners to invest in private super and thereby increase their household wealth, the evidence does not support the claim that these tax concessions significantly boost retirement incomes of the great majority of retirees. If the latter were true, it would be expected that retirees would hold larger super investments and that proportionally fewer retirees would claim the age pension (or at least fewer retirees would be projected to claim the pension when the SGS matures).

Admittedly, persistent data limitations should be considered here, but the inadequacy of most retirees' super holding to provide an income stream and few limits on how lump-sum benefits are spent suggest that these concessions mainly assist higher income earners without ensuring that private super provides retirement income. The STCs' high budgetary costs and the prevalence of lump-sum benefits cast doubt on their efficiency as a retirement incomes policy.

Alleviating the pressures of population ageing?

If there is little evidence of the super tax concessions boosting retirement incomes, then there is even less supporting their capacity to alleviate the anticipated budgetary pressures associated with population ageing. Australia's population, like other OECD countries, is projected to age significantly over the coming decades because of declining fertility and rising life expectancies. Fertility rates have fallen from 3.5 births per women in 1961 to around 2 births per women in 2008 (Treasury 2010: 7). They are projected to stabilise at 1.9 in 2013 and remain at this level until 2050 (*ibid*: 7). Life expectancy has increased by (at least) 24 years for men and women since 1901, reaching 79.2 years at birth for men and 83.7 years for women in 2006-07 (*ibid*: 6). *Table 5.8* presents data from the latest *Intergenerational Report* that shows that population ageing is projected to be more pronounced at the extremes of the life course over the coming decades. The proportion of the population aged less than 15 years is projected to decrease from 29 to 17 percent between 1970 and 2050 (*ibid*: 10). The working age population is projected to remain above 60 percent throughout the projection period and the proportion aged over 65 years is projected to grow from 8 percent of the population in 1970 to 23 percent in 2050 (*ibid*: 10). Although this will be offset by migration somewhat, the Treasury (2010: 10) projects that the aged-to-working-age ratio will nearly double from 20 percent in 2010 to more than 37 percent in 2050.

Table 5.8 Age Structure of the Australian population, 1970-2050

	1970	2010	2050 (Projected)
% of population			
0-14 years	28.8	19.1	17.2
15-64 years	62.8	67.4	60.2
65-84 years	7.8	11.7	17.6
85+ years	0.5	1.8	5.1

Source: Treasury (2010: 10) Intergenerational Report

These long-term population projections have clear implications for retirement incomes policy and fiscal policy (Borowski and McDonald 2007). But, the implications of population ageing for Australia is tempered by international comparison, consideration of the assumptions underlying official programs, and the long-term nature of these projections. Compared with most OECD countries, Australia has a 'favourable demographic profile', with relatively high birth rates and high migration expected to offset population ageing. Australia's aged-to-working-age ratio is expected to peak at around 37 percent in 2050, which compares to the OECD average of 50 percent (OECD 2009: 151). Moreover, the official projections used in the *Intergenerational Reports* are based on overly pessimistic assumptions and are sensitive to small adjustments. Dowrick and McDonald (2002: 9-10) claim that these reports underestimate the effects of high employment rates, potential increases in productivity, and the prospect of higher labour force participation rates, as well as overstating the certainty of projected health and care costs. They further contend that even in the unlikely scenario that the report's baseline scenario eventuates and taxes increase by 5 percent of GDP, real post-tax incomes are still expected to grow (*ibid*: 10).

Nevertheless, the implications of population ageing for Australia are moderated most by the long-term nature of official projections. As Johnson (1999) noted at a Productivity Commission conference on ageing,

> If, in Britain in 1951, it had been predicted that over the next forty years the manufacturing sector would collapse from over 50 per cent to under 25 per cent of the workforce, or that the divorce rate would rise to the point that one third of all marriages would end in divorce, then these prospective trends would have been seen as unsustainable, and there would have been a call for urgent ameliorative action by the government. As we all know, these changes did occur, but without creating economic misery or social collapse.

More recently, Australian social expenditures climbed from around 11 to about 18 percent of GDP between 1980 and 2001 without triggering a fiscal crisis (Wilson *et al.* 2005: 103). So, while population ageing will impact on the Budget in coming decades, viewing the projections as pointing to inevitable fiscal crisis is premature and perhaps alarmist (see Castles 2004).

Somewhat paradoxically, population ageing, together with its potential to foster future fiscal crises, has provided a rationale for extending occupational super and the super tax concessions in Australia. As discussed at greater length in *Chapter 6*, the link between retirement incomes and population ageing was forged publicly by the Cass

Social Security Review in the late 1980s and served to justify the Keating government's extension of occupational super in the early 1990s. Internationally, the World Bank's (1994) report *Averting the Old Age Crisis* and the OECD's (1997) *Ageing in OECD countries* gave credence to pre-existing perceptions in Australia that population ageing was a potential future crisis whose avoidance required a pre-emptive policy response. The Howard government's commissioning of the *Intergenerational Reports* to regularly update the fiscal implications of population ageing has also reinforced perceptions that fiscal constraint is necessary to limit the budgetary costs of ageing. However, as the rhetoric relating to the 'fiscal crisis' of ageing in official documents has intensified, the projections of the budgetary impact of population ageing that appear in the *Intergenerational Reports* have become less worrisome (Doughney and King 2006: 38), with the third report scaling back the budgetary cost of population ageing projected in the first and second reports.

However, even if population ageing were to add to fiscal pressures, the super tax concessions and private super are unlikely to offset the burdens on the public purse. The main budgetary pressures associated with population ageing stem from the expected increases to the cost of the age pension, health costs and aged care and reduced tax revenue (Treasury 2010: 46). The ability for private super to offset the public cost of population ageing is linked to its capacity to act as a substitute for the age pension, which is projected to increase from its current level of 2.7 percent of GDP to 3.9 percent in 2049-50 (*ibid*: 47). Since the private super system as a whole is projected by the Treasury to reduce the age pension's cost by only 6 percent in 2050 when the SGS matures, it follows that as well as having their benefits concentrated amongst the well-off, the super tax concessions will reduce public expenditure on the age pension only minutely. Put another way, the $30 billion or 2.2 percent of GDP currently allocated each year through the super tax concessions is projected to reduce expenditure on the age pension by less than 0.2 percent of GDP in 2050.[121] These figures still overstate the impact of the super tax concessions because they gauge the total effect of private super. It is thus difficult to avoid the conclusion that the super tax concessions provide an expensive and inefficient means to combat any fiscal pressures associated with population ageing.

[121] This figure is calculated as 6 percent of 3.9 percent of GDP, which is what the age pension is projected to cost in 2050. It substantially overstates the extent to which the super tax concessions will reduce expenditure on the age pension, since it effectively attributes the whole 6 percent to the super tax concessions rather than their contribution to the private super sector.

That this point is made in such an indirect manner stems from data limitations, especially the exclusion of the super tax concessions from the Budget's forward estimates. As previously noted, the STCs are excluded from official documents, such as the Budget and *Intergenerational Reports*, (like other tax expenditures) despite representing the government's largest financial contribution to the second tier and the retirement system as a whole. The omission of the STCs from these reports seems to reflect Treasury's established practice of not calculating long-term estimates of tax measures (Gordon 2006a: 2). This omission, however, limits the usefulness of the *Intergenerational Reports* because it means that when governments and other policy actors call for constraint in public spending to offset the fiscal pressures of population ageing, they do not consider the largest and most inequitable expenditure for retirement incomes. Moreover, since the STCs increase with investments in private super, proposals seeking to provide further incentives to invest in second tier super to relieve pressure on the first tier – such as the Howard government's 2006 reforms – may only appear cost effective but actually increase the government's outlays on retirement incomes and undermine the efficiency of public spending.

A boost for national savings?

A third justification for the STCs does not directly relate to retirement incomes. As incentives to invest in private super, the STCs have been argued to increase national saving by both the Keating and Howard governments. Governments of both persuasions have promoted macroeconomic policies to boost national saving because of concerns that savings had fallen to low levels by the early 1990s. National savings fell to 18 percent of GDP in 1993 from an average of 22 to 23 percent over the previous three decades (FitzGerald 1993: *xiii*). This fall was argued to expose Australia to shocks in global markets, which, in turn, was perceived to threaten sustainable economic and employment growth, as well as living standards (*ibid*: 5).[122] These arguments were underpinned by the 'twin deficits' thesis that asserted that Current Account and Budget deficits were linked (Coates 2004: 82). National saving (or cuts in public spending) was proffered as a solution to avoid the twin deficits, since it would provide business with a local substitute to borrowing from foreign financial institutions. The Keating government framed the

[122] FitzGerald (1993: *xiii*) notes that commentators have perceived this threat to be particularly pronounced because of the fiscal burden anticipated with population ageing. However, as Edey and Gower (2000: 301) point out, private national savings invested in super are unlikely to offset the costs of population ageing (except as a substitute for the pension), which is likely to funded through public savings.

SGS as a policy to boost national savings, as it forced low-income households to invest in private super and would reduce future public spending on the age pension (*ibid*: 82, 88). As super assets were preserved until retirement, the government also argue that it would channel investment into capital productive investments rather than housing (Coates 2004: 82, 88; Edey and Gower 2000: 277, 288). The STCs were also linked to national saving because they discounted the tax paid on private super and encouraged further super investments.

Although the link between super and national savings may seem self-evident, it too has proven difficult to establish in practice. Illustrating this difficulty, FitzGerald's (1993) report commissioned by Keating to vindicate this link concluded that redressing low public saving was more vital than increasing private saving. In a later report, FitzGerald (2007: 15) has claimed that there are conflicting signals as to the contribution super makes to national savings. On the one hand, there appears to be link between super and national savings; Australians have more than $1 trillion invested in super, which is below the national savings average in OECD countries but higher than such saving other English-speaking countries (*ibid*: 25-26). On the other, while government and business made larger contributions to national saving, record household debt outstripped the gains made because of the interactions between lump-sum super benefits and home ownership (*ibid*: *iii*). Moreover, the extent to which contributions to private super are offset by reductions to other savings vehicles is hard to measure (*ibid*: 6). Projections undertaken by researchers complicate this further, because estimates of super's contribution to household saving range from 37 to 75 percent (Edey and Gower 2000: 297).

More fundamentally, Coates (2004: 83) challenges the link between private super and national saving by arguing that the global integration of finance and capital makes it difficult to distinguish national savings from foreign savings. According to Coates (2004: 86, 90), a national savings pool cannot be presumed and that measures of it are arbitrary to some extent. The arbitrariness of these measures is evident in the issue of how to incorporate owner-occupied housing, which is a vehicle of household savings and source of household debt, into these calculations – it is hard to separate the savings and consumption components for accounting purposes (*ibid*: 91). Just as importantly, the concept of national saving is challenged by economic globalisation that involves household assets and mortgages, as well as private super funds and their portfolios, in international processes (*ibid*: 93). Since the national element of these savings cannot be easily separated, Coates claims that private super – and by inference the STCs – “locate savings for investment… not national savings for domestic investment” (2004: 97). These difficulties in ascertaining what super’s contribution is to national savings, as well as the issues with the concept of national savings itself, also apply to the STCs. Thus, at the very least, the link between the STCs to national savings cannot be assumed.

Surveying a range of criticisms and evidence, this discussion casts doubt on the STCs’ capacity to significantly boost retirement incomes, offset fiscal pressures of population ageing or increase national savings. It becomes apparent that the economic benefits of the STCs (and private super) are more often asserted rather than defended with evidence. The latter suggests that these concessions provide an ineffective means to support second-tier retirement incomes – especially given their budgetary scale. It is also remarkable that this much can be expended on a policy without there being evidence that it meets a clear set of outcomes.

IV. The ‘Upside Down Welfare’ of the Super Tax Concessions

The super tax concessions have regressive benefit structures like other second-tier policies and, because of their large scale, reinforce inequality. The concessional tax rate applying to super contributions and interest received from super, as well as the tax exemption for super benefits, may appear to treat taxpayers equally. However, the STCs are vastly inequitable because of their interactions with the progressive income tax scales – concessional tax rates and tax exemptions that apply a flat rate of tax actually reverse the progressive tax scales, thereby providing proportionately larger tax discounts to higher income earners who pay higher effective marginal rates of tax. The inequity of these second-tier policy tax concessions is particularly marked for those with low levels of super assets, including many women and others who leave the workforce for extended periods (and therefore do not benefit from the SGS). Moreover, current policy structures mean that some low-income earners pay higher rates of tax on their super contributions than on other income because of the STCs. While it is clear that STCs are regressive, data limitations present barriers to gauging the full extent of their distributive implications. To highlight these data issues, I discuss what remains unknown about these inequitable tax concessions. Then, turning to what is known about the inequity of the STCs, I discuss the distributive effects of the tax concessions applying to each stage of the super income stream.

The Unknown: The limits to available data

Both measurement issues and data limitations make it difficult to ascertain the distributive effects of the STCs. A central measurement issue that arises when measuring the STCs relates to how superannuation is incorporated into the tax benchmark. To prevent the tax benchmark from double-taxing superannuation, at least one of the three stages of the super income stream needs to be treated as part of the tax benchmark. In the TES, the Treasury (2010) includes super benefits within the tax benchmark and the concessional tax rates for both super contributions and earnings on super assets as deviations from it. The difficulty in this treatment of the STCs is that the tax arrangements for super have been altered multiple times over the last 90 years, including several times in recent decades (see *Chapter 6*). Tax concessions for super benefits have provided, and continue to provide, the primary tax discount for those holding super. Including the tax exemption for super benefits within the tax benchmark is therefore arbitrary, no matter how convenient it might be because super benefits have not been taxed since 2007. This issue is not easily resolved because of the host of policy changes over the last 20 years (see *Chapter 7*). Whilst providing no definitive answer, I acknowledge it and respond by discussing the equity of the tax treatment of super at all three stages.

Data limitations are a further hurdle in assessing the distributive effects of the STCs. As noted previously, there is limited data on these tax concessions because as tax expenditures they do not leave transactions trails. The TES, which remains the most reliable source of information on tax expenditures, provides only aggregate estimates of the STCs and has done so from 1986. As noted before, tax expenditures do not appear in longer-term projections such as the *Intergenerational Reports*. Recently, the ATO (2009) released Confidentialised Unit Record File (CURF) data that includes figures for the tax exemption for super benefits claimed by current retirees. This data is also limited because it does not indicate whether the benefits are received as lump-sum or annuities, which has significant distributive implications. But, even with complete information, difficulties would remain as the distributional effects of the STCs relate to lifetime earnings and the tax treatment of super over time (Stebbing and Spies-Butcher 2009: 5). Moreover, there is research measuring the impact of these tax concessions on the distribution of super benefits (*ibid*: 6).[123] The existing research on the STCs is incomplete and hypothetical,

[123] Rather, several studies have modelled the likely distribution of super income at retirement for the current cohort of retirees and made projections for future retirees (i.e. Bingham and Rothman 2005; Kelly

often using estimates of the tax concessions for super contributions from its design and/or income data rather than actual data (i.e. Denniss 2007; Ingles 2009; Spies-Butcher and Stebbing 2009). Given how much these concessions reduce tax revenue, it is surprising that *so little* is known about their distributional implications (Stebbing and Spies-Butcher 2009: 5). More research is needed to appraise the distributional effects of the STCs, but it is beyond the scope of this thesis to rectify the matter. Instead, I examine the distributive effects of the super tax concessions levied at each stage of the super income stream, drawing on empirical data and deductive inferences where available.

Upside-down Welfare: The concessional rate of tax for super contributions

Putting data issues to one side, the available data allow for estimation of the tax concession for the compulsory 9 percent employer contribution to private super (the SGS). Presenting estimates calculated from ATO (2009) income data, *Table 5.9* compares the tax discounts and monetary benefits that wage and salary earners receive from the tax concession for compulsory super contributions according to their effective marginal tax rate (the third column). This table shows that those earning up to $25,000, which was around the level of the minimum wage, received no benefit from the super tax concessions in either proportional or cash terms in 2006-07. In fact, since the concessional 15 percent tax rate is levied on contributions once they have been invested in the super fund (Henry 2010), some low-income earners paid more tax on the super contributions channelled through the SGS than on other income. This is because they receive the low-income tax offset and only pay tax on income above the tax-free threshold. *Table 5.9* also reveals that this tax concession is highly regressive, with both the estimated and proportional values of this tax discount increasing with the amount of income earned. It shows that in 2006-07, this concession provided the largest benefit in monetary and proportional terms to those who earned above $150,000 and paid the highest marginal rate of tax. This group received a 30 percent tax discount worth about $4,942 of extra super investment on average.

This concessional tax rate inverts the progressive income tax scales, providing proportionately higher tax discounts to high-income earners. The regressive design of this tax concession has broader distributive ramifications because of its considerable scale – it was estimated to reduce tax revenue by about $5.7 billion in 2006-07. *Table 5.10* displays

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2009; Kelly *et al.* 2004 etc.). Further research, such as Wilkins *et al.* (2009) and Sharp and Austen (2006), has also examined super holdings by age and gender.

estimates of the wider distributive implications of the tax concession for super investments made through the SGS. The table reveals that in 2006-07, the bottom 21 percent of wage and salary earners gained no benefit from this tax concession, while the 67 percent of those earning between $25,001 and $80,000 received about $3.2 billion or 57 percent of the benefits paid out. The table also shows that 27 percent of the benefits of this concession went to less than 10 percent of wage and salary earners earning between $80,000 and $150,000. Finally, the 2 percent of wage and salary earners with incomes of over $150,000 received $875 million or 15 percent of the total benefits. Clearly concentrated amongst high-income earners, these estimates suggest that the top 12 percent of wage and salary earners received 42 percent of the $5.7 billion flowing from this tax concession.

Table 5.9 Estimated Benefits of the Tax Concession for SGS Contributions in 2006-07

Tax Bracket 2006-07 ($)	Mean Y of Tax Bracket ($)	Marginal Tax Rate (%)	Mean Value of SG contribution ($)	Estimated Value of Tax Concession for SGS ($)	Tax Concession as % of SGS Contribution
1 – 6,000	3,612	0	0	0*	0
6,001 – 25,000	17,230	15	1,551	0*	0
25,001 – 80,000	45,224	30	4,070	610	15
80,001 – 150,000	91,247	40	8,212	2,053	25
150,001+	183,026	45	16,472	4,942	30
Estimated Budgetary Outlay: $5.7 billion					

* Levying the concessional 15 percent tax rate on incomes within these ranges actually increases the rate of tax paid.

Source: calculated from ATO (2009) Taxation Statistics, Detailed Table 5B

Table 5.10 The Distribution of the Super Tax Concession for SGS Contributions in 2006-07

Tax Bracket 2006-07 ($)	% of Salary & Wage Earners	Estimated % of Total Benefit Paid Out by the Tax Concession	Estimate of Tax Concession ($m)
1 – 25,000	21.4	0.0	0
25,001 – 80,000	67.1	57.5	3 254
80,001 – 150,000	9.4	27.0	1 530
150,001+	2.2	15.5	875

Source: calculated from ATO (2009) Taxation Statistics, Detailed Table 5B

Because the SGS only benefits those in paid employment, the corresponding tax concession reinforces the gender pay gap. As Sharp and Austen claim, women “tend to experience more broken work patterns, receive relatively low wages and have greater responsibility for unpaid work compared to men, and are, therefore, less likely to accumulate superannuation assets” (2006: 65). Since women receive lower incomes than men on average (see *Table 5.11*), they receive lower SG contributions and lower tax discounts than men. *Table 5.11* also shows that 28 percent of women but only 18 percent of men received no benefit from the STCs as they earned less than $25,000 in 2006-07. Moreover, the Spouse Contribution Tax Offset has proven grossly inadequate at reducing gender inequality because it reduces tax revenue by only $15 million in 2006-07 – only a miniscule proportion of the revenue forgone for the STCs. The policies that subsidise second-tier super are thus particularly inequitable to women on low incomes or those who do not participate in the labour force.

Table 5.11 Australian Tax Payers by Taxable Income and Gender, 2006-07*

Tax Bracket 2006-07 ($)	% of Men	% of Women
1 – 25,000	18	28
25,001 – 80,000	66	65
80,001 – 150,000	12	5
150,001+	4	2

**See similar table in Sharp and Austen (2006: 69).*

Source: ATO (2009)

Although I discuss on estimates relating to the concessions for SGS contributions, this understates the benefits received by higher income earners because they have greater capacity to receive further concessions through salary-sacrifices. At the same time, very few tax payers make voluntary super contributions, with the then Minister for Superannuation noting in 2009 that they only 5 percent of those with super accounts make such contributions despite the generous tax concessions (Bowen 2009). It is therefore highly likely that the tax concessions for super contributions disproportionately benefit men on high-incomes and disadvantage those not in the labour force for extended periods – including many women who continue to do the bulk of caring.

Upside-down welfare: The tax treatment of super assets and benefits

The distributive effects of the tax concessions for interest earned on super and super benefits are discussed together here as they both relate to the value of super assets held. Similar to the tax concession for super contributions, the distributive implications of these tax concessions can be inferred from survey and micro-simulation data on the distribution of super assets (*i.e.* Kelly 2009; Kelly *et al.* 2004; Rothman and Tellis 2008 *etc*.). Presenting data from HILDA in 2006, *Table 5.12* compares the super assets of non-retired men and women by age group. This table shows that men were more likely to hold super than women in every age group – except for the youngest and oldest age-groups where super coverage is similar – and that men held more super in every age-group in 2006, regardless of whether this is measured as mean or median holdings. Moreover, the table also confirms that super assets were (as expected) concentrated in wealthier households because the median level of super assets is lower than average holdings for men and women in all age groups. And, the table shows that overall the median and mean super holdings of men, at $32,000 and $96,000 respectively, are much higher than for women (at $17,000 and $51,000, respectively). Thus, super is concentrated amongst wealthier individuals and reinforces gender inequality.

The tax concessions for earnings on super assets and benefits are both expressed relative to the balances of super accounts. The concessional tax rate of 15 percent for super earnings has the same regressive features as the similar concession for super contributions shown in the final column of *Table 5.9* – the benefit increases proportionately with the taxable income earned. This concession has applied to an average industry-wide return from super assets of 6.5 percent over the last 30 years (Henry 2010: 133). It can be inferred from the survey data discussed previously that older people with high taxable incomes benefit most from this concession, younger people with low incomes receive a small benefit, and people not participating in the labour force with low levels of super benefit least. The tax exemption for super benefits directly inverts the tax scales listed in the third column of *Table 5.9*. The most generous of the super tax concessions, this exemption is also regressive by ensuring that no tax is collected on super benefits. Clearly, the benefit derived increases with wealth, particularly in the forms of taxable income and super assets. And since, as *Table 5.12* reveals, men typically hold more super than women, they also receive more from this tax exemption, regardless of whether super is received as an income stream or lump-sum payment.

The ATO (2009) published data on the tax concession received by the current cohort of retirees on their super benefits in 2006-07. This data, displayed in *Table 5.13*, has its limits as far as assessing the distributive effects of this tax concession goes because it does not distinguish between lump-sum and defined benefits, nor does it reveal the age of retirees. But this data is useful in demonstrating that those with higher super benefits receive larger concessions. *Table 5.13* shows that about 76 percent of the retirees identified by the ATO claimed the tax concession for less than $80,000 of super in 2006, which is consistent with the estimates Kelly *et al.* (2004) provide of the super holdings of the current cohort of retirees if they take their benefits as lump-sums. The table also provides further evidence of the inequity of the STCs, as the average value of the tax concession increases with the amount of super held and those with more than $150,000 of super receive more than five times the tax discount of those with less than $25,000 in super. And, although this concession is projected to rise as the population ages and SGS matures, it still accounted for a substantial slice of the Budget in 2006-07 at $1.2 billion of revenue forgone.

Table 5.12 Super Coverage and Super Holdings of the Non-retired, 2006

Age (years)	Male			Female		
	Mean ($)	Median ($)	Proportion	Mean ($)	Median ($)	Proportion
15-19	3,911	1,000	37	1,391	525	38
20-24	8,060	4,900	84	5,841	3,000	77
25-34	35,007	20,000	93	23,913	15,000	84
35-44	76,329	42,000	93	46,780	23,000	87
45-54	149,205	80,000	94	87,922	33,000	88
55-64	262,453	120,000	83	111,338	55,000	84
65+	274,010	153,000	48	150,032	50,000	47
Total	**96,303**	**32,000**	**84**	**50,946**	**17,000**	**79**

Source: Wilkins et al. (2009: 125)

Apart from their budget cost, the STCs are highly regressive and mostly benefit high-income earners, particularly men, at each stage of the super income stream. This seems likely to continue as the SGS matures over the coming decades. Using a deductive approach, Denniss (2007) has estimated that workers earning more than $72,000 per annum on average over their working lives will accrue more benefits from the STCs than they would receive from the age pension, paid at the full-rate for 20 years of retirement. So, although the specific distributive effects of these concessions remain unknown, the STCs clearly provide ‘upside-down’ welfare that most benefit to higher income earners and little benefit to low-income earners. It also seems likely that the benefits received from these second tier tax concessions will outstrip the first tier benefits received by low-income earners when the SGS matures.

Table 5.13 Tax Concession for Super Benefits Received by Retirees in 2006-07

Super Benefit Received in 2006-07 ($)	Recipients of Tax Concession (no.)	(%)	Average Value of Tax Concession ($)
1 – 6,000	40	0	785
6,001 – 25,000	26,050	9	1,661
25,001 – 80,000	222,230	76	3,078
80,001 – 150,000	31,680	11	5,162
150,001+	13,530	5	8,910

Estimated Budgetary Outlay: $1.2 billion

Source: calculated from ATO (2009) Taxation Statistics, Detailed Table 5D

Issues of inequality and retirement incomes systems

Although the STCs are clearly highly inequitable second-tier policies, it should be acknowledged that it is unclear whether Australia's retirement incomes policy is more inequitable overall than in other OECD countries. This uncertainty arises due to the data limitations mentioned previously for the current cohort of retirees, but also because it will be at least three decades before the Superannuation Guarantee matures.[124] Until the SGS matures, it will be difficult to estimate both the extent to which higher income earners will use salary-sacrificing provisions and how interactions between the STCs and mandatory employer contributions will impact on final super balances. At the same time, it is also difficult to project financial market growth (especially over the longer term), which Australian second-tier retirement incomes will depend on.

