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# **Equality of Opportunity in Australia Myth and Reality**

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<b>List of abbreviations and technical terms</b>
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ABS	Australian Bureau of Statistics
ACER	Australian Council of Educational Research
ACOSS	Australian Council of Social Services
AIHW	Australian Institute of Health and Welfare
CoA	Commonwealth of Australia
CEO	Chief executive officer
CEPR	Centre for Economic Policy Research, Australian National University
CIS	Centre for Independent Studies
DSF	Dusseldorp Skills Forum
EPL	Employment protection laws
EMTR	Effective marginal tax rates
FACS	Family and Community Services Commonwealth government department
FEOP	Formal equality of opportunity See section 1.1 for full definition.
FHOG	First Home Owners Grant
GDP	Gross Domestic Product
GINI coefficient	A summary overall measure of the extent of inequality of distribution after taxes and transfers.
GP	General (medical) practitioner
GST	Goods and Services Tax
HECS	Higher Education Contribution Scheme Commonwealth scheme under which eligible students bear part of the cost of their tertiary education, either through paying fees at the time of study, or paying through the taxation system at a later date.

HILDA	Household Income and Labour Dynamics Australia National household-based panel study commenced in 2001. For full details see: <a href="http://melbourneinstitute.com/hilda/">http://melbourneinstitute.com/hilda/</a> .
ICT	Information and communication technologies
IMF	International Monetary Fund
Inter-generational mobility	See section 1.2 for definition.
Intra-generational mobility	See section 1.2 for definition.
IR	Industrial relations
LIS	Luxembourg Income Study
NATSEM	National Centre for Social and Economic Modelling
NESB	Non-English-speaking background
OECD	Organisation for Economic Co-operation and Development
SEOP	Substantive equality of opportunity See section 1.1 for full definition.
SES scheme	Socio-Economic Status scheme Commonwealth education funding scheme designed to give greater funding per student to schools in lower SES areas.
Social class	See section 1.2 for definition.
Social mobility	See section 1.2 for definition.
VET	Vocational education and training

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## Summary

This study is about *equality of opportunity* – the opportunity available to well-motivated, capable and hard-working people to get ahead in life and achieve their maximum potential, no matter what their social background. Equality of opportunity can be measured in terms of *social mobility*: the frequency with which people move up the social hierarchy to a higher income or occupational ranking *irrespective of their different backgrounds and starting opportunities*.

Australians overwhelmingly believe in equality of opportunity as a social norm. A great many of them also believe that it is being realized in practice – that Australians' life chances are less dependent on their circumstances of birth and less hampered by rigid class structure, debilitating snobberies, or lack of social networks, than are the life chances of many people in comparable nations.

Is this widespread belief in line with reality? On many counts, it is. Australia remains among the more socially mobile societies in the world. But this paper warns that things are changing, and without a policy rethink will continue to change, for the worse.

For generations, successive Australian governments of all political persuasions sought to promote a fairer society by actively pursuing six policy goals:

- full-time employment for anyone who wanted it;
- a legislated set of minimum wages and conditions sufficient to sustain a decent standard of living in line with rising prosperity;
- a balance of bargaining power in the workplace;
- a means-tested, community-based and dignified social transfer safety net to cover short-term contingencies;
- a strongly progressive tax system; and
- equality of access (across socio-economic groups or geographic regions) to rewarding public goods, such as good education and health care, housing and public transport.

These policy goals, founded on a set of normative social beliefs and values peculiar to Australia, were not always achieved in practice but the *intent* – to temper the effects of markets on income and wealth inequality and to promote greater equality of opportunity – was clearly there. Today these goals are being steadily redefined or coming under strong challenge.

What is this doing to our society? The public policy debate in Australia has generally centered on past trends in the distribution of disposable (final, net) incomes and the role played by taxes and cash social security transfers. And on these criteria, there is no

cause for great social concern: Australia's income distribution has been remarkably stable for the last twenty years, despite accelerating economic and structural reform.

However this limited focus, apart from ignoring inequalities in quality of life (such as in predictability of hours and security), diverts attention away from the more fundamental underlying *structural* inequalities of education, health, employment, housing and location and from the wider social responsibilities of government. Passive redistribution, by itself, does not correct these market-based inequalities; it offers pain relief but does little to reduce welfare dependence – and can even increase it. Only an attack on the underlying structural inequalities in the market place can reduce welfare dependence in the long term.

This paper focuses on the underlying structural inequalities and on the barriers to mobility that are 'distorting' actual market outcomes (i.e. causing them to deviate from merit-based outcomes over the life cycle). It also discusses policy changes that could break down some of these barriers and make it easier for young Australians from disadvantaged homes to compete on a level playing field and improve themselves over their lifetime.

A rethink of policy is necessary for at least two reasons. Firstly, if existing barriers to social mobility are not markedly diminished, the perception will grow among Australians that equality of opportunity is largely a myth. Such a psychological reappraisal would unsettle long established community expectations and undermine social cohesion and stability. On that ground alone, a strong case can be made for pre-emptive government intervention. But the paper goes further and argues that, if the right policy instruments are used, the economic efficiency case is no less powerful.

# 1. Equality of opportunity

## 1.1 What does equality of opportunity mean?

When politicians pontificate about equality of opportunity and ‘a fair go for everyone’, they often mean little more than equality under the law. Their concern is to ensure that the legal, regulatory and institutional framework does not impede Australians from competing on equal terms. This can be called *formal* equality of opportunity (FEOP).

FEOP is commonly taken to mean:

- an absence of officially sanctioned or condoned discrimination based on characteristics such as age, religion, gender, ethnicity, race, sexual preferences;
- a ‘basic’ level of social security, affordable health care and education for everyone; and
- impersonal markets which give equal weight to the individual preferences of consumers, workers and employers and where success is largely determined by an open competitive process.

But many Australians have something much more ambitious in mind than this classical liberal vision. Their norm is *substantive* equality of opportunity (SEOP). SEOP refers to a situation where everyone is able to develop their full potential irrespective of the original circumstances of their birth and childhood and where a person’s economic prospects are determined overwhelmingly by their own ability and character.

SEOP differs fundamentally from FEOP in two ways. Firstly, it takes a longer term perspective. FEOP is about ensuring the best person wins *at any point in time*: individuals competing in schools or the labour market at any one time are judged only on the attributes they bring which are relevant to the duties of the position, without any bias on grounds of race, ethnicity, gender, caste hierarchy or nepotism. But SEOP is also concerned with *risk factors and handicaps in early childhood and teenage years*. While it too embraces meritocracy, it looks backward at the situation before the competition starts in the labour market (i.e. before the individuals get to the starting gate). That is, SEOP wants to ensure not only that selection for superior jobs is based on objective qualifications but also that all citizens have had an opportunity early in life to become qualified for these superior jobs. It thus looks at opportunities *over a lifetime*, not just at a point in time.

Secondly, the two concepts differ on the extent of government intervention required. On the narrow FEOP perspective, governments are only expected to minimally intervene to deter overt or covert discrimination. By contrast, under SEOP, governments would be expected to actively intervene to ensure that:

- as children, citizens are not unduly impeded by lack of parental wealth, status and power from achieving their full education potential; and

- as adults, citizens are not impeded by location, inadequate access to training and skill-enhancement, poor access to health and housing or poor networking from achieving their full employment potential.

A policy framework built on SEOP would allow considerable earnings inequality in the market place (before taxes and transfers) because children inherit genes from their parents and grow up with different attitudes to risk and work.<sup>1</sup> But the inequality would not be due to structural factors such as parental resources at birth or inequalities of access to important public services such as education, health care, housing and employment opportunities. Many analysts (such as Heckman 2006, and Jencks and Tach 2005, p. 19) contend that genes account for much less than half the observed positive correlation of adult earnings with parents' economic status. Early family environment is at least as important in predicting future cognitive (IQ) and socio-emotional abilities (such as motivation, perseverance, tenacity and self-discipline) and hence future market success. It is these inequalities of family opportunities early in life, as well as of access to key public goods later in life, which SEOP programs seek to diminish as far as possible.

## 1.2 Social mobility as a measure of equality of opportunity

It is possible to gauge the extent of equality of opportunity in a society by measuring social mobility. *Social mobility* refers to the ease and frequency by which people move up the social hierarchy (to a higher income or occupational ranking) during their lifetime and between generations, *irrespective of their different backgrounds and starting opportunities*.

Social mobility measurements are made on both an *intra*-generational and an *inter*-generational basis. Both types of measurement are related to equality of opportunity, but they measure quite different things.

*Intra-generational mobility* indicates the movement of adult individuals up and down the occupational and income hierarchy within a single generation (during the course of their lives). It seeks to assess to what extent individuals' social position or income changes over time. Intra-generational mobility is usually measured by averaging the income of individuals over a short to medium period of time – such as decade. It is an important social indicator because low income has much greater impact on life satisfaction and ability to spend on education and health if it is sustained and stubborn (long term) than if it is mostly transitional (with one cohort of poor being replaced by another).

Intra-generational mobility does not capture the effect of childhood circumstances. Moreover some observed intra-generational upward income mobility is simply due to

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<sup>1</sup> SEOP is not the widest possible concept of equality of opportunity by any means. It requires that persons with the same native talent and ambition have roughly equivalent competitive prospects. That is, it takes differences in genetic make-up and native talent as an unalterable natural fact. Many go further and see a need for governments to try to compensate for or offset these natural advantages so that everyone can participate equally in societal activities. This is not totally impractical in today's age of genetic engineering but it goes well beyond the scope of this paper.

structural and economic changes that allow everyone in the economy to improve their wellbeing. In the past, such structural changes have included: the shift of resources from low value to high value industries; increasing female participation in the labour force; and general reductions in unemployment.

By contrast, *inter-generational mobility*, which is measured by the degree of correlation between parental advantages and economic outcomes, relates to periods of over 40 years and implicitly abstracts from economy-wide influences. Its aim is to find out to what degree individuals ‘inherit’ their economic status through their circumstances in childhood; that is, whether a young person from a low social class has the same chance as a young person from a higher social class of achieving a high rank in adulthood or, to put it differently, the extent to which individuals can succeed by virtue of their own talents or motivation.<sup>2</sup> Inter-generational relative mobility is seen as a useful (although still imperfect) measure of how close a society is to equalizing opportunity (Noll 1998, Morgan and Young-Mi 2005, Breen 2004, Beenstock 2004).

If the correlation between origins and destinations exceeds a certain threshold, it can be viewed as evidence of high inequality of opportunity and low relative mobility. Where that threshold lies is open to dispute (see later).

Whatever the appropriate threshold, *trends in inter-generational mobility* can tell us if the importance of children’s home environment is increasing or decreasing over time; that is, whether young people of low socio-economic background have, over the long term, a greater or lesser chance of rising up the income scale.

Note that when the term *social class* is used in this paper it is not in terms of the archaic Marxist division between owners of capital (the bourgeoisie) and wage workers (the proletariat). The distinction being made is between people who have *occupational status, income, wealth and access to information and power* (sometimes called the ‘insiders’) and those who lack these advantages (the ‘outsiders’). These advantages improve access to things society considers valuable and rewarding in the long term such as education, health, the legal system, political participation and social networks. While there are other factors contributing to inequality of opportunity, such as gender, ethnicity and citizenship (immigration), social class (as defined) is of crucial importance.

### 1.3 Sorting out the evidence on equality of opportunity in Australia

It is our view that policy trends in Australia are so transforming our society that they will lead to a decline in equality of opportunity in the future. We try to explain why in three steps.

Firstly, there is a substantial international literature reviewing social mobility outcomes across a range of countries and analyzing the policy factors which help explain the

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<sup>2</sup> It should be noted that the degree of inter-generational correlation of adult earnings may differ from the degree of inter-generational correlation of occupation. Jencks and Tach (2005) point out that the US has a higher earnings correlation than other rich countries (lower mobility) but ranks lower on the occupational correlation measure (higher mobility).

different sorts of outcomes in different countries. This literature can throw light on the likely implications of present policy shifts in Australia for future social mobility.

Secondly, there is some useful research into social mobility trends in Australia which we explore in the paper. Unfortunately, at this stage, the evidence from this source is relatively limited and inconclusive.

Thirdly, we review the many sectional barriers to social mobility in Australia and highlight the threat they are posing for future equality of opportunity.

These three categories of evidence bearing upon the future of equality of opportunity in Australia are covered in detail in sections 2, 3 and 4 below.

## 2. International research on social mobility

The extensive international literature on social mobility covers income, occupational and educational mobility. The picture that emerges from this literature depends on what is being measured,<sup>3</sup> and it is often contradictory, but some common threads can be detected.

### 2.1 Intra-generational social mobility

People tend to move up the income distribution schedule during the course of the life cycle. For example, a person may progress from student to junior clerk to senior clerk as they get older. This kind of ‘vertical’ mobility is quite common: in most countries studied, between 30 and 40 per cent of adults rise to higher income and occupational ranks during their lifetime.

However most of this vertical mobility is short range such as from the lowest decile or occupational grade to the one just above it. There is relatively little *long range* intra-generational mobility; for example, from the lowest decile or two to the highest. The story of the unskilled manual worker who rises to become a professional or manager owes part of its popular appeal to the fact that such rises are so rare.<sup>4</sup>

Nonetheless, the fact that short range income mobility is common is still important for equality of opportunity. It shows that much observed ‘poverty’ in any given year is transitional rather than sustained;<sup>5</sup> that is, it reflects passing events such as joblessness and studying. It means that ‘permanent’ incomes, that is, incomes averaged over a multiple of years, are less unequal than single year incomes (Leigh 2005a; Kelly 2005).<sup>6</sup> In many of the countries studied, “permanent” inequality is about two thirds of cross-sectional annual inequality (OECD 1996, p. 77) i.e. approximately two thirds of the inequality observed in a single year tends to be persistent. However the *trend* in long-run inequality is not significantly different from the trend in annual inequality and the ranking of countries in regard to inequality is much the same whether cross-sectional or longitudinal analysis is used (OECD 1996 p. 94 and Leigh 2005).

These broad patterns of mobility have been found to be true of many developing, as well as developed, countries.<sup>7</sup>

<sup>3</sup> Is it intra- or inter- generational income mobility? Is it father-son correlations or father-daughter correlation? Is it actual earnings or earnings imputed from occupation or education? Is it earnings or family income or occupational status? Is it native-born only or does it include migrants? And so on.

<sup>4</sup> What is more, low-paid workers have poorer prospects of obtaining significantly better jobs than high paid workers, especially if cross-sectional inequality is relatively high to begin with. The evidence points to a high incidence and persistence of low-paid employment amongst low-skilled and inexperienced workers (OECD 1996, pp. 91, 94).

<sup>5</sup> For example, the longitudinal surveys of poverty in the US show that although at any one time up to 10 per cent fall below the poverty line, less than 1 per cent were continuously poor over a ten year period and less than 3 per cent remain poor for eight or more years.

<sup>6</sup> In the US, for example, although ten-year inequality is lower than annual inequality, both have shown a similar trend increase (Leigh 2005a, p. 12).

<sup>7</sup> On developing countries see for example Fields and Puerta 2005 and Rodrigo and Rafael 2005. Corak (2004) argues however that there is significantly less generational mobility in developing countries than in developed countries (p. 9)

## 2.2 Inter-generational mobility

In nearly all countries studied,<sup>8</sup> the income, occupational and education status of adults is strongly and positively correlated with that of their parents.<sup>9</sup> That is, there is a substantial association between class origins and destinations. The earnings correlation is greater at the bottom end of the earnings distribution than at the top (Eide and Showalter 1999). And the more years one averages, the more closely sons' earnings match their fathers' earnings; that is, the father/son earnings correlation is higher with permanent than with annual incomes.

The implication is that children from low socio-economic backgrounds have considerably less chance of achieving management or professional positions over their lifetime than those who come from a high socioeconomic background. For example, in the UK some 60 per cent of the sons born to poor parents (bottom quarter) either remained in the bottom quarter or rose to the second quartile and only 39 per cent ended up in the top or third quartile. By contrast, some 67 per cent of the sons born to rich parents (the top quarter) ended up in the top or third earnings quartile. And there is very little downward mobility from the top in the UK. The pattern is similar in other European countries. For example, in Germany the probability of getting access to the upper service class is much higher for a son whose father belonged to the upper class than for a son of an unskilled or semiskilled blue-collar worker.

## 2.3 Intra- and inter-generational mobility – comparisons of different countries

Many studies using comparable methodologies have found significant variations in both intra and inter-generational mobility between countries. The conclusion that emerges most commonly is that the US and UK are in the 'low social mobility' camp, implying low equality of opportunity.

The *intra*-generational differences are highlighted by Goodin *et al.* (2000). They find that about 6 per cent of Dutch households experience poverty (less than 50 per cent of median) in any given year but when income is averaged over a decade, the proportion falls to 1 per cent. By contrast, in the US about 18 per cent of households are poor in any given year and averaging over a decade reduces the proportion to 13 per cent. Although for much of the post war era, America was at the top of the league in terms of occupational and status mobility, it now has not only the most unequal year by year income distributions in the developed world but also, on many measures, a relatively high level of 'permanent' income inequality i.e. average income over a two to ten year

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<sup>8</sup> Sources used for this international section on inter-generational mobility include: Breen 2004; Bjorklund and Jantti 2005; Blanden *et al.* 2005; Wasow 2004; Leigh 2005a; Aldridge 2001; Anderberg and Andersson 2002; Bauer and Riphahn 2004; Beenstock 2004; De Graaf and Kalmijn 2002; Erikson and Goldthorpe 1992; Harding *et al.* 2001; Hout and Di Prete 2004; Klevmarcken 2004; Lefranc and Trannoy 2003; Lemel and Noll 2003; Maloney *et al.* 2003; Morgan and Young-Mi 2005; Ng 2004; Osterberg 2000; Osterbacka 2004; Aldridge 2001; Pizzigati 2005; Scott and Leonhardt 2005; Sociology encyclopaedia; Solon 2002; Torche 2005; Vallet 2005; Volscho 2004; Wessel 2005; Zweimuller 2000; and Zwi 2005.

<sup>9</sup> The correlation tends to be higher for earnings mobility than for income mobility and greater at the lower end of the income distribution than at the upper end. High correlations suggest low inter-generational mobility and a low degree of equality of opportunity.

period (Bjorkland and Jantti 1997, Kangas 2000 and Goodin *ibid*). It has also been found that 12-year earnings mobility is greater in Germany (Burkhauser and Poupore 1997) and Israel than in the US (Beenstock 2004). In fact, the low international ranking of the US on the benchmark of inequality remains unchanged whether one uses a multi-year or annual accounting period. The less regulated, more decentralised labour market in the US has not resulted in greater economic mobility than in the Nordic or European countries.

The literature on *inter*-generational mobility tells a similar story. While still somewhat inconclusive and not always consistent, studies tend to suggest that in the US, the association of fathers' and sons' incomes is appreciably stronger, and a child's economic background a better predictor of later earnings or school performance, than in the Scandinavian countries, some of the smaller continental European countries such as the Netherlands, and Canada and Singapore.<sup>10</sup> The UK is broadly in the same camp as the US. In England, sons are much more likely to remain stuck in the same income band as their fathers than sons in Norway, Denmark, Sweden, Finland, Germany and Canada (Blanden *et al.* 2005).

Corak (2004), who examined dozens of studies in the US, Canada and Europe, concludes that 'the US and Britain appear to stand out as the least mobile societies among the rich countries studied' (Wessel 2005). The Economist (2004 and 2005a), reviewing some recent studies, concludes that 'by some measures it (social mobility) may be worse (in the US and Britain) than it is in crusty old Europe'.<sup>11</sup> In short, in the US and Britain – both countries with relatively high levels of year by year income inequality<sup>12</sup> – the poor are more likely to be entrapped in their positions than in many other comparable rich countries.

Moreover the *trend* in mobility in the UK and US may be less favourable than for many other comparable rich countries. Whether measured by the percentage of persons who move up more than one quintile during their life or by the father/son association or by the persistence of relative poverty, mobility has been either stable or tending to increase in some European and Scandinavian countries (de Graaf and Kalmijn 2002; Breen

<sup>10</sup> See Solon 2002; Lee and Solon 2005; Breen 2004; Blanden, Gregg and Manchin 2005; Hout and DiPrete 2004; Agell 2003, Osterberg 2000; Osterbacka 2004, Ng 2004. Other works are cited by Wessel 2005, Bradbury and Katz 2002, Corak and Heisz 1999; and Pizzigati 2005. The coefficient measuring the elasticity of the son's income with respect to the father's income (the degree of earnings mobility) has been estimated at between 0.3 and 0.4 in the US, and between 0.4 and 0.55 in the UK but less than 0.3 in Sweden, Finland and Canada (Solon 2002). A high coefficient implies low mobility. Many estimates of the origins/destination correlation are fairly high in the US – around 0.6. But Harding *et al.* (2001, p. 14) find it to be closer to 0.3 – still higher than in Scandinavia but with a smaller gap. Blanden *et al.* estimates the inter-generational partial correlation coefficient – which is equal to the beta coefficient but scaled to adjust for changes in inequality across generations at 0.27 for UK and 0.29 for US compared with 0.14 for Canada and similar or lower coefficients for the Nordic countries (2005, p. 6).

