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On The Dry Side

Grimes Summit Speech

John Hyde 13/5/63

The importance of the Economic Summit was ^{not} consensus (which was not ^{achieved} ~~achieved~~ ^{any how})
 but the opportunity it afforded to bring vital political and economic issues
 into the open. Senator Don Grimes's speech on the role of social security is an
 example of the best use of the opportunity.

The burden of his speech was that Australian welfare expenditure is not excessive
 and ought not concern us too much at present and foreseeable levels. It is a
 conclusion I do not accept, but in defending it, the speech advances our understand-
 ing of the nature of welfare payments systems and neatly disposes of some spurious
 arguments. Grimes is not merely knocking over straw houses-- the misconceptions
 he tackles have wide currency.

He says that many countries with higher levels of welfare expenditure than ours
 " are doing rather better than we are.". "There is considerable difference
 between expenditure which involves government actually using up goods and services
 and transfer payments which merely move purchasing power from some individuals
 to others.... within wide limits there is no reason to suppose that the overall
 'cake' being divided will be any smaller".

All of that isn't quite so, but it is true that transfers ^{related} ~~related~~ to people's
 incomes rather than their occupations do not directly distort the economy. Welfare
 does not favour some occupations at the expense of others causing manpower and
 capital to be wastefully used. The minister might have added, as a useful aside,
 that the reason Australia doesn't do better may well be that we do in fact make
 rather a walter of paying welfare to occupation; employing tariffs, union preference
 and statutory monopolies to do it. The IAC inform us that each year a sum approx-
 imately equal to half the welfare vote is transferred between competing Australian
 citizens by import restrictions alone. Some critics of government handouts are
 hypocrites.

The other major, and in my view very fair point made by Senator Grimes is that

taxation and welfare are but two sides of the same coin; that there is little difference so far as the taxpayer/welfare recipient is concerned whether the benefit is received in cash or credited against his tax ^{due}s; that the various tax deductions (called taxation expenditures by welfarists) are, like cash payments, a form of welfare and they are expensive.

The minister almost too gently observes that the critics of direct spending were "often strangely silent on hidden spending through taxation expenditure". Some more critics of government handouts are hypocrites.

Further again, in my view correctly, Senator Grimes notes that ^{in comes} ~~means~~ tests are much the same in their effect on the citizen as taxes; the welfare recipient's cash in hand is the same whether a hundred dollars of his income is withdrawn by tax or a hundred dollars of his pension by income test.

However even with all these sound points conceded the high tax, universal welfare way is not the best way of coping with poverty. That way can be even more anomalous and even more damaging to the economy than a selective income tested system which concentrates its benefits on the needy. That cash transfers have no effect "within very wide limits on the size of the cake is, at very least, open to doubt. First, because transfers from rich to poor will tend to increase current consumption at the expense of current investment reducing future production--helping today's poor probably prejudices tomorrow's poor. I see no acceptable way around this problem but we should bear the cost in mind.

Second, the expectation of pension discourages saving and hence investment.

Third, although it is said that high tax ~~does~~ not discourage work the argument is debateable. It runs: workers, when faced with higher tax bills, work a bit harder to maintain ~~take~~ home pay. This, so called, "income effect" then offsets the tendency to substitute leisure for work which now yields less take home

pay. Empirical evidence supports Grimes' position but to the best of my knowledge it is all fairly short run. In the longer run it becomes easier for families to adjust. If work is less well rewarded then they will take life's rewards in ways that require less cash. A good garden and a low golf handicap look relatively more attractive alongside the alternatives of travel and a better house. Workers' demands for shorter hours reflect high taxes as much as high penalty rates.

In the long run we don't know whether income effects match substitution effects, but if income effects are such an important influence on the behaviour of taxpayers as they are said to be, then surely income effects influence welfare recipients' behaviour also. Even the family allowance must discourage work and in the case of unemployment, sickness and supporting mothers' benefits both income and substitution effects combine to discourage working. Enthusiasts for the income effect argument in discussion about tax are often "strangely silent" when it comes to welfare. Have I found some more hypocrites?

Income tests are, as Senator Grimes pointed out, similar to taxes. Like taxes they cause people to substitute leisure for work, or not, depending on the balance of income and substitution effects. However, income tests have another additional influence; they make it possible for the general tax scales to be pitched at a lower rates than would otherwise be possible. While the income test on those it catches is a greater tax than any likely change in the underlying scales, the scales affect more people.

The final, and most telling objection to the high tax/universal benefit path is that it can't be financed. Attempts to do so result in the break down of the tax base and neglect by the government of the most needy. There is a limit to the taxes that can be raised before the incentive not to pay destroys the tax system. Britain, Sweden, France and the Netherlands are not models of tax propriety, nor have they eliminated poverty.

Taxpayers avoid tax by working outside the tax base. I can build my own chicken

house, grow my own tomatoes, mend my own car and I can, with a bit of juggling, make tax deductions of monies spent improving my capital but all these involve a wasteful use of resources which, but for the tax advantages, would be unacceptable to me. Tax laws have so diverted the "Middenn hand" that there no longer coincidence between my interest and the national interest.

Millions of hours of the nations best management skills, that might be productively employed, are devoted to tax minimisation. Cheating the tax department has become morally acceptable and it would naive to expect those standards to remain quarantined to tax.

Inability to raise revenue, in the end, will force any government to stop spending. Even cash transfers must be raised by taxation and however desirable it may or may not be to pay the well to do, if the money can't be raised it can't be paid. Welfare must be directed to the poor.