Nonetheless, the evidence suggests that the Australian retirement incomes system remains more equitable than several European countries with social insurance schemes despite the recent growth in STCs. The main reason for this is that three quarters of Australian retirees receive the low flat-rate age pension, whereas European retirees draw earnings-related provisions from social insurance that also provide higher retirement incomes to middle income groups. *Tables 5.14* and *5.15* compare OECD data on the retirement incomes received by current retirees in Australia with those in Social Democratic welfare regimes such as Denmark and Sweden, and, Conservative regimes including France and Germany. These tables express the combined value of public and private pensions (where applicable) that retirees on various proportions of average income in these countries receive as both a replacement rate of their pre-retirement

[124] The SGS came into effect in 1992, but it was gradually increased from 3 percent to 9 percent of wages until 2002. Thus, individuals will not have had the opportunity to contribute to the scheme for a full working life for several decades to come.

income and as a proportion of the average income. *Table 5.14* shows that on average Australian retirement incomes are lower in both Denmark and Sweden, and more equitably distributed than those in Sweden. *Table 5.15* displays that retirement incomes also tend to be lower and more equitable in Australia than in France and Germany (on average). These figures should be read with caution, however, because the OECD assumes that lump-sum super benefits is used as an income stream over retirement rather than put to other uses. Moreover, these figures do not take account of the *Simpler Super* reforms that exempted super benefits from tax announced in 2006 (see *Chapter 7*). And, these figures compare different levels of average income without taking into account the income distributions in different countries, which is significant because of the relative equality of the income distribution in European countries.

Table 5.14 Retirement incomes in Australia, Denmark and Sweden as a proportion of average wages and as a replacement rate in 2006

	Australia		Denmark		Sweden	
Pre-retirement wage as % of mean	Proportion of mean wage (%)	Net replacement rate (%)	Proportion of mean wage (%)	Net replacement rate (%)	Proportion of mean wage (%)	Net replacement rate (%)
50	44.1	80.2	72.2	137	42.2	79.3
75	49.4	63.7	81.8	106.2	51.8	67.4
100	53.1	53.1	91.3	91.3	64.1	64.1
150	58.3	41.8	109.7	82.7	109.4	81.2
200	64.3	36.8	127.6	77.7	142.6	85.9

Source: OECD (2011)

Table 5.15 Retirement incomes in Australia, France and Germany as a proportion of average wages and as a replacement rate in 2006

	Australia		France		Germany	
Pre-retirement wage as % of mean	Proportion of mean wage (%)	Net replacement rate (%)	Proportion of mean wage (%)	Net replacement rate (%)	Proportion of mean wage (%)	Net replacement rate (%)
50	44.1	80.2	40.9	76.2	34.9	59.2
75	49.4	63.7	50.8	65.6	49.3	61.1
100	53.1	53.1	65.7	65.7	61.3	61.3
150	58.3	41.8	86.4	60.2	84.8	60.3
200	64.3	36.8	106	57.5	84.8	44.4

Source: OECD (2011)

However, there are also three aspects of current policy design that suggest that the Australian retirement incomes system will become more inequitable as the Superannuation Guarantee matures. First, the Superannuation Guarantee shifts the risk-bearing for retirement income from the state to individuals. Second, unlike European social insurance schemes, Australian private superannuation does not redistribute savings from higher income earners to low-income earners as most retirees hold market-based defined-contribution accounts. While the aged pension will continue to redistribute income, the greater roles private super is to play will increase inequality amongst retirees. Third, the tax treatment of private super in Australia is much more inequitable and concessional than in the European countries discussed above (Warburton and Hendy 2006: 232), which is my focus. Marginal tax rates apply to private pension benefits in Denmark and Sweden (although contributions and interest earnings are exempt) (*ibid*: 232; OECD 2011: 141). France and Germany have tax expenditures for private pensions, but their concessions are lower than in Australia (Warburton and Hendy 2006: 229, 232). Nevertheless, it is difficult to project how these aspects of policy design will manifest and how the Australian system will compare to other countries in future decades.

Although a comparison is not my primary intent, it is striking how inequitable the tax treatment of superannuation is in Australia compared to other countries. The contrast between Australian retirement incomes policy with New Zealand's policies is even starker than the above comparison of the tax treatment of social insurance benefits in European countries. New Zealand retirement incomes policies combine an equitable flat and universal public pension (set at about 40 percent of average wages) with *Kiwisaver*. *Kiwisaver* is a modest savings incentives scheme that involves 2 percent of mandated employer contributions and concessional tax treatment. Compared to the open-ended nature of Australian STCs, the maximum benefit that an individual can receive from the tax incentives is about $1,000. The differences between Australian and New Zealand retirement incomes policy is particularly remarkable considering the similar institutional origins of social provision in the two countries (Castles 1985). This reinforces that STCs are a major source of inequality to Australian retirement incomes policy compared to these other countries.

Owing to these considerations, I do not claim that Australian second-tier retirement incomes are more inequitable than those in other OECD countries or will become so. There is simply too much contingency and uncertainty to make such a claim. Rather, I more modestly contend that a two-tiered understanding of Australian retirement incomes policy that incorporates STCs is more inequitable than the targeted model that features in many accounts of Australian social policy. What is also clear, however, is that Australian

STCs appear to be more inequitable than those in many other OECD countries and are a major source of inequality in retirement incomes policy.

V. Conclusion: Entrenching inequality through the second tier

Reducing tax revenue by $30 billion in 2006-07, the STCs amount to one of the Commonwealth's single largest budgetary commitments and are the major second-tier policies for retirement incomes. Nevertheless, these tax concessions provide an ineffective means by which to increase retirement incomes, alleviate the fiscal pressures of population ageing and boost national savings. The STCs' limited success in meeting these goals stems in part from the assumption that the two tiers of the retirement incomes system have a substitutive relationship. However, second-tier private super mainly has a supplementary relationship to the first tier and only a minor substitutive one. This is because of both the relatively low level of super held by most retirees and the prevalence of lump-sum super. In other words, the policy goals identified for the STCs seem to assume that super will replace the age pension as the main form of income support for retirees, but the projections suggest that it will act as an income supplement for the large majority of retirees. At the same time, these concessions are highly inequitable second tier institutions that extend the already unequal distribution of income, providing little, if any, support to those who may not be employed for extended periods – especially women. Because of their scale and inequity, the STCs institutionalise inequalities in the retirement incomes system and reduce the progressivity of the Australian welfare model.

The STCs are old policies that are not particularly well suited to their new role in a retirement incomes system with an expansive second tier. As with the PHITR, we are confronted with a case of a second-tier policy that has a ballooning cost and plays a significant role in its policy domain that cannot be defended as the outcome of a rational evidence-based policy process. There are, as with the health rebate, more efficient and equitable policy options at the government's disposal to accommodate the current two-tier retirement incomes system. The government could seek to reduce the inequity of the second tier by converting the existing STEs into flat-rate rebates (as proposed by Ingles 2009 and Spies-Butcher and Stebbing 2009). The government could seek to integrate the two-tiers by requiring super funds to invest a portion of their portfolios into government bonds or other social investments to increase the public benefits derived from the scheme. And, on a more radical and equitable note, the government could abolish the second-tier of STCs then channel the extra revenue into a more substantial age pension. Still, the

STCs continue to receive bipartisan support despite their rapid budgetary expansion, questionable efficiency and inequity. The next chapter turns to the question of how this ineffective policy as the STCs became a major second-tier policy institution. Taking a similar approach to *Chapter 4*, I show that the STCs emerged as core second-tier policies because of political and institutional processes.

- Chapter 6 -

‘From Little Things Big Things Grow’:

The Superannuation Tax Concessions and early Australian retirement incomes policy

The sizable financial footprint of the super tax concessions (STCs) belies their early and modest beginnings. Established by the Commonwealth in 1915, these concessions have only become major second-tier policies in recent decades following Labor’s extension of private superannuation to the workforce. Rather than comprehending the inequitable and inefficient STCs as outcomes of evidence-based processes (see *Chapter 5*), this thesis presents the more plausible explanation that both the early entrenchment of second-tier policy and the prevailing policy environments have underpinned the unchecked growth of these concessions. The STCs have proven resistant to rollback in large part because their rapid growth from the mid-1980s (resultant of extending super coverage) reinforced their established role in supporting private pensions. To avoid political fallout from retrenching these concessions, governments of both major parties have responded with *conversion* strategies that have forwarded their policy goals through incremental reform. These conversion strategies have, however, been politicised by the degree that these concessions have expanded. Even the Hawke and Howard governments’ incremental reforms have had wide distributive effects. The next two chapters apply the historical institutionalist framework to analysing STCs as core second-tier policies. This chapter shows that the foundations of two-tiered retirement incomes policy were established in the early twentieth century. Chapter seven then charts the reforms of the Hawke and Howard governments before analysing the political influences on their decisions.

Until recently, retirement incomes policy received much less attention in scholarly accounts than health policy. This reflects the lack of major reform to retirement policy for most of the twentieth century until the recent expansion of the second tier and renewed concerns about population ageing. Private superannuation has received scant attention in Australian accounts of retirement policy – particularly those written before 1980 (e.g. Dixon 1977; Kewley 1973). Although STCs feature rarely in these accounts, these concessions have appeared with greater regularity in histories of taxation (e.g. Harris 2002; Smith 2004). To inform my account in this and the next chapter, I supplement existing accounts with an analysis of the legislation and records of the parliamentary debates that enshrined the super tax concessions at both State and Commonwealth levels, as well as newspaper articles and policy documents.

I. Retirement Incomes Policy: A structured narrative

In contrast to health policy, the foundations of the two-tiered retirement incomes system were established in the early twentieth century. These foundations included the age pension that gave targeted income support to many retirees and the super tax concessions, which provided generous subsidies to the few holding private superannuation. Despite attempts to enshrine alternative policies, retirement incomes policy was subject to only minor reform over the next 50 years.

Second-tier private super has, however, expanded rapidly since the 1970s. Private super coverage expanded first through industrial bargaining and then through regulation mandating employer super contributions for workers. By increasing super coverage and contributions, compulsory private super contributed to the escalating revenue forgone for the STCs. To contextualise the recent growth of the STCs within the longer history of second-tier policy, the next two chapters present a structured narrative of Australian retirement incomes policy from the lead-up to Federation to the Howard government's demise. This chapter charts the origins of retirement incomes policy to the early 1980s, while the next examines recent developments from the Hawke government onwards. As well as contributing a novel account of the development of the two-tiered retirement incomes policy, this structured narrative informs the ensuing analysis of second tier politics in the next chapter.

The origins of the two-tiered retirement incomes system

The Commonwealth's early retirement incomes policies were influenced by earlier first and second tier policies were developed in the larger colonies. As early as the 1890s, income security in retirement featured on the colonies' political agendas. Aged poverty became a visible social problem with economic conditions deteriorating in the wake of the deep 1890s recession and the ageing of the population as many who migrated during the gold rushes of the mid-1800s reached old age (Olsberg 1997: 49).[125] This problem coincided with the formation of new political parties, which brought stability to the colonial political environment while extending the influence of constituencies that demanded action on aged poverty (Dickey 1987: 74). Demands for state action to address aged poverty reflected dissatisfaction with existing charitable relief (including indoor and outdoor programs) and the spread of social liberalism (Kewley 1973: 3-4; Murphy 2008: 37).[126] Income security in retirement became a political issue in these conditions because policy-makers were receptive to state intervention at the same time that the economic downturn undermined perceptions that older individuals were responsible for their poverty (Dickey 1987: 76).

Nonetheless, the first policy to subsidise retirement incomes aimed to limit state interference in the not-for-profit sector rather than redress aged poverty. Established with other similar provisions, a tax concession for super contributions (up to £50 per year) was introduced via the Victorian *Income Tax Act 1896* (Harris 2002: 146). Declaring that this concession would encourage thrift, Premier George Turner of the Liberal party noted that it brought the tax treatment of super in line with that for life insurance (1897: 4395).[127] This concession can be linked to other provisions to limit state interference because mutual aid societies held 90 percent of super policies in 1890 (Keneley 2001: 149). Since fewer than 5 percent of workers held super, this concession unsurprisingly attracted little controversy (Olsberg 1997: 58). After Federation, Queensland and New South Wales

[125] Proportionately, the population aged 65 years or older increased rapidly from 2.9 percent in 1891 to 4.0 percent in 1901 (Dixon 1977: 2).

[126] Reflecting broader debates about the meaning of liberalism in the English-speaking countries (Dickey 1987: 74), social liberalism judged the state at least partly responsible for citizen welfare. Social liberalism was so prominent in the United States during the 1890s that this period is widely referred to as the Progressive Era (Skocpol 1992).

[127] Both the principle of thrift and the need to limit interference in the not-for-profit sector were voiced frequently in the parliamentary debate.

(NSW) amended their income taxes to include tax concessions for super contributions in 1903 and 1912 respectively (Harris 2002: 177, 187). Notably, this meant that the three largest States had second-tier concessions for super before the Commonwealth enacted income tax in 1915.

Shortly following Victoria's original super tax concession, the Victorian and NSW governments introduced age pensions in 1900. In the 1890s, debates about aged poverty in these colonies focused on age pensions because of limits to existing provision, the spread of social liberalism (as noted earlier) and international developments. Although Germany established a compulsory-contributory age pension in 1889 and Denmark enacted a non-contributory pension in 1891, developments in other English-speaking countries influenced Australian debates most (Kewley 1973: 49). Colonial ties saw debates in the UK about the age pension followed with interest, but New Zealand's enactment of a non-contributory pension overshadowed this (Dixon 1977: 6).[128] With age pensions coming to dominate public debate, policy-makers in NSW and Victoria focused on the available policy options (*ibid*: 6).

Ironically, the selective and non-contributory age pensions enacted in Victoria and NSW almost amounted to schemes of last resort. Debates about pension design in the late 1890s involved proposals for schemes financed through either private contributions (voluntary or compulsory) or through taxes, with universal or selective coverage (*ibid*: 7). Policy-makers did not pursue voluntary or contributory private pensions because the mutual aid organisations opposed state control of their operations and existing schemes had low coverage (*ibid*: 8-9). Although the compulsory-contributory model was popular since it had the potential to promote self-reliance, it was rejected because of administrative difficulties, the lengthy delay before it would mature and counter-claims that it would erode independence (Kewley 1973: 33). And, the universal and non-contributory model was deemed excessive (*ibid*: 38). The case for selective and non-contributory age pensions was bolstered by perceptions that obvious alternatives were infeasible.

The NSW and Victorian pensions were both selective and non-contributory

[128] The influence of debates in the UK was marked, as it was the origin of the two main non-contributory schemes considered in Australian debates – a universal and a selective scheme (Dixon 1977: 6).

schemes, resembling New Zealand's age pension (Dixon 1977; Kewley 1973).[129] But the politics of these schemes were different. The Victorian age pension was introduced first, but income support for retirees became an issue closer to its implementation. The Turner Liberal government established a Royal Commission chaired by Joseph Kurton to review the options for an age pension in 1898. It found that the state was obliged to support older people living in poverty without reducing individual initiative (Murphy 2008: 38). After political instability thwarted an attempt to introduce an age pension in 1899, Turner legislated a temporary age pension to operate from November 1900 – partly to pre-empt the imminent NSW scheme – that was available to residents for 20 continuous years who could persuade a magistrate of their poverty and 'good character' (*ibid*: 43).

In NSW, the age pension became a political issue during the mid-1890s. Attention focused on the selective and non-contributory model following two inquiries toward the end of the decade. The first – a Select Committee of the Legislative Assembly chaired by the Protectionist Edward O'Sullivan – argued that the age pension was a citizenship right, while the other report by the Free Trader John Neild conflated the age pension with 'outdoor relief' (*ibid*: 40).[130] In the event, O'Sullivan's arguments proved more popular and the Lyne Liberal government faced only weak opposition when enacting its pension in 1900 based largely on the Select Committee's recommendations (*ibid*: 40; Kewley 1973: 43). This age pension was paid at the full rate of £26 per annum to individuals aged 65 years or older, who satisfied means and character tests, and had been a continuous resident for 25 years (Kewley 1973: 44). Both men and women were paid the same pension, but married couples were paid less than two singles at £19 10*s* a year each (*ibid*: 45). The character test aimed to exclude 'non-deserving' recipients who could not demonstrate that they led a 'sober and reputable life' for five years before their eligibility (*ibid*: 45). The NSW pension bore closer resemblance to New Zealand's because its character test was less stringent than that of the Victorian scheme as it did not require "complete destitution" (Murphy 2008: 43).

At Federation, the two largest colonies had two-tiered retirement incomes policies comprising a selective and non-contributory age pension combined with a tax concession

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129 Like other Australian public policies, the age pension reflected racial prejudices by excluding Asian migrants and indigenous Australians.

130 Neild surveyed European retirement income schemes, which displays the influence of the social policies of foreign countries (Dixon 1977: 19; Kewley 1973: 33).

for super.[131] State support for age pensions put them on the Australasian Federal Convention's agenda (Dixon 1977: 22). In 1897, a motion to enable the Federal parliament to establish an age pension was passed, largely because it was perceived to enhance the popularity of the referendum (Kewley 1973: 66). However, the tax concessions for super were mostly invisible. These early first and second tier policies influenced the design of later Commonwealth policies because they provided working models, they influenced voter expectations, and they had similar legislators involved in their design. This influence is evident in the resemblance between these early retirement incomes policies and those adopted by the Commonwealth in the early twentieth century.

II. Laying the Foundations of the Two-tiers

The foundations of the current two-tiered retirement incomes system were built in the early twentieth century. After Howe's motion passed, pensions for retirees and those with disabilities appeared in the Constitution as the only direct social provisions assigned to the Commonwealth (*ibid*: 66). *Section 51(xxiii)* of the Constitution reads "The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to: - … (xxiii) Invalid and old-age pensions" (Australian Government 1901). Although escaping attention at the time, the Constitution also granted the Commonwealth the capacity to legislate STEs, albeit indirectly through taxation powers.[132] *Section 51(ii)* of the Constitution conferred the power to levy tax for "peace, order and good Government" (*ibid*). These constitutional clauses endowed the Commonwealth with considerable scope to legislative first and second tier policies.

Nonetheless, the early Commonwealth parliament hesitated to enact an age pension or raise taxes to fund it. On the one hand, the unresolved issue of how to share financial responsibilities with the States stymied the Commonwealth's financial capacity. This issue proved contentious, with competing viewpoints on the appropriate balance between Commonwealth and State finances receiving support (Kewley 1973: 67). In the interim, the Commonwealth had limited fiscal capacity. It had the exclusive power to levy customs and excise duties, but the Braddon Clause (*Section 87* of the Constitution) required that 75 percent of its unused revenue be returned to the States until 1911 (Dixon

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[131] Neither the NSW nor Victorian retirement income policies were radically reformed until they were dismantled when the Commonwealth introduced its scheme.

[132] It is unsurprising that the prospect of STEs received little attention, since the tax expenditure concept had not been developed and the State income taxes very paid mainly by the well off.

1977: 23). On the other, the political climate was unconducive to raising taxes. The parliament did not seek to raise direct taxes because they were viewed as a State domain only to be drawn on in national emergencies (*ibid*: 67; Harris 2002: 166-167).[133] At the same time, political instability stemming from the quick succession of minority federal governments directed parliamentary attention elsewhere. This policy environment meant that retirement incomes policies were not established in the early parliaments, even though age pensions received support from the three major parties – the Free Traders, the Protectionists and Labor (Kewley 1973: 66).

Building the first tier: The Commonwealth age pension of 1908

From the outset, the first and primary tier of retirement incomes policy established through the age pension targeted benefits at lower income households. This meant that Australian retirement incomes policy has offered little to the middle class compared to the more inclusive but less egalitarian social policies of European welfare states. Albeit under pressure from Labor, Deakin's Protectionist government established the age pension in 1908. By 1906, advocates had demonstrated their resolve for age pensions by advancing several proposals (*ibid*: 70). These included proposals floated by the Protectionist Senator Neild (who was involved in developing the NSW pension), Labor Senator King O'Malley and the Chapman Royal Commission. Following the 1906 election, Deakin's minority government relied on Labor's support. Labor agreed to support Deakin until unresolved tariff issues were settled, but still had significant influence because of its numbers (*ibid*: 65).[134] The age pension was, however, not yet on the agenda. Although Treasurer Lyne (former NSW Premier) had promised to reinvestigate the means through which to finance age pensions in July 1907, the preoccupation of parliament with the tariff meant that pensions were mostly off the agenda when Andrew Fisher became Labor leader in October that year.

Fisher put age pensions back on the agenda in March 1908 by introducing a motion in parliament (Kewley 1973: 71). Declaring an intention rather than forwarding a proposal, this motion lacked details about the design and financing of the scheme (*ibid*: 71). Initially, Deakin responded by pointing to the fiscal constraints imposed by the

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[133] This sentiment is captured by Prime Minister Barton's statement that the "power of direct taxation of the Commonwealth… is a power not to be lightly or rashly exercised… We ought not to cripple them [the States] using our power of direct taxation, unless under the stress of some great emergency; we ought to leave them free to enlarge their revenues by direct taxation" (in Smith 2004: 46-47).

[134] No party had a majority, but Labor held a plurality of 26 seats (Sawer 1956: 70).

Braddon Clause and his intention to renegotiate federal financial relationships with the States at the upcoming Premiers' conference (*ibid*: 71). Finance for age pensions was, however, secured within several months, via the controversial *Surplus Revenue Act 1908* tabled in parliament 12 days after Fisher's motion (*ibid*: 72). This Act circumvented the Braddon Clause by broadening the definition of expenditure to include proposals for future spending (Dixon 1977: 26).[135] Although the Act was intended to finance defence projects, the Labor Caucus made its support conditional on age pensions being the first appropriations through the new arrangements (Kewley 1973: 72).[136] As Labor had criticised recent government decisions, Deakin was receptive to Labor's request and legislation for age pensions was introduced in June 1908. The legislation for the age pension was assented to on 8 June 1908, receiving only limited opposition from a minority of conservatives (Dixon 1977: 27; Sawer 1956: 72).[137] The quick passage of this legislation reflected Deakin's desire to pass it before the session ended, but this process was aided by support from the three major parties (Sawer 1956: 71).

The Commonwealth established the non-contributory and targeted age pension through two Acts. The *Invalid and Old Age Pension Act 1908* outlined the design of the scheme. Like the NSW scheme, the federal age pension provided a maximum rate of £26 per annum to individuals aged 65 years or older who were of 'good character' and had resided in Australia for 25 years or longer (Dixon 1977: 28).[138] The age pension was also means tested, with the income limit set to £26 per annum and the asset limit set to £50 or £100 if this property included the family home, otherwise it phased out at £310 (Kewley 1973: 75).[139] The *Invalid and Old Age Pension Appropriations Act* created the Invalid and Old Age Pension Trust and earmarked £750,000 of general consolidated revenue to it (*ibid*: 73). To ensure that the Commonwealth had sufficient funds to pay the pension, this Act also delayed the age pension's starting date until 1 July 1909 (Dixon 1977: 27). Once these Acts were assented to, the NSW government challenged the constitutional validity of the *Surplus Revenue Act 1908* in the High Court (*ibid*: 27). The High Court upheld the validity of the federal laws following a four-day hearing. With this obstacle removed, the

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135 This thus abolished the requirement that surplus revenue be returned to the States.

136 The main focus here is age pension, but disability pensions also formed part of these proposals.

137 In the second reading debate, advocates forcibly argued that opposition to the Surplus Revenue meant opposition to the age pension (*ibid*: 72).

138 For consistency, I use the term the age pension throughout this chapter. Technically, it was referred to as the Old Age Pension until 1947 when it was renamed (Daniels 2006).

139 Similar to earlier state schemes, the age pension excluded indigenous Australians, Asian immigrants and aliens (Dixon 1977: 27)

Commonwealth's age pension commenced on 1 July 1909.

The age pension's non-contributory and selective design was a compromise between Labor and the Protectionists (Kewley 1973: 77). Labor preferred the universal model of the age pension canvassed by the Chapman Royal Commission, but the other parties opposed universalism because of cost (*ibid*: 83). The non-Labor parties also rejected the contributory model since it would expand direct taxation and was viewed as unsuitable to Australia's English heritage (*ibid*: 82).[140] In the event, Labor combined with the Protectionists in supporting the selective model, but several members indicated they would scrap the means test when the Commonwealth's finances improved (*ibid*: 82).

The Deakin government's age pension was also influenced by the earlier schemes of NSW, Victoria and Queensland (Dickey 1987: 87).[141] The Commonwealth age pension bore closest resemblance to the NSW scheme, which seems to reflect the infeasibility of reducing the pension to retirees who had received it since 1901 (*ibid*: 90). However, it also appears to reflect the involvement of former NSW politicians. Senator Neild, as noted before, persistently advocated for an age pension and, perhaps more significantly, Lyne influenced the policy in his role as Deakin's Treasurer (*ibid*: 90). But, the federal scheme was not identical to those of the States'. In contrast to NSW's scheme, the federal pension paid single and married pensioners at the same rate (Kewley 1973: 75). Nor was the federal scheme influenced solely by Australian developments because, like the New Zealand scheme, it gave a greater exemption to property owners than in NSW (*ibid*: 75).[142]

The Commonwealth age pension was subject to only minor revisions following its enactment. These included provisions that extended support to 'deserving groups', such as women aged 60 years (or over) and home owners (Warren 2008: 4; Kewley 1973: 79). Still, the major parties continued to consider policy alternatives because of concerns about the pension's adequacy. Labor continued to support a tax-financed universal scheme (despite some internal disagreement), while the Fusion parties (formerly the

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[140] The age pension was initially financed out of taxation from customs excise and tariffs, rather than direct forms of taxation such as an income tax.

[141] Queensland introduced an age pension in 1907.

[142] Of course, as noted previously, the New Zealand scheme was a major influence on the design of the NSW pension. But, this feature of the Commonwealth's scheme suggests that it was also an influence in its own right. It supports Harris' contention that New Zealand and the Australian States had a history of borrowing legislation from each other, as discussed below (2002: 201-207).

Protectionists and Free Traders) supported social insurance because of the pension's growing cost (Watts 1982: 230; Dixon 1977: 35, 37).[143] Interest in the latter was also stimulated by the proposal of Commonwealth Statistician George Knibbs for a state-operated social insurance scheme in 1910 and the adoption of social insurance in Germany, Iceland, France and Britain by 1912 (*ibid*: 38, 42). The Fusion party formally adopted a compulsory-contributory age pension on its policy platform in 1913 (*ibid*: 43). However, Labor and Fusion governments were both unable to achieve major revisions to Deakin's age pension by the outbreak of the First World War.

The Deakin government's age pension marked a major turning point in Australian social policy. This scheme has had a lasting legacy, with many of its features still present in the current age pension, which is financed out of general revenue and possesses both income and assets means tests (Bateman and Piggott 2003: 4). This scheme also effectively made the Commonwealth responsible for age pensions since the States repealed their schemes (Kewley 1973: 66). The failure of social insurance to take hold, especially in the years following its enactment, meant that the middle class continued to rely on private savings, including superannuation. This left open space for the development of a second-tier that catered to the demands of the middle class.

Building the second tier: The income tax of 1915

Second-tier retirement incomes policy had modest beginnings at the Commonwealth level, comprising tax expenditures for superannuation in the income tax of 1915 that benefitted the wealthy minority with super. The third Fisher government introduced the income tax of 1915 in response to the fiscal crisis generated by the First World War.[144] The war transformed the Commonwealth's budget surplus of £1.2 million in 1913-14 to a deficit of £14 million in 1914-15 (Harris 2002: 180). The Fisher government partly funded the deficit with a £10 million loan from the UK. In August 1915, Fisher decided to finance the shortfall with an income tax that would apply retrospectively from July of the same year (*ibid*: 180).