<sup>11</sup> Corak (2004, p. 9) finds that in the US and UK at least 40 per cent of the economic advantage high-income parents have over low-income parents is passed on to the next generation. The corresponding figure for the Nordic countries and Canada is 20 per cent. On France and Germany there is conflicting evidence. On some studies, their social mobility appears close to that of the UK and US but in others France and Germany are found to have greater inter-generational mobility than in the US and UK, although lower than in Scandinavian countries. See for example Lefranc and Trannoy 2003

<sup>12</sup> In the US, since the early 1980's the median income has increased 5.5 times but those in the bottom half earn little more in real terms than they did two decades ago.

2004; Braberg *et al.* 2005; Lefranc and Trannoy 2003). Breen (2004, p. 6.10) finds ‘a widespread tendency for social fluidity to increase’ (in Europe) – a conclusion which applies to both men and women.

By contrast, longitudinal studies suggest that US mobility (intra or inter generational) has been either stable or retreating after 1980 relative to the 1960s and 1970s. The view that mobility has been falling in recent decades comes from writers like Gottschalk and Danzinger 1997; Bradbury and Katz 2002; Levine 1999; Aaronson and Mazumder (2005; and other studies cited in *The Economist* 2004).<sup>13</sup> These studies suggest that the probability of staying in the same quintile has been tending to increase, the proportion of those born in the bottom fifth making it into the top has been tending to fall and the proportion starting and finishing in the second poorest quintile tending to rise. By contrast, Mayer and Loopo (2005) detect a downward trend in intergenerational elasticity (rising mobility) – but the estimates are imprecise and the estimated trend is statistically insignificant. Solon (2002) has argued that many of the earlier studies incorrectly used the available data and that in fact US mobility has been broadly stable over the last two decades.

In Britain, the evidence indicates ‘there has been little or no change’ and, on some measures, even a fall in inter-generational mobility for the cohort born in 1970 relative to the one born in 1958 (Blanden 2004); Richardson 2003 pp.30ff and 61ff). Solon (2005) finds the evidence of decline in mobility more convincing for the UK than the USA.

#### **2.4 What are the reasons for differences in mobility in different countries?**

It has surprised many people that social mobility in the US and Britain is no higher, and on some measures even lower and exhibits less favourable trends, than in social democratic countries like Sweden, Norway and the Netherlands. The USA and UK have been world leaders in economic liberalisation and structural change (although Europe has in more recent years started to embrace liberal market policies, the gap with the US remains appreciable). In theory, market liberalisation should make the employment market more merit-based and blinder to socio-economic status, gender, ethnicity etc. and it should widen the employment choices for low-paid workers and the opportunities for upward wage mobility. In addition, the US has a cultural advantage: it is less influenced by historical class distinctions and/or hierarchies than say old Europe, allowing more upward mobility for persons from less privileged origins.

So why hasn’t all this given the US a sustained edge on equality of opportunity? The missing link is political ideology on redistribution. While structural change, freer markets and economic growth create ‘more room at the top’, the role of the State may be decisive in determining who fills these places: the existing poor or people from a relatively high social class to begin with. The Scandinavians and many of the smaller European governments have generally been more successful in reducing education

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<sup>13</sup> In the 1970s, 49 per cent of all families which started a decade in the lowest quintile ended it still in the lowest quintile but the comparable figure was 53.3 per cent in the 1990s (Bradbury and Katz 2002). The proportion of adult men born in the bottom fifth who made it into the top fell from 27 per cent in the 1970s to 10 per cent now; and those who started and finished in the second poorest quintile rose from 28 per cent in the 1970s to 36 per cent in the 1990s (studies cited in *The Economist* 2004).

inequality and have given poor families better access to medical care and employment programs. These policies have helped reduce differences related to family background and wealth, generating benefits for income mobility which seem to have outweighed the disadvantages from having less flexible labour market and higher taxes.<sup>14</sup>

One of the most important ways in which progressive social policies impact on social mobility is through education. A broad based increase in education participation facilitates intra-generational income mobility but unless it is targeted at low-income families, education achievement can simply reproduce status from generation to generation. This seems to be happening in the US. Educated Americans have been investing heavily in their children's education but there has not been a proportional increase in spending by governments on public schools and on tertiary education. As a result, people of low socio-economic status have participated less and performed more poorly than the middle and upper class. Moreover employers have increasingly relied on the direct recruitment of highly qualified and educated individuals and paid high premiums for them, while the less qualified have found it more difficult to work their way up through the ranks. One writer (Harding *et al.* 2001, p. 22) finds that in the US parental education and resources contributed appreciably to the apparent fall in mobility.<sup>15</sup>

One suspects that the problem is all along the education channel in the US. There is poor access to affordable, high quality *early* education where children build reading, cognitive, verbal and social skills. Public schools are denied adequate funding. And increases in US college attendance are much smaller among children from poor than rich families (Anderberg and Andersson 2002, p. 1). The education system goes some way to explaining its relatively low levels of mobility despite its many other advantages.

Similarly, the low mobility in the UK can be partly explained by the strong and increasing relationship between parental income and educational attainment (Blanden *et al.* 2005; Bagehot 2005; Anderberg and Andersson 2002). Although the participation rate has more than doubled in the UK over the last 20 years, the rise in higher education participation has been much more pronounced among those from better off backgrounds.<sup>16</sup> 'The expansion of higher education since the late 1980s has so far

<sup>14</sup> A paper by Headey and Muffels (1999) acknowledged that social democratic countries like the Netherlands are 'highly dynamic societies – very much in flux'. It observes that because government benefits are 'generous, only 19 per cent of those who became poor are still in poverty two years later, whereas in the US, where 'most people escape poverty through the labour market rather than through government help', 43 per cent of the poor remain poor after two years. Solon cites a study by Corak and Heisz (1999) which suggests that Canada exhibits more inter-generational mobility than the United States because of Canada's more progressive public policies' (p. 8).

<sup>15</sup> However, according to Stephen Morgan and Young-Mi Kim (2005), patterns of educational attainment and inequality (measured by the relative likelihood of different socio-economic groups to be enrolled in college) have not changed much in the US or UK over the long term so and cannot *per se* explain the apparent decline in social mobility. Nor should one generalise about Europe. Switzerland for example rates 'particularly low' on inter-generational mobility' (Bauer and Riphahn 2004). The authors confirm that although education costs are a significant factor in determining educational attainment, 'the impact of parental education is considerable'.

<sup>16</sup> Since the early 1980s, the proportion of people from the poorest fifth of families obtaining a degree has increased from 6 to 9 per cent but the graduation rates for the richest fifth have risen from 20 to 47 per cent, so inequality of access to higher education has widened further in this period (Blanden *et al.* 2005).

disproportionately benefited those from affluent families' (Blanden *et al.*, pp. 2-3). A 2004 study by Ludger Woessmann, using comparable data on school students' performance (in maths) by family background, finds that, out of 17 Western European countries, educational inequality (measured by the strength of family background) is greatest in Britain (and least in France). This is because many Scandinavian and European governments have had (until recently at least) a more fundamental commitment to equal opportunities and equal access<sup>17</sup> and have been more successful in *reducing* education inequality (Anderberg and Andersson 2002).

The effects of education inequality in distorting market income distribution (relative to what a truly merit-based SEOP system would produce) are compounded in the UK and US (especially the latter) by other factors – such as relatively wide earnings differentials for skill, relatively high and exploding CEO salaries,<sup>18</sup> high levels of wealth concentration, growing corporate power and its frequent abuse,<sup>19</sup> and the relatively large proportion of 'trapped' working poor. But the main suspect must be policy-induced educational inequalities.

Similar arguments apply to health and other public benefits. While populations become healthier as the economy expands, *relative* health outcomes do not necessarily narrow. In European countries, greater government involvement in reducing health inequalities has given poor families better access to medical care; in the US, low-income children tend to suffer from more health problems both in childhood and as adults (Scott and Leonhardt 2005).

In many countries (notably the Nordic countries), greater investment in wider employment programs for the disadvantaged and more active redistribution have also helped to nullify the liberal market advantages of the US and the UK.

## 2.5 Conclusion

In the US and to a lesser extent the UK, radical laissez fair social policies (such as labour market deregulation, the shift from universal provision of high quality public services towards a user-pays model and the relative neglect of active equal opportunity policies) have tended to increase earnings, educational and health inequality and intensify the concentration of economic power. These policies have weighed on social mobility despite the otherwise positive effects of more competitive markets. That experience has some salutary lessons for Australia where, as will be shown later, there are forces pulling in the same direction.

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<sup>17</sup> Cross-country surveys find that Americans are much less likely to agree that it is the responsibility of the government to reduce income differences than Europeans and Scandinavians.

<sup>18</sup> American CEO remuneration (salaries, bonuses and stock options) was 44 times the average factory worker's in 1965. Today, the figure is 212 times (AFL/CIO Executive PayWatch web site). The contrast with Japan and Europe is startling.

<sup>19</sup> Senior Executives and Board Directors, together with leading fund managers, belong to a cosy club which insulates them to a large extent from the scrutiny or wrath of the small, scattered shareholder. Two related manifestations of growing corporate power are the relatively high earnings differentials and the relatively high and exploding CEO salaries.

### 3. Australian research on social mobility

On most conventional international criteria, Australia does not stand out as a particularly egalitarian society (see Section 4.2). But inequalities of outcome have been generally tolerated because, more often than not, Australians believe that their society performs well on equality of opportunity, that is, that well motivated, capable people prepared to work hard can get ahead in life, no matter what their social background. This popular perception is shared by many serious researchers; for example, Headey and Muffels (1999) confidently predicted that, when all the studies are completed, 'Australia will eventually be shown to be one of the most mobile societies of all'. This perception may help explain the relatively 'hard' attitudes of Australians to passive redistribution (Alesina and La Ferrara 2004).

To what degree do the results of social mobility research in Australia support this perception? The picture is a mixed one.

#### 3.1 Intra-generational

Studies of occupational mobility in Australia indicate that from year to year some 5 per cent of workers in low-income categories change their jobs and occupations (some involuntarily) – both upward and downward (ABS 6209.0, 2002). Fifty per cent of voluntary movers moved to a job that had the same technology level as the previous one, while the rest were equally distributed between ascending and descending groups. Those moving up the technological ladder tended to have more labor market experience and higher education than those moving down – underlining the importance of training and education for positive occupational mobility (see also Junankar *et al.* 2004).

Some studies have pointed to the low occupational mobility, through their working lives, of many immigrants to Australia, especially women from NESB who had low education when they arrived, and hence a relatively high risk of unemployment or under-employment (Alcorso 1995). But this situation has improved with the changing composition of immigration.

Occupational mobility in Australia was also studied by Shah and Burke (2004). They found that off the job (generic) training and education is more likely to lead to upward job and occupational change than on-the-job or no training. Other factors besides qualifications impacting on occupational mobility were age, marital status, full time/part-time casual status (especially for males) and location (with people outside the main cities being at a disadvantage).

More generally, some studies have detected a shrinking of the 'middle class' (those in the range of 75 to 125 per cent of median household income) in Australia. This is true of other countries too. In Australia, two thirds of the movement of the disappearing middle has been downward rather than upward (Pressman 2004).

Longitudinal studies currently under way<sup>20</sup> are producing some useful contemporary measures. The evidence from HILDA (Headey and Wooden 2005 and Headey 2005) suggests that between 2000-1 and 2002-3, one third of persons in the poorest decile moved up by more than one decile and 10 per cent of them found their way into the top half of the income distribution. The HILDA results show that most people who become poor don't stay poor for long: in 2001-3 about 21 per cent of the Australian population was below the poverty line at some time in any one year but just six per cent were beneath the line in two successive years and only 3.4 per cent in all three. Some people move into poverty and out again, often quickly.

The HILDA study was hailed by the Federal Minister for Family and Community Services as evidence of 'a high degree of income mobility' (Paterson 2004). Such an assessment is premature. The study so far covers only a short period (three years) and most of the revealed mobility of low-income people is short-range (up one decile). Such movements are common in most developed countries, especially in buoyant times like 2001-3. Many of the people moving up the scale were previously part-time students or under-employed workers who then found full-time jobs. Moreover, it is notable that 28 per cent of children experienced at least one spell of poverty, with 14 per cent estimated to be poor in at least two of the three years. More generally, with 21.4 per cent of the population poor for at least one year, 'at least a fifth of the population might be said to be at risk of persistent poverty and that is on the basis of only 3 years of HILDA evidence to date' (Headey 2005, p. 35). We should also bear in mind that HILDA does not adequately represent the Aboriginal population or homeless people and is based on limited information.

Andrew Leigh (2005a, pp. 15-17) calculates family income inequality based on 1 year income (the normal approach) and then on two year and three year income for the period 2001-03. He finds that over this short period, Australia is 'significantly more mobile than Britain, Germany or the USA in terms of post-government income – in that three-year income inequality (post government) is lower than annual income inequality by a larger margin than in the two other countries studied. Again, however, the period studied is short.

Kelly (2005), using a NATSEM micro-simulation model, looks at the accumulation of wealth over four decades by a cohort of Australians born between 1970 and 1975. He finds that, across all quintiles, average wealth grows with age – but it grows least significantly for those in the poorest quintile. If one accepts the assumptions underlying the model, the gap between the 75<sup>th</sup> and 25<sup>th</sup> percentiles of the cohort would have widened over the four decades as the cohort got older while most would have remained around the same wealth quintile for most of their life. This suggests that children who grow up in poor families will be asset poor all their lives.

In short, the evidence on intra-generational mobility in Australia is limited and mixed. In the last few years we have been enjoying relatively high levels of short-range income

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<sup>20</sup> Household Income and Labour Dynamics (HILDA); Negotiating the Life Course (NLC); Growing up in Australia – the Longitudinal Survey of Australian children (LSAC) and Footprints in Time – the Longitudinal Study of Indigenous Children (LSIC). Andrew Leigh, ANU, is also doing some work in this field. Longitudinal data gathers information by following the same individual or group over a long period of time.

and occupational mobility but this has been a period of strong economic and employment growth; longer term and longer range, the picture is unclear.

### 3.2 Inter-generational

As in other comparable countries, there is a high degree of inter-generational transmission of poor social and economic outcomes in Australia. Some early studies covering the 1970s and early 1980s did indicate that Australia was one the ‘more fluid societies’ in terms of inter-generational mobility<sup>21</sup> – less mobile than in Sweden and a few other European countries but towards the mobile end of the comparative range, although the range of results was small and the differences with old Europe were not very significant.

What more recent evidence do we have?

On the negative side, Evans and Kelley (2002a) explore the question of how much family background (the wealth, level of education and job status of fathers) matters for occupational success and conclude that the impact is major and can be discerned decades after people have left their parental nest and had abundant opportunity to invest in their skills and to make their own way. Likewise, the Life Chances Study, a survey conducted by the Brotherhood of St Laurence based on a relatively small sample of 167 children born in 1990, found that three quarters of the families who had been on low incomes in 1990 were still on low incomes twelve years later. And longitudinal studies of trans-generational experience find a strong correlation between the welfare dependence of young people and that of their parents (see section 4.3)

On the positive side, an important study by Leigh (2006) compares HILDA 2003 mean earnings of fathers and sons with those in earlier surveys in 1965, 1973 and 1987 and draws some comparisons with the US. It concludes that the level of inter-generational earnings mobility is higher in Australia than in the US and more comparable with the high Nordic rates of mobility. Australian mobility has shown no strong tendency to increase or decrease since the 1960s (Leigh 2006).

But Australia is increasingly embracing American social values. Could we, like them, soon slip down the mobility league table relative to many Nordic and European countries?

In the USA, the forces distorting market income distribution and weighing down on social mobility – wealth concentration, the abuse of corporate power, the growth of oligarchies, the high proportion of working poor and education inequalities – are the result of policies which are becoming increasingly relevant to Australia. These policies – such as regressive tax reforms, erosion of the minimum wage, falling levels of unionization, a decline in welfare payments relative to community standards, inequitable education policies and power shifts – have, until now, been less marked in Australia. But they are becoming increasingly pertinent and already the consequences

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<sup>21</sup> Discussed in Pressman 2004; Pech and McCoull 1998 and 2001; Bjorkland and Jantti 1997, Table 2; Hout 2003; and Kangas 2000.

are becoming evident in many sectors of Australian society. This theme is developed in the next section.

### **3.3 Conclusion**

The available research on both intra- and inter-generational social mobility in Australia is limited and inconclusive at present. The relatively comprehensive HILDA study will over time come to address this problem. In the meantime, it is all the more important to pay attention to the US experience and the growing barriers to social mobility being faced by many low income workers in Australia.

## 4. Barriers to equality of opportunity in Australia

There exist a number of barriers that impact negatively on social mobility in Australia. These limit the degree of equality of opportunity enjoyed by Australians. They are considered in turn in this section. They include:

- discrimination barriers
- asset barriers
- welfare traps
- employment barriers
- education barriers
- health barriers
- housing barriers
- spatial and transport barriers.

### 4.1 Discrimination barriers

Historically, discrimination against women and various minority groups has been a feature of Australian society. Even today it remains a significant impediment to income mobility but, unlike the other barriers considered in this section, it is generally diminishing in importance.

*Gender bias* has been substantially reduced relative to the 1960s and 1970s, with a closing of the gap in incomes, education and participation rates (Dwan and Western 2003, pp. 456-7; Shah and Burke 2004; and Productivity Commission 2005, p. 3.42). However there remain significant vestiges of gender discrimination. Some unexplained gender wage pay differences persist (NATSEM Annual Report 2001).<sup>22</sup> It is feared the new workplace reforms will widen the pay gap at the bottom end (Irvine 2005) and adversely affect the quality of life of many low-paid women workers (Hart 2006; Hammond 2006). Women's political involvement has progressed well over the last few decades but in some areas (such as female representation in national parliaments and through special public service institutions such as the Office of the Status of Women), there has recently been some regression (Horin 2006). And the retreat of governments in many areas of service provision is throwing more of the care-giving responsibilities onto women.

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<sup>22</sup> The NSW Industrial Relations Commission recently ruled that that the child care sector suffered "gender-based under valuation" i.e. wages are low because it is seen as women's work (*Sydney Morning Herald editorial* 2006).

The relative disadvantages suffered by *indigenous people* – more particularly the 50 per cent of them living in remote and regional areas – are well known. Life expectancy at birth is 17 years shorter than for other Australians and comparable to Bangladesh standards. Unemployment rates are about four times the rest of the population and imprisonment rates are eleven times greater. While retention rates for year 12 have been rising in recent years, the reading ability of indigenous students is around 20 per cent lower than non-indigenous children. This is a particular hindrance to future income and status mobility as failure in education is closely correlated to employment outcomes and even to health (Bantick 2005). In the labour market as well as in health and education, the gaps between indigenous and non-indigenous Australians have not narrowed significantly, as we will stress in later sections of this paper. While overt discrimination against our indigenous people is becoming increasingly unacceptable, many covert forms persist (especially in employment and housing) and policy is failing to allow for the special starting disadvantages they face.

*Age discrimination* has not disappeared but it is declining and will become less of a hindrance to workforce participation in the future as the labour force growth starts to slow down.

Across the world, newly arrived *immigrants* or those with language problems face hurdles in moving up the ladder. Australia's immigration program in the first few decades after the war generated a class of workers with poor command of English and they suffered most when the structural and policy changes occurred after the 1970s (Kabrelyan 2000). Much of the present structural, long term unemployment is drawn from this group. Even today, as we will note later, many old and some new immigrants remain disadvantaged in the employment market and could be most vulnerable to the new workplace/welfare reforms. But during the course of the last 15 years, the composition of immigration has been changed, with a reduced emphasis on family reunion and greater emphasis on the ability of migrants to fill gaps in the labour market and on self-employment.

There is even less bias against immigrants in higher education participation. Indeed the offspring of low-income non-English speaking immigrants (from China, Vietnam, Greece, Lebanon etc.) tend to have a higher tertiary admission rate than the children of Australian-born parents in low-income suburbs (Megalogenis 2005). Indeed, immigrant families tend to invest more resources in their children than Australian born families of similar income: the inter-generational earnings correlation (of fathers and sons) tends to increase when one excludes migrants (Leigh 2006, p. 14). Although recent events point to an under-current of racial bias, international opinion polls show that Australians have fewer 'racist' hang-ups (e.g. regarding the sorts of people they would not desire as neighbours) than most of the other countries surveyed (Tiffen and Gittins 2004).

Finally, as will be argued later, there is evidence of employer discrimination against *the long term unemployed* simply because of their poor work record.

Overall, while there are still some discrimination problems, they are diminishing in scale and are likely to come down still further in the future as demography, competitive markets and strong anti-discrimination laws combine to force employers to recruit the most productive workers and ignore prejudice and connections.

## 4.2 Income and asset barriers

It is clear from sections 2 and 3 that where persons start in the income and wealth distribution curve has an important bearing on their life chances. Too much income and wealth inequality impedes equality of opportunity.<sup>23</sup>

### *Current situation*

Income inequality in Australia is higher now than in the 1960s but, on some conventional measures (although not all) the trend seems to have levelled off in the last 15 to 20 years (ABS 2005a; Harding 2003 and Argy 2003). During that period, inequality of *market* incomes (earnings from work before taxes and social transfers) continued to rise on a trend basis<sup>24</sup> but this effect was largely neutralised by greatly improved family and other social benefits.

How does Australia stand on inequality relative to other comparable countries? Although some of the international data is open to challenge, it is clear that market incomes are very unequally distributed in Australia.<sup>25</sup> Although Australia's tax/transfer system redistributes more to the poorest 20 per cent than almost any other OECD country, it has to 'work harder' because of the high underlying level of inequality of market incomes among the working age population.<sup>26</sup> Moreover Australia's tax/transfer system is less effective in redistributing income from the two top quintiles to the two middle quintiles (where many low-income employed workers are found).

On the criterion of *final* disposable income distribution (incomes after taxes and transfers), Australia is close to the 'mean' OECD rate but in the more unequal half among developed countries – with more inequality than the Scandinavian and most European countries (OECD 2005a; Scutella and Smyth 2005, p. 27; Harding, Jencks *et al.* 2001; and Century Foundation 2004).<sup>27</sup> This is true whether one uses the GINI

<sup>23</sup> There is a close causal link between pre-existing annual inequality and long term ("permanent") inequality and relatively high annual inequality tends to produce relatively low levels of social mobility: see Campbell *et al.* 2004; Argy 2003, p. 78; Andrew Leigh 2005a; The Economist, 'Ever higher society, ever harder to ascend' December 29; Argy 2003 p. 78. The particular causation channels are unclear but one explanation is that high income and wealth inequality *per se* leads to wider education inequality, which in turn reduces relative mobility.

<sup>24</sup> In the 1990s the share of market income held by the poorest 30 per cent of workers – already very low by international standards – declined further (Forster and Pearson 2000). To an appreciable extent, the increase in market (private) income inequality reflects growing employment inequalities (e.g. the increase in both two-earner and no-earner families), which we discuss later, and a rise in relative wage rates at the higher end of the wage distribution.

<sup>25</sup> The bottom quintile accounts for 1.6 per cent of market incomes in Australia – the lowest of all the OECD countries and compared with an OECD average of 4.5 per cent (Forster and d'Ercole 2005, Annex Table A.4). One reason is Australia's low full-time employment to population ratio, including a high proportion of the working age population living in households where no adult works or only works part-time. Another could be the relatively high proportion of low-skilled occupations. Furthermore, the ratio of executive salaries to average earnings in Australia is only exceeded by the USA – Saunders 2002 Table 7.4 p. 197.

<sup>26</sup> International studies show a 'very strong positive association between changes in market inequality and changes in redistribution' (Kenworth and Pontussan 2005).

<sup>27</sup> Australia is close to the mean but that is not a good guide given that the USA, with a Third World level of inequality, pulls up the average. On conventional indicators, Australia has more inequality than 22 out of 28 developed countries, according to UN 2005 Development Programme Report (Wikipedia).

coefficient – a summary overall measure of the extent of inequality of distribution after taxes and transfers – or ‘relative poverty’ – the proportion of the population with final incomes below 50 per cent of median income (Forster and d’Ercole 2005, Figure 13). In both cases what we are measuring is not the extent of ‘deprivation’ but the lack of opportunities many people face relative to the rest of the community (although on some deprivation measures we appear to rank even worst).<sup>28</sup>

On other conventional criteria too, Australia does not stand out as a particularly egalitarian society. Even before the Howard Government’s recent workplace and welfare ‘reforms’, levels of employment protection were lower than 23 out of 28 OECD countries (OECD 2004b)<sup>29</sup> and unemployment benefits and conditions were barely average relative to other developed countries.<sup>30</sup> Sickness, parental and study leave arrangements are less generous, and spending on public education, training and ‘active’ labour market programs is low relative to most other comparable countries. For example, when it comes to placement, training, employment incentives, integration of the disabled, direct job creation and start-up incentives, Denmark, Norway, Sweden and the Netherlands spend nearly four times more on average relative to GDP than Australia (OECD 2004a).

For reasons explained later, a more crucial barrier to future income mobility than initial income inequality is initial *wealth* inequality. Australia’s GINI (inequality) coefficient of about 0.65 for wealth distribution is much greater than for income distribution (0.32). The bottom half of the distribution owns less than 10 per cent of total household net worth while the wealthiest 10 per cent account for just under half of all household net worth (Kelly and Harding forthcoming; Headey et al. 2004). Wealth varies by age, gender, family size, marital status and income-earning capacity. Indeed, much of the observed wealth inequality is indeed age-based. But it is not simply a function of the life cycle; even within age cohorts there is a very pronounced concentration of wealth in a few hands, suggesting that parental occupational status and income (capacity to save)

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<sup>28</sup> Relative measures of poverty are used in most countries including Australia. The usual objection is that as a country gets richer, the poverty rate can rise if the top incomes rise faster than the bottom ones. The US uses an absolute standard but it too is open to criticism because of what it excludes and queries about the accuracy of reported income by the poorest fifth of households (*The Economist*, 20 December 2005). In Australia, there is a hard core of real and persistent deprivation (absolute poverty), which is probably found in 5 to 7 per cent of households (see AIHW 2005 and Headey 2005) and this too may be high by world standards (Scruggs and Allan 2005 and Saunders and Adelman 2005). But in this paper we use the relative measure of poverty as an indicator of relative opportunity to participate in activities, including income-enhancing ones, which are treated as community norms.

<sup>29</sup> According to the OECD, Australia now has lower levels of employment protection (hiring and firing restrictions, flexibility of hours, strike laws and other forms of employment regulation) than 23 of the 28 OECD countries (OECD 2004b and Argy 2005, footnote 40). If the new workplace reforms are implemented we may end up with the second lowest level of worker protection after the US.

<sup>30</sup> Replacement rates (relative to wages) for low-paid short term unemployed are the least generous of OECD countries apart from Ireland. Replacement rates for long term unemployed (in 60<sup>th</sup> month of unemployment) are closer to the middle of the range. Taking an average of four types of family situation, replacement rates are well below the mean OECD rate (Tiffen and Gittins 2004, p. 148; Whiteford 2005). Australia looks better if we are comparing the purchasing power of benefits across countries, especially for long term unemployed with children. But new welfare measures are eroding this advantage. Another perspective is presented in a recent (LIS) study by Scruggs and Allan 2005. Using 1990s data, it finds that our unemployment, sickness and pension benefits are the least generous of sixteen OECD countries surveyed. Australia also has the highest absolute poverty rate of the 16 countries barring Italy.

have an important (although not predominant) bearing on wealth inequality. In turn, wealth concentration affects the income earning power of children in early years of adulthood in ways which have little to do with differential effort or merit.

The level of wealth concentration at the very top is much higher now than in the early 1980s; in the six years since 1993, the share of national wealth going to ‘millionaires’ has doubled (Stilwell 2004).<sup>31</sup> We have also seen a surge in house and equity prices and managerial remuneration over the last two and a half decades, an uneven receipt (across income classes) of capital gains and an increased tendency for tax policies to favour capital gains over income from effort. A recent Sydney-focused study found that over the past two decades, the material well-being (including the value of property and shares) of “asset-rich” households has increased almost four times faster than the material well-being of “asset-poor” households (Burrell 2006).

Yet, despite all this, there has been no clear trend in overall wealth inequality after the mid 1980s with both NATSEM and ABS studies suggesting no significant increase in overall inequality since the mid-1980s (Kelly 2001 and 2005; Headey and Wooden 2005). The main explanation for this paradox is the tempering effect of wider access to superannuation since the early 1990s. Nor is Australia’s distribution of wealth (with a GINI coefficient of about 0.65) particularly high relative to other developed countries (where GINI indexes range between 0.50 and 0.80, with the United States standing out virtually alone at the very high end).<sup>32</sup>

#### *Future outlook*

While recent trends in income and wealth inequality may be reassuring, a number of factors point to increased inequality of both income and wealth *in the future*.

Unemployment levels – a negative for income distribution – could drop a little further, but the scope for substantial declines is now limited. In any case, the changing policy climate will work markedly in the opposite direction – towards increasing inequality. Without the Senate constraint and under pressure from some of its constituents to sharply cut taxes, two policy safety valves of the past – a socially sensitive approach to economic reform and use of the tax and transfer system to spread the benefits of reform across the population – are now under threat. Recent workplace reforms (interacting with changing technology) will mean declining unionisation, shrinking worker protection regulations and increased managerial autonomy. And additional trade liberalisation at a time of relatively high commodity-led exchange rates will increase manufacturing competition from less developed countries and further disadvantage unskilled labour.<sup>33</sup>

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<sup>31</sup> Another straw in the wind in Stilwell’s analysis is that the wealthiest ten people in 1982 held 25 per cent of the total wealth of the top hundred. In the period 1997-2003 the top ten held 39-41 per cent – although here too there has been some levelling off in the last decade.

<sup>32</sup> Sources: Cagetti 2005 and Klevmarken 2006.

<sup>33</sup> There is much debate about the link between trade with under-developed countries and inequality in developed countries. Some recent studies have found a strong positive association between LDC imports and income inequality (Volscho jr 2004) but there is no unanimity in the profession.

So market income inequalities are bound to rise. At the same time, the tax/transfer system may not be able to fully neutralise these market effects because of the perceived pressures of globalisation and competitiveness.<sup>34</sup> Already the tax structure is, if anything, becoming less progressive. The big increase in family payments in 2004 was a huge concession to low-income families with children but it did not help low-income single or childless households. Since then, tax cuts have been targeted mainly at middle to high-income earners.

So we can expect to see some increase in ‘final’ income inequality and this will affect future wealth inequality in itself. The effect will be compounded by inheritance patterns. Only ten per cent of all those receiving inheritances over \$100,000 go to people in the two lowest wealth quintiles. Almost half of such inheritances go to the richest wealth quintile and this trend is likely to further skew the distribution of wealth in the future (Kelly and Harding forthcoming). Demographic factors will be pushing in the same direction (Kelly 2002).

#### *Compatibility of current policy with substantive equality of opportunity (SEOP)*

There is a correlation between parental wealth and ease of access to rewarding things like education and health, housing, career enhancing jobs, credit and the ability to bear risk. As well, wealth equates with power – including ability to influence policies and institutions. High wealth concentration equates with unequal opportunity. It tends to be associated with lower levels of inter-generational social mobility.<sup>35</sup>

All this will not help Australia’s chances of achieving SEOP. That alone is not a decisive argument for wealth redistribution (as other considerations such as the economy and individual freedom need to be brought into the equation). But *prima facie* it justifies policy concern.

### **4.3 Welfare traps**

Studies abroad have found that children of income support recipients with low education have a higher probability of becoming themselves dependent on welfare. It is evident in the US and a recent NZ study found that the correlation coefficient between the welfare participation of parents and their offspring is somewhere between one-third to two-thirds (but probably closer to the lower limit), with about one quarter of this effect operating through the lower educational attainment of children reared in families receiving welfare benefits (Maloney *et al.* 2003).

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<sup>34</sup> I have argued elsewhere (e.g. Argy 2003) that globalisation requires much more social protection if it is to be sustainable in the long term. Brady (2005) examines the experience of various rich countries with poverty and finds although economic growth and employment variables have a significant influence, welfare policy has ‘a much larger influence’ and is ‘most important to explaining poverty in rich Western democracies’. I have also argued that well-designed social protection need not damage competitiveness. Similar arguments are put by Forster and Pearson 2000. But it is policy perceptions which count. The capacity of governments to redistribute will be more constrained than ever and this has significant implications for distribution outcomes.

<sup>35</sup> See Campbell *et al.* 2004; Argy 2003 p. 78; and *The Economist*, ‘Ever higher society, ever harder to ascend’ December 29, 2004.

### *Current situation*

A similar high correlation with parental welfare experience<sup>36</sup> is evident in Australian studies. The Commonwealth Department of Family and Community Services followed a large group of young people for a three year period from just before their sixteenth birthday (Pech and McCoull 1998 and 2001; Brown 2005; Blackham *et al.* 2002 and Tseng and Wilkins 2003). Two hypotheses were tested:

- young people whose parents receive income support will be more likely to be receiving income support themselves during their teenage years; and
- the probability of bad social outcomes will increase as the degree of parental disadvantage and income support dependence increases.

The study found ‘some support’ for both, with young people from welfare-dependent families very much more likely than average to leave school early, experience long term unemployment, have children by the age of nineteen, receive income support themselves and be classified as homeless. These outcomes increased with the degree of parental disadvantage.

In a media release (5 March 2001), the Minister for Family and Community Services pointed out that one in six people in households where parents were receiving income support were highly dependent on income support – compared with one in fifteen of the general population. The Minister concluded that ‘generations can be caught in welfare dependency’ and that ‘joblessness and income support dependence all too often passed from parents to their children’. Indigenous Australians are particularly disadvantaged in this respect.

A more recent follow-up study and review of literature (Brown 2005) also found support for the hypotheses that young people whose parents experienced disadvantage (such as low socio-economic status, under-employment, welfare dependency, poor education and motivation, and fractured and fractious relationships) were more likely to experience disadvantage themselves when aged 19 to 20 years. Again, the level of disadvantage was greatest for children of the most disadvantaged. This has been attributed in part to ‘imitation’ and ‘learning’ effects as well as poverty traps and educational gaps. More heartening is the evidence that even among children of the most disadvantaged parents, at least half do not appear to suffer from low workforce participation when aged 19 to 20. So it is possible to break free of welfare.

### *Future outlook*

In the long term, the slow-down in labour force growth stemming from demographic change may well facilitate the transfer from welfare to work. But this effect will not reach its zenith for another decade and more. In the meantime, the biggest impact will come from recent policy developments in the welfare and workplace areas (legislation passed in December 2005)?

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<sup>36</sup> High correlations suggest low inter-generational mobility and a low degree of equality of opportunity.

The aim of the new workplace reforms is to increase workforce participation by:

- diminishing the protective umbrella provided by awards (with many entitlements, such as penalty rates, casual loadings, redundancy pay, up for renegotiation);
- slowing the growth of the minimum wage;
- removing the ‘no disadvantage’ test (so an employer will not have to compensate employees who are worse off);
- stripping the unfair dismissals protection from two thirds of the work force;
- weakening the trade union movement;
- lessening the role of collective bargaining; and
- strengthening managerial prerogative.

The Government has said that the minimum wage will not fall in nominal terms but it can and will decline *relative to median earnings* (otherwise what is the point of creating a new wage-setting body?). And there is no doubt that employers will have increased industrial bargaining power (in regard to penalty rates, allowances, when and for how long people need to work, use of temporary workers and outsourcing etc.). So *over time*, differentials in pay and employment conditions will widen and the ranks of the working poor will be swelled.

The workplace reforms have been accompanied by tougher welfare rules to put more pressure on the jobless (the long term unemployed, single parents, partially disabled workers) to accept whatever employment is on offer. More welfare recipients will be pushed into Newstart, where their benefits will be lower, and they will have to take virtually any job offered to them as their benefits can be automatically cut off for eight weeks if they do not accept a reasonable offer or if they leave for a reason Centrelink deems unreasonable. They could be required to accept a job at the minimum wage even if that is below the award in that occupation.<sup>37</sup>

While the welfare reform package has some ‘carrots’ such as 84,000 new outside-school-hours childcare places to assist sole working parents, it relies heavily on the ‘stick’.

#### *Compatibility of current policy with SEOP*

Will the welfare and workplace reforms be successful in reducing welfare dependence and increasing income mobility? The arguments pull in both directions.

*On the positive side*, one could note three possible implications of the reforms. Firstly, the lessening of restrictions on hiring and firing can increase the rate of vacancy creation in higher status jobs, thus increasing the scope for upward mobility in one’s

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<sup>37</sup> See Karvelas in *The Australian* 10 November 2005 and Perry 2005.

early career. In addition, it can reduce total labour costs for many firms and make it more attractive to recruit low-paid workers. These effects are likely to be less significant in a country which is already lightly regulated such as Australia (as noted earlier). Still, many economists believe that the removal of constraints on dismissals will have some positive impact on employment, with the estimates ranging between 0.1 and 0.7 per cent (Freyens and Oslington 2005 and Harding 2005).

Secondly, the less generous social security system could discourage a culture of welfare dependence and encourage more active job search. There is fairly strong cross-country evidence of negative employment effects from generous unemployment benefits, for example, those that are open-ended in duration (Nicoletti and Scarpetta 2005 pp. 8-9). In Australia the impact on the 'active' unemployed (those required to search for jobs) will be blunted by the very tough work tests already in place which virtually preclude sustained 'bludging'.<sup>38</sup> There is no doubt however that the new reforms will affect the willingness to work of the 'inactive' jobless (single parents and disabled persons who until recently have not been required to look for work). Even in the latter case, one should not expect the welfare reforms to have too large an impact on labour supply.

On the evidence of surveys, three quarters or more of people on disability support pensions or parenting payments want to work and are hindered by lack of suitable jobs in keeping with their limited training and child care services rather than by a lack of desire to work (Argy 2005; Perry 2005 and ABS 6239.0 6 February 2006). Other factors than the social security system are much more important in explaining the long term increase in the proportion of working age Australians on welfare. These include: growing market inequalities (due to structural change, globalisation, skill-biased technological change and reduced social and economic intervention through regulation and industry policy), shifts in demography and social norms and an explosion in middle-class benefits (such as for home owners and self-funded seniors). Although there will be a greater element of compulsion on inactive people to actively seek work, the work disincentives will be at least as great under the new welfare arrangements. Clearly the tougher welfare regime will need to be associated with earned income credits and a heavier investment in training and job-creation if it is to have the full desired effect of encouraging the transition from welfare to work.

Thirdly, the workplace/welfare reforms might enhance mobility if they led to a lowering of minimum wages and other labour costs (penalty rates and allowances). This would facilitate recruitment at lower skill levels and encourage the use of flexible contracts which allow greater job mobility (Houte and DiPrete 2004). However because of the guarantee of no change in nominal wages and the gradual implementation of many of the changes, any effect from a slowing down in labour costs will be slow and gradual. Moreover the impact of lower wage costs on employment is difficult to predict. Many like Wooden (2005) and Leigh (2005), the Commonwealth Treasury and the IMF see a moderate to strong relationship. But others are more sceptical (OECD 1996: pp. 76, 94;

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<sup>38</sup> The reasons are discussed in Argy 2003 pp. 78ff. Although Brown (2005) does find some evidence of a dependency culture developing among some young unemployed, the big increase in social security spending relative to GDP over recent decades, has little to do with a growing cultural preference for welfare over work among the unemployed. A study by Sapir (2005) finds that variations in the employment rate across countries is affected much more by the strictness of employment protection than by variations in unemployment benefit generosity (p. 8).

OECD 2004b; Arjona 2001; Martin 1998 and 2004; Freeman 2005). In November 2005, a group of 151 Australian scholars expressed concerns about ‘the lack of supportive evidence’ on the employment effects.<sup>39</sup>

In short, there are many uncertainties about the three potentially positive impacts of the workplace and welfare reforms on employment rates. Intuitively, one would expect them to have little or no impact on productivity.<sup>40</sup> But they could well lead to some improvement in employment levels. As well they could improve the resilience of employment in the face of adverse shocks.<sup>41</sup> To that extent, the reforms may contribute to higher social mobility.

However the less generous levels of social security and employment protection are almost certain to have many *offsetting negative effects on mobility*: Six are noted here.

Firstly, opportunities for career planning will be lessened. Under a tough welfare regime, job seekers tend to take the first acceptable job they find instead of searching more extensively for a better one. Generous unemployment benefits allow displaced persons to make a more careful selection, thus reducing the risk that it will have damaging career consequences (Hout and DiPrete 2004, p. 24).

Secondly, although studies show that increases in education can improve wage and employment outcomes among the population, policies that put pressure on income assistance recipients to exit welfare and enter the work force (whatever the terms of employment) could well have adverse side effects on the willingness and ability of single parents to invest in their training and education (Riddell and Riddell 2005, p. 38). From the perspective of employers, it could also mean there is less pressure on them to train and upgrade the skills of employees whose current duties become redundant. Any reduction in the intensity of worker training would compound inter-generational ‘poverty’.<sup>42</sup>

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<sup>39</sup> Research Evidence about the effects of the Work Choices Bill. Submission to the Senate Inquiry into the Workplace Relations Amendment (Work Choices) Bill (November 2005).

<sup>40</sup> The present low level of regulation by international standards is not a serious impediment to workplace flexibility and international competitiveness – so the efficiency gains from further managerial flexibility will be small. And if you force marginal workers reluctantly into taking the first job available, it is likely to reduce average labour productivity, as the NZ experience shows. As well, the reforms (insecurity, AWAs, poor union access) could impact negatively on the morale, trust, commitment and team spirit of employed workers and hence on workplace harmony and efficiency (Argy 2005; Luttner *et al.* 2006). And the ceiling for exemption from unfair dismissals of 100 employees could create a disincentive to the growth of businesses under 100 – that is if the unfair dismissals regulation is viewed as a serious cost impediment, as employers claim.

<sup>41</sup> OECD cross-country analysis indicates that the stricter the employment protection regulation the less the resilience of the economy following adverse shocks (OECD 2005).

<sup>42</sup> As against this, the expected decline in trade union and industrial tribunal protection and associated increase in individual workplace agreements could put increased pressure on unskilled workers to acquire qualifications, skills, and bargaining power

Thirdly, as noted above, without further measures, the complex new welfare arrangements could, in many cases, worsen work disincentives and the ‘entrapment’ problem (especially for casual and part-time workers).<sup>43</sup>

Fourthly, while increased flexibility is the great promise offered by the new IR reforms announced by the Howard Government in 2005, unskilled workers in jobs with no individual bargaining power will have less flexibility and less choice (as to hours and conditions of work, protection from unfair dismissals, access to trade unions and so on). Studies have shown that workers who work non-standard hours (such as late shifts or weekends) tend to have less family time opportunity and if there are young children in the family, they often end up with more emotional and behavioural problems (Heckman 2006 and studies cited by Creed 2006) – thus increasing the risk of inter-generational transmission of low-paid jobs and income poverty.