The government expedited the enactment of the income tax because of the war

[143] The Deakin government estimated that the age pension would not cost £1.9 million until 1919-20, it surpassed this amount in 1911 and climbed to £3.1 million by 1913 (*ibid*: 35).

[144] Earlier, the second Fisher government had introduced the land tax, the first direct tax at the Commonwealth level, in 1910. The Land Tax was highly progressive and levied on the "1/450th of the population owning three-eighths of the landed wealth of Australia" (Smith 2004: 50).

effort. The two Bills that established the income tax – the *Income Tax Assessment Bill* and the *Income Tax Bill* – passed on 9 September 1915, which was within three weeks of their introduction (*ibid*: 181). An early cue to their later invisibility, the super tax concessions (along with many other measures) received little mention in the shortened parliamentary debate. In fact, the STCs were only amended by a provision secured by Attorney-General Billy Hughes to limit their subsidies to funds "established for the benefit of employees in any business" (*The Advertiser* 1915: 11).

The income tax of 1915 applied to individual income and undistributed business profits (*ibid*: 181). The company tax rate was set at the low and flat rate of 6.25 percent (1*s* 6*d* per £1) to avoid discouraging productivity (Smith 2004: 231). The income tax applied scales that graduated progressively from 0 to 25 percent on income earned via employment and share ownership (*ibid*: 52, 231). The initial £156 earned was tax exempt for individuals with incomes £500. For every £10 earned over £500, a taper reduced the exemption by £3 (*ibid*: 53).[145]

Highly progressive, the Commonwealth's income tax targeted the 'surplus wealth' of high-income earners to minimise its economic and electoral impacts (Harris 2002: 180). The majority of wage-earners did not pay income tax because the tax exemption of £156 was equivalent to the arbitrated minimum living wage (*ibid*: 52). Moreover, most income earners paid low tax since higher marginal tax rates kicked in at the highest incomes; the highest marginal tax rate (25 percent) kicked in at incomes over £7,600 – an income about 49 times the minimum wage (*ibid*: 231).[146] And, crucially, tax payers could reduce their tax burden through tax expenditures for income spent on: friendly societies and trade unions; religious and charitable organisations; superannuation; and, life insurance (Smith 2004: 231; Australian Government 1916: 282). Higher income earners mainly benefited from these tax expenditures since they were only available to tax payers.

The super tax concessions only benefited the small proportion of income earners who held super and paid tax. The limited evidence suggests this group comprised a small

[145] It should also be noted that individuals and couples were treated differently. Whilst the initial £156 of income earned by couples was tax exempt (and increased by £13 for each child), this exemption was reduced to £104 for single individuals (Smith 2004: 231).

[146] At the time of its introduction, John Forrest estimated that only 1 in 40 people would pay income tax (1915: 6543).

minority of highly educated and wealthy men employed in long-term managerial positions (Olsberg 1997: 61). These early STCs applied at all three stages of the super stream, an arrangement that still applies today. These concessions included: tax exemptions for personal and employer super contributions up to £50; tax exemptions for interest on investments in not-for-profit super funds; and a concessional 5 percent (1*s* per £1) tax rate for lump sum super benefits (Australian Government 1916: 279, 281-282).[147] These STCs had regressive structures: benefits increased proportionately with recipients' marginal tax rates and thus also with income or size of the lump-sum benefit. The regressivity of the STCs meant that they are more inequitable than the contributory principle that underpins publicly administered social insurance schemes. Although regressive, the STCs had a small budgetary cost at their introduction because their generous benefits were available to a small minority. Still, it was these concessions that would emerge as a stable policy vehicle for the expansion of middle class welfare in retirement.

The inclusion of STCs in the 1915 income tax seems to represent an instance of policy transfer from earlier State income taxes to the Commonwealth. A form of feedback effect, policy transfer occurs when policy is designed by drawing on existing legislation. The tax exemption for super contributions appears to represent policy transfer from the States' income taxes, but the exemption for investment earnings and concession for benefits were Commonwealth innovations. That the Commonwealth, States and New Zealand had a history of 'cross-fertilising' each other's legislation is evident in the above discussion of age pensions (Harris 2002: 201-207). Similarly, Harris (2002: 182, 186) argues that the income tax of 1915 was derived from the existing schemes in New Zealand and the States (particularly NSW). This is not unexpected considering cultural ties with New Zealand and the practical reality that the Commonwealth scheme had to operate alongside existing State schemes.

However, the STCs of the 1915 income tax were Australian policy innovations without a New Zealand equivalent. The tax exemption for super contributions replicated schemes implemented across the three largest States by 1912. After Victoria, Queensland and NSW introduced tax exemptions for certain super contributions in 1902 and 1912

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[147] These tax expenditures were introduced through sections 14 (f), 18(g) and 18 (j) of the *Income Tax Assessment Act 1915* (Australian Government 1916: 280-282). Nielsen and Harris (2008) contend that the concessional tax rate for super benefits was note introduced until 1936, but it is clear that this formed section 14(f) of the 1915 legislation after citing the Act.

respectively (Harris 2002: 177, 187). Notwithstanding, the Victorian tax provision is particularly significant because it was identical to the federal provision (*ibid*: 177). Here, policy transfer seems to be linked to Knibbs – the Commonwealth Statistician and staunch advocate of contributory schemes – who assisted in designing the scheme (Smith 2004: 52). The STCs for super fund earnings and benefits in the 1915 legislation may also reflect Knibbs' involvement. More broadly, the STCs reflected the broader practice of not taxing mutual aid organisations along with other not-for-profits. This appears to reflect the lack of attention the new STCs received in parliamentary debates (Commonwealth Parliamentary Debates 1916).[148]

By 1915, the Commonwealth's responsibility for retirement incomes was established through these early foundations of the current two-tiered retirement system. The parallel development of the age pension and STCs reflect two broader patterns of Australian social provision. First, the 'social welfare' form of the age pension provided means-tested benefits to low and middle-income earners, while the 'fiscal welfare' form of the STCs had a regressive structure that benefited high-income earners. Second, whilst the introduction of the age pension was a very public and drawn out affair, the STCs hardly received a mention when enacted. This may reflect that they amounted to minor tax subsidies for the not-for-profit sector.[149] The low profile of these tax concessions may in part reflect both the urgency of the war effort and perceptions they streamlined State provisions. But this fails to explain the low profile of earlier STCs in Victoria and NSW. As will become clear over this chapter and the next, these patterns have become more pronounced as the early two-tiered foundations of retirement income policy became entrenched in the following decades.

III. 55 Years of Stasis? Incremental reforms and radical proposals, 1915-1970

After the foundations were laid, governments managed only incremental reforms to the age pension and the super tax concessions over the next five decades. Steadied by the failure of alternatives, the two-tiered structure of retirement incomes policy became entrenched and received bipartisan support. The budgetary scale of both tiers increased as

148 For example, the "choice of the figure of 5 percent [for the lump-sum tax] was plainly arbitrary and reflected in part the inequity of taxing a sum wholly in the year of receipt when it may have arisen from employment stretching over many years" (Asprey 1975: 351). But, this arbitrariness attracted no controversy.

149 In fact, when the clause including the super tax concessions was considered in the Committee stage in both the House of Representatives and the Senate, the discussion focused on whether the tax expenditures should apply more broadly (Hughes 1915: 6549-6551, Gould 1915: 6739-6743).

their benefit rates grew and coverage extended. Stability does not mean this period was one of inactivity: the age pension was liberalised; radical proposals for social insurance fell short; income tax reform transformed the distributive effects of the STCs; and, with each change of government after Curtin, the tax concession for super contributions was adjusted slightly. To show how developments in this period influenced later policy decisions, my focus here is on several successful reforms – and failed proposals – that further entrenched the two-tiered system.

Before the Second World War, retirement incomes policy was subject to only minor reform. Governments of both major persuasions increased the full-rate of the age pension four times by 1923 and relaxed its eligibility criteria (Kewley 1973: 120).[150] Along with population ageing, these reforms saw the number of pensioners grow to 155,196 between 1921 and 1930 – an increase in coverage from 1.9 to 2.4 percent of the population (*ibid*: 122). Despite this growth, the age pension only grew from 10.4 to 13.7 percent of Budget expenditure between 1912 and 1930 (*ibid*: 123). The age pension was not subject to other lasting reform before the war; the Scullin Labor government cut the rate of the age pension during the Great Depression in 1931, but the Lyons United Australia government restored its rate by 1937 (*ibid*: 59; Dixon 1977: 61).[151] The Hughes Nationalist government passed the only reform to the STCs over this period, which was to double the super contributions exempted from tax to £100 in 1921. Arguably, the creation of the Commonwealth Public Service Super Fund in 1922 had a great impact in expanding super coverage over the next five decades (Bateman and Piggott 2003: 31).

Proposals for social insurance: On, then off, the agenda

Social insurance was pursued as an alternative to the age pension in the 1920s and 1930s by the forerunners to the Liberal and National parties. This continued the policy divergence between Labor and Fusion (now called the Nationalist and Country parties). The Bruce-Page government floated a proposal to convert the age pension into a social insurance scheme and appointed a Royal Commission in 1923 to undertake a feasibility study (Dixon 1977: 48). In 1927, the Royal Commission recommended that a

[150] The governments that increased the age pension included those led by Hughes (Labor and Nationalist) and Bruce-Page (Kewley 1873: 120). The Bruce-Page government also liberalised the income and assets tests (*ibid*: 121).

[151] The Menzies government did amend the age pension in late 1940, so that its rate was automatically recalculated each quarter in line with inflation, which maintained its value throughout the war (Kewley 1973: 283).

compulsory-contributory scheme for workers be established; the scheme was to be administered by the government and friendly societies, and be funded by flat-rate employer and employee contributions (Dixon 1977: 48).[152] This recommendation provoked opposition from the friendly societies who feared that social insurance threatened their survival (Kewley 1973: 147).

Without placating the friendly societies, the government introduced the *National Insurance Bill* based on the Royal Commission's recommendations to parliament in 1928 (*ibid*: 144). This Bill proposed a social insurance scheme for workers aged 16 to 65 years with incomes below £416 per annum to be financed by workers and employers (*ibid*: 144). The proposed scheme covered benefits for sickness, disability, widows, orphans, and a marriage allowance (*ibid*: 145). It was to be administered by the government and approved friendly societies (Dixon 1977: 49). When introducing the Bill, the Treasurer Earl Page (later Menzies' health minister) announced that the government would only proceed with the first reading of the legislation to facilitate a public debate and allow interested parties to examine the proposal (Kewley 1973: 145).

The Bill preceded no further because Page and Bruce were unable to wring approval from their parties. Moreover, the friendly societies vehemently opposed the scheme, arguing that it "had not been asked for, that it was unnecessary, and that it would destroy the spirit of thrift and independence characteristic of, and inculcated by, their movement" (*ibid*: 147). Employers, insurance companies and the States also opposed the scheme (*ibid*: 148). And, Labor refrained from opposing or supporting the scheme (*ibid*: 146).[153] This lack of support for social insurance delayed the scheme until late 1929, when it was effectively taken off the agenda by the incoming Scullin Labor government whose attention was directed elsewhere by the Great Depression (*ibid*: 51).

Social insurance received further attention at the 1934 election, with Country Party leader Page declaring his party would inquire into social insurance if elected (Dixon 1977: 62). After Lyons retained office by forming a coalition government with the

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[152] This Royal Commission released four reports between 1925 and 1927 (Kewley 1973: 143). Two of these reports were of particular significance: the first report promoted a national social insurance scheme that covered superannuation, sickness, invalidity and maternity benefits; and, the fourth report outlined the membership, financial and administrative details for the Royal Commission's preferred scheme (Dixon 1977: 47-48).

[153] Opposition Leader Scullin, however, did protest the failure of the scheme to cover unemployment insurance – but as this did not directly impinge on retirement incomes, it was not emphasised here.

Country Party, this put social insurance back on the agenda (*ibid*: 62). In 1934, a Cabinet sub-committee appointed two advisors – Frederick Innes, the Assistance Actuary of AMP, and Western Australian Deputy-Statistician Samuel Bennett – who recommended a full inquiry to update the 1928 social insurance scheme. But, further interest did not follow until the Under-secretary for Employment Frederick Stewart advised the government to reconsider the British scheme when reporting on the International Labour Conference in 1935 (*ibid*: 160). Heeding Stewart's advice, the government brought out two British insurance experts, Godfrey Ince and Sir Walter Kinner, to assist in developing a social insurance scheme in 1936.[154] Reporting in February 1937, Ince advocated compulsory unemployment insurance (*ibid*: 66). Four months later, Kinnear proposed a compulsory-contributory pension and a national health insurance scheme based on British social insurance (*ibid*: 66). Meeting Lyons' approval, these proposals were incorporated into a social insurance scheme pledged at the 1937 election (Kewley 1973: 160).

Representing a rare crossover between retirement and health policy, the re-elected Lyons government enacted the *National Health and Pensions Insurance Act 1938*. This ratified a compulsory scheme for workers aged 14 to 55 years earning less than £365 per year. The scheme covered sickness, disability, and medical insurance, as well as super and benefits for orphans and widows (*ibid*: 161). The scheme was to be jointly financed by employees, employers and the state, with administration shared by the government and friendly societies (*ibid*: 161). This scheme, however, was never implemented because of concerted opposition from the States, the friendly societies and, crucially, the BMA (*ibid*: 162; Dixon 1977: 72; see *Chapter 4*). Labor also opposed the scheme. Condemning the contributory principle, Labor restated its view that "only those able to pay should pay, that is the wealthy, should pay for social services" (Watts 1982: 162).[155] Unable to appease the opposition, the government repealed the social insurance legislation in June 1939 (Sax 1984: 47). Menzies, who became Prime Minister after Lyons' death, tried unsuccessfully to revive the scheme in August 1939 before war diverted attention elsewhere (*ibid*: 42).

Ultimately, social insurance failed to take hold because of concerted opposition and

[154] Ince was the Chief Insurance Officer of the Ministry of Labour and Kinnear was the Controller of the Insurance Department in the Health Ministry (formerly Kinnear had also been Deputy Chairman of the National Health Insurance Joint Committee of Great Britain) (Dixon 1977: 64).

[155] This provides an interesting comparison to Sweden, where a red-green coalition between the social democrats and agrarian parties developed an alliance in support of social insurance (see Manow 2009).

tepid support. Even Country and United Australia backbenchers were lukewarm about the scheme. Coupled with the restoration of the pension to its pre-Depression rate, the failure of social insurance (the obvious alternative) reinforced the age pension as the primary retirement incomes policy by the Second World War.

From concessions to rebates: The STCs and the Uniform Income Tax

Retirement incomes policy was not a major focus of the Curtin and Chifley Labor governments' substantial expansion to social welfare. Nonetheless, the Curtin government introduced tax reform that altered second-tier policy and the tax concession for super contributions in particular.[156] These reforms were undertaken as part of the Uniform Income Tax, which enabled the Commonwealth to consolidate revenue to fund the war by taking over income tax from the States. Before Curtin took office, it was evident that the inconsistency of 26 Commonwealth and State income taxes hindered the war effort (Smith 2004: 75). To inquire into standardising income tax, the government appointed a bipartisan Committee on Uniform Taxation in early 1942.[157] In March, the committee proposed that a single Commonwealth income tax replace the State schemes, with grants to reimburse them for lost revenue (Laffer 1942; Committee on Uniform Taxation 1942). In June 1942, the government introduced a temporary Uniform Income Tax that was to operate for the duration of the war (Smith 2004: 235).[158] Similar to the 1915 income tax, the legislation to implement this tax was subject to truncated parliamentary debate because of the urgency demanded by the war.[159]

The smooth passage of the uniform tax reflected the lack of standing that its main opponents – the States – had in federal parliament.[160] Desiring to retain control of their revenue, the States opposed the compensation package offered by the Curtin government and lobbied against the tax when it was before parliament (*ibid*: 75-76). Aware of State opposition, the government designed the scheme so that reimbursement grants were

[156] Reform of the tax concessions for super contributions was implemented as part of broader reform to concessional deductions rather than reform to retirement incomes policy. However, it should be noted that Chifley extended the age pension to all retirees except indigenous Australians in 1947 (Kewley 1973: 4).
[157] The Committee on Uniform Taxation consisted of Richard Mills (the chair), former Prime Minister James Scullin and the United Australia MP Eric Spooner.
[158] Four Acts were utilised to establish the scheme as they drew on different constitutional powers: the *Income Tax Bill*; the *Income Tax Assessment Bill*; the *Income Tax (Wartime Arrangement) Bill*; and *States Grants (Income Tax Reimbursement) Bill* (Smith 2004: 76, 235).
[159] This was particularly the case for the *Income Tax Assessment Act 1942,* which contained the rebates discussed below. Much of the parliamentary debate focused on the *States Grants (Income Tax Reimbursement) Act* and the issue of how to compensate the States.
[160] The State governments had opposed many other proposals to centralise taxation since the early 1930s. This, however, did not mean that they opposed every measure.

withheld from States that refused to comply with the uniform tax (*ibid*: 235). This infuriated the States, leading the South Australian government to challenge the uniform tax's constitutional validity in the High Court (*ibid*: 76). Siding with the Commonwealth, the High Court upheld the uniform tax, ruling it 'tempted' rather than 'forced' State compliance (*ibid*: 76). With the public supporting the uniform tax (*ibid*: 76), the States grudgingly complied with the scheme. Although introduced as a temporary war measure, the States have not re-entered the field and the uniform tax has become entrenched.

What impact did the Uniform Income Tax have on the STCs? This reform converted the concessional tax deductions listed in the *Income Tax Assessment Act* – including the tax exemption of super contributions – into rebates calculated at the average tax rate paid by taxpayers (*ibid*: 65).[161] Although still inequitable, the rebate structure was more equitable than the earlier tax exemption because it reduced the benefits received by high-income earners. Made at the Committee on Uniform Taxation's (1942: 293) behest, Labor justified the rebates as the most scientific and equitable device available (Calwell 1950: 3,140). The government's incremental strategy appears to reflect the Opposition's support for the existing tax concessions, which was important as the government lacked a Senate majority. In the event, the Opposition voiced concerns about the rebates' complexity, but offered support for the legislation on the proviso they be revisited at the Budget (Fadden 1942: 1,766).

The Uniform Income Tax also indirectly affected the incidence of the STCs. As tax expenditures calculated in relation to marginal tax rates, the STCs were sensitive to reform of the tax scales. These indirect effects had the greatest long-term impact on the STCs because the uniform tax increased both the proportion of the population that paid tax and the highest marginal tax rates.[162] This reduced the taxes of many low and middle-income earners (in previous State schemes), while increasing the tax paid by high-income earners and property owners (*ibid*: 64-65).[163] Although highly progressive, these reforms increased the benefits those on high-incomes received from the super tax concessions. For instance, the tax exemption for super fund earnings would have paid no benefit to

[161] Since the tax exemption for super fund earnings and concessional tax on lump-sum benefits were located in other sections of the Act, this reform only affected the tax exemption for super contributions.
[162] The Curtin government raised the highest marginal tax rate at 90 percent (216*p* per £1) (Australian Government 1942: 66).
[163] The government also broadened the tax base in 1943 (after the High Court challenge) so that individuals earning annual incomes of £104 or more paid tax (*ibid*: 65). In 1942, the amount of income exempt had been £150. To put this into perspective, the basic wage was around £60 at this time (Smith 2004: 65).

those who could not afford super, gradually rising to a 90 percent benefit for those on the highest incomes. That the Curtin government – otherwise predisposed to progressive redistribution – did not improve the equity of the concessions further suggests that the STCs had also become entrenched policy institutions.

Menzies' tinkering with retirement incomes policy

Retirement incomes policy did not radically shift with the election of the Menzies Liberal government in 1949. Over the next 23 years, Menzies and his Coalition successors undertook only incremental reform to both tiers. Included within a package aimed at simplifying the Commonwealth income tax, the government's initial reform was to restore the tax concession for super contributions.[164] As well as increasing the super contributions limit to £200, the reform restored the benefit structure so that it inverted the tax scales, paying no benefit to those earning less than £104 but rising to 75 percent discount for those earning over £10,000 per year (Fadden 1950: 977).[165] The Labor Opposition criticised the inequity of reinstating the tax concession for super contributions, claiming that they were more inequitable than the current rebates and that the Liberal party was looking after the wealthy (Calwell 1950: 3139-3143). The government, including Treasurer Fadden, argued that the reforms simplified the income tax and that the tax concession for super would have minimal budgetary impact (Fadden 1950: 975; Leslie 1950: 3,154). However, Labor supported the reforms in the Senate as part of its strategy of criticising the government for offering insufficient tax relief in the Budget.

In 1961, the Menzies government undertook wider reform to second-tier policy, requiring that private super funds hold 30 percent of their portfolios in government bonds (20 percent of which had to be in Commonwealth bonds) to receive the tax exemption for their earnings (Nielson and Harris 2008). Enacted through the *Income Tax and Social Services Contribution Act 1961*, this reform applied to not-for-profit funds and those funds operated by life insurance that had a separate statutory fund for their superannuation activities (Holt 1961: 1,155). This package also increased the tax exemption limit to £400 of personal super contributions. The government argued that the reforms were necessary to redress the dwindling investment of the superannuation and

[164] This was part of a reform to all of tax concessions listed under the 'concessional deductions' of the Act, which had converted them into rebates. The tax concession for super contributions was not singled out.
[165] After the war, the highest marginal tax rate was lowered to 75 percent.

life insurance industries' in industry bonds, which it claimed was mostly responsible for the shortfalls in financing public works programs.[166]

These reforms attracted little opposition in parliament. Three government politicians – Turner, Wheeler and Killen – expressed concern that these reforms violated the free-enterprise *ethos* of the Coalition parties but they voted for the reform. The Opposition also voted for the Act, claiming that the changes to the tax exemptions for super funds represented an indirect means to socialise investment (Crean 1961: 1,222) – this later became an important justification for the industry super funds.[167] The super and life insurance industries formed the main opponents of these reforms because they opposed state interference in their operations (Thompson 1961: 1,324). Opposition to these reforms culminated in an unsuccessful High Court challenge in *Fairfax v. Federal Commissioner of Taxation* to the constitutional validity of these reforms (Nielson and Harris 2008). After the High Court's decision, the private funds had little choice but to comply with the reforms (Olsberg 1997: 66).

The Menzies government and its Coalition successors also liberalised access to the age pension once it abandoned social insurance. Under Menzies' leadership, the Coalition committed to social insurance at the 1946 and 1949 elections (Dixon 1977: 97). But, his government walked away from this commitment by the mid-1950s; in 1951, Menzies watered down his proposal for social insurance to a retirement scheme, and, in 1954, the government took this off the agenda (*ibid*: 100). The government changed its policy to support the age pension because it was cheaper to extend the existing scheme than build a new one. At the same time, Dixon (1977: 101) argues that the Coalition feared social insurance might be perceived as a backhanded means of raising tax. Once refocused on the age pension, Coalition governments introduced a series of reforms between 1954 and 1966 to liberalise the scheme's coverage.[168] These reforms considerably liberalised the

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[166] The government's concern stemmed from data that suggested the life insurance firms' investment in bonds dropped from 50 to 33 percent of their portfolios between 1939 and 1960, whilst the superannuation funds' investment also fell from 50 percent in 1956 to 39 percent in 1959 (Holt 1961: 1,152).

[167] Labor's support was not without qualification. For instance, Frank Crean was concerned that private super funds would remain under-regulated since employers used super to limit worker mobility (Crean 1961: 1,223).

[168] The Coalition undertook no less than seven reforms. In 1954 and 1958, the government relaxed the income and assets tests (Kewley 1973: 294). In 1961, the income and assets tests were merged into a single means-test (*ibid*: 295). The residency requirement was reduced to 10 years in 1963 and separate rates for single and married pensioners were established in 1963 (Daniels 2007: 6). And, the separate means test for the Pensioner Medical Service was dropped in 1966 (*ibid*: 6). These reforms also ended the racism of the age pension, with indigenous Australians finally able to claim benefits from 1960.

age pension, particularly among the middle classes, with the number of recipients rising from 375,000 to 607,000 in the ten years leading up to 1963 (Daniels 2007).

The Menzies government's failure to implement social insurance in the mid-1950s marked the fourth unsuccessful attempt by a Coalition government since the age pension was established. The government's policy reversal on the age pension also suggests that the policy debate had shifted by the 1950s since social insurance was abandoned by the Coalition without major conflict. Moreover, later Labor proposals used the terminology of national superannuation instead of social insurance. The government's liberalisation of the age pension also represented the attempt of a centre-right government to extend benefits to their middle class constituency, a response typical of such governments in the post-war period (Baldwin 1990).

This consolidated the age pension as the primary retirement incomes policy. It also further entrenched the existing two-tiered structure of retirement incomes policy, which still resembled the policy institutions established in the early twentieth century. These policy institutions actually became more entrenched by 1970, with successive governments increasing the coverage of the two tiers, the benefits they delivered, and thus their budgetary cost. Exogenous developments, particularly the Commonwealth public service's super scheme also contributed to this by increasing the coverage of private super and thus those that benefited from the STCs. But, the period between 1915 and 1970 was thus not one of inactivity, with radical proposals stalling and the two-tiered structure of retirement incomes policy being reinforced. Finally, the policies of Labor and the Coalition appear to have converged in supporting the age pension during the 1950s and 1960s, even though both parties continued the search for alternatives.

Back on the agenda: National super and tax reform from the 1970s to 1980s

By the early 1970s, Labor put social insurance back on the agenda, albeit under the new name 'national superannuation'. Like social insurance, national super consists of a single state-administered super fund that (typically) covers the workforce. Before particular models were canvassed in the 1970s, interest was rekindled in national super in the 1960s by interest groups – including the peak business body the Associated Chamber of Commerce – and academics – especially the proposal of Professor Downing in 1968

(Kewley 1973: 299).[169] Whilst members of the major parties expressed interest in national super, Labor publicly embraced the policy and the Coalition (eventually) opposed it. But, despite Labor's support, national super did not eventuate in the 1970s and reform to retirement incomes policy focused on the age pension and STCs. Nonetheless, two parallel developments kept superannuation on the agenda in the early 1970s: a series of government reviews and proposals concerned with retirement incomes policy, and, a union campaign to extend employer-sponsored super to their members when a national super scheme did not materialise.