Fifthly, while lower joblessness might reduce the dependency of working age Australians on social security, many of the people moving out of welfare are likely to end up in low-paid casual jobs and their earnings will be low and tend to decline relative to median earnings. As a result, there will be a greater number of ‘working poor’ qualifying for income-support assistance such as family benefits, parenting payments and disability support pensions.

Finally, and most fundamentally, the easy route of clawing back welfare and employment protection is likely to discourage governments from considering alternative ‘active’ ways of enhancing joblessness – ways which ultimately have the most positive effects on social mobility (see discussion in section 5).

It might be possible to compensate low-paid workers fiscally (through the tax and welfare system) for the effects of the workplace and welfare reforms. But many economists would question the practicability and fairness of using deregulation with fiscal compensation as the principal strategy against joblessness. There would need to be big unit labour cost cuts to achieve the kind of employment impact on the million or so jobless Australians (allowing for the under-employed and discouraged workers) so the fiscal compensation required would be huge and put extra strains on both the tax and welfare systems at the very time when influential commentators are urging governments to reduce both tax levels and welfare dependence. How long could governments sustain such a strategy? And what would happen to the self-esteem and dignity of low-paid workers and their incentive to work if they had to give up wages for welfare?

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<sup>43</sup> In fact there will be a two-tiered system of welfare for people with disabilities and single parents. *Current* recipients have been quarantined from the new measures. Existing disability pensioners will have no activity test applied and no change in benefits. Single parents now on parental benefits will have to face new activity tests when their child turns 8 but will retain their parenting payments. These two groups of welfare recipients will presumably continue to have their payments indexed to average weekly earnings whereas minimum wage rates will almost certainly decline relative to average earnings. So for them the incentive to work will be reduced.

On the other hand, new applicants (e.g. people who acquire a disability or separate from partners) will receive Newstart benefits which are lower and more tightly means tested than the disability or parenting payments. It has been estimated by NATSEM that people would make very low financial gains moving from welfare to work because tougher income tests and higher tax rates (Peatling 2005; Steketee 2005; Wooden 2005, pp. 87-8). As well, deregulation of the labour market will lead to more irregular hours and work-family stresses which would discourage mothers from working

Furthermore, while fiscal measures can in theory compensate for wage inequalities, they cannot effectively address workers' quality of life and empowerment – especially their control of how and when they work.

Four conclusions flow from the above discussion:

- the present high level of inter-generational welfare dependence is incompatible with a society genuinely committed to substantive equality of opportunity as a high priority national goal;
- while demographic factors may allow the welfare dependence problem to gradually resolve itself over the long term, the current policy strategy of seeking to reduce levels of social protection is unlikely to do much if at all to reduce overall welfare dependence in the near term<sup>44</sup>; poverty traps will continue but in a different form;
- the social costs of recent hard-line reforms can be partially alleviated by passive fiscal compensation, but this alone will do nothing to alter the fundamental inequalities in the labour market;
- to achieve a sustained reduction in welfare dependence, labour market reform needs to be backed by more active social intervention.

#### **4.4 Employment barriers**

##### *Current situation*

There are many positives in the present employment situation. The official unemployment rate is at the lowest level since the early 1970s; long term unemployment (as a percentage of the labour force) and the average duration of unemployment have both been falling since the early 1990s; and labour participation rates for women have been steadily rising for some time. Moreover Australian workers appear to have a higher average level of job satisfaction than their counterparts in the US, UK, and NZ (Levine and Morgan 2004).

However, employment opportunities continue to be unevenly distributed across households and regions. People with the same skills and aptitudes have different job opportunities, because of location, age or other barriers, and people with low skills face a much more difficult job market than the skilled and professionals.

The first barrier to employment is the chronic under-supply of suitable unskilled jobs (at existing relative minimum wage rates). Between 1990 and 2003, while total employment expanded 18 per cent, jobs requiring no qualifications only grew by four per cent. Jobs requiring trade qualifications grew eight per cent and jobs requiring

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<sup>44</sup> It is worth adding that the losers are likely to be the 1 to 2 million workers who are earning low wages and have high marginal utilities from each dollar foregone while the winners are likely to be skilled, professional and managerial employees and share-owners, all of whom have low marginal utilities for each dollar gained.

tertiary qualifications increased 100 per cent and accounted for seven out of ten new jobs created since 1990.<sup>45</sup> The relative decline in demand for low-skilled workers reflects the skill-intensive bias of technological change, such as computerisation, which has reduced the marginal productivity of the low-skill worker. It also reflects the effects of globalization (greater competition from low wage countries) and the relative contraction of industries, such as the public sector, which directly employ unskilled people.

The unskilled workers that are most at risk of unemployment are:<sup>46</sup>

- teenagers that are low-educated or unskilled and neither in full time study nor full time work; their incidence rate has not changed much since the recession of the early 1990s despite rapid employment growth and falling unemployment at the national level;<sup>47</sup>
- indigenous Australians, who have an unemployment rate of 20.3 per cent and a much greater likelihood of working part-time or being under-employed;
- single parents, with an official unemployment rate of 12 per cent; and
- migrants, especially those who are newly arrived and come from non-English speaking countries – notably from North Africa, the Middle East and Vietnam, with official unemployment rates ranging from 11 per cent to 13 per cent and a propensity to long duration and under-employment.

The mismatch in the market for unskilled labour is not just evident among the formal unemployed. There is much ‘hidden unemployment’ of unskilled workers which is not accounted for in the official data. It takes the form of under-employed and discouraged workers. Total ‘joblessness’ (a concept which allows for both types of hidden unemployment) is nearly twice the official (headline) unemployment. While the overall jobless rate has declined, it has declined less than the headline unemployment rate over the last two decades (Argy 2005). The proportion of dependent children (aged under 15) living in ‘no job’ households increased in the decade after 1990 from 13 to 16 per cent and in 2002 the proportion was very high relative to other countries (Dickens 2002). In recent years this trend has been slightly reversed, but many of the former jobless have remained under-employed – which is why ‘22 per cent of children under 15 are currently living in families with very low incomes’ (AIHW 2005).

The unskilled market is increasingly being made up of casual and part-time workers (up from 22 per cent of the work force in 1993 to 26 per cent in 2003), most of them wanting to work longer hours. Our temporary employment and under-employment rates are very high by OECD standards.<sup>48</sup> Relative to other employees, low-skill casual

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<sup>45</sup> AMP/NATSEM Income and Wealth Report Issue 12, November 2005 (‘May the labour force be with you’), NATSEM.

<sup>46</sup> The figures cited are from a Research Note by Tony Kryger in a paper put out by Department of Parliamentary Services 31 October 2005.

<sup>47</sup> Dusseldorp Skills Forum (Long and DSF 2005)

<sup>48</sup> Persons working part-time make up some 27 per cent of total employment in Australia compared with an OECD mean of 19 per cent. Only The Netherlands has a higher ratio (Tiffen and Gittins 2004, p. 78).

and contract workers have more insecure jobs, more unpredictable hours, greater difficulties getting a bank loan and are also less likely to receive in-house training. They are typically working in service industries (such as hospitality and retail) and in firms which are less unionised and offer very limited career paths or scope for upward wage mobility over time. They are at risk of being trapped in low-paid, dead-end jobs and a near-lifetime of poverty and insecurity. The empirical literature finds clear evidence that among such workers there is ‘a strong persistence of low pay status’, especially in countries like the US and UK which have low employment and wage protection and education policy is poorly targeted (Richardson 2003 29ff and 61ff). Elisabeth Wynhausen’s agonising personal experience working undercover as a kitchen hand, checkout chick and office cleaner (Wynhausen 2005) tells it all. The pressures on low-paid, casual Australian workers seem likely to intensify under the new workplace and welfare laws.

Over the last few decades, the Australian policy norm has shifted gradually from one which implicitly guaranteed good jobs for everyone able and willing to work to one which forces people to work whatever the quality of the job, its precariousness, pay and conditions.

A second barrier to job mobility is the uneven spatial distribution of employment opportunities. A recent study of all adults aged 15 years and over (NATSEM/AMP 2004, p. 7) found that 48 per cent of those living in the bottom 10 per cent of postcodes are out of the labour force – but in the top 10 per cent of postcodes only 30 per cent are out of the labour force. The worst affected postcodes are in vulnerable manufacturing regions and urban fringes. This locational disparity is compounded by the inadequacy of public transport in job-poor outer suburbs and the high housing costs in job-rich areas. The lack of affordable child-care in some areas is a further hindrance to employment of some jobless mothers, with an estimated 250,000 women not in the work force because they are unable to find a place.<sup>49</sup> The spatial employment ‘gap’ has been widening on a trend basis since the 1970s. Although for a period recently there were signs of a closing unemployment gap between capital cities and regional areas (CoA, 2004, pp. 4-18), this progress seems to be evaporating.<sup>50</sup>

Long periods out of the work force compound the employment problem for many. The median duration of unemployment is now around 16 weeks – well down on the 26 weeks in 1998, but still above the 10 weeks that was common in the 1960s and 1970s.

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Of eighteen developed economies with comparable data, Australia is ranked first on the proportion of temporary employment (and) second on the proportion of part-time employment who would prefer full-time employment” (Andrew Leigh and Glenn Withers, “Social laboratory of the world”, *New Matilda* 25 January 2006). The under-employment phenomenon is discussed in Argy 2005. At the other end of the spectrum we have professional and managerial people living in households with ‘multiple jobs’ and working at least 50 hours per week – high relative to other OECD countries. An increasing proportion of the labour force is in ‘multiple jobs’ has increased from 50 to 52 per cent since 1990 (Lloyd, 2004) and a rising proportion of Australian workers is working at least 50 hours per week—which is high relative to most countries, especially Europe and Japan. Australian employees work on average 1855 hours each year, compared to the developed country average of 1643 (Tiffen and Gittins 2004, p. 82).

<sup>49</sup> ABS finding reported in *Sydney Morning Herald* editorial, 2006.

<sup>50</sup> In Victoria and NSW the disparity in unemployment rates seems to have widened again in the last few years. Areas like central-west Sydney and Melbourne’s industrial northwest have experienced a big rise in unemployment at a time when the national average has been falling.

And, although the long term unemployed represent a lower ratio of the work force than in the 1980s, they account for a slightly higher proportion – about 23 per cent – of the total unemployed.<sup>51</sup> Job seekers are taking longer to fit into jobs. This is a special problem with the mature age jobless.<sup>52</sup>

Long-term joblessness can have sustained income-earning effects, often extending to one's lifetime. One study (Gregg and Tominey 2004) finds that repeated or long-period youth unemployment has self-reinforcing effects on employability and imposes a wage penalty of between 12 and 15 per cent at age 42, after controlling for education, region, residence and other family characteristics. Similar arguments apply to under-employment. Moreover the long-term jobless are particularly unhappy people<sup>53</sup> – more so than can be explained simply by the loss of income they suffer by not having a job. They suffer trauma, stress, loss of self-esteem, poorer health, family breakdown and increasing risk of suicide and crime. There is evidence of employer discrimination against many of them (Cartwright 2004).

The people most vulnerable to long term joblessness or under-employment are the over 50 year olds, sole parents, indigenous Australians, people with disabilities and older migrants with English as a second language.<sup>54</sup>

#### *Future outlook*

Will employment inequalities improve in the future? Leaving aside normal economic fluctuations, the answer will depend on demography and policy responses.

Demographic changes should help strengthen the job situation for unskilled workers generally. The ageing of the population – which will halve the number of workers per retired person and reduce the ratio of employment to population from 48 per cent now to 43 per cent in 2050 – is likely eventually to generate severe labour shortages. This should in turn induce employers to adopt a more positive attitude to recruitment and training and to become more accommodating towards people of mature age, unskilled workers with poor English, people with disabilities and parents requiring flexible hours. Moreover marginally attached older workers will be more eager to work because they will be healthier and have a longer life expectancy and possibly because the returns on their retirement savings will be lower.<sup>55</sup>

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<sup>51</sup> See Argy 2005. Note also that 59 per cent of today's unemployment benefit recipients have been on some form of unemployment allowance for more than one year.

<sup>52</sup> The long term unemployed 'considered too old by employers' have a median duration of unemployment of 39 weeks compared with 12 weeks for all unemployed people (ABS 2005).

<sup>53</sup> Frey 2004; Gittins 2004; Wilkins 2004; Carroll 2005 and Ganley 2004. Indeed 'joblessness appears to be the most important economic driver of unhappiness' (Andrew Leigh, 2005b, *Imagining Australia* blog 13 August 2005).

<sup>54</sup> The word 'older' migrants is used because for some years now Australian immigration has been (apart from a small humanitarian program) largely based on skill and ability to integrate economically whereas the old system was more heavily slanted towards family reunification. So the more recent inflow of Australian immigrants had a low percentage of low-educated compared both with the past and with other countries like US and Canada (Kabrelyan 2000).

<sup>55</sup> With slower growth rates, investment rates (which are a function of the rate of increase in GDP) should decline more than rates of saving (which are related to levels of GDP), forcing down real interest rates. As well, labour will be able to demand a higher share of the national cake relative to profits. So both

But such ‘market-based’ adjustments will occur slowly and not reach their peak for at least another ten years. In the meantime the policy response will be critical.

### *Compatibility of policy with SEOP*

Existing employment and training inequalities pose a real risk that many low-paid unskilled workers will experience chronic under-employment or low-pay – locking themselves into poverty and insecurity for long periods.

Child care arrangements will have an important bearing on future work decisions of many ‘inactive’ mothers. These arrangements have been receiving increasing policy attention. The means-tested child-care benefit is proving well targeted but the proposed 30 per cent child-care tax rebate is not. The rising cost of child care and commercialization of the sector could combine with the policy framework to create a two-tier system, one for the rich and one for the poor.

Another problem is that, while there has certainly been a large and growing investment in the job matching and intensive support activities of Jobs Network and more recently a revived policy interest in vocational training, the availability of jobs, training and retraining for low-skilled school leavers and workers is deficient relative to need (the training issue is discussed in the next section).

It is not clear what impact of Howard Government’s workplace and welfare measures will have. They might improve the job opportunities for low-productivity workers but only by creating wider earnings differentials, thus creating a bigger starting hurdle from which to advance, and reducing workers’ control over their working hours and conditions. Earlier we expressed the view that the net effect of such a strategy on the income mobility of young people from disadvantaged homes is at least as likely to be negative as positive.

A more competitive labour market, unlike a more competitive product market, is not necessarily more ‘economically efficient’ because:

- most unskilled employees do not have a range of employers to choose from;
- in general, employers (large or small) have an advantage over most of their employees, especially those who lack individual bargaining power, so there is no genuine level playing field between parties to the transactions; and
- there are economic adjustment costs associated with the transition to a more competitive labour market which need to be weighed against any longer term benefits.

Nor, as argued in section 4.3, does a more competitive labour market necessarily improve income mobility. The answer is not to back away from labour market reform (which is necessary up to a point in a global market place which has changed in fundamental ways since the 1970s) but to link it with other more social sensitive ways

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interest and dividend returns on retirement savings could well be lower. However all this is highly speculative.

of reducing the jobless rate – such as improved tax/social security work incentives for the inactive jobless, increased investment in selective employment-generating programs, temporary, targeted employer subsidies and improved lifelong learning and training facilities (the subject of the next section). Such a hard/soft mix of policies would achieve the dual objective of generating jobs and enhancing equality of opportunity, whereas a policy which relied predominantly on an up-front attack on trade unions, the minimum wage, employment protection regulation and welfare availability would achieve one of these objectives but fail the other.<sup>56</sup>

#### 4.5 Education barriers

The importance of education to upward income mobility cannot be over-estimated. In most countries, education credentials are a major determinant of work prospects (Marks 1999; Hout 2003; Ng 2004) and a failed school to work transition is an important risk factor in terms of propensity to long-term unemployment (Spierings 2002).

##### *Current situation*

On most international benchmarks, Australia has average to high education standards and our better schools are world class in terms of literacy and numeracy standards.<sup>57</sup> Further, the great educational expansion in Australia over the last thirty years, reflected in rising retention and participation rates (AIHW 2005, pp. 102-4) has made education more accessible to young people from low-income families, allowing them to rise to higher occupational ranks than their parents. It has also reduced the gender gap: women no longer suffer from an educational disadvantage.

But there remains considerable education inequality between socio-economic groups.

In 2003, estimated completion rates for students from low and medium socioeconomic backgrounds were 16 percentage points and 12 percentage points respectively below those for students from a high socioeconomic background. Retention rates are also considerably higher in metropolitan than in provincial and remote areas (Productivity Commission 2005, pp. 3.40-3.42). A 2004 study of Victorian and NSW early school leavers found that 25 per cent of them came from just five per cent of postcodes (Scutella and Smyth 2005, p. 20). Low education capability is persistent, with all those who lacked adequate education or work experience in 2001 continuing to do so for all three years (Headey 2005, p. 27).

The socio-economic spread of education performance is particularly great in Australia, with the poorest performing students doing worst than the poorest performing students

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<sup>56</sup> Andrew Leigh (2006, p. 7) points out that more of the rise in employment over the 1990's was due to carrots such as the Earned Income Tax Credit (EITC) than sticks such as time limits on welfare receipt. 'If you want to be successful, an EITC should be part of the solution'.

<sup>57</sup> The OECD assesses 40 countries on skills in mathematics, science and reading. On its findings, Australian 15 year olds are among the best while year 4 and 8 are about average. A *Sun-Herald* editorial ("No clear finishing line", 29 January 2006) reports a recent OECD finding that NSW schoolchildren rank second only to those of Finland in terms of literacy. A more critical view of Australian education standards can be found in Kevin Donnelly's writings (e.g. *The Australian* 25 November 2005) and in Andrew Leigh's papers.

of the high-ranking countries. The distribution of literacy is also wide compared with most European and Scandinavian countries although less than in the UK and US. Yet ‘literacy and numeracy have a huge impact on employment status and income’ (Headey 2005, p. 28). Australia has one of the strongest relationships between reading ability and social background among OECD countries and is classed, along with Britain, as ‘one of the least equitable countries on this score’ (OECD Education at a glance 2001 Table F3-1). The OECD, in a policy brief on education (Education and Equity, *OECD Observer*, February 2004), puts Australia in the high-quality-low-equity box, comparing it adversely with high-quality-high-equity countries like Canada, Finland, Sweden, Japan and Ireland. The OECD has also found that students’ socioeconomic background is a more reliable predictor of achievement in Australia than in other parts of the developed world (*The Age* editorial 2005b). Significantly for the future, the ‘digital divide’ is particularly great in Australia – see later discussion.<sup>58</sup>

Some of the key education barriers in Australia are outlined below.

### *Early childhood education*

Although some state governments (e.g. Victoria) help low income families with their kindergarten costs, pre-schooling remains unaffordable or inaccessible to many<sup>59</sup>. Between one-half and one-third of four-year olds do not attend preschool in the year prior to school, with children from low income households and those living in regional and remote areas more likely to be missing out on preschool education (Flood 2004).<sup>60</sup> Participation in preschool programs in Australia is very low compared with other OECD nations (Scutella and Smyth 2005 p. 16-8) and so too is total public expenditure for pre-school education relative to GDP (Flood 2004, p. 19). With public preschools facing long waiting lists, private entrepreneurs have taken the opportunity to fill the gap for those who can afford the fees – but many cannot afford to use these services. A two-tier system is developing.

Yet we know that early childhood education and care contribute greatly to children’s emotional and cognitive development, economic well-being and health and that those who go through preschools perform better at secondary school (Scutella and Smyth 2005 p. 17 and Flood 2004, pp. 31-32) and in adult training.<sup>61</sup> Cognitive and non-cognitive deficiencies emerge between ages four and nine. Children who attend high quality pre-school programs do better in school and life than children who do not have this opportunity and social exclusion is lessened when governments intervene early to

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<sup>58</sup> The evidence is clear that children of low-income households, especially where parents are unemployed or underemployed, face an acute educational disadvantage. Dr. Richard Teese (2000) has shown that the greater education success of rich children and young people is in good part based on class advantage.

<sup>59</sup> A survey in Victoria found widespread evidence that families in Victoria were not sending their children to non-compulsory pre-schooling because they could not afford the fees (Rood 2005).

<sup>60</sup> Data based on the ABS’s last national child-care survey in 2002 shows that only one in five children from low income families in Sydney attended long-day-care centres or preschool (Horin 2006a).