Announcing his platform at the 1969 election, Opposition leader Whitlam included national super as part of a three-pronged retirement incomes policy that also proposed to abolish the means test and peg the age pension to wage rates (*ibid*: 429). But, other than signalling that super would be supplementary to the pension, this announcement carried few details. It was, nonetheless, significant that Whitlam placed national super on Labor's platform as it reversed the typical partisan divide (Kewley 1973: 415).[170] After narrowly losing the 1969 election, Labor continued to support national superannuation as a potential means of capturing middle class votes (Solomon in Kewley 1973: 415). Shadow Minister for Social Security Hayden played a central role in directing further attention on national super through a series of papers presented before the 1972 election (SSCHA 1988: 332). Although Hayden floated a detailed proposal in the early 1970s, Labor did not commit to a particular scheme before winning office (*ibid*: 332). Rather, Whitlam promised to establish an inquiry (the Hancock Inquiry) to look into super (Kewley 1973: 430). However, he lost office by the time this enquiry released its final report, which took national super off the agenda.

Conversely, the Coalition matched Labor's commitment in 1972 but did not recommit to the policy in the late 1970s. Initially, national super proved a divisive issue for the Coalition. Gorton formally rejected proposals for national super in 1969, but several backbenchers supported it (*ibid*: 431). The Coalition gave little more attention to super until McMahon became prime minister in 1971, when the Minister for Social Services Wentworth independently announcing that the government was considering a national scheme (*ibid*: 432). Responding to Wentworth's musings, the Federal Council of

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[169] However, unlike Scotton and Deeble's proposal for universal health insurance, neither party adopted these academic proposals.
[170] Chifley had flirted with the idea of national super toward the end of his term, but this never amounted to a full proposal because of concerns about the expenditure required (Kewley 1973: 292).

the Liberal Party requested that Treasurer Snedden inquire into national super in May 1971 (*ibid*: 432). The ensuing report, however, explored the issues rather than specific proposals (*ibid*: 432). With an election looming in late 1972, the government matched several of Labor retirement incomes policies. These policies included a commitment to abolish the means test for the pension over three years and to consider national super (*ibid*: 433). This appears to reflect the government's concern that new approaches were needed to retain office as the polity was shifting to the left (*ibid*: 433). But, the Coalition did not recommit to national super when returned to office in 1975. As Prime Minister, Fraser was initially unsympathetic to the Hancock proposals for national super (see below). He formally rejected the scheme in 1979, arguing that its compulsion placed too great a burden on low-income earners (Warren 2008: 12).

Formal reform to the two tiers in the 1970s

Despite the activity surrounding national super, formal revision focused on existing retirement income policy during the 1970s. The McMahon, Whitlam and Fraser governments reformed the first tier's age pension. To renew Coalition policy, the McMahon government liberalised the age pension's means test and signalled its intent to introduce the broader reform (before losing office). This proposal included increasing the free means (the assessable income that a pensioner could earn before taper kicked in) from \$10 to \$20, and, treating income from annuities and private pensions as income from property for purposes of the means test (meaning that 10 percent of it was counted as assessable income) (Kewley 1973: 413). The Whitlam government significantly liberalised the age pension as part of its redistributive agenda; it abolished the means test for the age pension for those over 75 years, and then further reduced this to 70 years in 1973 and 1975 respectively (Bateman and Piggott 1994: 31). And, after initially liberalising the age pension so that it increased with inflation every 6 months, the Fraser government scaled back the automatic increase to once per year in 1978 and reintroduced the assets test for pensioners aged over 70 years in 1979 (*ibid*: 31). Both of these measures formed part of the government's attempts to tighten public spending and reduce the Budget deficit.

The reforms to the STCs undertaken in the 1970s followed a familiar pattern – Labor's reforms slightly increased the equity of the tax concessions, while Fraser enhanced their simplicity at the expense of their equity. Interest in the STCs was garnered by the Asprey Tax Review (discussed in more detail below), which undertook the first systematic review of the 'concessional deductions' listed in the *Income Tax Assessment Act* since their introduction. The review found that 23 concessional deductions reduced tax revenue by 20 percent and income tax collection by one third; of this amount, 24 percent was attributed to the tax exemptions for super and life insurance (Asprey 1975: 166-167). Adopting several of the less contentious recommendations made by the review, the Whitlam government replaced the tax exemption for super contributions (and the other 22 concessional deductions) with a flat-rate 40 percent tax rebate (Smith 2004: 110).[171] The rebate for super contributions had a $1,200 limit, but if a taxpayer had less than $1,350 of allowable expenses they could claim a block rebate (Australian Government 1975: 1099; Willis 1975: 2,482). The tax rebate for super contributions was introduced through the *Income Tax Assessment Act (No.2) 1975*, which was largely uncontroversial and received bipartisan support. The tax rebates (and other aspects of this legislation) received very little attention in the parliamentary debates, which were focused on issues of tax reform and the unfolding loans scandal (Lynch 1975: 2,479-2,480; Willis 1975: 2,481-2,482). Compared to Curtin's earlier rebate, the tax rebate for super contributions had a simpler design, but it too had a more equitable structure than the tax exemption it replaced.

However, less than two years later, the Fraser government restructured the tax rebate for super contributions as part of a package in the 1977-78 Budget to reduce state expenditure and lower tax avoidance. These reforms replaced the block rebate (that had been increased to $1,690) with a tax-free threshold on the first $3,750 of taxable income (Lynch 1977: 2,271). The rebate for super contributions was lowered to 32 percent so that it was inline with other rebates (such as the PHITR) and was claimable when allowable expenses reached $1,590 (*ibid*: 2,271). The annual limit on super contributions of $1,200 still applied. In support of these reforms, Treasurer Phillip Lynch argued that the tax-free threshold was received universally and that the rebate merely extended access to tax benefits (*ibid*: 2,271). Opposing these reforms, Labor argued that the reforms to the block rebate and super tax rebate represented upward redistribution from the 'have-nots to the

[171] This reform also received support from the Commission of Inquiry into Poverty (also known as the Henderson Commission) and the Downing Report in 1975 and 1964 respectively (Smith 2004: 111). The Hancock Committee, which reported in the year following these reforms, argued for a tax concession for super contributions but seemed ambivalent as to whether a tax rebate or a tax deduction should be used and indicated its support for the existing arrangements on the grounds of simplicity (NSCE 1976: 73).

haves' (Hurford 1977: 2,634).[172] But, with majorities in both houses of parliament, the government passed its reforms.

On the agenda: Reviews and proposals for reform

National super did not eventuate through formal reform, but super remained on the agenda from the mid-1970s because of two developments. The first of these was the series of reports and proposals for superannuation released in the 1970s and early 1980s. The most significant of these was the Hancock Report commissioned by Whitlam. In meeting his election promise, Whitlam appointed a three-person National Superannuation Committee of Enquiry (NSCE) chaired by Professor Keith Hancock in 1973 to explore the implications of implementing proposals for national super in Australia (Warren 2008: 11). As the most thorough examination of national super since the 1920s, the committee's terms of reference included finding the most equitable means to finance and tax both super contributions and benefits (NSCE 1976: *ix-x*).

The NSCE released its final report – known as the Hancock Report – in majority and minority report form in 1976. The majority report, tabled by Hancock and McCrossin, recommended that national super be established to "enhance the economic security and living standards of the aged" (NSCE 1976: 3). It recommended that the government establish a two-tiered scheme, comprising a

> partially contributory, universal pension system with an earnings-related supplement that would raise pension rates to a minimum of 30 per cent of average weekly earnings… [and] a broadening of existing arrangements through a scheme encompassing a non-contributory flat rate universal pension, a means tested supplement and greater encouragement of voluntary savings through an expansion of occupational superannuation (Treasury 2001).

The scheme envisaged by the majority report was to be administered by the government and funded through contributions and taxation revenue (NSCE 1976: 3-5). It was projected to cost $3.6 billion per year, which was $1.4 billion more than the age pension (SSCHA 1988: 334). In contrast, the minority report released by Hedley advised against national super and recommended that the government continue to liberalise the age pension (NSCE 1976: 117).

The Hancock Report also provided rare insight into the consumer profile of super funds. The report discussed a recent ABS survey, which established that around 32

[172] Because the reforms also scaled back tax indexation, the Opposition argued that they did not reduce the tax of everyone.

percent of wage and salary earners held superannuation in 1974 (NSCE 1976b: 6). The survey found that super coverage was concentrated amongst workers who had held their current job for five or more years and, to lesser extent, older workers (ABS 1974).[173] The survey also noted gender differences in super coverage: while 41 percent of working men held super, only 17 percent of working women had super (*ibid*: 6). Olsberg (1997: 67) argues that this reflected the concentration of women in low paid sectors of the economy, their broken patterns of employment and their over-representation in casual and part time work. And, the survey found that individuals (mainly men) in high status jobs were most likely to hold super (NSCE 1976: 7). The Hancock report speculated that higher income earners were more likely to have super, but acknowledged that insufficient evidence existed (*ibid*: 8). Overall, the survey suggested that super was concentrated amongst high-paid men in managerial, professional, public service and financial sector positions in the early 1970s (*ibid*: 8). However, the concentration of super amongst this group appears to reflect a life-cycle effect in addition to class inequality because older workers and those who had held jobs for longer duration were also more likely to hold super. As the Fraser government rejected the Hancock Report's recommendations, this report's mainly stimulated debate.

Two later reports kept private super and second tier policy more broadly on the agenda in the early 1980s. The Life Insurance Federation of Australia (LIFA), the umbrella organisation of the life insurance and superannuation industries, presented a proposal for national super to the Fraser government in 1981. Although termed national superannuation, LIFA's scheme amounted to a more generous age pension that was to provide a flat-rate universal benefit equal to 30 percent of average weekly earnings for single pensioners (50 percent for couples) and be financed out of general revenue (LIFA 1981: *i*). Sharp (1992: 35) argues that this represented an attempt by the finance industry to undermine proposals for a state-administered scheme. Commissioned at the request of Hayden (now Opposition leader), the second report was developed by the Welfare Committee and the Economics Committee of the Labor party's Federal Caucus in 1982. The committee proposed that the age pension stay means tested (through the income test) and that a super supplement valued between 3.3 to 13.3 percent of average weekly

[173] Whilst only 17 percent of workers had super if they had been in their current job for under 5 years, super was held by 42 percent of workers who had been in their jobs for more than five but less than ten years and 51 percent of workers who had held their job for 10 or more years (ABS 1974: 6). Moreover, super coverage amongst workers increased with age (not including those of retirement age and continued to work) in 1974; about 11 percent of workers aged under 20 years had super, about one third of workers aged 25 to 34 years held super, and about 40 percent of workers aged 35 to 64 years held super (ABS 1974).

earnings be introduced (*ibid*: 334). This two-tiered proposal became known as the Hurford proposal because of Shadow Minister for Industry Christopher Hurford's role in convincing Caucus to adopt it (*ibid*: 334). A detailed proposal with Caucus support, the Hurford proposal formed part of Hawke's platform when Labor returned to office.

And, two other reports advanced reform of the STCs. The Asprey tax review (noted previously) devoted one chapter of its final report to the taxation of superannuation. The review contended that the tax exemption for super fund earnings was justifiable because it encouraged individuals to provide for their future needs and employers to recognise their moral obligation to assist their employees as well as redressing an underlying bias in the tax system against savings, which were taxed when earned as income and when investments gleaned returns (Asprey 1975: 349, 367). The review also advised the government to repeal the provision requiring super funds to invest 30 percent of their assets in government bonds to receive the tax exemption and argued that the concession for super benefits be retained (*ibid*: 373). However, the review found that the concessional deductions were applied in a piecemeal fashion and recommended that they should be converted into 'carefully administered public expenditure programs' wherever possible (*ibid*: 168-169). The Campbell Committee's report focused further attention on the STCs in 1981, proposing that the government tax super contributions and earnings like other income and make super benefits tax exempt (because of deficiencies with the STC for lump-sum benefits) (Campbell 1981: 248).[174] This report added credence to the Asprey review's concerns about the taxation of super, but the Fraser government did not take-up its proposal.

Unions enter the fray: Bargaining for occupational superannuation

National super also remained on the agenda because of the growth in private super coverage resulting from the union movement's campaign to include super in industrial awards in the mid-1970s. Unions had campaigned for employer-funded super benefits for their members since the early 1960s, frustrated by the lack of progress with national super. This campaign gathered momentum in the mid-1970s (Olsberg 1997: 76). Following the establishment of centralised national wage indexation by Whitlam in 1975, unions had limited means to increase wages as they had committed to wage restraint

[174] The Campbell committee was also known as the Committee of Inquiry into the Australian Financial System. It was commissioned by the Fraser government and chaired by Kenneth Campbell. The broad focus of this committee was on the workings of the Australian financial system and the reform options. Super was not a central focus.

within this national system (*ibid*: 75). When the Fraser government later pursued tight monetary policies that constrained union wage demands and also failed to introduce national super, the union campaign for private super – along with shorter working hours – offered a means to improve the lot of workers without increasing inflation (*ibid*: 75-76). This reflected a broader shift in the union movement's agenda to include demands for social benefits and issues (*ibid*: 75). The union movement understood private super as deferred pay for workers, which provided a supplement to the age pension and presented an opportunity to extend the generous tax concessions that had hitherto been the province of the middle class to workers (*ibid*: 76; Combet 2004: 17).

As part of this industrial campaign, several unions – including the Pulp and Paperworkers Federation (PPF) and the Federated Storemen and Packers' Union (FSPU) – opted to extend the coverage of super by creating their own schemes (Gallery *et al.* 1996: 101). Under the leadership of Bill Landeryou, the FSPU advocated a 'comprehensive, government sponsored super scheme' but indicated that unions would pursue employer-funded occupational super in its absence (Olsberg 1997: 78). Pursuing this strategy, Landeryou and senior FSPU officials including Simon Crean, Bill Kelty and Greg Sword played a central role in this campaign by establishing a super fund named the Labour Union Cooperative Retirement Fund (LUCRF) for members (Olsberg 1997: 78). This was significant because it gave workers flexibility over their super, whereas previous schemes tended to remain under employer control (Combet 2004: 18). Furthermore, the same FSPU leadership team organised a strike of Woolworths workers to extend super to all workers in 1979 (*ibid*: 77-78). This strike, which represented the first union demand for occupational super, received wide media coverage and softened union members' resistance to the idea (*ibid*: 79).

Coupled with the examinations of super and its tax treatment by both the Asprey Review and Hancock Report, the FSPU's strike helped to place superannuation on both the ACTU and Labor agendas (*ibid*: 80). In 1979, the ACTU piloted a super fund that aimed to eventually cover 60 percent of members and Labor embraced a policy to encourage union super funds (*ibid*). However, the push for super stagnated in 1980, with the ACTU recommending that unions pursue coverage individually rather than embark on a national campaign (*ibid*). Nonetheless, the union campaign for private super also made Labor more receptive to a national scheme.

Despite its stagnation, the union campaign to extend private super to workers had some success. Evidence for this is offered in the ABS's follow-up survey of private super fielded in 1982, which revealed that super coverage rose to 44 percent of workers (from 32 percent in 1974) in the absence of other developments (ABS 1982a: 8). This survey also confirmed that super remained concentrated amongst men working in professional, managerial, clerical and administrative roles (*ibid*). These workers were most likely to work in the public service, communications industry, as well as the mining and finance sectors (*ibid*: 17). However, private super expanded beyond its concentration amongst older workers, with slightly more than half of those aged 25 to 64 years coming to holding super (ABS 1982: 16).[175] Still, super coverage remained higher amongst those who had remained in the same job for extended periods, with 75 percent of those covered who had held a job for 10 or more years covered (ABS 1979). The extension of super to younger workers and to those who remained in the same job for long periods – which was the major impact of the union campaign for mass super membership – increased private super's capacity to foster life-cycle redistribution over the longer-term.

The ABS (1982a) survey also confirmed the Hancock Committee's suspicion that super was concentrated amongst the well off. On the one hand, super coverage rose with income. While super was held by well under half of workers who earned less than average weekly earnings, more than three quarters of higher income-earners had super (ABS 1982a).[176] On the other hand, super benefits remained the purview of the well off. Most private pensioners (around 60 percent) received less than $120 per week, which was less than 45 percent of average weekly earnings but still higher than the age pension (*ibid*: 7). Of those who received lump sum benefits, 73 percent received less than $20,000 (which was below one and a half times average annual earnings) and only 2.6 percent received more than $100,000 (*ibid*). Moreover, lump sum super benefits did not necessarily serve a retirement incomes function in the 1970s because the preservation age had not yet been established, which meant that investments could be withdrawn at any time. So, although private super's coverage expanded through the union campaign, most benefits were received by the well off.

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[175] These figures have to be read with some caution for two reasons. First, less than one third of workers aged under 25 years held super (ABS 1982). Second, the later ABS survey focused on workers who worked 20 or more hours per week on average, so these figures are not directly comparable with the 1974 survey.

[176] Average weekly earnings were $283.90 in June 1982 (ABS 1982b). Whilst less than 30 percent of those earnings up to $200 per week had super accounts, more than 80 percent of those on incomes of $450 and higher held super (ABS 1982a).

IV. Conclusion: A foundation built firmly on tax concessions

In 1980, the two-tiered structure of the retirement incomes system established in the early twentieth century remained in place. The first tier age pension had been liberalised, but it retained its non-contributory and targeted structure. Olsberg (1997: 71) argues the age pension had become a ‘political sacred cow’, surviving numerous proposals for reform because the public and both major parties supported it. The second tier shaped by STCs remained largely unchanged, but their distributive impact had become more pronounced because of the expansion in super coverage and the broadening of the tax base. Sharp (1992: 34) contends that the Australian superannuation industry was ‘built on tax concessions’ over the twentieth century, as growth in super investments and coverage had coincided with sharp rises in the cost of the STCs.

Although the 1970s and early 1980s did not bring radical reform, developments during this period nevertheless put second tier reform onto the agenda for at least the next decade. These proposals, and the union movement’s campaign for occupational super, kept national superannuation on the agenda and led Labor to adopt the Hurford proposal before returning to government. If implemented, national super would have sounded the death knell for the STCs because contributions were to be universal and administered by the state. However, the failure of this proposal to take hold kept the issue of super firmly on the agenda, which I will show was a crucial step in developing the mandatory occupational super scheme.

- Chapter 7 -

A Response to Population Ageing?

Drift, Conversion and the Superannuation Tax Concessions

The policy initiatives of recent Labor and Coalition governments deserve lengthy treatment because they are crucial to understanding the political dynamics of current two-tiered retirement incomes policy. Despite maintaining the two-tiered structure of early policy, the Hawke and Keating governments enacted the most radical reforms to retirement incomes policy since the early twentieth century. The age pension was retained as the major first-tier social program, but was retargeted to exclude the wealthy. With the Superannuation Guarantee Scheme (SGS), Labor expanded the second tier of private super to almost the entire workforce by the early 1990s. Although the rise of occupational welfare has contributed most to the four-fold growth of the STCs since the early 1980s, the Hawke and Howard governments strategically used incremental reform to reorient them toward their policy priorities. Resuming where the last left off, this chapter continues the structured narrative of retirement incomes policy until the end of the Howard years. Then, in applying the historical institutionalist framework (see *Chapter 2*), I claim that the STCs' rapid growth is attributable to both *drift* following the establishment of the SGS and to the *conversion* strategies of the Hawke and Howard governments.

I. 'Labour' Builds New Second-tier Institutions

The Hawke government switched its policy focus from the Hurford proposal to mandatory private super for workers because of two reinforcing political developments. First, the union movement revived its campaign to extend private super to workers – also called occupational super when received by workers – and it experienced success in expanding cover through the *Accords*. This also gave the government a stake in private super's success. Second, Labor's interest in national super stagnated in the late 1980s because of its budgetary cost and perceptions private super proffered a more efficient option, particularly in the context of population ageing (i.e. Foster 1988a). In this policy environment, the Hawke government's support for private super thus allowed it to realise several policy ambitions. Culminating in the SGS, the Hawke and Keating governments extended second-tier coverage to most workers and thereby channelled considerable resources to the finance sector. As later parts of my structured narrative shows, the huge expansion of the second tier had major implications for the STCs and the structure of retirement incomes policy more broadly.[177]

The ACTU put super back on the agenda when the Hawke government took office. It formed a Superannuation Committee to co-ordinate policy, which included former FSPU officials Simon Crean and Bill Kelty (Olsberg 1997: 81). However, private superannuation resurfaced in the *Accord* negotiations rather than through a national industrial campaign. A Labor innovation, the *Accords* were neo-corporatist wage-fixing agreements negotiated between the government, ACTU and employers. In 1983, the first *Accord* increased the social wage in return for wage constraint (Sharp 1992: 35). Although this agreement did not initially cover private super, the government raised the prospect of including super in future *Accords* with the ACTU (Treasury 2001: 77).

However, the *Accord* was put in jeopardy when the Industrial Relations Commission (IRC) rejected the building unions' proposal to deliver unpaid benefits as over-award payments in 1984 (McDonald 2004).[178] The building unions negotiated with

[177] The expansion of private super in the Hawke and Keating years is treated here separately to reform of the STCs because of the different policy processes involved. However, when appropriate, crossovers between the campaign for private super and the STCs are mentioned.
[178] The IRC was formally known as the Conciliation and Arbitration Commission.

employers to overcome this by having over-payments paid as super (Olsberg 1997: 81). While affecting a minority of workers, the building unions' success acted as a reminder of super's potential to increase income in times of wages restraint.

The building unions' success marked another policy innovation because it managed to have these contributions paid into the first industry super fund – the Builders Unions' Superannuation Fund (BUS) that operated from July 1984. Industry super funds have industry-wide coverage, are mostly financed by employer contributions and are controlled jointly by trade union and employer representatives (Olsberg 1997: 81). Initially, the National Industrial Construction Council representing master builders opposed BUS, but eventually agreement was reached. Both the government and ACTU promoted BUS as a union prototype, emphasising its industry-level coverage, employer contributions, and 'vested' investments (meaning investments were mobile) (*ibid*: 82).[179] BUS' founding acted as a catalyst for union campaigns for occupational super; other unions began to use BUS and LUCRF as models to lobby for occupational super in lieu of wage increases. As the momentum increased, senior ACTU officials including the Superannuation Committee took over the campaign (*ibid*: 82).

Coupled with worsening fiscal conditions, the union campaign for occupation super lay behind the inclusion of award super in the *Accord Mark II*. In 1985, the government confronted worsening economic conditions, including: high inflation and interest rates; a growing Current Account Deficit; and a declining currency (Stilwell 1986: 17-18; Treasury 2001: 78). Labor came to agree with business that these threats meant that wages should not be indexed. At the same time, the National Tax Summit (of 1985) fuelled ACTU and employee expectations of wage increases (Stilwell 1986: 17). These competing demands made the government more receptive to award super as a means to increase real incomes while constraining wage growth.

Consequently, in the second Accord, the government negotiated to include employer-financed award super in return for keeping wages growth below inflation (Treasury 2001: 78). This deal reflected trust between Labor and the ACTU, but more specifically personal trust and close ties between their chief negotiators Keating and

[179] BUS required employers to make a flat rate $11 payment each week, which was made up of a $9 super contribution, $1 life insurance contribution, and $1 administration payment (McDonald 2004).

Kelty (Kelly 2008: 282).[180] Initially set at three percent of wages and paid into industry super funds, award super formed part of the 6 percent wage increase included in the 1986 National Wage Case presented to the IRC (*ibid*: 78).

Both the ACTU and government framed award super as deferred wages that would relieve inflation – but this was not their only rationale. Award super also appealed to the ACTU because it expanded the role of industry super funds and thus union involvement in managing super (Sharp 1992: 35). In addition, the government was attracted to award super because it increased retiree resources and national savings without increasing public spending (Treasury 2001: 78). Award super also appealed to Hawke and Keating (as members of Labor's right faction) as an alternative to the national super scheme favoured by Labor's left faction (Kelly 2008: 283).

However, award super divided business interests. Employer interests opposed award super as it increased their expenses while weakening their capacity to control employees' super (Sharp 1992: 35). These interests also opposed award super because it increased the role of unions and industry super funds (*ibid*: 35). However, the life insurance and super industries – as well as some employers – supported extensions to private super because it provided a major source of equity for the finance industry and some employer-operated super funds competed against them as a source of cheap business loans (Sharp 2010: 200, 202).

Similar to the early wage-earner institutions developed at the outset of the twentieth century, award super was established through the arbitration system (Castles 1994: 135). In the 1986 National Wage Case, the IRC approved award super being paid into industry super funds (Treasury 2001: 79). But, it decided that award super was to be negotiated on an industry-by-industry basis and required the government to ensure that these funds met operational standards (Treasury 2001: 79). Opposing this ruling, the Confederation of Australian Industry (CAI) challenged the IRC's constitutional authority to approve award super in the High Court (*ibid*: 78). However, unions were officially given the capacity to negotiate award super when the High Court ruled that it fit within the IRC's jurisdiction in May 1986 (*ibid*: 79).

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[180] According to Kelty, award super was first the ACTU's idea, then it was taken up by Keating (in Kelly 2008: 282). The historical record supports this. For more on the close ties between Keating and Kelty see Kelly (2008) and Love (2008).

In response to the IRC's concerns, the government introduced new regulation of the super industry in the *Superannuation Standards Act 1987*. The Act legislated operating standards, such as: the vesting of super contributions and benefits; preserving super benefits until recipients reached 55 years of age; and requiring members to occupy half the positions on trustee boards for super funds with over 200 members (Treasury 2001: 79-80). To oversee these operating standards, the Insurance and Superannuation Commission was created (Howe 1989: 6).

The award super provisions of the *Accord Mark II* helped to increase super coverage to 51 percent of workers by 1988 (up from 44 percent in 1982), including 63 percent of men and 47 percent of women (ABS 1988: 1). Super coverage was highest amongst workers aged 35 to 54 years, but more than half of workers aged over 25 years (except workers of retirement age) were covered (*ibid*: 10). However, award super was not without its limits, with compliance issues arising – particularly with small business – and persistent gaps in coverage (Nielson and Harris 2009: 87-88). Super coverage continued to rise with income and was much more likely to be held by those who had held their jobs for longer periods (ABS 1988: 17).[181] Private super also tended to be concentrated in the public sector and sectors with strong unions such as communications, manufacturing and mining (*ibid*: 14).[182] Thus, the award super provisions in the Accords provided little support for younger women in low-paid private sector work who did not belong to a union.

At the same time, the shifting policy environment of the 1980s made occupational super an appealing policy alternative to national super. In this policy environment, national super floundered on perceptions that a public scheme would place undue pressure on the Budget. The Treasury had consistently opposed national super since Hawke took office, mainly because of its cost (Sharp 2010: 202; also see Pusey 1990). Inheriting a Budget deficit, high inflation and high unemployment from the Fraser government, the Hawke government's economic policy was influenced by economic rationalism. This agenda was most evident in Hawke's election pledge in 1984 to the

[181] The ABS survey estimates that less than 25 percent of those on half the average wage were covered by super, about 62 percent of those on the average wage had super and around 86 percent of those on about twice the average wage had cover (ABS 1988). It also shows that over 70 percent of workers who had held their job for 10 years or more were covered, but only 39 percent of those in their jobs for five years or less held super (*ibid*).