<sup>61</sup> Training programs for the long term unemployed tend to have a relatively low benefit-cost rating (Andrew Leigh, ‘Experiment now and save society’, *Sydney Morning Herald*, 15 February 2006) – but this is mainly because of their early parental upbringing. If more were spent on childhood programs, including pre-schooling and home visits, the economic returns from adult training later in life would rise considerably.

expose children to pre-school programs (Byneer 2001, p. 16).<sup>62</sup> It is not surprising to find for example that of 16,000 Australian children examined in their first year at school, 22 per cent were ‘developmentally at risk’ in areas such as physical health, social competence, emotional maturity and communications skills (Gooch 2005). These children are also most likely to show up later with low literacy and numeracy skills. Narrowing the gap between the child-care stage and the first year of compulsory education by targeting disadvantaged children would yield benefits not only to the children but to society at large (through lower welfare dependence and crime and higher national productivity). Fortunately governments are becoming increasingly aware of this and this is being reflected in new but still tentative policy initiatives.<sup>63</sup>

### *Secondary education*

In the area of secondary public schooling, we are seeing another great divide. On standard retention and performance benchmarks, the gap between students from low socio-economic backgrounds and other students has been either stable or tending to widen (Teese 2000 and Argy 2003, p. 24). Students attending schools with high concentrations of students from low socio-economic groups are achieving relatively low scores (in both reading and mathematics) and their scores are deteriorating relative to those of students in other schools. That is, the school-level influence has been tending to increase, although this is not true of the gap at an individual level (Penman 2004 and ACER Media release 5 February 2003). Indigenous children are the most affected, with year 10 retention rates 11.3 percentage points lower than the national rate and also disadvantaged in terms of access to vocational education participation (Productivity Commission 2005, pp. 3.21-3.22 and pp. 4.13-4.16).

Educational inequality is not just a ‘rich-poor’ problem. There are also geographical inequalities between young people within urban Australia and between urban and rural/remote young people. Country students are less likely to finish school and perform more poorly than urban students and they have a more restricted choice of subjects (HREOC 2000). Education performances are also relatively low in almost all outer suburbs of Melbourne because of the more limited choice of schools available (Argy 2003, p. 22).

And the forces driving education inequality are strengthening. We are seeing a mushrooming of non-government schools and growing academic segregation in Australian schools. The total government (federal and state) subsidy per student is growing at a faster rate for non-government than for government schools (Productivity Commission 2006, B3) and parents are stepping up their investment in private schooling. As a result, we are seeing a widening gap between the total education resources (public and private) deployed on rich children relative to poor children: total investment in schooling *per pupil* in independent schools has been ‘at much higher

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<sup>62</sup> There are risks in starting too early. Children who start to attend child care centres between age two and three, while they too may achieve positive gains in reading and maths skills, may also suffer from behavioural problems. Andrew Leigh web site *Imagining Australia*, 8 December 2005.

<sup>63</sup> The Prime Minister and Premiers recently acknowledged that confronting early disadvantage was generally far more effective than seeking the remedy to disadvantage later in life and agreed to seek reforms in this area (Colebatch 2006).

levels' and growing much faster than investment in public schools.<sup>64</sup> Even within the public school system, those in middle class areas have much better access to parental and local donations than those in low-income areas.

True, State Government allocations to individual schools take account of relative disadvantage, so low-income students benefit most from means tested education spending – but this is being done on a modest and in some cases decreasing scale. An independent report in NSW (by Professor Vinson) paints a picture of 'a school system under increasing financial and social pressure' (*Sydney Morning Herald* editorial 2006) at the same time as resources available to non-government schools have become relatively more plentiful.

There is also a physical deterioration occurring. In NSW there are first hand reports of dilapidated toilet blocks, poor building maintenance, poor working conditions for teachers and a standard of design ill-suited to an era of personalised learning and changing technology (Conde 2005).<sup>65</sup> The position is as bad or worse in Victoria. A review of Victorian schools by the former dean of education at Melbourne University, finds that 'the overall state of facilities in Victorian government schools is deplorable' – being 'the worst among those in developed nations' (Caldwell 2005). The Editorial in the same paper warns that 'physical resources do make a difference to the perception the public has about the value placed on schooling. Our current school buildings are sending the wrong messages' (*The Age* editorial 2005c). A massive injection of capital into public schools is needed.

In the increasingly intense competition between public and private schools, there is a vicious circle at work. First, as consequence of the growing exodus of 'better' students from comprehensive public schools to selective schools and private schools, the comprehensive public schools are finding themselves with an increasing proportion of low-income and 'slow-learning' students. As the exodus continues, these schools will become less appealing to middle class parents, further accelerating the exodus. The problem could be further compounded if attempts are made to link teacher pays to performance and the latter is narrowly assessed without allowing for the special problems teachers face with disadvantaged students.

Secondly, and related to the first point, the exodus of students from public schools inflates their unit cost per student, as disadvantaged young people are relatively costly to educate and the exodus reduces the economies of scale available to these schools. Ironically, this then tends to increase the subsidies to private schools, as they are based on the public system's cost per student, even though their economies of scale are improving due to the reverse movement of students (Gittins 2005).

There is a third sense in which a vicious circle is at work in the competition between public and private schools. Private schools which receive government funding have been increasing fees each year at double the inflation rate. Since these schools are not allowed to skim off profits, they have ploughed the additional money into hiring the

<sup>64</sup> Professor Richard Teese Media Release 1 December 2004a.

<sup>65</sup> Sara Conde refers to non-matching chairs, teachers' desks falling apart, tatty textbooks and toilets that have not been updated since the 1970s and 'are just one step above what you'd find at a public park'. Assembly halls are a rarity.

best teachers and upgrading facilities. ‘As fees rise, so too does the gap widen between elite private schools and the rest’ (*Sydney Morning Herald* editorial 2006).

With the public school system under increasing and self-reinforcing financial, social and physical pressure, it is not surprising that in recent years Year 12 completion rates have been falling in low-income suburbs, and are currently below 60 per cent – whereas completion rates have been increasing in high income suburbs and are currently at 79 per cent (Productivity Commission 2006, B.3). The big educational divide seems set to widen further in the future.

One small positive development (not without risks) is that parents, especially in Victoria, are being given a greater choice of public schools within a region, rather than just one school on the basis of where one lives. Another is the cooperative government plan to test all five year olds for basic reading skills and to set higher literacy standards.

### *The ‘digital divide’*

Children and youth living in low socio-economic homes have less access to information and communication technologies (ICT), especially if they live in outer urban and remote communities. Special concern is being expressed about the ‘great digital divide’ – the chasm in opportunities between those who have and those who do not have access to the internet and related computer-based information technologies. Some 18 per cent of Australian children, predominantly from low-income families, do not have access to a computer at home (Scutella and Smyth 2005, p. 20) Low achievers (those with low literacy scores) have much less access to computers and the internet (either in the school or at home) than high achievers and the access gap is wide in Australia relative to most other countries – yet the low achievers have no less interest in computers (Sweet and Meates 2004, pp.16, 21, 23). With the development and spread of digital connectedness based on faster broadband technology, the regional digital divide may intensify in the future because this new technology works beautifully in Sydney suburbs, but not Brewarinna.

If the ICT performance of the lowest achievers (those scoring at level 1 or below on the combined reading literacy scale) can be enhanced, there would be positive economic as well as social returns because of ‘the important role that ICT skills play in providing access to good jobs in modern economies’ and because ‘ICT can be used as a tool to improve learning skills and the motivation to learn of low achieving students’ (Sweet and Meates 2004, p. 13).

### *Tertiary education*

The Commonwealth’s contribution to the nation’s *universities* has been steadily declining since 1996-7 from 54 per cent of total funding to 41 per cent in 2004. This has been associated with an explosion in both student fees and in the number of fee-paying students. While HECS has generally contributed to wider participation, the rising costs of university education are making it harder for children of poorer families to enrol at tertiary level.<sup>66</sup> More than one third of students will soon be able to buy places with a

<sup>66</sup> The recent increases in Higher Education Contributions Scheme (HECS) could be acting as a deterrent but it is not clear by how much. The introduction of HECS in 1989 was associated with increases in the

lower entry-score than HECS students. This is creating two classes of university student – those able to buy a place and those who have got there on merit. Overall applications for entry to public Universities have recently been falling<sup>67</sup> while at the same time full-fee enrolments in private universities have been rising markedly.

A recent report by the Centre for Population and Urban Research (reported in Leung 2005) finds that fewer than 20 per cent of year 12 students went to independent schools in 2003, yet they received about one-third of all university offers – up more than four percentage points from 2000.<sup>68</sup> The study notes that ‘the government sector is no longer serving as a ladder of educational opportunity for aspiring students from low socioeconomic areas’.

As well, there is evidence indicating that low incomes and the stress of combining studies with long hours of paid work seriously hamper the education efforts of poorer Australian university students.<sup>69</sup>

### *Vocational education and training*

For some time, we have been seeing a trend decline in levels of participation in vocational education and training (VET) by some disadvantaged social groups. Young people who miss out on VET tend to have a history of parental unemployment, come from non-English-speaking backgrounds and live in rural and remote communities.

Declining participation has been a consequence of deliberate decisions by employers in the public and private sectors to invest less in in-house training – whether due to outsourcing, fiscal stringency or an increasing focus on short term financial performance in a more competitive market. Privatisation of VET has improved choice, diversity and responsiveness but has had negative effects on access and equity (Anderson 2006). Low apprentice wages may also have deterred able applicants and the attrition rate is high (Toner 2005). At the same time, hours of training have been tending to decline with the replacement of apprenticeships by short term traineeships.

There are now signs of progress. The number of school students participating in vocational education and training is rising markedly, employers have stepped up their intake of apprentices (Gittins 2006) and the Howard Government is substantially increasing its spending on vocational education and apprenticeships. Already, the situation in terms of institutional availability and apprenticeship uptake is starting to improve (Considine *et al.* 2005).<sup>70</sup> The federal policy agenda is partly ideology-driven (it is favouring private sector projects where unions are weak and insufficient effort is being made to cooperate with State governments). Even so, VET looks like faring better in terms of access and equity than the university sector.

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participation of prospective students from relatively poor families, but the absolute increases were higher for relatively advantaged students (See Chapman and Ryan 2002, p. 13).

<sup>67</sup> This may be partly because of the strong labour market and the shift to more vocational training.

<sup>68</sup> This reflects differences in application rather than in the ratio of offers to applications: ‘the great majority of students who received a TAFE offer did not apply for university because they did not have the required score’.

<sup>69</sup> Papers by the Australian Catholic University and by the Vice Chancellors Committee (reported by Lawnham in *The Australian Education Supplement* 17 April 2002) forcefully bring this out.

<sup>70</sup> Dusseldorp Skills Forum (Long and DSF 2005)

### *Compatibility of current policy with SEOP*

It is evident from the above that, while we are lifting the education level of disadvantaged students – that is, widening their participation in higher secondary and tertiary education – we are not closing or reducing the gap in educational attainment between students with similar capabilities, whether due to socioeconomic circumstances or geography. ACER longitudinal studies confirm that education success rates at school and post-school, especially in the transition from elementary to high school, are in good part being determined by social class origin – in particular by parents' wealth, occupation, status, education and aspirations (Marks 1999 and Penman 2004).<sup>71</sup> Educational inequality then flows on to employment inequality: school achievement in literacy and numeracy is the single main consistent factor related to being unemployed for three months or more (Penman 2004). The playing field is becoming more tilted.

What we have here is a form of structural market failure. The education market, left to its own devices, works very poorly. Under-spending on education occurs because, with limited knowledge on the future skills that will be required and their portability, individuals generally are constrained by uncertainties about longer term income returns from additional education.

Then there are financial constraints on the ability of low-income youth to further their education, due to lower parental spending and borrowing power and poorer social environment (as outlined above). The evidence shows that the greater the inequality of family incomes and wealth, the greater the dispersion of education outcomes (both in quantity and quality of teaching, aids and facilities).<sup>72</sup> Furthermore, children of rich parents live in areas offering better choice of and access to education, go to schools with better facilities and teachers, on average study in better home conditions, mix with more academically inclined peers (which they are encouraged to emulate), have more books at home and better access to superior social networks, and are better informed about

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<sup>71</sup> One would expect to see some correlation between social origin (such as occupational status and educational level and income of parents) and educational attainment because people inherit genes (innate ability), values and knowledge from their parents as well as attitudes such as the weight and value given to education, relative aspirations and so on (Breen 2004). But how much is 'natural'? Many scholars in this field have found that when parents' occupations are ranked on the basis of both their income and their education (as a kind of joint socio-economic indicator), it becomes a better predictor of a child's success than earnings alone. This is because parents in occupations with high educational requirements are able to transmit their cognitive and social skills to their children better than, say, financially successful but poorly educated entrepreneurs. It is impractical to assume that all children can be equal achievers if given the same opportunities in their early years. The best one can hope for is to ensure the opportunities they get are not dependent on parental income and location.

<sup>72</sup> A recent study found that increased economic inequality significantly increases the inequality of schooling attainments (Campbell *et al.* 2004). In the USA, after two decades of rising income and wealth inequality, the standard deviation in educational outcomes has increased significantly – an outcome that theory and empirical studies could have predicted (see Campbell *et al.* 2004). Even in countries where income and wealth inequality is not increasing much, such as Australia, education outcomes can become more unequal because of a deliberate and systematic policy of reducing the access of public schools to funds relative to private schools. As those at the bottom of educational attainment fall further from the mean, there is a relative loss of human capital among those who have the least of it. The credit constraint is most marked for young people aged 16 and over contemplating higher education. And there is evidence that in some countries such as the UK and US this constraint has been growing in importance.

potential job opportunities and the relationship between education and job prospects (Anderberg and Andersson 2002, p. 4).

A further market distortion arises in the area of training. Employers have a disincentive to train their own staff because of the risk of poaching; low-paid employees in particular tend to work in firms which do not provide training. This too can lead to under-spending on education relative to the optimal, preventing many from making their fullest potential contribution to the economy.

In the face of these market distortions, policy has a crucial role to play in levelling education opportunities. As noted earlier in this paper, US educational inequality has increased due to relatively low expenditure on targeted public education programs and this has been blamed for the relative decline in US social mobility in recent decades.<sup>73</sup> There is also evidence suggesting that low and falling social mobility in the UK is due to the poor quality of the state secondary education system. On the other hand lower levels of inequality and good education policies in countries such as the Netherlands, Sweden, Norway and Singapore have allowed them to increase mobility and to outperform the US and England on the benchmark of education inequality.

Australian policy seems to be heading down the US route. There are some positive policy developments such as new programs to improve literacy skills for students deemed to fall below a national reading benchmark and greater access to vocational education. However, the new federal funding arrangements for public schooling are having perverse effects in terms of equalising education opportunities. So too are funding arrangements for some programs such as the Federal SES scheme and the Assistance for Isolated Children program. And State Government funding of both government and non-government schools is poorly targeted at need and their investment in special programs for disadvantaged public schools is pitifully low.<sup>74</sup> As well, there is a great unevenness in the quality and availability of pre-schooling (so crucial to future educational development) across the country.<sup>75</sup>

Of course low investment and poor targeting are not the only problems affecting opportunities; teacher quality and curriculum deficiencies also need attention. But if governments want to make up for the failures of markets, they should put considerably more resources into educating disadvantaged students (from birth up). At the very least

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<sup>73</sup> The US 'has done less than most rich democracies' to reduce the impact of parental income on children's access to higher education; this undermines the claim that America has an unusually strong commitment to equal opportunity (Jencks and Tach 2005, p. 33). *The Economist* ('Now for the good news', 21 July 2005) observes that 'the growing gap between the educational performance of the rich and the poor, and between the majority and minorities, is arguably the biggest threat to America's traditional conception of itself as a meritocracy'.

<sup>74</sup> Professor Teese, in a paper entitled *Ending failure in our schools* (Teese 2004b) argues that State Government expenditures on disadvantaged children and young people remains both very small (relative to the total education budget) and ineffectively targeted. Victoria has taken a lead in helping disadvantaged schools and students with its recently announced increased allocation of funds to schools in poorer areas.

<sup>75</sup> 'Some States have a vibrant preschool program; in other states it's woeful'; and people are choosing long day care instead (report by Karvelas on the views of several Liberal backbenchers in *The Australian* 12 November 2005). The lack of a national approach to pre-schooling, unlike the situation with childcare, is seen as a key problem. Ministers say the issue is under review.

they should embrace the key goals set by the Productivity Commission (2005) – to ‘develop fully the talents and capacities of all students’ and seek to ensure that ‘the learning outcomes of educationally disadvantaged students improve, and over time, match those of other students’ (pp. 3.14-3.17).

Apart from equity considerations, improving educational mobility would yield many positive economic ‘externalities’ – an issue we discuss in sections 5 and 6.

#### 4.6 Health barriers

Australia has health institutions in place which should minimise inequality of access. Health standards are high, there is universal access to good health care for life-threatening conditions (except perhaps in some very remote regions) and social security recipients generally have good access to GPs, many of whom bulk bill. There are a few worrying national health problems: obesity and diabetes are becoming more prevalent and so is the incidence of asthma and mental illness. These are however more a product of social, working and environmental factors than of the health system *per se*. If one focuses on mean health outcomes in key areas like life expectancy and morbidity, Australia ranks high on most international comparisons (AIHW 2005) and the trend is generally positive.

##### *Current situation*

However, mean outcomes can conceal major inequalities – where people with the same need have different access to health services and are not being treated equally. This is true of Australia.

A recent report by the Australian Institute of Health and Welfare (AIHW 2005)<sup>76</sup> reported that in 2000-1 life expectancy at birth was 79.8 for males born in the least disadvantaged areas and 76.2 for males in the most disadvantaged areas, with similar discrepancies for females, and that mortality rates for manual workers (from cancer, pneumonia, stroke etc) were significantly higher than average, with higher mortality among manuals being ‘linked to socioeconomic status rather than specific jobs’. The AIHW also noted that over the period 1985-87 and 1998-2000, differences in death rates between the most and least disadvantaged generally increased for males from 65 per cent to 75 per cent for all causes, with females showing a similar pattern.<sup>77</sup> Several other studies also concluded that for many long-term conditions the health divide is widening.<sup>78</sup>

<sup>76</sup> Health Inequalities in Australia: mortality, Canberra, September 2004. See also AIHW 2005.

<sup>77</sup> However the gap in absolute death rates narrowed because of the general fall in death rates

<sup>78</sup> A report by the Royal Australasian College of Physicians (RACP) notes that ‘health inequities are growing not shrinking’. The RACP estimates that ‘about 7000 disadvantaged Australians a year die prematurely because of the growing inequities in health care’ (Cresswell 2005). Death rates from cancer and circulatory diseases among the least well off were worse in 1998-2000 than they were in 1985-87 and the gap had widened with the richest members of society. Data collected from ABS material by the Public Health Information Development Unit at the University of Adelaide found that ‘the difference between high and low socioeconomic backgrounds has increased for long term conditions such as asthma, bronchitis and emphysema’ (Robotham 2005a). Studies of the NSW health system similarly indicate that

Relative to other comparable countries, our health system rates moderately well overall on the criterion of equity but the record is patchy. A recent OECD study (Doorslaer *et al.* 2004) finds that with respect to GP utilisation and in-patient care utilisation, Australia, although not among the best, suffers from relatively little ‘standardised horizontal inequity’.<sup>79</sup> However horizontal inequity is more evident in Australia with respect to consultations of medical specialists and dentists, where the distribution of care is more pro-rich by comparison with many other countries. The main sources of this distributional inequality are income and regional disparities and the advantage conferred by health insurance (in buying better access to private hospitals, medical specialists and dentists).

An international survey by the New York-based Commonwealth Fund found that while a relatively high proportion of Australians are relatively satisfied with their health services, cost barriers to treatment are a more common problem here than in many other comparable countries (with 35 per cent going without needed care due to costs in Australia compared with 17 per cent in Britain and 26 per cent in Canada – report in Robotham 2005b).

We describe briefly below ten of the specific sources of health inequality in Australia that act as barriers to upward income mobility.

#### *Unequal access to bulk billing medical centres*

While those on welfare have access to bulk billing, many low-income working families without concession cards and living in areas where there is limited bulk billing (as in some outer suburbs and towns)<sup>80</sup> are faced with co-payments of up to \$15 for every GP visit. This makes them more reluctant to seek medical attention. And when bulk billed, they are less free to choose their preferred GP and more likely to receive shorter time at the GP’s practice than full-paying patients (Argy 2003, p. 32).

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the relative gap is widening for some important health indices: in a letter to *Medical Journal of Australia*, John Furler, Elizabeth Harris, Don Nubbeam and Mark Harris, MJA 2004; 181 (10) note that between 1980 and 2000, the percentage difference in premature death rates (under 70 years of age) between high and low socioeconomic groups has increased for males from 30 per cent to 52 per cent and from 24 per cent to 32 per cent for women. Mark Whiteside, School of Population Health, University of Queensland, writes of ‘a widening gap between rich and poor and therefore endemic and worsening health inequalities’ (Whiteside 2005).

<sup>79</sup> The goal of horizontal equity is satisfied when people in equal need of care are treated equally, irrespective of characteristics such as income, place of residence, race etc. The OECD study’s approach is to compare the actual observed distribution of medical care by income with the distribution of need. The ‘standardised’ horizontal inequity index allows for the greater need (poorer health status) of different socio-economic groups (the poor suffer from health problems more frequently but also with greater severity). Although Australia rates well on this health indicator, the OECD acknowledges that it is unable to capture the timeliness of care provided, e.g. it cannot allow for long waiting times for various types of care (which is a serious problem for the poor in Australia).

<sup>80</sup> The Productivity Commission (2005, p. 10.16-10.18) noted that the bulk-billed proportion of non-specialist medical attendances was around 55 per cent for rural centres compared with 73 per cent for capital cities. This is partly affected by the availability of GPs. While there were 88 GPs per 100,000 in capital cities the ratio declines to under 55 the further remote the region is to the capital city.