[182] The ABS estimates that 72 percent of workers in the public sector were covered compared to 48 percent in the private sector (1988: 15). It also found that 73 percent of union members and 41 percent of non-union workers were covered.

'trilogy' of not increasing public spending, income taxes or the Budget deficit as a proportion of GDP (Willis 2003: 145). Although social expenditure still expanded during the Hawke years (as *Chapter 4* shows), economic rationalism still influenced economic policy and it appears that it made reform of the financial sector unpalatable to the government (Sharp 2010: 202). However, when economic conditions improved in the late 1980s, national super did not reappear on the policy agenda because of concerns about the budgetary costs of population ageing.

As private super's coverage expanded in the late 1980s, a series of reports framed it as part of a long-term response to population ageing. Two of these reports were particularly important. The Social Security Review (SSR) chaired by Professor Bettina Cass released *Toward a National Retirement Incomes Policy* in October 1988 (Foster 1988a).[183] This report highlighted the need for a long-term strategy to deal with population ageing and argued national super was no longer viable because of excessive start-up costs (*ibid*: 190; Foster 1988b: 1). The SSR recommended that the age pension be integrated with occupational super to provide retirees with a guaranteed minimum income set at 30 percent of average weekly earnings (Foster 1988a: 183). The Senate Standing Committee on Community Affairs (SSCHA) released another report on retirement incomes and population ageing in 1988. The Labor dominated committee reinforced the SSR's recommendations, proposing a two-tiered retirement incomes policy that entailed a universal pension set at 20 percent of average weekly earnings and a means-tested pension supplement set at 10 percent of weekly earnings (SSCHA 1988: *xliv*).[184] Importantly, both reports argued that occupational super should occupy the role formerly assigned to national super in Labor's platform, signalling to key interest groups that further reform was on the agenda.

Occupational super thus supplanted national super as the Labor government's major second-tier policy in the late 1980s. In fact, both Labor and the ACTU came to prioritise occupational super (over national super) in this period. The ACTU's position reversal reflected the union movement's stake in award super established by its inclusion in the *Accord Mark II* and the role of union officials in administrating industry super funds – which was greater than that afforded by national super (Sharp 2010: 202). The

[183] This report did mention the STCs. Touching on them briefly, the SSR noted that the STCs mainly benefited the well off.
[184] This report made more detailed recommendations concerning the STCs. These are covered in greater detail below in the discussion of the Hawke government's changes to the STCs.

government is likely to have found compulsory occupational super appealing as it shared similarities with national super and required less upheaval or public expenditure. The latter may have been particularly appealing because the government perceived it necessary to limit growth in public expenditure (Castles 1994: 134). The government may also have found private super appealing because it did not invoke the same opposition from the life insurance and super industries, which had an interest in increasing their investment pools and limiting state interference (*ibid*: 202). And, the close ties between the ACTU and the government – especially between Kelty and Keating who persuaded others in their organisations – also seem to reinforce the resolve of both arms of the labour movement to support private super (Kelly 2008: 282; Lowe 2008: 91). The government was also able to shift its position as it had not actively pursued national super after taking office and it too, particularly senior figures like Keating, had a stake in the success of award super.

The Labor government formally changed its position in the *Better Incomes* policy statement launched by Minister for Social Security Brian Howe in August 1989. In his ministerial address, Howe declared that Labor supported "a balanced retirement income system operating on the twin pillars of our age pension effectively linked and integrated with annuities and superannuation" (1989). He provided just two reasons for the twin pillar policy. The first reason was that increasing occupational super provided a means to redress inadequate private savings, which Howe (1989: 4) argued underpinned inadequate retirement incomes. The second reason was the compatibility of occupational super with Labor's macroeconomic policy because it would increase national savings and channel considerable investment into Australian corporations (largely due to the 1988 reforms to the STCs discussed below).

Howe (1989) claimed that the overarching objective was to provide retirees with adequate long-term incomes – the most pressing concern identified by the SSR and SSCHA. To meet this objective, the government proposed to raise the age pension to 25 percent of average weekly earnings, index the income test for pension, increase tax concessions for the self-employed, and provide tax rebates for those employed under 10 hours per week (Howe 1989: 42-44).[185] These policies aimed to extend occupational

[185] The government committed to implementing these reforms over the next 7 years (Howe 1989). It also vowed to integrate the social security and tax systems so that no age (or service) pensioner would pay income tax (on their pensions) and to increase the vesting of super in 1995 (*ibid*: 44).

coverage as much as possible and effectively ended Labor's support of national super, which was conspicuous by its absence.

The government's expansion of occupational super confronted an institutional hurdle in the early 1990s. While the proportion of the workforce with award super climbed to about 80 percent of full-time employees and 40 percent of part-time employees in 1991, the 3 percent contribution rate was widely perceived to be insufficient (Mann 1993: 38-39). At around the same time it released *Better Incomes*, the Hawke government had mixed success in meeting its *Accord* obligations and postponed wage growth to curb inflation (Olsberg 1997: 88). The ACTU responded by falling back on the proven strategy of negotiating extensions to occupational super in lieu of wage rises (*ibid*: 89-90). The ACTU campaign for occupational super reached a new apex in the *Accord Mark VI* negotiations in 1990, with the government agreeing to double award super to 6 percent of wages (*ibid*: 90). But, the IRC refused to ratify the *Accord Mark VI* in 1991, restating earlier concerns about the administration of private super funds and expressing alarm at employer failure to comply with award super (IRC 1991: 61). Instead, the IRC recommended that a national conference be arranged to consider award super and declared that it "may be flawed to the point of frustrating its contribution to the achievement of an adequate national retirement incomes system" (*ibid*: 61). This institutional hurdle ended Labor's use of the *Accords* to extend super coverage; it changed tack to pursue legislative avenues to reform.

The Superannuation Guarantee Scheme

After the IRC rejected the super provisions of the *Accord Mark VI*, the ACTU continued lobbying the government to increase the rate of award super (Olsberg 1997: 90; Combet 2004: 18). Reflecting support for occupational super in the party and the threat that inaction posed to the Accords, the Hawke government decided upon a legislative route to extend occupational super. In the 1991-92 Budget, Treasurer John Kerin – replacing Keating following the latter's failed leadership bid – announced the Superannuation Guarantee Scheme (SGS). This scheme mandated employer super contributions for almost all workers aged less than 65 years, set at either 3 or 5 percent of employee wages (Kerin 1991). The higher rate initially applied to organisations with payrolls exceeding $500,000 per annum, but the contribution rate was to gradually increase until it reached 9 percent of earnings in 2000 (*ibid*). Employers could opt to contribute to super funds on behalf of their employees or pay the Superannuation

Guarantee Levy to finance government contributions made to their employees' super accounts (*ibid*). The SGS had wide but not universal coverage, with employers exempted from making super contributions for employees earning less than $450 per month, part-time employees aged under 18 years or over 65 years (Treasury 2001: 84). Although mandating employer contributions, the government indicated that it planned to introduce incentives for voluntary employee super contributions (*ibid*).

The SGS's announcement received mixed responses. Predictably, the Labor party, the ACTU, and the private super industry were the chief proponents of the SGS (Mann 1993: 41). The ACTU and Labor party supported the SGS as a legislative version of the provisions for award super in the *Accord Mark VI*. The ACTU's support was buoyed by the scheme's resemblance to a similar levy proposed by the joint ACTU and Trade Development Council report *Australia Reconstructed* after their delegation surveyed the industrial and social policies of Western Europe. Again, the close relationship between the ACTU and Labor – at both personal and institutional levels – allowed both entities to co-ordinate their campaigns for the SGS (*ibid*: 49). Labor's support was bolstered by the elevation of Keating to the prime ministership in December 1991, because of his reliance on ACTU support in his leadership bid, previous support for occupational super and ties to pro-reform ACTU officials such as Bill Kelty (*ibid*; 49). The support of private super funds for Labor's scheme was also understandable since the SGS would boost the investments they managed and thus their potential profits.

The SGS, however, was opposed by a wide array of organisations. These groups included the Coalition parties, major employer organisations, ACOSS, pensioner groups, consumer groups, women's organisations, and, at least initially, the Democrats (Mann 1993: 41).[186] While supporters of the SGS presented a united front and benefited from influential institutional positions, interests opposing the scheme proved incapable of developing a consistent, let alone coherent, strategy (*ibid*: 49).

Opposition to the SGS was divided between those espousing efficiency and equity arguments. The Coalition parties opposed the SGS, arguing it would put further pressure on inflation and unemployment (which was at 10 percent) (Hewson 1991). Business interests voiced similar concerns and complained about their lack of input (Mann 1993:

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[186] Most of these perspectives were pronounced during hearings before the Senate Select Committee on Superannuation mentioned below.

43). In particular, the CAI argued that the SGS threatened jobs (by increasing hiring costs), reduced international competitiveness, and was unnecessary as projections of population ageing ignored potential increases to participation rates (*ibid*: 41-42).[187]

Conversely, ACOSS opposed the SGS because low-income earners would forgo wage increases for super contributions that were inadequate to mature into meaningful retirement incomes (*ibid*: 45). Instead, ACOSS advocated reducing the STCs and to target more assistance at the poor (*ibid*: 46).[188] Similarly, the Australian Pensioners and Superannuants Federation criticised the inequity of the SGS and proposed a tax levy to finance a universal age pension for individuals aged over 60 years (*ibid*: 47). And, the Women's Economic Think Tank (WETT) raised equity concerns about the SGS, arguing it would entrench inequalities between full-time workers and those in casual, part-time and impermanent employment – outcomes that would, as Eva Cox argued, increase gender inequality since women dominated these positions (*ibid*: 50). With few joint institutional resources and competing interests, these opposing voices were unable to co-ordinate their campaigns.

Nonetheless, the government's main obstacle to passing the SGS legislation came in securing support from Democrat Senators. While supporting it in principle, the Democrats hesitated to pass the *Superannuation Guarantee (Administration) Bill 1992* because of concerns about the inequity of the STCs and doubts about whether small business could afford the additional labour costs (Maley 1992; Scott 1992). The Democrats also believed that further controls should be exerted on super funds and were concerned about the lack of Treasury modelling for the SGS (Cleary 1992a; 1992b). Reflecting these concerns, the Democrats referred the Bill to the Senate Select Committee on Super but proved willing to negotiate with Labor (Cleary 1992c: 11). The government refused to restore investment controls on super, arguing that market forces were sufficient to ensure efficiently (Gallery *et al.* 1996: 104-105). Nor would the government reform the STCs; Labor announced it would not alter the tax treatment of super to avoid further complexity (Lampe 1992: 3; Walsh 1992: 25). But, to address the lack of modelling, the

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[187] The CAI argued that the SGS would decrease competitiveness because foreign competitors did not have to pay the levy and that the participation rates may increase through delayed retirement and higher female participation rates (*ibid*: 41-42).

[188] Julian Disney, an ACOSS spokesperson, further argued that the SGS was a 'short-term industrial relations fix' to stabilise the political momentum of the *Accords* rather than a serious retirement incomes policy (*ibid*: 45). He saw the SGS as an inequitable tax that would not provide low-income earners with access to the generous super tax concessions on the savings and lump-sum benefits received by the affluent (*ibid*: 46).

government did set up the Retirement Incomes Modelling Taskforce (Cleary 1992e: 11). And, it reduced the impact of SGS's impact on small business by lowering the early contribution rate to 4 percent, by raising the threshold at which the concessional rate applied to organisations with payrolls up to $1 million and by increasing the preservation age to 60 years (Cleary 1992f: 1; Mann 1993: 30). This secured the Democrats support, with the SGS coming into effect in July 1992.

The SGS was a milestone in the history of retirement incomes policy, establishing private social insurance after a series of unsuccessful attempts to institute a public scheme. The SGS was the culmination of political processes and industrial campaigns that began in the mid-1970s. Senior officials in the Labor government and the ACTU – with the super industry's support – played a crucial role and used their influential institutional positions to ensure that the scheme was adopted (Mann 1993: 39). But, this role should not be overstated, as the SGS was compatible with its prevailing policy environment (Marriott 2009: 492). The SGS was compatible with neoliberal ideas because it gave a greater role to the private sector than public alternatives. At the same time, the scheme represented an extension of wage-earner welfare funded by employers, and was supported by both Labor and the union movement (Castles 1994: 135).

Matching its political significance, the SGS has had wide ramifications for the super industry. Award super and the SGS considerably boosted the assets invested in super funds from $41 to $169 billion between 1987 and 1993, but their main impact has been on the type of super policies held by members (Nielson and Harris 2008: 5). Award super and the SGS supplanted the focus of the super industry onto accumulation accounts and away from the defined-benefit accounts previously held by most superannuants (*ibid*: 84). This was because most workers received contributions from award super and the SGS that were insufficient to fund private pensions. As shown in *Table 7.1*, these policies rapidly restructured the super industry, with accumulation accounts growing from 18 to 81 percent of total super accounts between 1982 and 1996.[189]

In the final three years of Labor's term, the SGS was for the most part popular and subject to only minor reform.[190] The World Bank (1994) championed Australia's three-

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[189] By 2000, 86 percent of super fund members held their investments in accumulation accounts (Treasury 2001: 84).

[190] Ironically, one of the reports more critical of the SGS, the FitzGerald (1993) report *National Savings: A Report to the Treasurer*, was tasked with identifying the link between super and national

pillar retirement incomes system (see *Chapter 5*), which included the SGS, as the 'world's best practice'. In this environment, the Keating government limited itself to minor reforms.[191] The more controversial of these reforms was Treasurer Ralph Willis' (1995) announcement that the L-A-W tax cuts Keating promised during the 1993 election would be paid as super contributions to boost national savings. This was to pre-empt gradual increases to a Superannuation Guarantee of 15 percent of wages, a target that was shelved after Labor lost office at the 1996 election.

Table 7.1 The Proportion of Defined Benefits and Accumulation Accounts, 1982-2000

Year	Proportion of Defined Benefit Accounts	Proportion of Accumulation Accounts
1982-83	81.8	18.2
1991-92	24.3	73.2
1995-96	18.7	81.3
1999-00	13.9	86.1

Source: Treasury (2001: 85)

II. Minor But Significant: Hawke Labor reforms the Super Tax Concessions

Although expanding the second tier of occupational super was its major policy innovation, the Hawke government also undertook minor but significant reform of existing policies. The government reformed the super tax concessions twice – shortly after taking office in 1983 and following the *Accord Mark II's* ratification in 1988 – and tightened the eligibility criteria for the age pension. Reinforcing the dual structure of retirement incomes policy, these reforms retained STEs for the middle class and retargeted the age pension at the less well off.

Shortly after winning office, the Hawke government devised a package to combat the twin threats of high inflation and unemployment. Announced by Keating in May 1983, this package entailed three reforms to retirement incomes policy. The first restructured the tax for lump-sum super benefits – the first $50,000 of super benefits was to be taxed at 15 percent (the remainder at 30 percent) – and limited eligibility to the lower concessional tax to those aged 55 years or older. The second exempted lump-sum super benefits converted into private annuities from tax. And, the third reinstated the age

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savings. This report argued that the SGS would boost private savings, but that public savings presented a more effective route to increase national savings (Nielson and Harris 2008: 5; Bryan 2004: 101). The report did not support the link between super and national savings but nor did it expunge it (*ibid*: 101).

[191] These reforms included the abolition fees for super accounts that held less than $1,000 and establishment of the Superannuation Holding Accounts Reserve to hold employees' super when employers could not find accounts (Treasury 2001: 86).

pension's income test for those older than 70 years (Keating 1983).[192] Of these reforms, the reintroduction of the income test was estimated to have the greatest budgetary impact by saving $167 million in 1983-84, whereas changes to the taxation of lump-sum benefits were projected to save $15 million initially but increase until peaking at $420 million per year (*ibid*).

The government's reforms to the tax treatment of super benefits aimed to provide incentives for self-provision and remove 'unwarranted concessions' (*ibid*). These reforms responded to the Campbell committee's criticisms that the taxation of super benefits was highly inequitable and facilitated double-dipping. As Sharp (1992: 27) notes, more than 50 percent of recipients received lump-sum payments below $10,000 and only 10 percent received over $50,000. The tax discount was also perceived to offer incentives to consume super before drawing on the age pension, which is consistent with 80 percent of those who received lump-sum super benefits also drawing on pension (*ibid*: 27). These concerns underpinned Keating's speech, in which he argued that,

> the $2 billion or so of assistance for occupational superannuation goes mostly to people who are neither needy nor poor and largely fails to achieve one of its principal objectives – the promotion of more effective self-provision in retirement. This is because benefits are principally being taken in the form of lump sums rather than pensions. The present tax provisions also facilitate tax avoidance arrangements under which an employee's pay is deferred so as to be taken in a lump sum termination payment at the end of his or her employment in a particular job (Keating 1983).

Whilst responding to concerns raised by the Campbell committee, these reforms fell well short of the comprehensive overhaul of the super system it recommended.

Despite their inequity and doubtful effects on self-provision, Keating's reforms to STCs for lump-sum super benefits brought together an unlikely coalition of employer organisations, the ACTU, the Australian Federation of Pilots and at least 20 other unions (Sharp 1992: 29). The union movement's opposition to these changes seems to reflect their larger stake in private super since the mid-1970s because of successes in extending private super for members and establishing union super funds. Unprepared for this opposition, the government entered negotiations with the ACTU and employers (*ibid*: 30). Labor agreed to grandfather the new tax arrangements to benefits from super investments made after 1 July 1983 and, in return, the ACTU supported the restoration of

[192] Super benefits could still be accessed before individuals were 55 years old, but now a 30 percent tax for lump-sums applied. Similar to the earlier provision of 1912 (that operated until Whitlam abolished the means test), the family home was excluded from the age pension's assets test (Nielson and Harris (2008).

the age pension's assets test (see below) (*ibid*: 30; Treasury 2001: 73).[193] The government also agreed to develop Approved Deposit Funds that provided super beneficiaries with a vehicle to transfer lump-sum benefits into annuities (Olsberg 1997: 83). Although relatively minor, this reform marked the first change in the taxation of super benefits since they were introduced in 1915 and, by increasing the tax paid by those with larger super benefits, it increased the equity of the STCs.

The Hawke government reformed the super tax concessions a second time following the rollout of award super in the Accords.[194] The growing cost of the STCs – which surged from $2.4 to $3.8 billion between 1983-84 and 1988-89 – loomed as one of the largest and least equitable measures listed in the new TES. This fact did not escape the government's attention. In May 1988, Treasurer Keating released the discussion paper *Reform of the Taxation of Superannuation* that proposed reform to the timing and structure of STCs.[195] This package proposed to introduce 15 percent flat rate taxes on employer contributions and the investment earnings of super funds (Australian Government 1988: 5).[196] It also proposed to restructure the taxation of super benefits, so that benefits under $60,000 would be tax exempt, sums over this amount were taxed at 15 percent, and annuities subject to a 15 percent rebate (*ibid*: 12). The package further proposed caps on the STCs receivable by individuals through Reasonable Benefit Limits (RBLs) that imposed a limit on the super benefits to which the concessions could apply (*ibid*: 12). And, to offset the new tax on super fund earnings, the government was to allow super fund access to tax credits through the dividend imputation system, which would also encourage them to invest in Australian corporations (Keating 1988).

Attempting to curb political backlash, the government framed this package as a set of revenue neutral measures that brought forward tax revenue. Keating argued that the reforms would bring forward $1 billion of tax revenue, encourage investment in Australian business and enhance the equity of the concessions, as well as limiting their

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[193] The government also developed Approved Deposit Funds and Deferred Annuities that provided super beneficiaries with a vehicle to transfer lump-sum benefits into income streams (Olsberg 1997: 83).

[194] In 1988, STCs pertained to all three stages of the super income stream: employer contributions and the investment earnings of super funds were tax exempt, whilst super benefits received as lump-sums were taxed at either 15 or 30 percent depending on their size. Except for the 1983 provision, no special tax treatment applied to annuities, nor did it apply to personal contributions following Labor's abolition of the general tax rebate in the 1985-86 Budget (as it only benefited 7 percent of workers) (SSCHA 1988: 194).

[195] This was release at the same time as the Treasurer's May Economic Statement.

[196] The package also proposed to double the contributions for which the self-employed could receive concessions to $3,000 per annum.

exploitation by the affluent (*ibid*). Keating and the government had mixed success at selling their package, with the ACTU, the super funds and Coalition parties appraising the government's reform proposals cautiously. ACTU president Simon Crean and other union leaders indicated their opposition to hiking the tax levied on super (before the reforms were announced), but they expressed support for removing 'rorts' for high-income earners (Milne and Clark 1988). Large super fund managers, such as AMP, expressed doubts about the revenue neutrality of the reforms, but Keating persuaded them in a special meeting (Burton and Milne 1988). And, the Coalition parties favoured increasing the tax concessions for the self-employed, but opposed taxing the investment earnings of super funds (Howard 1989).

The government did not introduce the legislation for these reforms until November 1988, which delayed passage of the five Bills comprising the reform package until early 1989.[197] After the Bills passed the House of Representatives, the government faced a hostile Senate controlled by the Coalition and Democrats. In May 1989, Coalition Senators refused to pass the legislative package unless the tax on investment earnings of super funds was removed and the lump-sum tax-free threshold was doubled (Jones 1989). Rather than conceding these amendments, the government negotiated a compromise with the Democrats. The Democrats, holding the balance of power, initially joined with the Coalition to block passage of the Bills. But, in return for a transitional 10-year measure that would not tax the super earnings of funds invested in Approved Deposit Funds, the Democrats agreed to vote with the government (Cleary 1989).[198] To ensure the measures would come into operation in the new financial year, the House of Representatives was recalled on 15 June to pass the Bills and they received royal assent on 30 June 1989 (*ibid*). These reforms represented the widest-ranging reforms to the STCs since their introduction.

At the same time that the government expanded the second tier, it also tightened eligibility to the core first-tier program – the age pension. Following the re-extension of

[197] The five Bills that made up this package were: the *Taxation Laws Amendment Bill (No.2) 1989* (it was early known as the *Taxation Laws Amendment Bill [No. 6] 1988*); *Taxation Laws Amendment (Superannuation) Bill 1989*; *Income Tax Amendment Bill (No.2) 1988; Income Tax (Fund Contributions) Bill 1988*; and the *Income Tax Rates Amendment Bill (No.2) 1989*.

[198] The Democrats secured an amendment that granted a tax exemption for early retirees who invested in ADFs from the tax on funds' investment earnings, because these funds did not invest in shares and thus would not be able to offset this new tax with credits from the dividend imputation system (Cleary 1989). The government agreed to tax exemptions for investors in ADFs who had retired before May 1988 and were either 55 years or over or who were over the age of 50 and forced to retire (*ibid*).

the income test in 1983, the Hawke government reintroduced the assets test for the age pension in 1985. This assets test introduced a taper when a single pensioner's holdings were above $120,000 or a couples assets were above $150,000, with some exceptions such as the primary residence and private annuities (Daniels 2007). But, rather than applying both, either the incomes or assets test applied to particular recipients (whichever gave a lower pension) (*ibid*). In 1994, the government tightened the eligibility for the pension further by announcing that retirement age for women would gradually rise to 65 years (*ibid*). However, the government also maintained the age pension at 25 percent of average weekly earnings – the level Whitlam set – in its *Better Incomes* policy statement.

Table 7.2 The Regressive Benefits of the 15 Percent Concessional Tax Rate, 1988-89

		From 1988-89	**Before 1988-89**
Taxable Income Range ($)	Marginal Tax Rate (%)	Tax Discount of 15 percent Flat Rate Tax Rate (%)	Tax Discount of Tax Exemption (%)
1 – 5,099	0	0	0
5,100 – 12,600	24	9	24
12,601 – 19,500	29	14	29
19,501 – 35,000	40	25	40
35 001+	49	34	49

Source: ATO (2010)

Nonetheless, the Hawke government's reforms to the STCs had wider implications than its pension reforms because of the rapid growth in super coverage and investments brought about by the extension of occupational super. Super coverage expanded from around 44 to 72 percent of the workforce following the *Accord Mark II* between the 1983 and 1992. At the same time, the revenue forgone for the super tax concessions ballooned from $2.2 to $4.8 billion, an increase of 48 percent in real terms. Similarly, after the SGS was established, the STCs rose by 67 percent in real terms between 1992 and 1994, from $4.8 to $8.3 billion (Treasury 1995).

Overall, Labor's reforms to the STCs slightly increased their equity. As *Table 7.2* shows, the 1988 reforms to the tax discounts for super contributions made this policy more equitable than earlier measures since it gave lower tax discounts to higher income-earners. With similar designs, the STCs applying to super fund earnings and benefits yielded comparable benefit structures. However, the government's desire to bring revenue forward appears to have overshadowed concerns about the equity of these concessions. This is because the government retained the regressive structure of the STCs and would not support the Democrats' more equitable proposals.

III. The Coalition Reconfigures the Superannuation Tax Concessions

Over its 11-year term, the Howard Coalition government retained the two-tiered structure of retirement incomes policy. Leaving the first tier mostly alone, the Howard government focused on second-tier policy like its immediate Labor predecessors. But, rather than raising the SGS (as Keating foreshadowed), the government's attention focused on reforming the STCs and other policy incentives to invest in super.

Although ultimately increasing inequality, the Coalition's reforms of these tax concessions can be divided into two periods differentiated by who held the balance of power in the Senate. During its first three years when it relied on Labor or the Democrats in the Senate, the Coalition pursued reforms to retirement incomes policy that were unlikely to elicit opposition (as these measures were attached to revenue bills). These reforms involved legislation to set the age pension at its existing level, improve incentives to invest in super and improve the equity of the STCs. But, when the Senate's composition shifted in the early 21st century, the Coalition – particularly after gaining a Senate majority – refocused on promoting private super through ever more generous and inequitable tax concessions.

In the 1996-97 Budget, Treasurer Peter Costello announced the Coalition's first package of reforms for retirement incomes policy. This reform package was mainly concerned with enhancing the equity of the incentives for private super. This included the Super Surcharge, requiring those earning more than $75,000 per year to pay an additional 15 percent tax on contributions. Other measures supported particular low-income groups, including the super opt-out for those earning up to $900 per month and the 18 percent rebate for up to $3,000 of super contributions made on behalf of low-income spouses (Treasury 2001: 87). Although to lesser extent, this package also sought to boost consumer choice by establishing Retirement Savings Accounts (RSAs) as cheaper alternatives to super (Olsberg 1997: 94). And, this package proposed to increase the preservation age for super to 65 years by 2025, remove award super from industrial agreements, and grant employees greater choice of super fund (Olsberg 1997: 87).

The Budget measures combined long-term commitments and new announcements. Howard foreshadowed the spouse tax offset and RSAs in the 1980s.[199] Conversely, the super surcharge, removal of award super, the opt-out scheme and choice provisions were new announcements. When spruiking the super surcharge, Costello (1996) justified it as addressing the inequity of the STCs:

> [the] major deficiency of the current system is that tax benefits for superannuation are overwhelmingly biased in favour of high income earners. For a person on the top tax rate, superannuation is a 33 percentage point tax concession while a person earning $20,000 receives a 5 percentage point tax concession. High-income earners can take added advantage through salary sacrifice arrangements that are not available to lower income earners.

Using the same rhetoric as Labor, Costello (1996) also claimed that occupational super was key to facilitating self-provision in retirement, coping with population ageing, boosting national saving and creating jobs.

The super surcharge was most contentious of the retirement incomes policies.[200] Led by ASFA, the super industry campaigned against the surcharge, arguing that it would raise administrative costs and disadvantage those who received redundancy pay as super (Kavanagh 1997: 22). The main accountancy associations – the Institute of Chartered Accounts and Australian Society of Practising Accountants – also opposed the surcharge, claiming it would increase costs and create confusion (Chamberlain 1996: 3). And, after supporting the surcharge for nine months, Labor voted against it with Independent Senators Harradine and Colston because of concerns it would be levied on the less well off (Chamberlain 1997: 7).

Conversely, the Democrats and ACOSS supported the surcharge as it (partially) closed a tax loophole for high-income earners that both had campaigned against (Gunn 1996: 19). With Labor and the Independents opposing the surcharge, the Democrats' support for the *Superannuation Contributions Tax (Assessment and Collection) Act 1997* became crucial for its passage through the Senate. Aware of their bargaining position, the Democrats negotiated with the government to exempt redundancy payments and concede the surcharge was a tax (Davis 1997). While supporting the Bill, the Democrats claimed

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[199] As Liberal Leader in 1988, Howard had announced this measure in his *Future Directions* policy statement.

[200] The other relatively controversial element of this super reform package was the RSAs, which eventually passed into law with the *Retirement Savings Accounts Act 1997* after a deal was done with the Democrats (Hudson 1997. Since my concern is with the taxation of super, and considering that the super surcharge was more contentious, I focus on the latter.

their support reflected its significance to the Budget rather than acceptance of all its elements – suggesting that its inclusion helped secure their support for the Budget.

In the 1997-98 Budget, the Coalition government announced that it would not honour Labor's promise to increase the SGS to 15 percent. In his Budget speech, Costello declared that the government would instead introduce a 15 percent rebate for up to $3,000 of post-tax income into savings vehicles including super; it was to phase in at 7.5 percent in 1998 and climb to 15 percent from 1999 (Treasury 2001: 88). The government also liberalised the regulations for the early release of super when individuals experienced hardship or emigrated (Nielson and Harris 2008: 6).[201] Further, Costello announced that employees would have the option of nominating which super fund would receive their employer's contributions. And, he undertook to formally index the age pension to 25 percent of average weekly male earnings through legislation (*ibid*: 6).

These super reforms formed part of a Budget aimed at boosting national savings to stimulate local investment without excessive reliance on foreign credit (Costello 1997: 3,394). When outlining the savings rebate, Costello argued that compulsory super was "discriminatory – to one class of saving (superannuation) – and to one part of society (those in the workforce)" (*ibid*: 3,394), whereas the savings rebate was available to taxpayers and applied to all savings vehicles. He justified the other measures as promoting the three goals of "savings, choice and incentive" (*ibid*: 3,395).

Labor fervently opposed the decision to leave the SGS at 9 percent of wages; Labor leader Kim Beazley charged that it was tantamount to 'stealing $3.7 billion from workers' (1997: 3830). However, Labor did not oppose the Budget proposals altogether and took a similar position to reforms as the Democrats. Labor and the Democrats both supported the principle of the savings rebate, but proposed to means-test it (Brown 1997: 18). Both parties also opposed the choice of super fund reform, arguing it gave employers too much power (Silins 1998a).

Without a Senate majority, the government was forced to negotiate with either the Democrats or Labor to pass the Budget reforms. Once the government indicated it would

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[201] The reasons for early release of super was expanded to include: retirement due to permanent incapacity; emigration; unemployment and less than $500 holdings in super; and/or severe hardship, which required receipt of a Commonwealth income support payment for 26 weeks on a continuous basis or 39 weeks intermittingly.

not proceed with the choice of super fund proposal, Labor supported the savings rebate and provisions for the early release of super in the *Taxation Laws Amendment Bill (No.3) 1998*, arguing it had a duty to pass key Budget measures (Silins 1998b; Brown 1997: 18).[202] These reforms overall impact was to maintain the age pension and slightly improve the equity of the STCs.

Apart from introducing the Pension Bonus Scheme as a work incentive for those of retirement age in 1998 (Nielson and Harris 2008: 6), the Howard government's early retirement income policies modestly improved the tax treatment for super. Aware that its Budget reforms required the support of the Democrats or Labor to pass the Senate, the Coalition appears to have designed its super policies along lines that would not jeopardise the support of either party. Considering their advocacy to improve the equity of the STCs, the Democrats were especially unlikely to support reform that increased the benefits received by high-income earners. The influence of the Senate's composition on Coalition policy is evident when these measures are compared to later reforms – especially those introduced after the Coalition secured a Senate majority.

Superannuation policy in the early 21st century

After 2002, the government's second-tier policies focused on encouraging private investments in super to respond to population ageing. Although it did not hold a Senate majority until 2005, the Coalition did not solely rely on support from the Democrats and Labor after 2001 because of the Senate's shifting composition. In the policy statement *A Better Superannuation System* (Howard 2001) launched during the 2001 election, the Coalition touted further superannuation reform as a means to reduce the (projected) fiscal pressures of population ageing.

The Coalition delivered on these promises in the 2002-03 Budget. Drawing on the projections of population ageing, Costello (2002: 10) argued that further measures were needed to offset the future cost of the age pension. These measures included lowering the super surcharge to 10.5 percent over 3 years and establishing the superannuation co-contribution scheme (SCS). The SCS matched the voluntary super contributions made by low-income earners dollar-for-dollar up to $1,000 per year (Warren 2008: 18).[203] And, to

[202] The rebate was a short-lived policy and repealed as part of the GST reforms in 2000 (Warren 2008: 33).

[203] The SCS was paid at the full amount for those earning up to $20,000 per annum, at which point it was tapered out until individuals earned $32 500 per annum (Warren 2008: 18).

close the loophole, the government stated that super assets – and contributions – would be included within divorce settlements from the end of 2002 (*ibid*: 18).

Despite Labor and Democrat opposition, the government passed the reforms without their support due to the Senate's new composition (Gordon 2003: 5). Under Simon Crean's leadership, Labor supported the SCS but opposed the reduction of the super surcharge because only the highest 3 percent of income earners served to benefit (2002: 2391). The Democrats initially agreed to pass the legislation after the government signalled that the super surcharge would be reduced to only 12.5 percent and that the income threshold would be raised (Spits 2003). But, the Democrats decided to tie their support to equivalent super rights for same-sex couples (Gordon 2003: 5). Refusing to budge, the government passed its legislation with the support of the three Independents and a One Nation Senator (*ibid*: 5). In another sign of the Senate's changing composition, the government was finally able to pass its choice of super fund legislation that it had announced in 1997 after agreeing to let employees choose between five funds nominated by their employers (Warren 2008: 18).

The government cited concerns about future budgetary pressures from population ageing to justify further reform in its policy statement *A More Flexible and Adaptable Retirement Income System* before the 2004-05 Budget. Drawing on the *Intergenerational Report* once more, this statement canvassed reform to encourage older workers to remain in paid employment by extending access to super them. In the Budget, Costello revealed that the government would lower the super surcharge further to 7.5 percent in 2006-07 and extend the SCS by increasing its matching rate to $1.50 and income threshold to $58,000 (Warren 2008: 19). He also outlined changes to the work-test governing super contributions: abolishing the test for those aged less than 65 years, simplifying eligibility for workers aged 65 to 74 years to 40 hours of work per 30 days (*ibid*: 19). And, as an incentive to encourage retirees to use super as income, Costello announced super funds were required to pay benefits when members reached 70 years and to surviving partners in interdependent relationships – including same-sex couples (Nielson and Harris 2008: 8). And, to increase competition among super funds, the government extended the super choice legislation and improved the transparency of fund fees.

The government passed these reforms with support from the Democrats. Following Senator Helen Coonan's announcement that tax-exempt super benefits would be extended to same-sex partners, Democrats leader Senator Andrew Bartlett indicated his party's willingness to support the super choice legislation to secure this provision (Lawrence 2004: 10). And, after initially joining with Labor to block the SCS and super surcharge reform, the Democrats negotiated to extend access to the SCS to individuals earning less than $450 a month in return for their support in the Senate (Lewis 2004: 1). Labor continued to block these reforms, instead advocating to reduce the tax on super contributions to 13 percent and committing to exempting them from tax in the longer run as part of a package aimed at raising retirement incomes to 65 percent of pre-retirement incomes (Garnaut 2004a: 8).[204] Reversing Labor's support for policies that improved the equity of the STCs, this proposal represented an attempt to court the middle class vote (Garnaut 2004b: 8). However, the government ruled out reducing the STCs, with Coonan claiming that "further calls for more tax concessions might be more convincing if the super industry volunteered to reduce fees" (Noye 2004: 79). Nonetheless, Labor's proposal reveals that the STCs continued to be supported by both parties.

A barrel full of pork? The 2006 super tax reforms

Nevertheless, this policy reversal was temporary, with the Howard government introducing its most far-reaching and inequitable reforms to the STCs after taking control of the Senate in 2005. In May 2006, Costello (2006: 1) announced the *Simplified Super* package to simplify the taxation of super, boost incentives to work and save, and increase flexibility of how super benefits could be withdrawn. The main means through which the government proposed to meet these objectives was to exempt super benefits from tax – which clearly benefited those with the largest super investments the most (see *Chapter 5*). According to Treasury Secretary Ken Henry, the reforms reduced complexity for those with super by downgrading other considerations such as equity (Malone 2006: 4).

The *Simplified Super* package proposed to: exempt super benefits received by individuals aged 60 years or older from tax; replace the Reasonable Benefit Limits with annual limits on super contributions (up to $150,000 per year); remove work tests on super for individuals aged over 65 years; extend the co-contribution scheme to the self-employed; halve the taper rate on the age pension; and make it easier to transfer super between funds (Warren 2008: 21-23; Costello 2006: 7). These reforms commenced from

[204] This position was outlined in three policy documents *Safer Super*, *Simpler Super* and *Setting a Goal: 65 at 65*.

July 2007 except for the annual limits to super contributions, which would be phased in with a transitory $1 million limit from May 2006 until June 2007 (Warren 2008: 23).

Although the *Simplified Super* reforms could have been enacted without support from Labor, the government pressed for bipartisan support in the hope that this would make the reforms more enduring (Guest 2006). Labor leader Kim Beazley gave in principle support for the tax exemption of super benefits, noting as he did that the Coalition seemed to have come around to Labor's idea of universal super (Beazley in Grattan 2006). Beazley also indicated that Labor reserved the right to oppose the reforms when more details of their costing became available (Grattan 2006: 9). However, the further modelling on the proposed reforms STCs was not forthcoming. In fact, senior Treasury official Mike Callaghan told the Senate that the Treasury had not conducted such modelling, was not aware of the long-term implications of the reforms, and that it was not "the practice by the Treasury to prepare long-term costings of tax measures" (in Gordon 2006a: 2).[205] Despite this, Nick Sherry – Labor's superannuation spokesperson – indicated that if elected a Rudd Labor government would retain the reforms and the legislation thus passed through parliament with bipartisan support (Khadem 2006: 5).[206]

Even though the *Simplified Super* package received bipartisan support and was welcomed by industry groups – such as the ICA and AIG (Maiden 2006: 1) – the reforms were controversial and the subject of opposition. The Democrats and Greens both opposed the policy package. The Democrats opposed the inequity of the *Simplified Super* reforms, arguing that they aimed to win votes rather than invest in people; Democrats leader Lyn Allison claimed,

> [the] Government's bolt from the blue – to take tax off superannuation payouts – is perhaps the most blatant vote-buying measure that we have seen in this budget and it is most likely to advantage only the baby boomer due for retirement soon (in Fraser 2006: 7).

The Greens claimed that the overall effect of the Budget would be to increase social inequality and released research that challenged the contention that super required further concessional treatment (Gordon 2006b: 2; Schubert and Topsfield 2006: 2). Similarly, ACOSS expressed concern that the reforms only benefited those who with high-incomes, that they were likely to encourage savings only amongst those nearing retirement age and

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[205] As an aside that reveals tax expenditures' lack of visibility, Callaghan also noted that the Treasury would not incorporate this policy change into the second intergenerational report, despite its potential to significantly reduce revenue (*ibid*: 2).
[206] Kevin Rudd became Opposition leader in December 2006.

had unclear implications for Budget revenue (2006: 17). Moreover, the left-wing union bloc led by the CPSU tried to convince the union movement and Labor to restore tax on super benefits at the next opportunity (Franklin 2007: 1). And, various economists and finance experts opposed *Simplified Super* because of its inequities and impact on tax revenue (Garnaut 2006: 1).[207] Yet, this opposition did not affect bipartisan support for the reforms and they passed into law (as noted above).

In the early 2000s, the Howard government changed tack by introducing reforms that increased simplicity at the expense of equity, particularly after securing an unexpected Senate majority. These later reforms, as Lyn Allison from the Democrats noted, appear to be timed to come into effect in the middle of an election year and represented a conscious effort to deliver benefits to a core middle class constituency. Although the Coalition chose not to increase the rate of the SGS, the lack of political conflict hinted at significant bipartisan agreement over the shape of retirement incomes policy. Both parties accepted compulsory private super and the STCs as core second tier policies; this is evident in the lack of Coalition proposals to erode the compulsion of the SGS and Labor's support for the inequitable reforms to the STCs in 2006. Having documented how the STCs grew from a minor fiscal policy at the State level to a major fiscal policy amongst the largest social programs, the next section explains how recent decisions of policy actors were influenced by broader political and institutional factors.

IV. Drift and Conversion: Explaining the rise of the Super Tax Concessions

Unlike the PHITR, the STCs have existed at the Commonwealth level since 1915 and long enjoyed a measure of bipartisan support. But their emergence as core second-tier policy institutions occurred only recently, having previously provided a small proportion of high-income earners with generous tax cuts for most of their existence. Perhaps paradoxically, the recent and rapid growth of the STCs is a by-product of Labor's and the union movement's expansion of private super. This expansion has politicised even minor reforms to the STCs.

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[207] These experts included: Bernie Fraser (former RBA governor) who argued that the reforms would benefit the wealthy at the expense of average workers; Professor John Head who perceived the reforms to shift the tax burden from the old and wealthy to the young and not so well off; and Sinclair Davidson, who argued that the reforms created a fiscal problem for future governments by narrowing the tax base (Garnaut 2006: 1).

Why did Labor and the Coalition both retain (and in the case of the latter extend) the regressive and expensive second-tier institutions of STCs? In this section, I argue that the rapid growth of the STCs largely reflects the process that Hacker (2004) terms *drift*. Broad reforms to occupational super expanded the cost of pre-existing STCs. STCs have, in turn, been 'stabilised' by interests that supported the expansion of private super, including the finance industry and union movement. This is not to claim that a complete consensus emerged on the proper role of the STCs, nor to contend that this prevented reform. The Hawke and Howard governments undertook minor reform, using conversion strategies to reorient these tax concessions to their preferred ends. This section examines each of these processes in turn.

Policy drift: Explaining the growth of the STCs

The four-fold growth of the super tax concessions over recent decades is largely a by-product of the campaign for occupational super that increased super contributions, assets and benefits to unprecedented levels, which tax concessions further subsidised. Preserving STCs thus became important to a wide set of actors including the ACTU and the finance industry. Because political actors and interests opposed reducing the concessions, this unprecedented growth of the STCs can be understood as an instance of what Hacker (2004) calls *drift*. The concept of drift was originally developed to explain the erosion of social programs without formal change. More recently, Hacker and Pierson (2010a: 171) identify drift as the failure to adapt a policy when its distributive effects are altered due to a shifting policy environment because it benefits an influential minority.

The logic of drift explains the growth of the STCs. But, rather than involving the threat of erosion, drift in this instance involves the lack of response to the ballooning financial cost and inequity of these concessions. To explain how drift contributed to the expansion of the STCs, it is first necessary to explain why Labor chose to extend private super to the workforce considering this indirect effect was foreseeable. Then, I discuss why Labor failed to constrain these concessions when their growing cost became obvious. The political and institutional factors that influenced these developments are examined in turn.

Labor's support for private super

The most significant, albeit indirect, factor that contributed to the rapid growth of STCs was Labor's extension of the second tier via occupational super in the 1980s and early 1990s. Culminating in the SGS, Labor's campaign for mandatory occupational super was influenced by several reinforcing developments. The initial development that put superannuation on Labor's radar was Whitlam's inclusion of national super in his election platform. The Labor party was also pressured by the union movement to extend superannuation after unions successfully pursued occupational super in wage bargaining during the 1970s. Involving the combined efforts of Labor and ACTU leadership, award super was established through the *Accords* as the product a further campaign to increase workers incomes during a period of high inflation. And, Labor appears to have been influenced by prevailing policy ideas because private super was more consistent with the policy environment of fiscal constraint than national super.

Overturning Labor's long-term opposition to social insurance, Whitlam's embrace of national super at the 1969 election was the initial development that led to Labor's eventual adoption of mandatory occupational super. National super remained part of Labor's platform under Whitlam's leadership until 1977. This appears to have established Labor support for the goal of superannuation because the following two party leaders, Bill Hayden and Bob Hawke, reaffirmed their support for it before Labor's re-election in 1983. As previously noted, national super was taken effectively off the agenda in the late 1980s following both the expansion of award super in the *Accord Mark II* and a series of reports declared that this policy out-of-date. Labor's prior commitment to a national scheme made it easier for the Hawke and Keating governments to throw their support behind private super as a minor shift from public to private sector management. This policy shift would have been more difficult had Labor supported the universal age pension favoured by the Party until the 1970s.

The union movement's previous success in industrial campaigns for occupational super prompted the ACTU to fall back on this strategy when the Hawke and Keating governments called for wage restraint. The ACTU's decision to apply this strategy is an example of 'learning' – where previous experience in applying political or policy strategies influence later decisions (Pierson 1993: 613). In the 1970s, union officials became enamoured with private super as a means of securing 'deferred pay' for workers without adding to inflation and increasing union influence over investment through the creation of industry super funds. This experience meant that, as far as the union movement was concerned, substituting wage rises for deferred pay was a proven strategy in periods of wage restraint. The creation of early union super funds also made private super popular with the union movement because it was perceived to provide unions with influence over investment. The elevation of Kelty and Crean to ACTU leadership roles in the early 1980s – senior members of the FSPU campaign for super – ensured that this experience remained at the forefront of union negotiations with Labor governments.

The close institutional relationship between the Labor government and the ACTU during the *Accord* negotiations was another source of feedback. The labour movement – including those on the political left like ACTU negotiator Laurie Carmichael – viewed the *Accord* negotiations as an opportunity for unions to influence on economic policy and direct investment through industry super funds (Stilwell 1986: 8). The involvement of Labor party and ACTU elites in the *Accords* contributed to the success of award super because it fostered trust and facilitated the transfer of policy ideas (Kelly 2008: 282). The government was receptive to proposals from the ACTU because Prime Minister Hawke had much political capital riding on the success of the *Accords* and he had personal ties as former ACTU president (Marriott 2009: 489). But, the relationships developed through the *Accords* made Labor figures such as Keating more receptive to union movement's proposals when senior ACTU officials such as Kelty suggested that wage increases be substituted for occupational super (Kelly 2008: 283).

After award super was included in the *Accord Mark II*, it was clear that Labor and the ACTU both had a stake in its survival. While forming part of the Labor's central economic policy, the ACTU also had an interest in the success of occupational super because of the benefits union members received and the role of the union movement in administering industry super funds. Unsurprisingly, this mutual interest reinforced the support of both organisations for occupational super and made support for STCs logical. The influence of this coalition reinforced the government's embrace of the twin-pillar retirement incomes policy in 1989 and was instrumental in its campaign for extensions to award super in 1990 (both in lieu of national super).

Labor's adoption of occupational super also reflected the SGS's consistency with prevailing policy ideas. As previously noted, compulsory occupational super shared common ground with both neoliberalism and wage-earner welfarism. The SGS is compatible with neoliberal policy (see *Chapter 4*) as a form of occupational welfare that increases individual savings and does not draw on tax revenue or increase social expenditure. The SGS also reinforces the market distribution of income and thus market incentives. These features of the scheme allowed it to avoid the backlash directed at taxation and the animosity directed at social welfare programs in the late 1980s and early 1990s (Castles 1990: 34).

Proposals for national superannuation, on the other hand, was less compatible with neoliberal policymaking because they would incur substantial cost, visibly assist the middle class, and create a single state-administered fund. National superannuation was also inconsistent with the underlying logic of wage-earner institutions, which identified a subsidiary role for state institutions (Sharp 2009: 203). In contrast, the SGS was consistent with the long tradition of the state mandating occupational forms of welfare (Castles 1997: 136; Sharp 2009: 203). The influence of both these prevailing ideas is evident in the view of the Hawke government that middle class welfare is (with few exceptions) abhorrent since “it unnecessarily wastes resources on those who do not need them, to the detriment of those who do” (Castles 1990: 33). This view that underpinned the government scaling back its universal goals in childcare, as well as retirement incomes (*ibid*: 33).

The SGS was largely the culmination of these developments, with Labor and the ACTU ‘converting’ award super into a scheme of occupational welfare that covered the workforce. The SGS became a consolidated feature of retirement incomes policy shortly after its introduction, with super coverage climbing to 90 percent and super assets rising to $1.1 trillion in 2007 (Nielson and Harris 2009). By increasing the financial flows at all stages of the super stream, these policies have also increased the scale of the STCs. It is also clear that the rise of occupational super was the main contributing factor to the growth of the STCs (see *Figure 5.1*) since the concessions were not subject to wide-sweeping reform between the 1980s and mid-2000s.

High opportunity costs: Difficulties in reforming the super tax concessions

Labor’s failure to reign in the STCs when their runaway cost became evident reflected political and institutional constraints. The STCs were difficult to reform because they had come to inform consumers and business expectations long before the 1980s. Although originating as modest measures to encourage thrift, these concessions came to benefit more than 40 percent of workers by 1982 (Sharp 2009: 200). The life insurance industry also came to rely on super for new business (*ibid*). As Marriott (2009: 491) notes, the STCs were largely accepted in Australia because of the wide practice of using tax incentives for private social provision. The taken-for-granted character of the STCs reinforced any hesitation on the part of both major parties to radically alter them when in government and the expansion of super would amplify any such move. The acceptance of these policies was also already evident in the early (and minor) reforms enacted by the Labor governments of Curtin, Whitlam and Hawke, which adjusted these concessions without fully addressing their inequity.[208]

The cross-class coalition of the labour movement and business interests limited reform to the STCs even after their costs exploded. Although not claiming a formal alliance was built, joint opposition by labour and business to reducing the STCs limited the policy options available to Labor. The ACTU's involvement in this coalition was particularly crucial because it had a long tradition of representing the interests of the poor (and low-income workers) and had strong links with Labor. This joint opposition was particularly evident in the Labor years, with the ACTU objecting to even the modest reform of the STCs proposed in the 1980s. The ACTU, and to a lesser extent Labor, tolerated the growth of STCs as a consequence of their support for occupational super. This coalition was less important in the Howard years, as the scaling back of STCs was not a Coalition priority. Nonetheless, the support of this cross-class coalition for the STCs was a major reason for little reform to these concessions over the 1980s and 1990s.

The tax expenditure design of the STCs further prevented reform because their low profile made it difficult for advocates to argue for fairer reform. Like other tax expenditures, the concessions rank among the most hidden fiscal policies and avoided scrutiny until the Asprey Review. The inclusion of the STCs in a Budget appendix in 1980 and, more permanently, the annual publication of the TES since 1986 has improved the situation. But these policy documents only provide aggregate estimates and fail to attract much attention (see *Chapter 1*).[209] By lowering their profile, the design of the super tax concessions has largely veiled their cost and inequity. For instance, if the inequity of the STCs was more widely known, it is likely to have made it difficult for the ACTU and blue-collar unions to campaign against reforms that would have increased the tax paid by the highest income earners in 1983. The same low profile has also made it

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[208] This hesitation is also evident in the reforms undertaken by the Menzies and Fraser governments that restored the original design of the STCs.
[209] As noted in *Chapter 5*, the STCs still avoid much scrutiny and, notably, are absent from the *Intergenerational Reports* despite being potentially the largest cost to the Budget of population ageing.

difficult for governments to find support for proposed reforms, even among those who would benefit.

Drift explains the rapid growth of the STCs because policy actors chose not to adapt them despite awareness of the concessions' ballooning cost and inequitable benefit structures. Rather, policy actors of both major political persuasions retained these tax concessions and in so doing extended benefits for a better-off minority. Awareness of the inequity and cost of the STCs was evident in the Hawke government's minor reforms in the 1980s. Lobbying by both the Democrats and ACOSS over the long-term also highlighted the STCs inequity. Yet, the low profile, entrenchment and support for the STCs constrained the scope of reform that governments of both parties have been willing to entertain.

Policy conversion of STCs in the Hawke years

The drift of the STCs, however, limited rather than ruled out reform. The Hawke and Howard governments have responded to constraints from the policy environment by adopting conversion strategies that reoriented the STCs toward their respective goals. To recap, conversion entails the reorientation of existing policies toward new functions (Streeck and Thelen 2005: 26). Although examples of conversion often involve non-legislative change (i.e. Thelen 2004), the concept can be applied to the reforms carried out to STCs from the early 1980s. Reflecting distinct partisan emphases, the conversion strategies employed by the Hawke and Howard governments are examined in turn.

The Hawke government's conversion strategy reoriented the super tax concessions by reducing their inequity and bringing forward needed tax revenue. The 1983 reforms slightly reduced the inequity of the STCs by increasing the tax paid by those with larger lump-sum super benefits. The 1988 reforms reduced the STCs' inequity by introducing 15 percent concessional tax rates on super contributions, earnings and benefits. But the main impact of the 1988 reforms was to bring forward $1 billion of tax revenue.

The twin directions of the Hawke government's reforms – improving equity and increasing revenue – reflected its ideological commitments and fiscal situation. Labor's reforms to the STCs reflected its commitments to social justice and neoliberal economic policy. Social justice considerations underlay the Hawke government's reforms to the STCs; improving the equity of these concessions featured as a major goal of the 1983 reforms, but appeared to be of secondary importance when bringing revenue forward in 1988. Nonetheless, Labor policy-makers (since the Curtin government) have given the inequity of the STCs greater consideration than their Coalition counterparts.