### *Unequal access to specialists*

Although responses to life-threatening illnesses might be equal for rich and poor, low-income people have relatively low access to specialists that might pick up life-threatening illnesses at an early stage. The rich are significantly more likely to see a specialist than the poor (OECD 2001-2005)

### *Inequality in waiting times for elective surgery*

There are much longer waiting times for elective surgery for public patients and the difference in waiting times between access-poor public patients and access-rich private patients is becoming more pronounced. In the case of orthopaedic surgery, the standard waiting time for an initial appointment is about 10 months and waiting list for a routine colonoscopy can be a year but private patients are seen within weeks (Pirani and Gosch 2005). An *Age* editorial (Hannan and Noble 2004) notes that ‘waiting times for all but four of the 16 most common semi-urgent procedures, involving patients in pain, have grown. Such cases are meant to be treated within 90 days’. A further report in the same paper notes that people on waiting lists for public hospitals are being told that they could be done more quickly if they can pay in advance (Hannan and Noble 2004).

Socio-economic status is a factor in the increasing obesity of children (Scutella and Smyth 2005, p. 10). Obesity stems in part from poor diet and inadequate exercise, but it is also caused by unequal access to bariatric surgery – gastric reduction or bypass (Dickenson and Johnstone 2005).<sup>81</sup>

### *Poor health outcomes of indigenous Australians*

The plight of indigenous children, especially those in remote and very remote regions, is well known. In Aboriginal and Torres Strait islander children, average death rates remain 2.5 times those in non-indigenous children and there is evidence that mortality inequalities have widened over time in Australia (Zwi and Henry 2005, p. 3). The health inequality problem of indigenous Australians, although stemming from a range of complex causes,<sup>82</sup> is due in good part to poorer access to good medical care and poor policy targeting. The indigenous populations of Australia now have a markedly lower life expectancy than those of New Zealand and Canada, whereas thirty years ago they were all on a par (Pollard 2006).

### *Spatial disadvantage for those living in rural-remote and outer urban areas*

Apart from the special situation of indigenous people, there is a wider spatial health divide in Australia. The Rural Doctors Association points to the ‘poor cancer outcomes’ for Australians living in rural and remote areas’ and ‘the far higher mortality rate for country people’ (Ramsey 2005). Rural and indigenous people are sicker but get

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<sup>81</sup> NSW Health Department data compiled for the *Sun-Herald* shows that the incidence is higher in poor, rural and regional areas (Lawson 2005).

<sup>82</sup> Some medical problems are related to ‘social capital’ deficiencies such as high school dropout rates, criminality, smoking, petrol sniffing, racial discrimination, culturally insensitive services etc. The lack of many forms of social capital can help explain the more acute health problems of Australian indigenous people relative to the indigenous peoples of NZ and Canada (Zwi and Henry 2005).

relatively less care and there is a serious divide between health care in outer-metropolitan and inner metropolitan areas, with corresponding differences in risk of premature death from preventative diseases.

*Unequal access to dental and allied services*

Access to oral health and allied services such as physio and other much-needed therapies are unequally distributed across socio-economic groups. Since abolition of the Commonwealth Dental Health Program in 1996, the gap between public and private dental services has widened. The OECD sees evidence of pro-rich distribution of dental visits (Doorslaer *et al.* 2004). An investigation by *The Australian* found that there were more than 650,000 people on public dental waiting lists, with many waiting up to four years for treatment. The paper's editorial noted that 'since public dental care is provided by state governments to concession-card holders, the burden of this crisis falls overwhelmingly on the elderly and the disadvantaged, with rural and remote areas doing it particularly hard' (*The Australian* editorial 2005).

Again, a *Sydney Morning Herald* investigation found that 'there are only about 240 public dentists in NSW for more than 2.5 million health card holders, children and the elderly – and 3000 private dentists to treat the rest of the State's population of 4.5 million. The poor and vulnerable are now having to wait for up to 8 years get treatment through a run-down public system' (Pearlman 2005). According to a report in *The Age*, the average waiting time for public health dentists in Victoria has blown out to two and a half years (*The Age* editorial 2005a). Victorian pensioners have to wait many years for basic care (more than four years for dentures).

*Inadequate funding of mental health services*

The long neglect of mental health, on which Australia appears to spend much less than other developed countries, has recently received wide attention in the *Medical Journal of Australia* (Pollard 2005). It mainly affects the poor and disadvantaged (Zwi and Henry 2005, p. 6; Scutella and Smyth 2005, p. 12).

*Unequal access to medical technologies*

A Productivity Commission report (2005a) found strong evidence that low-income earners, people in remote areas and indigenous Australians are less likely than others to receive some types of services, encompassing both old and new technological interventions and this unequal access is likely to worsen as newer technologies are introduced (p. 118)

*Inadequate funding of community-based preventative care*

An important but neglected source of health inequality is that most health funding is spent on curing the sick and only a small proportion on preventing people from getting sick, where the socio-economic disadvantage is most pronounced. People living in disadvantaged areas or coming from low socioeconomic backgrounds are less likely to engage in activities that modify cardiac risk factors, such as recreational exercise, and less likely to have breast scans before age 50. They are more likely to live in poorly

maintained housing and to have knowledge and understanding of health needs and risks. Moreover they don't have the same choice of treatment and rehabilitation and the where-with-all to get themselves back into another line of employment if they suffer serious injury.

What is needed is a redeployment of resources towards community-based preventative care, using nurses, health workers, specialists, social workers and other allied health staff to get people exercising more, eating better food, quitting bad habits and participating more actively in community activities.<sup>83</sup>

*Negative impacts of some aspects of health policy*

Some aspects of health policy are tending to widen the socio-economic inequalities of access to elective surgery.

The subsidization of private care through the 30 per cent health insurance rebate (40 per cent for seniors) is mainly of advantage to the rich (Denniss 2005a; 2005b) and has had the perverse effect of increasing waiting times for non-urgent, elective surgery and treatment in public institutions, which are predominantly patronized by low-income households, while reducing waiting times for privately insured households who are predominantly high to middle income households. Dental inequality has been accentuated by the federal re-weighting of funds away from direct payments to public dental programs and towards rebates for private health insurance, including for 'extras' cover, which mainly helps higher income families. It has been estimated that, because of this and the application of the private insurance rebate, 'households on incomes of \$80,000 or more received 4.5 times the public subsidy for dental care received by households on less than \$12,000' (Horin 2004).

One could accept the inequities generated by subsidisation of private insurance if it eased the pressure on public hospitals. And to some extent it does (by encouraging some people to use private services when they were previously using public hospitals). But is it the most cost-effective or equitable way to spend some 3 billion dollars on the health system? The health insurance rebate is wasted on many households which would have purchased private insurance without it. Heavily subsidised private hospitals are subject to less cost controls than public hospitals, their surgical procedures are more costly and often performed excessively and their services are less readily available to in regional and country areas (Harvey 2006). Moreover scarce skilled resources are being diverted to the private sector for ancillary care, thus inflating the costs of basic health care and waiting times (McAuley 2004).

The health insurance rebate is not the only policy anomaly. The absence of bulk billing in many low socio-economic areas is leading to greater use of accident and emergency departments for what is normally GP treatment. Again, because middle and upper income earners make more frequent visits to expensive specialists, the non-means tested Medicare 'safety net' introduced by the Howard Government is being used much more extensively by the rich than the poor.

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<sup>83</sup> This is the view of a cross-section of about 70 health workers in NSW (Boxall and Leeder in *Sydney Morning Herald*, 14 December 2005).

Health policy in Australia remains broadly progressive in its social impact (Walker 2005) but it is steadily becoming less so.

#### *Compatibility of policy with SEOP*

Inequities in health care usage translate into inequities in health outcomes such as life expectancy and morbidity (Doorslaer *et al.* 2004). A kind of vicious cycle is at work: income inequality produces uneven access to medical care; bad health outcomes then become self-reinforcing; and this in turn further reduces the capacity of the poor to rise up the ladder. For example, bad health is conducive to psycho-social distress and a reduced sense of wellbeing due to loss of control, lack of hope and social exclusion; these mental problems then further worsen the original health problem and limit mobility (a key requirement for many to get jobs). The environment in early life results in biological changes that determine resilience and health outcome in adult life (Mooney 2005).

Ideally, there should be equal access to equal health care for equal need across socio-economic groups or geographic regions. This ideal is very hard to meet in practice. The best one can hope for is 'adequate' access by low socio-economic groups to quality health care (including preventative health care) and some narrowing over time of the inequalities of access of different socio-economic groups.

But, on the facts outlined in this section, even this limited test is not being met (although Australia is far from being among the worst in the OECD). It is difficult to argue that present health inequalities are fully compatible with any reasonable interpretation of SEOP.

An improvement in low-income families' access to health care would facilitate upward income mobility and help raise expectations about future incomes. By leading to reduced morbidity and sickness, it would have positive spin-offs for employment and the economy.

#### **4.7 Housing barriers**

In overall terms, Australia has good housing standards and high rates of home ownership. But, as with employment, education and health, the average conceals wide socio-economic variations and disturbing trends.

##### *Current situation*

Around 10 per cent of Australian families live in sub-standard housing or experience stress (with housing costs exceeding 39 per cent of disposable income). Many of them are socially isolated in terms of location, school choice and way of life and face poor lifetime wealth accumulation prospects (AIHW 2005, p. 270).

Over the last twenty years, there has been a decline in housing affordability, especially in the more desirable locations and especially for low-paid wage earners (Department of Family and Community Services 2005; Wilkinson 2005). Low cost accommodation is becoming more difficult to access (Yates 2004) and home-ownership is now out of the

reach of many. One reason is the sustained boom in house prices (now subsiding), which has been driven by low interest rates, financial deregulation, strong population growth, spatial concentration in capital cities and retirement zones, growth of single person households and growth of two-income households. The policy framework has also contributed to booming house prices (see later).

With the stock of accessible boarding houses also declining, it is not surprising we have a shameful problem of homelessness, estimated by the Australian Institute of Health and Welfare (2005) at 123,000 – including some 36,000 children (Scutella and Smyth 2005, p. 14).

#### *Future outlook*

Low-income families are being gradually squeezed out of the inner job-rich areas and are drifting to the outer areas where jobs are scarce and where there are fewer job or education opportunities and poor public transport, creating a ‘dysfunction in the labour market’.<sup>84</sup> There are signs that housing stress has recently been declining (Harding *et al.* 2004) and new technologies and increased freedom of choice on schools may reduce dependence on neighbourhood services. But the growing segregation of housing will further accentuate the location-related education and employment disadvantages of many low-income youth.<sup>85</sup>

#### *Compatibility of policy with SEOP*

At the same time as the private housing market has become less friendly, the equalising role of policy has if anything diminished (Wilkinson 2005). The stock of public housing has been declining (AIHW 2005, p. 287) and waiting lists now stretch out more than five years. Rental assistance has become less generous, providing an implicit subsidy of only \$1600 whereas public housing tenants receive an implicit subsidy of \$4000 (Keating 2004, pp. 105-6).

Much of the indirect housing assistance is poorly targeted. This is certainly true of the first home owner grant (FHOG).<sup>86</sup> In some cases, policy is even having perverse effects on low-income people. For example, favourable tax treatment of capital gains, extended negative gearing and FHOG have combined to push up house prices, including at the lower end. We also noted above the anomaly between public housing tenants and rental assistance subsidies.<sup>87</sup> And state zoning systems have done nothing to increase the supply of land for affordable housing use.

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<sup>84</sup> Prof. Terry Burke, Swinburne University (Millar 2005)

<sup>85</sup> Recent plans (e.g. in Sydney) to move poor and disadvantaged people out of inner suburban ‘ghettos’ and into mixed public/private housing in outer suburban middle-class areas are designed to further break down the spatial concentration of disadvantage but the plans are also being driven by a desire to realise latent land values.

<sup>86</sup> Other indirect assistance that is poorly targeted are non-taxation of capital gains and imputed rent. These are principally of benefit to the middle and upper class (AIHW 2005, p. 311).

<sup>87</sup> This prompted Michael Keating (2004, p. 106) to suggest that the Commonwealth Government should take over sole responsibility for rental assistance and housing affordability and pay a single income-tested subsidy to all tenants, irrespective of whether the landlord was a public housing authority or a private owner.

Two other policy complications are worth noting. One is that as housing assistance is tightly targeted at disadvantaged people and quickly withdrawn as incomes improve, it adds further to the already serious work disincentives stemming from the interaction of the tax and welfare systems (Department of Family and Community Services 2005; Wood and Ong 2005, pp. 7-10). It is no coincidence that employment participation among housing assistance recipients is low and has been declining over the last two decades (*ibid.* p. 3). Another unintended consequence of labour market policy, with its encouragement of casual, part-time, insecure employment, is that it is adding to the difficulties of low-income home seekers accessing credit.

Housing inequalities can be a major barrier to long-term equality of opportunity. Longitudinal studies show that the living environment in childhood and teenage years (security of accommodation, degree of overcrowding, access to key services, quality of schools and so on) has a crucial bearing on one's ability to advance in later life (Byneer 2001).

Existing housing inequalities in Australia are limiting the ability of children to learn and perform in a home environment conducive to study and denying them easy access to such things as good education, health facilities, transport, wide networks for social participation and a diversity of jobs. If their parents cannot afford home ownership and are forced to rent, the children are denied opportunities for wealth accumulation and easy access to credit – although it should also be said that home ownership can impair job mobility.

Deficiencies in the supply of social and low-cost housing and the barriers to home ownership are impeding relative social mobility and the achievement of equality of opportunity. Policies currently in place are not only inadequate relative to the scale of the problem – some are perverse in their effects.

#### **4.8 Spatial and transport barriers to mobility**

Spatial inequality may not be as much of a problem in Australia as in many other countries but it is a real hindrance to social mobility nonetheless. The disparities in employment and incomes across postcodes, although levelling out of late,<sup>88</sup> are greater today than in the 1960s (Argy 2003, pp. 37-9). The relatively poor are increasingly clustering in outer suburbs of cities or in relatively remote non-metropolitan regions, where housing is more affordable but where unskilled and semi-skilled service industry jobs are relatively scarce and public transport connecting them to employment centres, education, health services and so on, is often poor.

A study by Dodson (2004) stresses the role of inadequate public transport in the incidence of joblessness. And a case study of the Gold Coast by Buchanan (2005) notes that some low-income groups have particularly poor access to good quality public

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<sup>88</sup> The levelling out is patchy. It does not apply to the Sydney-Illawarra region. In the last year or two, unemployment rates in disadvantaged suburbs of Sydney and in Wollongong have increased sharply (to over 9 per cent) while unemployment rates in high socio-economic areas like the Eastern suburbs and the North Shore have remained steady at very levels (around 3 per cent) – *Sydney Morning Herald* report 20 January 2006.

transport services and that ‘inequalities in the distribution of public transport services may be exacerbating socio-political disadvantage’. In the same way as health and education, location disadvantage creates a vicious circle: the further out the poor are pushed out to counter the housing bubble, the lesser their ability to lift themselves up in the labour market. Not surprisingly, the public transport system is seen by Australians themselves as the most important infrastructure challenge facing Australia and a particular employment hindrance to low income people.<sup>89</sup>

Free markets tend to under spend on investment goods with large positive externalities. This is particularly true of public transport, which is not only an essential pre-condition for effective participation in education, training, employment and social activities but also has positive secondary effects on the environment, on other people’s travel time, on the incidence of accidents and on the productivity of the unpaid household sector. So an attempt to rectify the public transport market failure would yield a gain in national economic wellbeing as well as contributing to greater equality of opportunity. Much the same can be said of policies which even out the imbalance in regional opportunities (Argy 1998, pp. 154-6 and 2003, pp. 39, 152).

It will be argued later that the unreasonable reluctance of governments to borrow for long term infrastructure is unnecessarily compounding the transport inequities.

#### **4.9 Conclusion: The bottom line on social mobility**

The evidence presented in section 4 is clear. Australian society has some of the most open, efficient and competitive markets in the world. Yet these markets are not producing equality of opportunity in any reasonable sense.

Many Australians are impeded by childhood experiences such as dysfunctional home environments, low parental incomes and aspirations, and poor networking. These experiences then perpetuate disadvantage in adulthood. And many Australians suffer from serious access barriers to employment, education (especially pre-school and early primary education), health care, good housing and other key services.

In particular, we noted the following serious deficiencies and risks for mobility:

- Wealth (an important predictor of future life chances) is very unequally distributed and the signs are it will become more unequal in the future.
- While official unemployment rates have declined, employment opportunities, have become more polarised, with an increasing concentration of joblessness by skills, households and location and a growing incidence of under-employment.

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<sup>89</sup> Morgan and Levine (2005) report on a Morgan poll showing that 39 per cent of Australians rated public transport as the number one challenge, with water conservation second (33 per cent) and the others all under 20 per cent. A focus group survey of people on welfare found that lack of public transport, particularly in outer urban and rural areas, was a major hindrance to job search and employment (‘Experiencing poverty: the voices of low-income Australians’, Social Policy Research Centre, University of NSW, March 2006).

- Dependence on government welfare has, until recently, been rising – as has financial dependence of young people on their families. The Government is dealing with this problem with harsher welfare measures and work tests rather than attacking the underlying problem of poverty traps and unequal employment opportunities. While the welfare policy reforms have some rational economic justification, they are ill-balanced and, alone, will not lead to a sustained decline in overall welfare dependence.
- In the workplace, the new policy environment and marked shift in the balance of industrial and institutional power towards employers, might create some new jobs for unskilled workers but, without complementary government measures (in taxation and active labour market programs), it will leave many disadvantaged workers (those who lack individual market power) trapped, impotent and voiceless in low-paid, casual jobs, with little scope for upward mobility and more welfare-dependent than before.
- The spatial and regional divide is large and, in some of its dimensions, growing.
- The competitive gap between students in private and public schools appears to be widening and is likely to widen further as the exodus to subsidised private schools or selective schools continues. Early childhood and tertiary education are also becoming less equal and the digital divide is large and growing.
- The relative health experience of lower income people may be worsening as access to GPs, dental treatment and elective surgery becomes more selective. Policy is having a perverse effect in some areas.
- Home ownership and rental accommodation are becoming less affordable for many low-income families and the policy response so far has been weak or even perverse.
- Public transport is poorly accessible to many low-income families and hindering their potential mobility; the unreasonable reluctance of governments to borrow for long term infrastructure is unnecessarily compounding the problem.
- Across these various areas, we are seeing a stubbornly wide (and possibly widening) opportunity gap between *indigenous* and non-indigenous Australians and between different *geographic locations*.

The current policy position on public goods spending has been called ‘universalism plus choice’. For example, with Medicare we have a ‘safety net’ for the poor to ensure basic access to GPs and public hospitals, while everyone else gets subsidies for superior private health provision. Similarly, in education, public schools get the most funding but with ever-increasing funding for the richest private schools where students get a superior quality of service. A similar thing is happening in child care: with private operators now owning about two thirds of the nation’s heavily tax-subsidised long-day child care centres, the quality and accessibility of child care is becoming a function of income and location.

Recent studies (Stanley, Prior and Richardson 2005; Australian Institute of Health and Welfare 2005; Scutella and Smyth 2005) have warned that Australian children from low-income backgrounds face marked disparities in opportunities which are impeding their future mobility. Without considerably more targeted public investment, present trends will lead to a steady erosion of substantive equality of opportunity.



## 5. Policy rationale for government involvement

The case for government involvement in promoting substantive equality of opportunity is partly cultural, partly socio-political and partly economic.

### 5.1 Community support

The most fundamental reason why governments need to worry about equality of opportunity is that it is a basic aspiration of most citizens across the world. The discussion which follows asks two distinct questions:

- How do Australians perceive equality of opportunity as a normative *ideal*?
- How do they perceive *actual* opportunity levels in today's Australia relative to this ideal?

We start with the first of these questions. Australians are not enthusiastic about governments pursuing 'more equal outcomes' *per se* but they warm to the idea of governments seeking to improve 'equality of opportunity', which is seen as an essential part of a just and fair society.<sup>90</sup> Kelley and Evans (Kelley 2000; Kelley and Evans 2001 and 2002; Evans and Kelley 2002b, p. 13) report, on the basis of their comprehensive opinion survey and multivariate analysis, that views on the desirability of equal outcomes as a social goal 'elicit a low rating' in terms of warmth of support – an average of only 38 out of 100, which is much lower than in Europe (Bosco 2004). This is consistent with the apparent lukewarm Australian support (relative to other countries) for 'closing the gap between rich and poor'.<sup>91</sup> On the other hand, 'the ideal of equal opportunity is rated a warm 85 on average' by Australians – not as high as in Europe and Scandinavia – but much higher than Australian support for equal outcomes. Moreover, this ideal is very widely diffused. Even the most disadvantaged in the community say they want not hand-outs but 'a chance to make it happen'.<sup>92</sup>

Elsewhere, Kelley and Evans note that, although Australians strongly support means-tested transfers to the aged and disabled, they generally want to see merit, education and enterprise well rewarded, dislike taxes that penalise effort and innovation and expect the recipients of government assistance to try hard to improve themselves (to 'have a go').

<sup>90</sup> This dual set of values may explain, for example, why most Australians, while unfriendly to passive redistribution, seem willing – increasingly so in recent years – to pay higher taxes to pay for better community and public services like health, education, housing and public transport and to widen regional employment opportunities (see later discussion). One can speculate about the reasons for the dual stance. Apart from the strong individualistic streak in the Australian character and the distrust of welfare hand-outs to working age Australians, there may be some concern about the economic effects of passive forms of redistribution. Even though there doesn't appear to be any correlation between high inequality, low tax rates and economic growth, it is perceptions which count. Those with low incomes who might otherwise be sympathetic to passive redistribution tend to be politically inactive and are easily convinced by arguments which link redistribution to job security. The fact that a reasonable equality of outcomes is a pre-condition for equality of opportunity may not play a great role in their thinking.