Still, neoliberal economic ideas increased the appeal of reforming the STCs to bring forward revenue. The influence of neoliberalism was more marked in the 1988 reforms, with Keating stressing that they would increase investment in Australian business and reallocate benefits more efficiently. Nevertheless, the capacity of the 1988 reforms to bring forward $1 billion of tax revenue (without increasing the deficit) seems to have had particular appeal to the government in light of its 'trilogy' promise, which included a pledge to limit the deficit.

The Hawke government's reforms of the STCs meet the criteria of conversion. Rather than expending political capital on wide-reaching reform of these concessions, the government reoriented the STCs through gradual, but substantive, reforms. These reforms reflected Labor's support for both social justice (by reducing inequity) and neoliberal policy-making (by bringing forward revenue rather than raising new taxes). Despite their modesty, these reforms represented the widest reforms undertaken to the STCs since they were introduced almost 70 years earlier.

Policy conversion in the Howard years

Although inconsistent, the Howard government's incremental reforms to the STCs considerably increased the benefits received by their core middle class constituencies. Two periods of reform over the life of the government can be distinguished, with later reforms overturning earlier initiatives. Spanning 1996 to 2001, the first set of reforms increased the equity of the STCs by increasing the tax paid by high-income earners. The second set of reforms from 2002 to 2006 reversed this trend and increased the inequity of these already regressive policies.

The apparently conflicting directions of the reforms to the STCs at times appear to reflect different conversion strategies that the government adapted in light of the Senate's changing composition – with the Coalition's Senate majority from 2005 providing an opportunity to reward its political base. Both periods of reform are understood as instances of policy conversion because they left the main features of the STCs intact, but reoriented the policies toward the Coalition's political goals. Like its Labor predecessors, the Howard government appears to have ruled out radical reform of the STCs despite their escalating impact on the Budget because of their institutional embeddedness, their low profile and their assistance to a loyal constituency. The Coalition's deeper embrace of neoliberalism also made the STCs appealing as they offered incentives to individuals and subsidised a private alternative to the age pension.

The STCs had become more institutionally entrenched – and more resistant to radical reform – by the time the Howard government took office. More broadly, the establishment of the SGS coincided with a surge in the flows through the super income stream, which increased the potential for radical reform to inspire voter backlash and opposition from the finance industry. This was especially pronounced after the expansion of the STCs following the increase of the SGS to 9 percent of incomes, with these concessions increasing by 25 percent each year on average since 2002. Taken together, these developments further contributed to the 'taken for granted nature' of the STCs and increased the likelihood that major reform would inspire concerted opposition from powerful groups. The latter is likely to have constrained Coalition policy-makers, considering that the Liberal party relied on financial support from big business and, as Singh (2008: 435) notes, higher income groups and older people are its political base.

Again, a product of their tax expenditure design, the STCs' low profile made it easier for the Howard government to challenge opposition to its reforms. Despite the *Charter of Budget Honesty Act 1998* making the annual TES a legislative requirement, the STCs (like other STEs) remain much less visible and accountable than direct expenditures. This made it easier for the government to cut direct expenditures that benefited low-income groups while mostly retaining the STCs in its 1996-97 Budget. This low visibility also contributed to the omission of the STCs from the *Intergenerational Reports* (potentially the greatest cost of population ageing), which allowed Costello to argue that private super would alleviate future budgetary pressures without providing supporting evidence.

The most significant effect of the STCs' low visibility, however, has been to limit opposition to reform because those against them could not draw on data or modelling. The lack of data on the STCs made it difficult for opponents to gauge the distributive effects of the reforms proposed in 1998, 2002, and 2004. This was particularly crucial when the government announced the *Simplified Super* package in 2006, because the wide distributive effects of the reforms were not modelled – Treasury justified this as their standard practice. Overall, the government strategically used the policy design of the STCs, emphasising what it saw as the positive goals of its policies without drawing attention to their distributive effects.

The Coalition was also amenable to the STCs subsidising an alternative to the age pension because its embrace of neoliberal ideas was more pronounced than that Labor's.[210] Viewed through a neoliberal lens, these tax concessions restrict state involvement in retirement incomes by offering incentives to self-provide through private super. Like the PHITR, the STCs amounted to market intervention, but in a way that was more consistent with neoliberal ideology than the age pension.

Neoliberal ideas also underpinned both sets of Howard-era reforms more directly. The three goals the government announced in its 1997 reforms – savings, choice and incentives – capture the intent of its earlier reforms and resonate with what I have, with Ben Spies-Butcher (2010), called the 'reformist spirit of neoliberalism' that has reconfigured social policy rather than retrenching it in the Australian case. This is not to claim that neoliberalism explains every feature of these reforms, for the super surcharge and spouse tax offset did slightly enhance equity. The second set of reforms between 2002 and 2006 were more attuned with neoliberal ideas because they increased the incentives to invest and increase the role of private provision. Although the government's framing of the reforms conveniently assumed that super assets fund retirement incomes (despite some evidence to the contrary), the Coalition's focus on incentives reflected a neoliberal ambition aimed at ensuring consumers would respond to appropriate signals and increase efficiency above other considerations such as equity.

Similar to the Hawke government, the Howard government reoriented the STCs through the process of conversion and left the main features of these pre-existing concessions intact. The STCs were perhaps more resistant to reform in the Howard years because private super had been extended to the workforce and the low profile of tax expenditures meant that both their inequity and rising cost went largely unnoticed. The government used its reforms of the STCs to reorient the incentives that these concessions provided different groups to invest in super. In its first two terms, Coalition policies were

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[210] The influence of neoliberalism was more pronounced in the industrial relations, tax and active labour market policies of the Howard government than its Labor predecessors.

also restrained by the Democrats holding the balance of power in the Senate. When the government came to control the Senate, it increased the benefits for a core constituency. Overall, the government's incremental reforms of the STCs converted them to its preferred ends by altering the incentives for different social groups to invest in super and reducing the complexity of the tax arrangements at the expense of equity. Despite the incrementalism of the reforms, the scale of the STCs meant that the Howard government's reforms substantially increased both the benefits received by the wealthy and the inequity of Australian social policy.

V. Conclusion: An entrenched and inequitable second tier

As the previous chapter showed, the STCs were established as foundational second-tier policies achieved through policy transfer from the income taxes of the States to that of the Commonwealth. They have received bipartisan support since their enactment. Both the current inequity and the budgetary scale of these concessions would have been inconceivable to the Fisher government when it enacted the STCs for those holding super amongst the minority of workers who paid income tax. Their inequity and ballooning budgetary expense in recent times reflects the unwillingness of the major political parties to update the STCs for the expanded role of the second tier in Australia's retirement income system – particularly with the advent of the SGS.

The major parties' reluctance to update the STCs reflects: their entrenchment; their support from key interests; and, their compatibility with neoliberalism. After the extension of occupational super, these concessions have rapidly expanded through policy drift because they are supported by a cross-class coalition and escape scrutiny due to their low profile. This did not, however, prevent the Hawke and Howard governments from adopting conversion strategies to reorient these concessions toward new goals. The conversion undertaken by the Hawke government to the STCs expanded the tax base (in the short term) and reduced their inequity. Conversely, the Coalition strategically altered its policy to reflect the changing composition of the Senate. However, when it held a Senate majority, the Coalition converted the STEs to reward a key constituency of older, middle class voters. *Chapter 5* highlighted the limits to an evidence-based rationale for the STCs. This chapter has shown that processes of drift and conversion provide a better explanation for the current state of these inequitable policies.

- Conclusion -

The Dual Welfare State:

Social Tax Expenditures and the Second Tier of Australian Welfare

Social tax expenditures (STEs) account for a growing slice of social provision, but they rarely feature prominently in studies of the Australian welfare state. This thesis has taken steps to address this gap in our knowledge by drawing attention to the scale, the inequity and the institutional dynamics of STEs. The case studies reveal that large social tax expenditures in the core social policy domains of health and retirement incomes are inequitable and have questionable effectiveness. They also show that these design features attract little controversy and that these policies have become institutionally entrenched. Drawing on details from the case studies and wider evidence, this final chapter concludes by discussing the implications that STEs have for both our understanding of the Australian welfare model and its institutional dynamics. Initially, I consider evidence to justify situating STEs in the second tier of the dual welfare state model. This is followed by an account of the institutional forces that led to the emergence of this distinct second tier in the wake of the gradual demise of the wage-earner model. My main argument is that STEs have grown rapidly in this policy environment because they offered policymakers a means to satisfy middle class demands for social provision and have grown as an indirect consequence of extending new forms of occupational welfare. To round off this discussion, I undertake two further tests of the 'validity' of the dual welfare state model proposed here. I first examine whether the Rudd government's policies were consistent with the dual welfare model. Then, to get an indication of whether the dual welfare model reflects cross-national trends, developments in Australia are compared briefly with those in the United States.

I. Evidence from the Cases: Tax expenditures for private health and super

The case study analysis of the tax expenditures for private health insurance and super confirms that STEs are inequitable social policies that have questionable effectiveness and institutionalise private social provision. The PHITR and STCs are effectively targeted at the middle class – comprising middle and high-income earners – since they provide little, if any, benefit to the poor and low-income earners. Even more inequitable, the STCs have regressive structures at all points of the super income stream, offering little to those with low incomes, including many women engaged in full-time informal labour. Further afield, the STEs for housing and childcare replicate this pattern, providing most to those who can afford private housing or expensive childcare respectively. This means that STEs reinforce existing income and gender inequalities. These distributive effects of STEs are partly explained by their interaction with the tax system: flat-rate rebates and concessional tax rates (amongst other designs) flatten or invert the impact of progressive income tax scales. These inequities contrast starkly with Australia's targeted first-tier programs identified by Whiteford (2008), Saunders (1999) and Korpi and Palme (1998), which mostly benefit the poor and low-income earners. The propensity for STEs to reinforce existing inequalities thus provides a strong rationale for revising the Australian welfare model.

In addition, the STCs and PHITRs both represent an expensive way to meet the (often questionable) policy goals assigned to them. Considering its cost, the private health insurance rebate makes a relatively small contribution to private health insurance coverage. The STCs are projected to offset the age pension only marginally because their benefits are concentrated among the wealthy (who do not qualify) and private super is not necessarily drawn on as retirement income. The open-ended cost of the STCs and PHITR magnify these concerns – particularly in light of the super tax concessions' four-fold growth over the last three decades. More fundamentally, however, the major goals assigned to these polices have questionable exigency. The decline in private health insurance coverage that justified the PHITR does not appear to threaten either tier of the health system, with private health service usage increasing after Medicare's establishment. The fiscal pressures of population ageing used to justify both policies are also exaggerated; Australia possesses a 'favourable demographic profile' compared to other OECD countries. And, as Coates (2004) argues, the strategy of boosting national savings through super is questionable. Although data limitations make it difficult to ascertain how much these two policies reflect broader patterns, the large cost of these policies and unresolved questions about their goals cast doubt on the efficacy of existing STEs. It also seems highly unlikely that the inequity of these policies reflects a fair trade-off for efficiency improvements.

The main impact of the STEs for superannuation and private health insurance has been to institutionalise public support for private social provision. In both instances, subsidising private service providers – the other main beneficiaries of STEs – has not alleviated pressures on first-tier social programs. The STEs for private health insurance introduced as part of the PNHS contributed to expanding the coverage of private health insurance coverage when there was no public alternative (Scotton and Macdonald 1993: 12). Operating alongside the sole public-insurer, however, the PHITR increases the selling power of private health providers, which has the potential to erode Medicare's monopsony-like power to constrain prices. The STCs had a similar effect on the development of private super, with Sharp (1992: 34) contending that they were the key factor behind the expansion of super until the 1980s. The impact of STCs on the first tier is more indirect; it undermines the fiscal sustainability of the first tier by significantly reducing taxes whilst having only a marginal impact on age pension costs.

Although both the STCs and PHITR have expanded private social provision, they have not subsidised programs acting as substitutes to first-tier programs for the majority. Rather, the STCs and PHITR have mainly subsidised supplementary private insurance that offers recipients additional benefits not available through the first tier.[211] Taken together, these features of STEs make it difficult to either view them as 'evidence-based' policies or locate them in dominant understandings of the Australian welfare state. Moreover, STEs make it clear that the government supports both tiers financially, which

[211] The STEs for housing appear to have a similar effects: the $40 billion of revenue forgone for them provides a remarkable benefit for owner-occupiers, but has the potential to place more pressure on social housing by promoting a boom-bust cycle in the property market (Productivity Commission 2004; Spies-Butcher and Stebbing 2010: 274).

provides another compelling reason to expand our understanding of the Australian welfare state to include them.

II. The Dual Welfare State: Social Tax Expenditures and the Australian Model

My argument is that the Australian welfare model needs revising because the substantive, albeit subsidiary, role of STEs remains under-recognised. The inequitable and sometimes regressive distributive effects of STEs contrast with the progressive social expenditures of the targeted model. Whiteford (2008: 104-105, 112) argues that Australia combines one of the most targeted income transfers with one of the more progressive tax systems of OECD countries, which reduces income inequality to a similar extent to Sweden and Denmark. The inequity of STEs also sets them apart from wage-earner institutions that mandated occupational welfare for workers (Castles 1997: 33). Although STEs also subsidise non-state welfare provision, wage-earner institutions tend to be more equitable and their emphasis is on ‘security through employment’. Wage-earner institutions range from more equitable measures, such as sickness benefits, to less equitable ones, including mandatory private super (*ibid*: 32-33). With the inequity of STEs eclipsing social expenditures and wage-earner institutions, they are difficult to accommodate within the dominant ‘egalitarian’ understandings of the Australian welfare state. To demonstrate how much is missed by ignoring STEs, I locate them within the second tier of an ideal-typical model of the Australian welfare state – the dual welfare state. Once this more expansive welfare model has been outlined, the next section offers an account of why STEs have emerged as core second-tier programs.

The dual welfare state model builds on Esping-Andersen’s (1990) observations on the policy dynamics of liberal welfare states such as Australia. Esping-Andersen (1990: 26) claims that liberal welfare states are prone to welfare dualism, in which targeted social welfare for those in need develops alongside private social provision for the middle class. Although not covering it in any depth, he also observes that this dualism is manifest in the support that the middle class receives as ‘tax subsidies’ for private social provision (*ibid*: 26); in his words, the “welfare state caters essentially to the working class and poor. Private insurance and occupational fringe benefits cater to the middle classes” (Esping-Andersen 1990: 31). Wage-earner institutions complicate Australian welfare, but locating STEs within the dual welfare model vindicates Esping-Andersen’s observations. While STEs already warrant attention, the welfare dualism of Australian welfare is likely to become only more pronounced over coming decades. This is because the 'winner-takes-all' politics of liberal welfare states tends to concentrate substantial rewards from economic growth at the top of the income distribution (Hacker and Pierson 2010b: 268). In this eventuality, the dual welfare model will be more useful to scholars since it can, unlike alternative models, account for these developments.

The dual welfare state model offers a more complete characterisation of Australian welfare state than available alternatives by accounting for STEs as a second-tier of social provision. This model involves two-tiers of social provision that are largely differentiated by the policy instruments used to deliver them. *Table 8.1* lists the largest social programs for each of these tiers and their budgetary cost (where appropriate). The first tier consists of the targeted social welfare programs that pervade scholarly accounts (see Whiteford and Angenent 2001). The core of the first tier includes social expenditures such as: the age pension; Medicare (the universal health insurance scheme); and assistance for families in the form of the Family Tax Benefit Part A and B, as well as the Child Care Benefit. These programs provide most assistance to the poor and low-income households. But they also benefit many, if not the majority, of Australians since they have relatively generous taper rates (Saunders 1999: 503; Castles 2001: 30). Rather than targeting benefits exclusively at the poor, these programs generally exclude the wealthy (apart from Medicare). Most other first tier programs take the form of social expenditures, and are aimed at those who do not participate in the labour market. The largest programs here include the Disability Support Pension, the Parenting Payment, the Newstart Allowance, which support individuals with disabilities, single parents and those who are unemployed. In recent years, these social programs – particularly the Newstart Allowance and Disability Support Pension – have been made increasingly conditional, either imposing quarantines that direct income transfers towards particular purchases or requiring individuals to undertake certain actions to maintain eligibility (Coad *et al.* 2006).

The second tier of the dual welfare state disproportionately benefits high-income earners and mostly provides fiscal welfare – particularly STEs – but also occupational welfare. The second tier has a large financial footprint, accounting for around 38 percent of total social expenditure, but it is currently below than that of the first.[212] If, however, STEs continue to grow at roughly the rate that they have grown over previous decades,

[212] Revenue forgone is not directly equivalent with direct outlays. This is thus a rough estimate.

the second tier will outstrip the first-tier as a proportion of total social expenditure sometime in the next decade. Core second-tier programs include: the PHITR; the STCs; tax exemptions for imputed rent and capital gains on the principal residence; and the

Table 8.1 The Australian Dual Welfare State in 2006-07

Key Area of Welfare	First Tier	($ m)	Second Tier	Revenue Forgone ($ m)
Income security	Newstart Allowance	4,494	Social Security Recipients Tax Offset	1,200
	Disability Support Pension	8,651	*Sickness Benefits for Workers*	-
	Parenting Payment	5,913		
	Carers Allowance	1,349		
	Carers Payment	1,408		
	Low-income Tax Offset	2,251		
	Youth Allowance	2,074		
	Abstudy	156		
Families with dependent children	Family Tax Benefit Part A and Part B	14,043	Tax Exemption of the Family Tax Benefits	2,480
	Child Care Benefit	1,478	Child Care Tax Rebate	450
	Baby Bonus	1,162		
Retirement income support	Age Pension	22,598	*Superannuation Guarantee Scheme*	-
	Age Service Pension	2,949	Concessional Taxation of Superannuation	30,208
			Senior Australian's Tax Offset	1,010
Health	Medicare Benefits Schedule	13,100	Private Health Insurance Tax Rebate	3,500
	Pharmaceutical Benefits Scheme**	6,163	Private Health Insurance Rebate Tax Exemption	980
	Australian Health Care Agreements	9,900	Medical Expenses Tax Offset	345
Housing	Rental assistance	944	Non-taxation of capital gains for principal residence	21,500
	Community Housing & Infrastructure Program	228	Non-taxation of imputed rent	17,000
			First Home Owners Grant*	751

* Figures from 2005-06 Financial Year.

Source: ABS (2008); Treasury (2008, 2010); Senate (2008); AIHW (2008a, 2008b)

Child Care Tax Rebate. The largest category of STEs subsidise private housing. Retirement incomes, health and childcare are the next largest categories of STEs. These social programs are effectively targeted at the middle-class because poor and low-income households are unlikely to pay high enough tax rates or have the purchasing power necessary to qualify for a discount. As higher income earners pay higher marginal tax rates and possess greater purchasing power, they tend to receive more from fiscal welfare than middle-income earners. This, as noted above, also reinforces gender inequalities because women still have lower incomes than men (see *Table 5.11*). Contrasting sharply with conditional programs of the first tier, STEs also openly seek to extend the choices available to their middle class recipients and place minimal constraints on behaviour.

The first tier of social welfare is targeted to exclude the highest income earners, while the second tier of fiscal welfare benefits the middle class and high-income earners in particular. The following two tables convey this trend, but they are not directly comparable because data for social expenditures are presented at the household level while that for STEs are available at the individual level. *Table 8.2* shows the proportion of social expenditures received by households ranked by income quintile in 2003-04. Data confirm that Australian social expenditure is progressive: households in the first and second income quintiles receive 64 percent of social expenditure, while households in the highest quintile receive 9 percent of its benefits. Moreover, income transfers are highly progressive, with about 61 percent of their benefits going to households in the lowest income quintile and less than 2 percent received by those in the highest quintile.

Table 8.2 Proportion of Social Expenditures Paid by Household Income Quintile, 2003-04

	Social Expenditure		
Equivalised Private Household Income	Income Transfers (%)	Benefits in Kind (%)	Total (%)
Lowest Quintile	60.8	29.8	41.1
Second Quintile	23.7	22.5	23.0
Third Quintile	9.9	18.7	15.5
Fourth Quintile	3.9	15.8	11.5
Highest Quintile	1.7	13.2	9.0
Total	100	100	100

Source: ABS (2007b: 12)

Table 8.3 displays the proportion of the tax concession for super contributions, the PHITR and the Child Care Tax Rebate (CCTR) received by individuals according to their taxable income in 2006-07. The table shows that these three STEs disproportionately benefit individuals with incomes over $150,000 in 2006-07; despite accounting for only 2.2 percent of taxpayers, this group received 15.5 percent of the tax concession for super contributions and 7.3 percent of the benefits received from the PHITR. At the same time, the 21 percent of taxpayers earning less than $25,000 received no benefit from the STC for contributions, 5 percent of the benefits from the PHITR and 12 percent of the CCTR's benefits. So, whilst incorporating the second tier offers a more expansive understanding of the Australian welfare state, it also shows it to be more inequitable.

Table 8.3 Proportion of Social Tax Expenditures Received by Individual Income, 2006-07*

Taxable Income ($)	Taxpayers (%)	Social Tax Expenditure STC (%)	PHITR (%)	CCTR (%)
1 – 25,000	21.4	0.0	5.0	12.0
25,001 – 80,000	67.1	57.5	62.6	72.8
80,001 – 150,000	9.4	27.0	25.1	12.4
150,001+	2.2	15.5	7.3	2.9
Total	100	100	100	100

Source: Calculated from ATO (2010) *Taxation Statistics 2006-07*, Detailed Tables 5B & 5D

The dual welfare state model outlined here is an ideal type model that is intended to draw attention to both the highly visible targeted system of welfare transfers and benefits, and the much less well recognised stream of transfers and concessions that takes place through the taxation system and which benefits, by and large, higher income earners. The approach is not intended to deny the importance and progressive character of many other elements of the Australian system. Although Medicare provides most benefit to the poor and low-income earners (and is therefore classified as a first-tier policy), it is a universal program that provides access to health services according to the principle of need. The First Home Owners Grant is an income transfer more accurately classified as a second-tier policy because home ownership is concentrated in the middle class even though the grant is not a tax expenditure. There are also STEs that do not have inequitable structures such as the Low Income Tax Offset, which increases the tax-free threshold of the income tax for low-income earners. Hybrid policies discussed in the first chapter complicate matters further – particularly STEs, such as the PHITR, which take on characteristics of income transfers. Moreover, wage-earner institutions add a further layer of complexity. Although more equitable than fiscal welfare, the SGS and sickness benefits for workers have been classified as part of the second tier in *Table 8.1* because they provide most benefit to higher income workers and do not benefit non-workers. These classifications are tentative and are not a major focus here as they have received attention elsewhere (see Castles 1992, 1994, 1996). In recognising this ambiguity, the policies mentioned here do not represent the trends discussed in the next section unless explicitly noted.

III. Explaining the Institutional Development of the Second Tier

STEs emerged as core second-tier policies because of their early development and appeal to political actors in the policy environment of recent decades – particularly as the wage-earner model gradually broke down. The early development of STEs in key areas of social policy such as retirement incomes and health contributed to their entrenchment and established the practice of using tax provisions to subsidise private social provision. The entrenchment of STEs also reflects the low profile afforded to these policies by their tax expenditure design, which has allowed them to largely escape scrutiny and limited their exposure to political conflict. However, the rise of STEs as core second-tier policies has coincided with the gradual decline of the wage-earner model, which suggests these two developments are related.

On closer inspection, the recent and rapid growth of STEs is the product of two 'overlapping processes' (Pierson 2004: 136) relating to the winding back of the wage-earner model. Pierson (2004: 136) argues that overlapping processes – which refer to the interactions between institutional arrangements – can have a greater impact on change than a single institution by itself. The first of the overlapping processes that contributed to the growth of the STEs is the extension of the logic of the wage-earner model in the creation of new mandatory occupational welfare programs (see Castles 1994). The rapid growth of STEs is an indirect consequence of this process, in that mandating private social provision also extends tax provisions that subsidise them.

The second process entails the gradual demise of the wage-earner model, which has re-opened political space for middle class demands for social provision. As the targeted programs that compensated lower income earners for post-wage earner economic restructuring ruled out public universalism, the middle class, their representatives and private interests pressured the state for other forms of assistance. STEs have proliferated in this policy environment because they provided a proven and relatively hidden means to meet middle class demands and appealed to the reformist spirit of neoliberalism (Stebbing and Spies-Butcher 2010: 593). Policymakers have also had few incentives to wind back STEs since they have the capacity to activate powerful coalitions of interests and enjoy a low profile by design. These two overlapping processes have accelerated the growth of STEs by simultaneously contributing to the extension of existing policies and the creation of new provisions.

Although the recent emergence of STEs as core second-tier policies reflects the combination of these factors, the case study analysis has highlighted some as more significant than others. The following discussion accounts for the influence of these factors on the second tier's development, using evidence from the case studies to 'rank' them according to their contribution to the expansion of STEs. In order of their perceived explanatory power, these factors include: the early entrenchment of STEs; the low profile of social tax expenditures; the legacy of the wage-earner model; the spread of neoliberalism; the strategies of political actors; and, the influence of coalitions. Applying the comparative case study approach foreshadowed in the second chapter, I discuss the contribution of each of these factors, emphasising consistencies as well variations across the cases to draw out insights about the second tier's development. As the two cases clearly do not represent the whole picture, the following account should be read with some caution because further study will lead to refinement.

The role of path dependence

The cases revealed that it was not merely the combination of these political and institutional factors, but their timing and sequence that explained the rising significance of STEs. The Howard government's decision to layer the PHITR onto Medicare reflected the impracticality of retrenching the established universal health insurance program and the political appeal of reintroducing STEs in a subsidiary role. This appeal reflected the influence of feedbacks resulting from their early consolidation in the Page scheme, Coalition ideology, the rise of neoliberalism, and pressure from private health interests, particularly in light of concern about declining private insurance cover. In contrast, STCs have played a subsidiary role to the age pension since their introduction in 1915, only to expand recently through drift, with their financial cost exploding as an indirect consequence of Labor's compulsory occupational super scheme. Super tax reform was then limited to the conversion strategies of the Hawke and Howard governments, which were constrained by their early consolidation, their low profile, their support from a cross-class coalition, and the prevailing ideas of the policy environment. Of the developments to have influenced the institutional paths of STEs, their early entrenchment and maintenance by virtue of the failure of policy alternatives were crucial to their development as core second-tier policies.

The institutional paths of the STEs for super and private health insurance were reinforced by their early development and uninterrupted operation for multiple decades.

The STCs remained largely unaltered for 65 years after their introduction as minor provisions of the 1915 income tax, while the STEs for private health insurance operated for three decades before the Hawke government temporarily retrenched them. These early policies established the practice of using tax expenditures to subsidise private social provision – particularly that of the not-for-profit sector. This practice received support from both major parties, with Labor establishing the STCs and the Coalition enacting the STEs for private health insurance. The lasting impact of this practice is evident in bipartisan support for the PHITR and STCs, even though Labor's support for the latter has been more tenuous. The early development of these policies directly contributed to their expansion because, as the STCs demonstrate, extensions to private social provision also expand the pre-existing STEs that subsidise them. The early development of STEs was also an indirect factor in their growth since, as with the PHITR, they fuelled the expectations of private interests (and voters) that private insurance would be subsidised through the tax system. The early development of STEs thus established their use in social policy and was a factor underpinning their recent emergence as core second-tier policies.