<sup>91</sup> Levine and Morgan 2004, Melbourne. Similar results emerge from a survey by CIS/ACNielsen which found weak support for equality of outcomes (Saunders 2004)

<sup>92</sup> Lin Hatfield, ACOSS President, Opportunities for 2006, *Impact*, Summer 2006.

Moreover Australians have become more accepting of high earnings for top occupations than they were (Kelley and Evans 2002, p. 14). A survey study in 22 developed economies in 1999 asked people if objective merit-based criteria (such as years spent in education, how well a job is done and how hard a person works) should be the main driver of pay in the market. The responses showed that Australians have a relatively strong commitment to these normative criteria and are relatively more likely to concur broadly with the proposition that large differences in earnings are necessary for prosperity.<sup>93</sup> Their much stronger support for meritocracy than egalitarianism is also evident in a recent CIS/AC Nielsen opinion survey (Saunders 2004).

And they believe strongly in ‘having a go’, with more Australians than not agreeing with the proposition that you ‘can’t help people who can’t work out how to help themselves’.<sup>94</sup> ‘By international standards, Australians take a relatively hard line on the responsibilities of unemployed people to actively seek work’. A majority also appears to support the Howard Government’s policy of putting additional obligations on welfare recipients to find work (Gibson *et al* 2005) and does not strongly support passive redistribution to single working age parents (with the exception of family benefits).<sup>95</sup> This is also evident in their attitude to helping the very poor around the world, with five times as many suggesting we should help provide tools and training as those favouring more aid (Levine 2002). With increasing deregulation of the labour market, self-help has become a stronger element in what Australians understand by equality of opportunity. Indeed, it is at the heart of the grassroots values most politicians promote in their rhetoric.<sup>96</sup>

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<sup>93</sup> Redmond *et al.* (2002) have some revealing survey results. When asked if ‘it is the responsibility of governments to reduce differences in incomes’, those who agreed amounted to about 50 per cent – the second lowest of 23 countries studied and low compared with the average of 80 per cent. Again, asked if ‘differences in income are too large’, 71 per cent of Australians agreed, the fourth lowest response of the 23 countries, compared with an average of 92 per cent. Again, asked if ‘differences in income are too large in your country’, only 71 per cent of Australians agreed – one of the four lowest – compared with an average of 92.3 per cent for the other 22 countries. And although they mostly accept the need for a progressive tax system to help redistribute market incomes around, even on this issue they hold the belief less strongly than most other countries (Redmond 2002 Table 5). See also Osberg and Smeeding 2005. On these results, Australians are not great egalitarians in their attitudes. Irving Saulwick is reported to have said (Jennifer Hewitt, *Australian Financial Review Magazine*, January 2005) that Australia ‘has always been a petit-bourgeois society but that has accelerated in recent years ... we have become an acquisitive, consumer-oriented middle-class society with middle-class values’.

<sup>94</sup> Morgan Poll reported in Levine 2002.

<sup>95</sup> This can be discerned from attitudinal surveys (see previous footnote) and from the fact that when asked to compare ‘legitimate’ with ‘perceived’ inequality, Australians fall into a small group where the gap between the two is small (suggesting no strong concerns about inequality requiring early or massive government action). Interestingly, perceived inequality is less than the actual real inequality – implying some complacency about inequality based perhaps on a belief that there is plenty of equality of opportunity.

<sup>96</sup> For example Mark Latham, former Leader of the Labor Opposition, says in his Diaries (2005, 4 January 2004): ‘everything I put must be underpinned by the right kind of values: opportunity for all, aspiration and social mobility, mutual responsibility, community building and public participation’ (p. 261). Later he also says ‘embracing social rights at the expense of social responsibility is out of step with suburban attitudes and expectations’ (p. 172), that ‘one of the pillars of social justice is the shared expectation that people are responsible for their own behaviour’, and that ‘the underlying battle in Federal politics is about economic aspiration and social responsibility’ (p. 173).

But apart from strongly supporting merit-based outcomes, *what exactly do Australians mean by equality of opportunity?* In truth, we do not know for sure. But there is sufficient survey evidence to suggest that the Australian perception goes well beyond the narrow FEOP (classical liberal) view, which only requires equality of treatment before the law, competitive markets free of overt discrimination and a very basic welfare, health and education safety net.<sup>97</sup> Rather, the Australian ideal seems to be a moderate version of SEOP – where children are able to achieve their full education potential irrespective of parental wealth, status and power and where, as adults, they are able to achieve similar labour market outcomes as others of equal ability – provided they *make every effort to improve themselves*. In this ideal society, the distribution of ‘market’ incomes (i.e. pre government intervention) is fairly unequal but reflects relative ability and effort and is not unduly distorted by the presence of major barriers which obstruct the upward income and occupational mobility of meritorious individuals from disadvantaged backgrounds.

*But do Australians also believe that the ideal of equal opportunity is being generally achieved in practice*, that individuals are in reality able, through their own efforts and skills, to move easily to a higher class or social status than those of their social origin? One test is the attitude of Australians towards people (especially of working age) who are poor or under-employed. A cynical or negative view of the poor would suggest a strong belief that equality of opportunity exists to a high degree and that people should try harder. This is in fact what we find in surveys.

When people are asked about the causes of poverty, the proportion blaming the poor themselves (by attributing poverty to lack of thrift and effort and loose morals rather than bad luck or bad policy) tends to be higher in Australia than in Europe or Scandinavia, although somewhat lower than in the UK, US and Canada (Glazer 2003). A Brotherhood of St Laurence focus group study found ‘a fairly widespread view that those in poverty are to blame for their situation to some degree’ and they detect a ‘hardening of attitudes towards poverty’ (Johnson and Taylor 2000). Newspoll surveys on the importance of federal issues also indicate a growing nonchalance towards social issues in recent years.<sup>98</sup> And in order of importance, poverty concerns rank low in Australia compared with most other countries, including those with much lower levels of relative poverty than we have (Morgan and Levine 2005).

Furthermore, we noted earlier that Australians have a relatively negative attitude towards able-bodied people who are welfare dependent, including minority groups like indigenous people (despite their long history of alienation and injustice) and non-English speaking migrants (who start with a major handicap). This too is suggestive of a

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<sup>97</sup> Saunders (2004) claims, on the basis of a CIS/AC Nielsen opinion survey, that there is more support in Australia for classical liberalism than for ‘egalitarianism’. In the survey, classical liberalism is defined as a society where “people’s incomes depend on how other people value their services” and an egalitarian society as one where “nobody gets an income bigger or a lot smaller than anybody else gets”. Only out and out communists would prefer the latter to the former, so the much higher proportion agreeing with classical liberal society is hardly surprising. As we note later, the CIS survey finds that a meritocratic society has more support than a classical liberal society.

<sup>98</sup> In the October 2005 Newspoll survey on importance of federal issues, welfare and social issues such as poverty are ranked below national security and the economy as important issues – a lower ranking than in 2003. The earlier long term trend 1973-1999 indicated that the tendency for Australians to blame the poor was declining (Saunders 2002) but there seems to have been a reversal over recent years.

belief that Australians enjoy considerable social mobility, so that there is no reason for healthy persons of working age to be on welfare for long periods.

The belief among Australians that their country today is a land of opportunity for everyone also comes across in international surveys. Thus we find that only 18 per cent of Australians disagree with the proposition that in practice, ‘people get rewarded for their effort’ and only 15 per cent disagree with the proposition that ‘people are rewarded for their skills’ – whereas the average ‘disagree’ response rate of the other 21 countries surveyed is 46.5 per cent and 37.7 per cent respectively (Redmond *et al.* 2002). Again, when respondents are asked how important they think that coming from a wealthy family is to getting ahead – an indication of the extent to which they perceive non-merit criteria to apply in their country – about 21 per cent of respondents in Australia say it is essential or very important – below the average of 29.4 per cent for the other 22 countries (Redmond 2002 Table 6).<sup>99</sup>

Interestingly, too, the results of recent federal elections have been partly attributed to a strong ‘aspirational’ vote among low-income households – a common desire to rise higher up the ladder and an expectation that their efforts will succeed. There is evidence that this kind of aspirational voter helped determine the 2004 election in key seats (Manning 2005). If so, it could indicate that a high proportion of middle and low-income Australians have positive expectations about their own chances of rising up in rank and position over time.

The fact that market liberalisation has been more readily accepted in Australia than in Europe (Graham and Pettinato 1999) – although not relative to other Anglo-Celtic countries (Levine and Morgan 2004) – and that young Australians may be increasingly embracing economic liberalism (Nguyen 2005), may also indicate a high degree of confidence in the efficiency of markets in rewarding merit.

In short, it would appear that many (perhaps most) Australians seem to think governments and markets are doing a reasonable job of providing opportunities for everybody able and willing to work.

However it does not follow that they believe nothing more needs to be done. Increased government intervention to promote social mobility, effectively explained, should still gain wide acceptance in the electorate for at least four reasons.

Firstly, while Australians, more often than not, seem content with their society, survey results indicate a strong residual element of discontent in Australia, even about equality of opportunity. There are many Australians (although not among many of our business leaders<sup>100</sup>) who believe present inequality levels are excessive relative to what one

<sup>99</sup> A sign that Australians generally believe that opportunities are becoming more equally spread over time is that when asked in a 1986 survey if they saw themselves as belonging to a particular social class, only 49 per cent answered in the affirmative, whereas a similar question in 1965 elicited an 88 per cent affirmative response (Leigh 2005a). This survey is however rather dated.

<sup>100</sup> Gary Morgan (“Confidence abounds among affluent Australian Opinion Leaders and Shareholders”, 5<sup>th</sup> Annual Forbes Global CEO Conference, Sydney August 30 – September 1 2005) reported on a survey of Opinion leaders in Australia and abroad about the most important problem facing the nation. The Australian leaders gave virtually half the weight to poverty and the gap between rich and poor that other world leaders did. On the other hand, a recent survey of the attitude of Australian academics (by Flora,

would expect in a meritocracy and who say they want to reduce it. (Kelley and Evans 2001; Redmond *et al.* 2002 Table 5).<sup>101</sup> They are far from sure that existing market inequality outcomes do indeed reflect relative merit. Surveys show for example some unease about large earnings differentials and exorbitant executive pay (Kelley and Evans 2001 and S. Austen (1999). And this social discontent may be growing. A Newspoll survey in January 2000 asked respondents about the ‘fairness’ of wealth distribution now compared with ten years ago. Those who responded ‘less fair’ (55 per cent) were five times greater than those who thought distribution was ‘more fair’ (10 per cent), with 28 per cent seeing no difference. This sense of growing unfairness is also evident in a recent Herald-Saulwick poll which found that a narrow majority believe Australia has become a “meaner” society than it was ten years ago. More pertinently, 4 out of 10 believed Australia was a “less fair society”. Presumably, among low income householders, the proportion would be much higher.<sup>102</sup>

In fact, the evidence presented in this paper suggests that Australia does not perform as well on equality of opportunity as its citizens seem to think. Once these facts are better understood by ordinary Australians, there could be stronger pressure on governments to act.

Secondly, Australians may react negatively to passive welfare spending but they are positive about other forms of social spending. In particular, they are becoming increasingly uneasy about the inequality of access to key services and seem prepared to pay significantly higher taxes to improve community and public services like health and education and the environment (Withers and Edwards 2001; Evans and Kelley 2002b; Wilson and Breusch 2004<sup>103</sup>) – although they need to be told how and where the money will be spent and reassured that it would improve public services (Grant 2004). Australians also disapprove of the trend to user pays and privatisation of public services and like the idea of governments providing key services at subsidised rates (Meagher 2004; Hayward 2002). And they are more wary about globalisation (i.e. leaving outcomes to the market) than either the US, UK or NZ (Levine and Morgan 2004).<sup>104</sup>

Thirdly, while many Australians might feel that the high level of ‘joblessness’ (active and inactive) among people of working age is a symptom of a widespread welfare culture, only a minority want governments to embrace labour market deregulation and

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Gustavson, Hartmann and Konrad) found an overwhelming majority expressing concern about inequality and rejecting the proposition that “everyone has a fair chance” or there is “an equal chance for all” (although academics in Business Faculties diverged from the rest). Similar results were found in a survey of ACT economists (Fred Argy, Economic Papers March 2001).

<sup>101</sup> The Australian Survey of Social Attitudes (2003) also showed a high proportion agreeing that the gap between high and low incomes is currently too large.

<sup>102</sup> Report by Damien Murphy, ‘A meaner country and a good job too’, and Tony Stephens, ‘Our new mean streak’, *Sydney Morning Herald*, 20 February 2006.

<sup>103</sup> For example, Wilson and Breusch (2004) find the earlier trend showing a preference for lower taxes over increased social spending of the active kind reversed itself in the 1990s. In 1987, two thirds said they preferred lower taxes whereas today 42 per cent prefer tax cuts over higher spending. See also Argy (2003).

<sup>104</sup> A Morgan Poll found much stronger support in Australia for the proposition that ‘globalisation brings more problems than it solves’ than in the UK, US, and NZ (Levine 2002).

tough welfare reform as the main policy response.<sup>105</sup> They accept the need for an active government role on employment, including presumably active labour market programs (Eardley and Matheson 1999), even if it were to require higher taxes.<sup>106</sup>

Fourthly, a sizeable proportion of Australians still see governments as an important agent of social and economic control,<sup>107</sup> and as important to their wellbeing. What they seem to be saying is that, *provided individuals make every effort to help themselves*, governments should have in place a strong and wide-ranging social safety – one which includes a decent level of unemployment benefits, a minimum ‘living’ wage which rises broadly in line with community standards, a progressive tax system etc. And they should offer a strong helping hand to slow-starters who are competitively impeded by lack of parental wealth, status and power.

That said, it is a moot point *how much* additional social intervention Australians would be prepared to accept. Many will be concerned at the prospect of a large increase in government intervention. For example, individualists will resent the unwarranted interference with individual freedom – the right to do whatever one chooses and apply their property as they see fit, so long as they do not violate or infringe the rights of others (the Lockean principle of justice). People who are risk-averse will see the additional uncertainty associated with increased mobility as a threat to their wellbeing – at least *ex ante* (Abatemarco 2004). To them, the prospect of losses would worry them more than the prospect of identical gains (see Harding *et al.* 2001, p.24; Martin 2005). And some Australians will be concerned that an expanded government role will threaten economic prosperity (an issue developed later).

Although there are trade-offs here that need to be considered, many of the above concerns (especially the last) can be mitigated if the economic benefits are explained and the programs are well targeted. This is the task of the remainder of this section.

## 5.2 Social benefits and effects on happiness

An important reason why policy-makers need to be concerned about equality of opportunity and social mobility is that they relate strongly to people’s happiness.

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<sup>105</sup> This is illustrated by the opinion polling on the Howard Government’s workplace reforms in 2005. While many remained indifferent, the ‘no’ responses overwhelmingly exceeded the ‘yes’ (supportive) responses – e.g. see *The Age* Readers poll 5 November 2005. And public opinion polls in the months after the announcement of the reforms showed a decline in Coalition support, despite some \$40 million dollars of government advertising. See also Humphries 2005, Morgan Poll 18 October 2005 and Newpoll 25 October 2005. It is true that a large number of respondents adopted a wait and see attitude, so the level of negativity may decline over time. Moreover younger people – Generation Y (those aged 14-29) generally like flexibility in the workplace and seem more receptive to the proposed workplace reforms (*Sun-Herald* report by O’Dwyer, 6 November 2005). Overall, however, the early reactions indicate a strong base of support for worker protection regulation. The strong support for the award system is broadly confirmed in the Australian Social Attitudes Survey (2005).

<sup>106</sup> A Morgan Poll in 2002 found that 57 per cent of Australians believe it is the Government’s duty to support those who can’t find work compared with 48 per cent in the UK, 46 per cent in NZ and only 25 per cent in the USA (Levine 2002).

<sup>107</sup> Rachel Gibson commenting on *Portrait of a Nation 2003: Reporting on the inaugural Australian Survey of Social Attitudes, 2004* (Academy of the Social Sciences in Australia).

First, the wellbeing of people in the lower income brackets is affected by the income of their peer groups (the median income earner rather than the highest quintile) and what enters into their utility function is relative *permanent* income – not relative *current* annual income. If low-income people believe they have good chances of moving up the scale, they will be less likely to resent the rising affluence of others and so should be happier overall. Various surveys abroad (Alesina *et al.* 2004) have found that low-income persons, especially those with an aspirational bent, will accept high levels of income dispersion (and structural change) only so long as they believe that they and their children have broadly the same opportunity to succeed as those with the same abilities, talents and efforts who come from more fortunate backgrounds. Their concerns are greater the longer the period of disadvantage and the shorter the hope for the future. On the other hand, adverse perceptions of the scope for upward income mobility leads to greater concerns about poverty and financial deprivation, with associated effects on health, marriage, the chances of finding true love and overall happiness (Pizzigati 2005; Leigh 2005a, p. 4).

Secondly, many Australians feel happier just knowing that they are living in a just and fair society. This is evident for example from the public response to the recent workplace reforms: a majority of high income professionals said they were concerned about the reforms and saw them as ‘unfair’<sup>108</sup> even though they were not themselves adversely affected. Australians generally, while non-ideological and pragmatic, want governments to protect workers with little market power (Norton).

Thirdly, a belief that everyone of equal ability has an equal chance to succeed is crucial to interpersonal trust (social capital)<sup>109</sup> and it instills confidence in the ‘legitimacy’ of the political process. If this belief is allowed to erode, it increases the risk of tax revolts,<sup>110</sup> crime and social disorder.

Fourthly, a narrowing of educational inequality (a key element of any equal opportunity strategy) enhances tolerance, understanding and social integration as ‘more educated people have wider, deeper, stronger social networks and participate more in social, community and political life’ (Putnam 2004). Surveys find that happiness is much more positively affected by social relationships than by improvements in material wellbeing (Bagaric 2006).

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<sup>108</sup> Polling by the Association of Professionals, Engineers, Scientists and Managers Australia reported by Glenn Milne in *The Australian* 19 December 2005. Ross Gittins (‘It’s disability pensioners’ turn to oblige’, *Sydney Morning Herald*, 16 February 2005) points to literature showing that acceptance of redistribution is best explained not by self-interest (in fact a large proportion of the poor oppose redistribution) but by people’s “well-developed sense of fairness”.

<sup>109</sup> A discussion paper by Andrew Leigh (January 2006) finds a strong negative association between inequality and trust – the more unequal a country is, the fewer of its residents believe that most people can be trusted (p. 3). Patulny (2004) sees evidence that in countries with long social democratic traditions there is much more trust in strangers (less social divisiveness) than in countries with more libertarian values.

<sup>110</sup> B. Torgler and Kristina Murphy, *Tax morale in Australia* (RSSH, ANU 31 August 2004) argue that the willingness of Australians to pay tax and comply with the tax rules has increased significantly in Australia in the two decades after the early 1980s. They partly attribute this to a greater perception of policy fairness.

Fifth, happiness surveys also suggest that more money contributes in a lasting way to happiness up to about average income; after that it has virtually no sustained effect on one's level of contentment (Layard 2005; Bagaric 2006). The people most likely to benefit substantially from equal opportunity measures are those who start as low-income earners, whereas the cost of these measures tends to be spread across taxpayers, most of them in the higher income range. Provided such a redistribution of incomes does not seriously harm economic growth (see below), the utility gains will tend to be larger, and last longer, than the more dispersed utility losses.

None of the above arguments, taken individually, are conclusive. But taken together they lend weight to the case for government intervention designed to increase income mobility at the lower end of the social spectrum.

### 5.3 Economic benefits

Economic growth is an important vehicle for the enhancement of community wellbeing. It generates new and better opportunities for advancement and employment, contributes to personal happiness (as people are less worried about others getting ahead if they are themselves better off relative to their own recent past), enhances social stability (acting as deterrent to blame-shifting extremism) and provides a broader revenue base for assisting the disadvantaged and for improving the quality of the living and natural environment. With appropriate government policies, economic growth can also foster social mobility. As well, the economy is a key determinant of political standing.<sup>111</sup> For all these reasons, the economic implications of any new social strategy need careful attention.

Government policies that seek to enhance mobility inevitably have an impact on economic growth – both good and bad. The potential costs are mainly on the finance raising side while the potential benefits are mostly on the spending side. Here we focus on the benefits to the community from the spending program and defer to section 5.4 discussion of the costs.

The positive (and often overlooked) economic spin-offs from equal opportunity spending programs stem fundamentally from market failure.<sup>112</sup> Even the most liberal economy, with an open and competitive market system, does not necessarily produce a genuine meritocracy. The earnings inequalities it spawns do not simply reflect

<sup>111</sup> A Saulwick poll of voter attitudes found that a majority considered Mr. Howard's ten years in government had been a success. The main reason was his management of the economy; they rated him poorly on fairness, health, education, the environment and industrial relations reform as well as on Iraq (Murphy 2006).