The failure of alternative social policies that might cater to middle class demands also contributed to the consolidation of STEs. In retirement incomes policy, these alternatives entailed the social insurance schemes floated by both parties and Labor's universal age pension. Similarly, in health policy, the Coalition failed to implement its proposals for social (health) insurance and Labor was unable to establish a national health service. Had these alternative policies been implemented, state administered social programs would have undercut the need for STEs. Moreover, when these alternatives failed, STEs became even more appealing to governments as a policy backdoor and an established route to realise their goals. This appeal seems to have extended to recent STEs that emulate the structure of earlier tax provisions in an effort to manage new demands for social provision – particularly from the middle class who increasingly demand protection from new social risks such as childcare, maternity leave, housing affordability and income stability (Taylor-Gooby 2004). The established practice of using STEs, as well as the failure of policy alternatives, gave governments a proven means to expand social provision that particularly suited the policy environment shaped by the gradual demise of wage-earner institutions and rise of neoliberalism.

The role of tax expenditure design

The tax expenditure design of the PHITR and STCs was crucial to their emergence as core second-tier policies because it has afforded these policies a low profile that led Howard (1997) to call STEs the 'hidden welfare state'. As tax expenditures, the initial forms of both policies were not reviewed following their introduction, which meant that their growth also went unchecked. STCs were not reviewed until the 1970s, while STEs for private health insurance were not formally scrutinised until the late 1960s. STCs still have a low profile: they do not have transaction trails, nor do they appear in the Budget or *Intergenerational Reports*, and reforms to them tend to appear as minor tax provisions in revenue bills (rather than separate legislation).[213] By contrast, the PHITR had a larger profile and was introduced in special legislation. This reflected the more ideologically charged nature of health policy and the government's perception that it had to draw attention to the tax subsidies to ensure adequate take-up of private insurance (and thus reverse declining coverage) because they were not mandated like super. This was less the case with STCs because super contributions mandated for workers and benefits are preserved until retirement. Still, the PHITR receives less attention than private health insurance or Medicare.

The low profile of tax expenditures has also allowed proponents to 'strategically' frame them because their low profile conceals their potentially unpopular design features, such as their inequitable distributive effects (Howard 1997: 179).[214] While design issues have potentially gone unnoticed, proponents have emphasised that STEs provide incentives for self-reliance, reduce social expenditure and offer tax relief. This strategy was especially relevant to the PHITR, which the Howard government framed as a 'tax rebate' to emphasise the benefits consumers received and to link it to established practice.[215] The low profile of STEs has thus contributed to the second tier's development by increasing the prospect that their design faults and inequitable redistributive effects went unnoticed.

The low profile of STEs has reduced, in turn, awareness of their inequity and any political opposition such inequity might produce. Because STCs have received bipartisan

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[213] This is similar to Howard's (1997: 179) observation of the American experience.

[214] The term 'strategic framing' is a reference to what Howard (1997) and Stone (2002) call 'strategic representations'. As the language of framing is used throughout this thesis, the former term is adopted here. For example, Prime Minister John Howard insisted the PHITR was an incentive and not welfare.

[215] This also meant that the government did not have to justify restoring a new industry subsidy, which was potentially incongruous with its neoliberal economic policies.

support since their introduction, political conflict has been limited and mainly focused on minor design features of the tax concession for super contributions. The STEs for private health insurance have attracted greater controversy with the major parties involved in an ideological struggle over the merits of private and public health insurance. This struggle culminated in the Coalition's privatisation of Medibank and Labor's retrenchment of the 32 percent tax rebate for private health insurance.[216] However, after the policy debate shifted in the mid 1990s so that STEs took on a subsidiary rather than alternative role to public health insurance, Labor reversed its position to support targeted STEs for private health insurance and later came to support the flat-rate rebate in the early 2000s. The degree of bipartisan support for STEs, at least in subsidiary roles, is remarkable, especially considering their inequitable benefits and budgetary scale.

The low profile of STEs has limited political dissent because it has allowed them to escape the scrutiny directed at social expenditures and increased the political costs of reform. As Iversen and Soskice (2006: 165) note, democracies tend to develop equitable social expenditures because they empower groups who benefit from redistribution. As is evident in their inequity, the low profile of STEs often allows them to avoid the legitimacy constraints that prevent inequitable social expenditures (Stebbing and Spies-Butcher 2010: 599). Moreover, reforming STEs is typically difficult since: design issues go unnoticed; interactions with the tax scale may conceal their inequity; and, they are frequently framed as tax relief. It may also be difficult to block inequitable reforms to STEs because they tend to have 'delayed consequences' (Pierson 2004) so that the impact of reforms do not become evident until well after they have been implemented. This was particularly evident in the case of the STEs, as the impact of the Superannuation Guarantee on the tax concessions could not be fully appreciated until the scheme matured in 2002. At the same time, private interests which benefit from tax expenditures are likely to closely follow tax reforms and organise campaigns that emphasis unpopular elements of reform such as higher taxes and service prices. Examples include the campaigns of the finance industry against the Hawke government's reform of the STCs and private health insurers for a flat-rate rebate in the 1990s. The potential for radical reform of STEs to produce more political opposition than support provides incentives for governments to avoid reform and further consolidates these policies.

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216 The Fraser government also removed tax expenditures for private health insurance. But, this appears to reflect the instability of this period, for it did not involve protracted political conflict and an STE for private health insurance was restored shortly thereafter.

The role of wage-earner institutions

The gradual demise of the wage-earner model has also been a contributing factor to the emergence of STEs as core second-tier policies. Built on a cross-class coalition of workers and business interests, wage-earner institutions provided welfare through 'other means' that left a subsidiary, residual role for the social expenditures typical of European welfare states (Castles 1997: 31). From the outset, the wage-earner model delivered few public alternatives to private services for the majority and the living wage made allowance for friendly society membership. Put another way, the wage-earner model reinforced bipartisan consensus for low taxes by empowering the breadwinner as the self-providing economic actor, instead of extending public benefits to the middle class (Castles 1985: 95; Wilson 2006: 520). By lowering demand for public welfare spending and promoting private provision, fiscal welfare reinforced this aspect of wage-earner logic (the strategy of security through employment). As the SGS shows, the mandatory occupational welfare of wage-earner programs (Castles 1997: 33) also has the potential to fuel the growth of fiscal welfare since it extends STE benefits, once the privilege of high-income earners, to workers. STEs for wage-earner benefits, like wage-earner institutions themselves, also tend to receive cross-class support because of their wide coverage.

As the first chapter noted, the three economic pillars of the wage-earner model – the minimum living wage, protective tariffs and controlled migration – have been in decline since the 1970s. The demise of the wage-earner model has involved the gradual withdrawal of industry protectionism and the Arbitration Commission's retreat from a social agenda (Jamrozik 1994: 165), as well as broader social changes to work and family life. Of the two overlapping processes discussed above, the STCs provide an example of the first process and the PHITR an instance of the second. The rise of STEs has also been an indirect consequence of the development of attempts to build new wage-earner institutions. These institutions involve new forms of state-mandated occupational welfare. While refurbishing the wage-earner model, these new wage-earner institutions are less equitable than those developed through the arbitration system (*ibid*: 33) and have increased the fiscal welfare programs that subsidise them. This was clearly the case with the STCs, which had a long history but rapidly expanded after the institutionalisation of mandatory occupational super.

At the same time, the winding back of wage-earner institutions since the 1970s and the increased targeting of social expenditure has contributed to the growth of the second tier by re-opening space for political contestation (Castles 1997: 32). Political actors have compensated lower income earners for economic restructuring with improvements to the social wage and by targeting social provision (which is captured by the targeted model). This policy environment was not conducive to expanding social expenditures for the middle class (with few exceptions). As this ruled out public universalism, governments were left with few alternatives for meeting demands from the middle class and their representatives for social provision. Governments found STEs appealing in this policy environment because they offered a policy backdoor to extend provision to the middle class. Moreover, these provisions did not require the removal of targeted programs and could garner political support by uniting the interests of middle and high-income earners (Stebbing and Spies-Butcher 2010: 598). The layering of the private health insurance tax rebate onto Medicare provides an illustration, because it enabled the Howard government to extend support to the middle class and private health sector without confronting the opposition that retrenchment of Medicare would have stimulated. The expansion and entrenchment of the second tier in these conditions suggests that it was a by-product of the increased targeting of the first-tier.

The role of neoliberal policymaking

The emergence of the second tier also reflects the compatibility of the tax expenditure design with neoliberalism. The ascendancy of neoliberalism from the early 1980s has, as earlier chapters note, increased the appeal of STEs and other tax expenditures as policies that offer incentives for private provision. The Liberal party's preference for the PHITR and the tax incentives of the PHIIS facilitated neoliberal goals of enhancing consumer choice and expanding the role of private provision. In Prime Minister Howard's words, the "principle of choice was applied wherever practical… It was the introduction of a non-means tested 30 per cent rebate… which did the trick" (2010: 487). STCs also furthered neoliberal ideas of reducing public expenditure on age pensions and enabling greater self-provision.[217] Myles and Pierson (1997: 451-452) make a similar claim about the success of STEs for income support during an anti-welfare era in North America. Moreover, the two policies appealed to policy-makers since they forwarded the reformist spirit of neoliberalism by shifting resources to the private sector without retrenching the popular first-tier programs of the age pension and Medicare. The

[217] Neoliberalism also contributed to the rapid growth of the STCs by increasing the appeal of private super over national super to Labor.

compatibility of STEs with neoliberalism is confirmed by their consolidation and rapid growth since it became the hegemonic discourse in the early 1980s.

The role of political strategy

Strategies adopted by political actors also contributed to the architecture of the second tier. The tactics of layering and conversion identified by historical institutionalism were especially relevant to the two policies. The decision of senior members of the Howard government – including Howard and Wooldridge – to layer the STEs for private health insurance onto Medicare avoided the political controversy of Fraser's retrenchment of Medibank. The conversion strategies that the Hawke and Howard governments used in reforming the STCs attracted relatively little scrutiny as minor reforms and did not elicit widespread resistance. The Hawke and Keating governments' strategy of converting occupational super into a national scheme through the SGS avoided the public outcry that would have accompanied a direct move on the pension. The co-operation of key actors and their decisions to pursue these strategies helps to explain why STEs became major second-tier policies when earlier direct strategies failed. Close personal ties between senior Labor figures, including Hawke and Keating, and senior ACTU officials – such as Kelty and Crean – further reinforced the resolve of both organisations to reform occupational super and ensured the feasibility of reforms to the STCs. Similarly, close ties between the Howard government and private health insurers underpinned the development of the PHITR. Overall, the decision of key actors to develop STEs as subsidiary – rather than substitutive – policies to the first-tier, together with their co-operation helped to maintain the low profile of these policies and avoid controversy.

The role of coalitions and cross-class coalitions

The establishment and maintenance of STEs as core second-tier programs reflects their capacity to activate influential political coalitions and constituencies. The long-established practice of using STEs to subsidise private services that benefit middle class consumers and business interests suggests that these groups played a greater role in the development of Australian social provision than is typically acknowledged. This is perhaps unsurprising in light of the larger role that Swenson (1989) and Baldwin (1990) give to business interests and the middle class respectively in explaining the development of the Scandinavian model. However, the influence of these groups is more evident in the consolidation of the STCs and PHITR than in their initial design. At their introduction, these two measures provided minor subsidies for private insurance offered by the not-for-profit sector. The STCs were introduced to streamline the taxation of the not-for-profit sector, while the AMA (then BMA) was involved in designing the STEs for private health insurance. Nonetheless, the operation of these STEs subsequently activated business interests and middle class voters in ways that reinforced their entrenchment. Through the demutualisation of not-for-profit insurers and the establishment of for-profit insurers, business interests (including private health insurers and super funds) have come to directly benefit from STEs and have lobbied governments for more assistance.[218]

The PHITR and STCs have also built constituencies of middle class beneficiaries, which tend to make STEs difficult to reform. As Iversen and Soskice (2006) argue, majoritarian systems such as Australia's involve electoral contests between two large parties that represent workers and business interests. Both major parties rely on support from middle-income earners to win elections. STEs have the potential to unite middle-income and high-income earners because they benefit most from these policies. Recent research suggests that middle and high-income earners support subsidies for private social provision, including STEs (Wilson *et al.* 2008). The support of business interests and middle-income earners for STEs has contributed to their entrenchment by reinforcing bipartisan support because both parties have incentives to keep both well-resourced private interests and an electorally significant constituency onside. This explains Labor's policy reversal on the PHITR after its beneficiaries came to represent a sizeable minority of the population and it was openly supported by the private health sector. The potential for STEs to activate constituencies reflects their use by governments of the political left as well as the political right.

Bipartisan support for STEs does not, however, mean partisan differences have disappeared. The Coalition more fervently embraces STEs than Labor, prioritising reforms that reduce complexity with little consideration to their inequity and cost.[219] Labor has supported less-equitable policies advocated by the Coalition (mainly when in Opposition), but it has occasionally prioritised reforms to STEs in government that curb their inequity, even at the cost of increased complexity. And, while the Coalition has

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[218] Business interests also have considerable resources that can be directed at funding campaigns to generate bad publicity for governments.

[219] One exception is the Superannuation Surcharge introduced by the Howard government, which increased the taxes paid by high-income earners. However, the government removed the surcharge in its 2006 *Simplified Super* reform package.

advocated STEs as substitutes for social expenditures, Labor has limited its support for these policies to secondary roles. The PHITR provides one example of this; although unwilling to support STEs for private health insurance as a substitute to universal public insurance, Labor supported these programs in a secondary role.

Coalitions involving interests and political parties have mattered to the development of social expenditures (Manow 2008: 103; Esping-Andersen 1990: 30). Equally, in the case of STEs, coalitions have been more critical to their development than any social group alone. The PHITR has received support from a coalition consisting of private health funds, the AMA and the Liberal party. Dating back to the late 1940s, this coalition reflects the congruence of the Liberal party's ideological support for residualism with the material interests of both the AMA and private insurers. This coalition repeatedly secured tax incentives for private health insurance – including the PHITR – in periods of Coalition government because it fostered close ties between Liberal policy-makers and private service providers. This coalition also increased the political acceptance of using STEs in health policy, which is confirmed by their bipartisan support. The STCs received support from a cross-class coalition of the labour movement and business interests (mainly the super and finance industries). This coalition successfully blocked radical reform to the STCs in the 1980s because it combined the two main cleavages in liberal welfare states like Australia (that have majoritarian electoral systems) (Manow 2008: 106). In sum, these political coalitions have aided in implementing STEs, as well in blocking radical reform to second-tier policies.

The role of historical contingency

The focus here on structural factors is not, however, to dismiss the impact that historical contingency and key actors have had on the second tier's development. This contingency is demonstrated by the failure of Lyons' social insurance scheme in the 1930s. Although enacted, this scheme confronted strong resistance during implementation and the same government that introduced it also repealed it. A social insurance scheme would have altered the trajectory of the Australian welfare state because it is likely to have benefited the middle class. The dismissal of Whitlam in late 1975, after less than six months of Medibank's operation, did not allow universal health insurance to become entrenched before its opponents took office. And, after narrowly losing the 1993 election, the so-called unlosable election, the Coalition parties were motivated to reverse their position on Medicare. While skirting about the surface, these examples show that welfare politics are clearly contingent. To claim that political and institutional processes have influenced social tax expenditures over time is not to contend that the second tier's development was either *determined* or *inevitable*.

The politics of the second tier: Universal welfare by 'other means'?

The entrenchment of STEs as the second tier of the Australian dual welfare state cannot be understood in isolation from first-tier or wage-earner institutions. While the second-tier has its own political dynamics, there appears to be considerable interaction between the three sets of policy institutions. Although the dual welfare state model is more inclusive and expansive than the targeted model, it has distinct distributive effects and political dynamics that contrast with the social democratic regimes found in the Scandinavian countries. Comprising two separate systems of social provision, the dual welfare model – and the second tier of STEs in particular – is less equitable than the universalism of the social democratic regime. Moreover, political coalitions between social democrats and agrarian parties underpinned the social democratic model (Baldwin 1990; Manow 2008), but the two tiers of the dual welfare state have different beneficiaries and bases of political support that are unlikely to lead to cross-class coalitions in support of more equitable social provisions. Rather, the dual welfare model achieves wide coverage without cross-class solidarity. Thus, the dual welfare state model does not represent the achievement of universal welfare through 'other means'.

IV. Social Policy and Social Tax Expenditures in the Rudd Years

The Rudd Labor government's social policies provide a further 'test' for my thesis. The reforms of the Rudd government between 2007 and 2010 continued support for the dual welfare model, expanding provision in both tiers. The government continued to support targeted first-tier policies like its Labor predecessors. The government raised the age pension's weekly rate by $32.49 for singles and $10.14 for couples, and, tightened eligibility by increasing the commencement age to 67 years (Spies-Butcher and Stebbing 2010). As part of the second stimulus package in response to the Global Financial Crisis (GFC), the government also committed $6.6 billion to build 20,000 units of social housing (*ibid*). But, the Rudd government also actively expanded the role of the second tier in childcare by increasing the CCTR to 50 percent up to a ceiling of $15,000 in 2008 (*ibid*). At the same time, the government took steps to avoid an active role in providing childcare, choosing to inject $58 million into the sector when ABC Learning collapsed rather than directly provide public services (*ibid*). And, the government proposed new tax incentives through First Home Saver Accounts to augment the support received by first home-buyers even though the inequity of the reforms prompted public attention and eventually a reassessment (Spies-Butcher and Stebbing 2009).

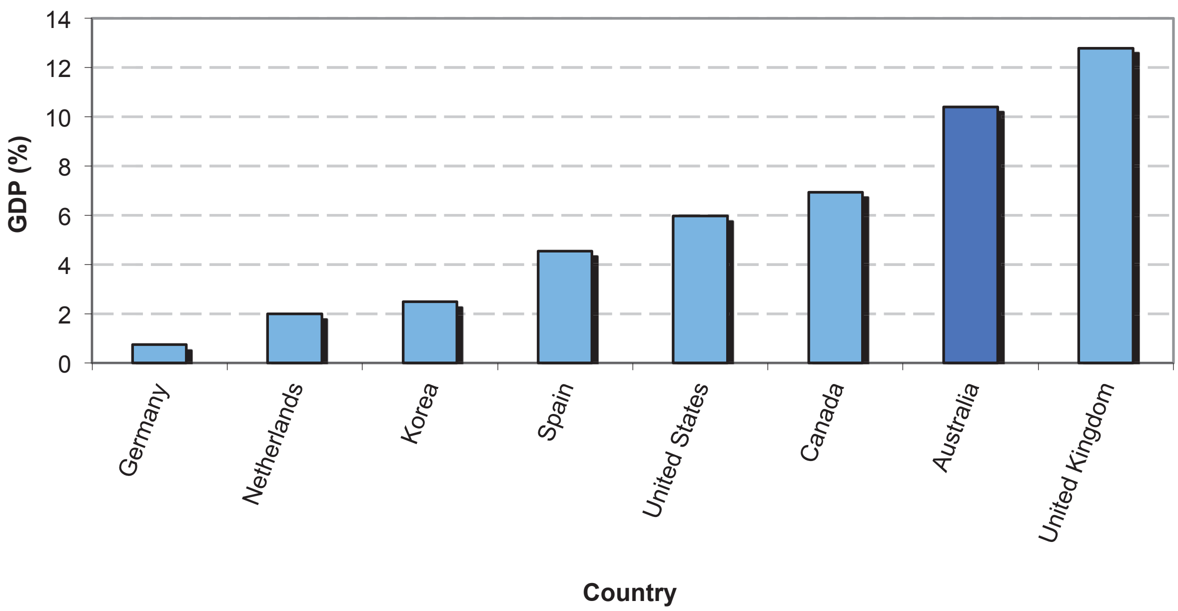
The Rudd government's reforms also indicate that Labor continued to be concerned by excesses in the second tier, but adopted an incremental approach to reforming STEs – including both the STCs and PHITR – to minimise political resistance. Facing a $60 billion Budget deficit brought about by the GFC, the government revoked an election promise to retain the PHITR in its entirety and, in 2009, proposed to means test the rebate to exclude high-income earners. In the event, Labor was not able to legislate this reform because the Coalition and an independent senator blocked its passage in the Senate. Labor's inability to build support for this modest reform provides further evidence of the PHITR's entrenched policy status and the coalition of interests that supports STEs in health. While not implemented, this proposed reform to the PHITR was significant in that it adopted a similar approach to curbing the inequity of the rebate as the Hawke government's had in reforming the STCs.

The Rudd government also touted minor reform to how super is taxed as part of its response to the Henry Tax Review in early 2010. Rather than taking on the wider reform recommended by the review, the government proposed a rebate to exempt contributions made as part of the SGS from tax for those earning less than $37,000 per year. Whether Labor will proceed with this reform is unclear – further details have not emerged since Gillard replaced Rudd as prime minister in June 2010. Nonetheless, the Rudd government's approach preserved the architecture of the second tier in maintaining STEs and, like earlier Labor governments, adopting an incremental approach to curbing second-tier inequities. However, the STCs' budgetary scale will accelerate through drift if Labor increases the SGS contribution to 12 percent of wages as proposed by Rudd then Gillard.

V. The Australian Dual Welfare State in International Comparison

Although my analysis is focused on Australia, similar developments in STEs have taken place in other liberal welfare states. The comparative study of STEs and their incorporation into welfare state analysis is, however, still in its infancy. As noted in the introduction, Adema and Ladaique (2005: 32) show that STEs play a role in other OECD countries such as the United States, Germany, Japan, and France. A more recent study that surveyed tax expenditures in a selection of OECD countries (that did not include Australia) suggests that STEs are more prevalent in liberal English-speaking countries (OECD 2010a). The scale of tax expenditures as a proportion of GDP in Australia and other countries from this study are compared in *Figure 8.1*. This figure reveals that English-speaking countries such as the United Kingdom, Australia, Canada and the United States (US) spend more on tax expenditures than other countries in the study. These comparisons are suggestive rather than supportive of broader trends, because countries apply different measures, both OECD studies involve a small number of countries, and the latter focuses on tax expenditures rather than the subset of STEs. Nevertheless, research on the United States' welfare state confirms that STEs are an important arm of social provision in this archetypal liberal regime (Howard 1997, 2006, 2009; Hacker 2002). To better gauge the extent to which the patterns noted in this thesis reflect broader trends, I make some brief comparisons between the United States and Australia before offering some final concluding remarks.

Figure 8.1 Tax Expenditures in Australia and other OECD countries as a proportion of GDP, various years (between 2000 and 2007)



Source: OECD (2010a: 124); Treasury (2010: 4)

The Australian and American welfare states both have extensive systems of STEs with long histories that largely benefit the middle class and private interests. Over the past century, the US has developed what Howard (1997) calls a *hidden welfare state* of

STEs in the major areas of social provision including pensions, health, childcare and housing. The oldest of these policies include the tax deductions for home mortgage interest and employer retirement pensions, which were enacted in 1913 and 1914 respectively (*ibid*: 176). In the two liberal regimes, the recipients of STEs are also concentrated amongst the middle class, particularly when compared to social expenditures (Howard 2009: 90; Hacker 2002: 332). An example of this is the tax expenditure for extraordinary medical expenses, which provides over 60 percent of its total benefits to those earning over $75,000 per year (Howard 2009: 91). And, in both countries, occupational welfare provides an incentive for fiscal welfare. This has taken a slightly different form in the US, where STEs exist for employer-funded health insurance, childcare and retirement pensions (Howard 1997: 176). However, there are also differences. Although STEs seem to account for a larger proportion of GDP in Australia, they are directed toward a wider range of uses in the US – including major social programs targeted at low-income families with children such as the Earned Income Tax Credit and low-income workers through the Targeted Jobs Tax Credit (Howard 1997; Meyer 2001).[220] This may indicate that more generous 'liberal' welfare states such as Australia are most at risk of STEs directing even more resources toward the middle class. Nonetheless, these brief comparisons are suggestive, without being definitive, that American social provision is consistent with the dual welfare state model proposed here.

There are also similarities in the political development of STEs in these two liberal welfare regimes. In both countries, STEs have a low profile in the legislative process and are often attached as minor measures to large revenue Bills (Howard 1997). The Australian experience is also consistent with that of America, in that tax expenditures have not been the exclusive contribution of one political party. The Democrats and Republicans have each introduced new STEs for low-income earners and the middle class in recent decades, including in periods of divided government (i.e. when each party controlled one house of Congress) and of fiscal constraint (Howard 2009: 95). To some extent, bipartisan support for STEs is grounded in boosting electoral appeal to white-collar professionals, which both parties rely on for election success (*ibid*: 98). Like Australia, STEs in the US have continued to grow 'without advocacy', regardless of which political party is in power (*ibid*: 95). These trends in STEs contrasts starkly with

[220] The EITC is roughly comparable to the Family Tax Benefit, which, despite its name, is received as an income transfer by the overwhelming majority of its recipients.

the politics of American social expenditure programs, which were mostly established through the New Deal and Great Society programs (*ibid*: 95).

Although the social policies of the two countries have many differences, the extensive use of STEs in Australia and the US suggest that liberal welfare states provide favourable policy environments for their development and further institutional entrenchment. Targeted and residual systems of social provision appear to leave political space for coalitions of private interests and the middle class to press for (what become) less transparent and inequitable social programs. But, as these brief comparisons of Australia and the US hint at, there is need for further research to confirm these observations and explore the roles that STEs play in modern welfare states, particularly at the cross-national level.

VI. Final Thoughts: Where do we go from here?

By accounting for the second tier of STEs, the dual welfare state thesis presents a more expansive but less equitable rendering of the Australian welfare model. While the targeted social programs of the dual welfare state's first-tier progressively redistribute resources, less visible second-tier social programs are targeted at the middle class and reinforce the trend of growing inequality. By focusing on the impact of incremental decisions over time, the account here affords greater recognition to the subsidiary roles that private social provision and middle class interests have long played in the political development of Australian social policy. Although the second-tier has slightly altered – rather than extinguished – the redistribution carried out by the Australian welfare state, the low transparency, accountability and continued growth of STEs are threats to the overall equity of Australian social policy and its ongoing fiscal sustainability. This is because these features of STEs shield their inequitable and inefficient designs from public debate, which often fixates on (relatively minor) issues pertaining to social expenditures such as welfare dependency and population ageing. If this situation continues unabated, STEs seem likely to become more entrenched and account for an ever-growing slice of Australian social provision because of their open-ended fiscal design. However, to end on a positive note, a more expansive and inequitable second tier is not inevitable. There is potential for the incremental strategies that have increased the second tier's inequity and scope – such as conversion and layering – to be applied to redirect the substantial resources currently devoted to STEs to more equitable and productive uses.

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