<sup>112</sup> Market failure arises when imperfections in the market mechanism prevent the achievement of an optimum allocation of national resources. This can take various forms. Competitive markets cannot be guaranteed to produce good employment outcomes for everyone and cannot take account of 'external' effects such as on the environment and workplace quality of life. There is also a tendency for free markets to under-spend on 'merit goods' such as health, education, job search, and specific training; or land transport and urban and regional facilities: these activities yield benefits for society as a whole (after allowing, for example, for travel time, accidents, and the productivity of the unpaid household sector) that exceed individual consumer wellbeing. Competitive markets are also impeded by information asymmetries, high transaction costs involved in collecting and evaluating information, learning curves, herd mentality affecting buyers and sellers and so on. These various market failures can be partly or wholly neutralized by social spending of the equal opportunity kind.

legitimate differences in personal capacities, skills, attitudes to risk, motivation etc.; they also reflect efficiency distortions. We will illustrate this proposition with a few examples.

Firstly, market outcomes are often affected by overt or covert discrimination. For example, when women are discriminated against in the work force, markets function less efficiently because women are by-passed for men of lesser talent. Gender discrimination is less of a major problem in Australia and other forms of employer discrimination (based say, on age or ethnicity) are also becoming less common. But these still exist to some extent.

Secondly, market outcomes are also distorted by unequal starting opportunities. As we noted in sections 2 and 3, numerous longitudinal studies show clearly that social exclusion in childhood and in early teenage years has large effects on achievement in adulthood. Families at the bottom of the social class scale are most likely to have children at risk (Byneer 2001, pp. 14ff); people find it hard to escape their birth circumstances. Unequal starting opportunities represent a fundamental form of market failure because it means that society does not make best use of all its citizens (a lot of human potential is wasted) and over the long term the economy under-performs.<sup>113</sup> Fears have been expressed in the US that its meritocracy will turn into an aristocracy ‘and ultimately stifle economic growth by putting too much of the nation’s capital in the hands of inheritors rather than strivers and innovators’ (Johnston 2005, p. 4)

Thirdly, even the most deregulated labour markets suffer from imperfect job and geographical mobility and are unable to deal smoothly and efficiently with macroeconomic and structural shocks. Well-targeted labour market and structural adjustment programs, as part of an equal opportunity strategy, can improve the geographical and occupational mobility of labour and lessen the risk of prolonged joblessness and long-term loss of employability. We rightly hear a lot said about how generous social benefits impair labour market flexibility. This concern disappears when the focus turns from passive welfare to active measures which encourage equality of opportunity because these involve putting more emphasis on strengthening individual capabilities and requiring some structural adjustment from recipients of government assistance.

Fourthly, there is a tendency for free markets to under-spend on ‘merit goods’ such as health, education, specific training, housing and public transport. For example, as noted in section 4.5, increased public investment in education and training services for low income youth can generate substantial long term returns for the economy. While there is a debate about the cost-effectiveness of some active programs, such as public sector job creation and wage subsidies, there is almost unanimity among economists about the economic merits of programs which seek to improve low-income access to key public services (education, including remedial training, health, housing, public transport etc),

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<sup>113</sup> Don Aitkin (*New Matilda*, 20 April 2005) argues that ‘the variation within the population in ‘natural talent’ is nowhere as great as the variation in motivation, encouragement and preparation, and these latter variables are crucially dependent on parents and their situation in life’.

which sharpen work to welfare incentives and which address early childhood disadvantage. This is particularly true of the last.<sup>114</sup>

Fifthly, there are similar deficiencies in capital markets. For example, because of inadequate and asymmetrical information (such as the tendency to exaggerate the risk of inability to repay or pay rent), there is a tendency for capital markets to put too high a risk premium on asset-poor, low-income borrowers and people with irregular incomes, even though they have good entrepreneurial or business skills. People with casual, insecure jobs or seasonal jobs do not have an equal chance to develop their capacities to the full (in terms of skill enhancement, self-employment, job preparation etc.) because of information asymmetries. Conversely, some people with wealth but limited ability may over-invest in skills and entrepreneurship. Equal opportunity programs thus serve as a partial substitute for imperfect or missing credit and insurance markets and help to improve national productivity.<sup>115</sup>

Aside from correcting for market failure, active policies to promote increased social mobility give rise to other ‘third party’ economic benefits. For example, as noted earlier, increased social mobility has the side-effect of promoting greater community trust and harmony and reducing the incidence of crime. This is a social good; but if it also minimises the need for transaction and self-protection costs (explicit contracts, controls, regulations), it becomes an economic benefit as well. Equal opportunity policies serve in effect, as a less costly substitute for police, prison and property expenses.

Another ‘external’ economic benefit is generated if equal opportunity policies lower resistance to desirable economic reform. If people sense that they all have an equal chance to capture the benefits of reform, they are likely to take a more positive attitude to proposed structural changes. In this way, some otherwise ‘unpopular’ policies (such as those that increase workplace flexibility and encourage the enterprise culture) can be legitimized and the path of economic reform smoothed.

In short, a policy of targeting equality of opportunity and social mobility has the potential to generate a number of positive economic spin-offs.

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<sup>114</sup> A Nobel Prize-winning economist, James Heckman (2006), drawing on experience in the USA, argues that the gains from investing in disadvantaged children in the critical preschool years, through intensive enrichment programs (including preschool and home visiting programs), generates high rates of return to society. The gains stem from reduced crime, lower welfare dependency, better schooling outcomes (early skill makes later skill acquisition easier) and improved workforce productivity.

<sup>115</sup> If as well there are policy distortions such as tax concessions to new home buyers, negative gearing, special tax treatment of capital gains which in combination with the social security system lead to over-investment in houses, their effect is to worsen the under-investment in low-cost housing because they drive up house prices and rents and do nothing for the supply of low-rental accommodation. If the policy distortions are incapable of being addressed directly because of political constraints, then well-targeted assistance for low-cost housing, as part of an equal opportunity agenda, can make the housing market more efficient in the truest sense of the term (increasing total wellbeing).

## 5.4 Economic risks

Along with the potential benefits, there are also some economic risks associated with any form of redistribution – even when it is of the active kind which seeks to improve the operation of markets rather than simply compensating losers after the event. Apart from direct implementation costs, the risks for economic growth stem principally from the impact of redistribution on third parties other than the direct givers (usually taxpayers) and recipients (the beneficiaries). These are known in the literature as negative externalities. What are they?

### *Relationship between personal income taxes and work effort*

The first is that personal income taxes can impact on work effort. Australia is a low-tax country overall but our personal income tax rates remain high relative to many countries outside continental Europe and Scandinavia. The difference between what a typical skilled worker earns after tax and what an employer has to pay (in wages, payroll tax and superannuation) is more than 50 per cent – a gap which is higher than in most competitor countries.<sup>116</sup>

It is not clear how significant this work disincentive effect is in practice. Theory is inconclusive. On the one hand, higher income taxes have ‘income effects’ i.e. reduce spending power, so if someone is aiming to sustain a given consumption standard, a tax increase may be an incentive to work harder. On the other hand, taxes have ‘substitution effects’, that is, they encourage a switch from work to leisure, leading to a decrease in labour supply. The empirical evidence suggests that the hours worked by high-income professionals and managers are relatively unresponsive to income tax changes (Argy 2003, ch. 2). This is not to deny that internationally high personal tax rates can discourage some skilled and professional expatriate workers from returning to Australia and that some people might work less intensely and with less motivation per hour at work (Robson 2005, pp. 6-7). But these are not likely to be of great significance in the overall picture. In any case, there are many full time skilled and professional workers who do not have the flexibility to vary their working hours in response to changes in take-home pay.

The problem is more with secondary earners, part-time low-paid workers, some contractors and ‘inactive’ young welfare recipients. They do have a more elastic labour supply. Such people are increasing in numbers relative to the rest of the work force. Many are at the lower end of the tax schedule, where the tax and welfare systems interact, and they face serious work disincentives. But the fact that Australia is a relatively low tax, low social spending country to begin with (AIHW 2005, p. 379)<sup>117</sup> limits the potential economic damage. The incentive effects will also depend on the tax/welfare policy structure and the methods of redistribution (see later discussion).

<sup>116</sup> Figures by Professor Warren cited in *The Australian* 17 December 2005 (Uren 2005).

<sup>117</sup> If one includes superannuation payments as part of total welfare-related social expenditure, Australia comes out about the middle of the range. But if superannuation is excluded, Australian social expenditure comes out well below the mean. The figures exclude health, housing and labour market programs (where Australia is a notably low spender). Nor is the so-called tax wedge (the gap between cost of labour to employers and the take-home pay of workers) exceptionally high in Australia (Nicoletti and Scarpetta 2005, Figure 1 p. 13).

### *Relationship between personal income taxes and saving*

A *second* potentially negative economic externality from higher taxation is its effects on saving. In Australia, the persistence of chronic, large current deficits is seen as evidence of a deficiency in saving relative to investment needs and some economists have warned that a policy of fiscal redistribution would tend to worsen this ‘problem’ (as the rich tend to have a higher savings rate than the poor). Here too one must be wary. It is not clear that higher taxes adversely impact on saving rates. It depends on the motivation for saving: if for example a person’s strongest motivation is to maintain bequest levels, higher taxes would make them want to save more, not less. Nor is the persistence of structural current account deficits in Australia necessarily proof of national under-saving. It could, and almost certainly does, reflect a stronger rate of economic growth and higher investment needs than in other countries.

### *Any increase in taxation has secondary distorting effects*

A third negative externality of concern is that a rise in scale of redistribution, apart from involving some extra administrative and compliance costs, has secondary distorting effects such as encouraging tax avoidance and minimization practices that are economically distorting. This claim too needs to be kept in perspective, given the recent decline in marginal income tax rates.

In conclusion, there are undoubtedly some economic risks on the financing side from pursuing a redistributive agenda. But the risks seem to have been exaggerated (for reasons explained above) and can be minimized by carefully choosing one’s methods of redistribution (see section 6). There are bound to be some residual efficiency costs but these need to be weighed against the positive *economic* spin-offs outlined in 5.4 (as well as the social benefits outlined in 5.3).

## **5.5 Economic balance sheet**

If there are both economic risks and benefits, what is the overall economic balance sheet?

Any answer to this question must be to a degree judgmental, as neither theory nor empirical evidence offers a firm answer. Nonetheless, the evidence presented below is moderately encouraging for those who want to pursue further redistribution through investment in “active” social programs (those aimed at improving the operations of markets and removing barriers to labour market participation). It shows that pursuit of active social redistribution policies through a sensible mix of spending and fiscal instruments does not significantly impede economic growth.

Four performance criteria have been selected:

- income inequality – the share of GDP going to the lowest income quintiles;
- income mobility – the degree of upward income mobility over one’s lifetime or relative to one’s parents, as measured by longitudinal studies;

- productivity – measured either by GDP per hour worked or multi-factor productivity (which are better indicators than GDP per worker as the latter ignores cross-country differences in rates of investment and in work/leisure preferences); and
- employment – measured as a proportion of working age population.

These indicators are far from comprehensive<sup>118</sup> but they are all important predictors of community happiness and cohesion. More controversially, we have also taken account of the results of subjective well-being (happiness) by World Values Surveys and others (Leigh and Wolfers 2005).

Governments differ as to the relative policy weight they give to each of these four goals. They also differ as to the methods they use to advance these goals and here there seem to be four distinct ‘social models’ – each has its own distinct policy approach and they produce significantly different economic and social outcomes.

*Model 1* is dominated by the US. Its overall scale of fiscal redistribution is at the low end of the spectrum, with relatively ‘flat’ tax structures and low levels of income support and social investment. And it has relatively free labour markets, with little use made of employment protection laws (EPL) – laws which restrict the rights of employers to set wages, dismiss employees, use casuals, and so on

This model delivers very good economic outcomes but poor distribution outcomes, both in terms of income inequality and income mobility.

*Model 2* has been embraced by countries like Britain, Canada, Ireland and NZ. Relative to model 1, income support benefits are more generous (although conditional) and there is a little more job protection. But the overall scale of redistribution, especially through EPL, is modest compared to models 3 and 4.

Model 2 can boast good economic outcomes but on income distribution and mobility it produces very mediocre results – although with less inequality than model 1.

*Model 3* is found among the larger continental Europeans such as France and Germany and some of their neighbours. It redistributes on a large scale, making extensive use of EPL and unconditional income support.

This model delivers a more equal income distribution than models 1 and 2 but its performance on social mobility is only marginally better. Its productivity performance (properly measured) is not far below that of the first two groups. But it performs poorly

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<sup>118</sup> For example, because of inadequate data, quality of life indicators (such as the living, working and natural environment) are largely ignored in the evaluation. Again, the effects of policy on individual freedom are ignored – not because they are unimportant but because ‘freedom’ is hard to measure and its relationship to inequality and redistribution is unclear. Further, the evaluation takes no account of economic stability (i.e. the resilience of the economy following adverse shocks), which is also an important ingredient in happiness. Note too that, for presentational simplicity, employment outcomes are treated as ‘economic’ in that they affect the size of the economic cake (GDP), yet employment outcomes also have a big impact on income distribution.

on employment - not as poorly as is often claimed by those who focus solely on official unemployment figures, but certainly well below par.

*Model 4* is favoured by the Scandinavian countries and some of the smaller Europeans (such as the Netherlands and Austria). It involves high taxes and redistribution on an even larger scale than group 3 – but the income support provided, while generous, is more work-conditional and employment protection laws are less strict than group 3 – although stricter than in groups 1 and 2 (or Australia). Instead this model relies heavily on ‘active’ social programs to enhance the productivity and mobility of low-income people throughout their life cycle. For example, in addition to spending much more on education, governments in Denmark, Norway, Sweden and the Netherlands invest about four times more (relative to GDP) on active labour market programs – job placement, training, employment incentives, integration of the disabled, direct job creation and start-up incentives – than the English-speaking countries.

The policy works. Model 4 delivers low and stable levels of income inequality, high and rising levels of income mobility and very good productivity and employment outcomes.<sup>119</sup> The Scandinavians also rank high in international competitiveness league tables. And they appear to be among the happiest in terms of subjective well-being or life satisfaction and trust.

Table 1 summarises the results. On outcomes delivered, the stars reflect our evaluation of performance over the last 15 to 20 years (with most stars going to the best performers on the four selected societal outcomes). The number of stars implies no normative judgment.

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<sup>119</sup> Model 4 countries, in common with others, experience occasional economic fluctuations. For example, The Netherlands has just experienced four years of cyclically-induced productivity slow-down but it is now recovering and the long term productivity trend (over two decades) remains relatively strong.

**Table 1 Social models and their impacts**

	Model 1	Model 2	Model 3	Model 4
<b>Policy inputs</b>				
Scale of fiscal redistribution	*	***	***(*)	****
Scale of employment regulation	*	**	****	***
<b>Societal outcomes</b>				
Income equality	*	**	****	****
Income mobility	*(*)	*(*)	**	***(*)
Productivity	****	***(*)	***(*)	***(*)
Employment	****	****	**	****
Subjective well-being	***(*)	***	**(*)	***(*)

Note: More stars indicates better performance on the relevant criterion.

#### *The 'best' mix of redistribution instruments?*

The poor employment outcomes in much of continental Europe are more than partly due to rigid monetary policy but, one suspects, they are also due to excessive reliance on EPL. This suspicion is confirmed when one looks at Italy, Spain, Portugal, Turkey and Greece. These countries, which are not included in our tabular analysis, have very restrictive job-protection laws and deliver poor employment outcomes (as well, they are not generous with fiscal redistribution so they also produce poor distribution outcomes!). And the literature is generally consistent with this assessment: excessive use of EPL's can deter employment of low-skill workers.<sup>120</sup>

On the other hand, the success of model 4 suggests that high levels of redistribution (including employment protection that is limited relative to model 3 but still greater than Australia had before the Howard Government reforms) are not *per se* incompatible with good economic and employment outcomes – provided the redistribution policy mix is liberally spiced with 'active' government intervention to help people get jobs and improve mobility and work incentives.

<sup>120</sup> Sapir 2005 in his extensive cross-country study finds that the stricter the employment protection legislation the lower the employment rate. But he acknowledges that the results rely heavily on the experience of model 3 countries and that Scandinavian levels of employment protection, although higher than in Anglo-Saxon countries, appear to have little effect on employment.

### *Lessons for Australia*

Australia's policy mix of the last decade – liberal economic reform with moderate employment protection regulation<sup>121</sup> and conditional income support for working age Australians – has been fairly close to that of model 2. And it has delivered similar employment and productivity outcomes but with somewhat less income inequality.<sup>122</sup> With a record like this, Australia could have simply rested on its laurels. But the recent workplace and welfare reforms take us towards model 1 (indeed in terms of how we treat trade unions and how we reward welfare to work, Australia now has a harsher regime than the Americans!).

But the cross-country evidence above suggests that moving from model 2 to model 1 produces little economic benefit and considerable distributional pain. On the other hand, even a partial move from model 2 to model 4 offers more equality of opportunity without any great national economic cost. Sweden is a good example. It has much less income inequality than Australia, as well as more generous sickness, parental and study leave arrangements, better education outcomes and, it appears, greater intra-generational social mobility! Yet over the last five years it has achieved much stronger productivity growth than Australia, as well as higher employment/population ratios (with fewer casual jobs) and lower inflation. It also runs a substantial external account surplus – that is, it is relying on its own savings to fund its investment needs, rather than heavily drawing on external capital as Australia has been doing in a big way (despite booming commodity prices). Much the same can be said of the other Scandinavian countries.

The above exercise may be crude but it is consistent with other, more systematic studies which show that the impact of social spending on economic growth depends crucially on the structure and composition of the spending. If a high proportion of it is spent on active social programs such as education, health, public infrastructure, training, work incentives, selective employment subsidies, personal employment support, it is likely to be good for growth as well as lowering inequality.<sup>123</sup>

This is not to concede in any way that funds applied to passive income support are necessarily bad for the economy. The evidence of serious economic damage from passive transfers is far from conclusive.<sup>124</sup> The argument we are putting here is simply

<sup>121</sup> This was noted earlier in the paper. See also Nicoletti and Scarpetta 2005, Figure 2 p. 15.

<sup>122</sup> We noted earlier that market (private) incomes (before taxes and transfers) are more unequal in Australia than in most other comparable OECD countries but because our redistributive system is particularly effective in reallocating private incomes to people in the lowest income quintile, the inequality of final incomes is lower here than in UK, NZ and USA and average by OECD standards.

<sup>123</sup> Key articles include: Arjona, Ladaique and Pearson 2001; Bertola 2000; Pressman, 2005; Perotti 1996; Zweimuller 2000; OECD 2004a; Martin 1998 and 2004; Canadian Council on Social Development 2000 and Smeeding 2005. Smeeding (pp. 12 and 17-19), reviewing the literature, makes two salient points: (a) social programs such as those adopted by the Nordic countries are effective in reducing inequality and (b) there is no evidence that the stronger economic performance of the US and UK in the last ten years, relative to many other OECD countries, was “caused” by their lower levels of social spending. A somewhat contrary view can be found in Forbes 2000.

<sup>124</sup> An OECD report (Klasen 2005) states: ‘there appears to be links between initial (income or asset) inequality and growth. The majority of studies seems to suggest that high initial inequality is harmful for overall economic growth’. It adds that while some have found that redistribution to reduce inequality lowers growth in the short term, this finding is ‘based on very weak data so that this important question (namely the impact of redistribution on growth) remains unanswered’ (p. 9). Scuggs and Allan 2005,

that with active redistribution policies, the economic risks are much less – and indeed the net economic balance sheet could be positive. *There are many alternative social paths to economic and employment success.*

## 5.6 Threshold for government intervention

We have argued the case for active social programs to promote more equal opportunity. In deciding when to intervene and by how much, governments need some goals or benchmarks. These are hard to define.

A fully mobile society in which, say, the top earnings quartile would have a quarter of people born to poor parents and a quarter born to rich parents, is totally unattainable. People inherit genes (innate ability), values, attitudes, risk propensity and knowledge from their parents. And because of differences in inherited wealth, human aptitudes, luck and location advantages, there will always be some unavoidable differences in opportunities for upward mobility. Nor is full mobility necessarily optimal if it proves disruptive. Realistically therefore, Australia must expect to live with significant deviations from perfect equality of opportunity.

But we know from the experience and research in other countries that differences in inherited intelligence and related values explain less than half of the wide gap in lifetime human performance. The rest is probably due to socio-economic factors such as early parental environment, quality of schooling, access to health care, ability to borrow and social networks (Wasow 2004, p. 5; Century Foundation 2004 p. 5; and Heckman 2006). And we also know that the association between fathers and sons' incomes varies significantly from country to country: there is no universal, nature-ordained law determining a country's degree of market inequality even in a free and open economy. The implication is that some of the laggard countries on social mobility have considerable room for improvement.

So at what 'threshold' point does inequality of opportunity (income immobility) become "excessive and a problem for public policy? This is a difficult question to answer but it is arguable that a community should start to worry about mobility if (i) opinion polls are showing a significant and growing disillusionment on the issue of equality of opportunity; (ii) *when set against other comparable countries*, inequality of market earnings is high and remains relatively high even when we move away from annual incomes and look at long run – or 'permanent' – incomes over say 10 to 15 years and (iii) the underlying trend in income mobility is less favourable than in some of the leading countries in this field.

On all three grounds, concerns are rising in countries like the US and UK (Blanden *et al.* 2002). Lesser concerns should apply in Australia: the evidence does not suggest Australian social mobility has been lagging far behind other comparable countries. But there are warning signals. It is clear from the discussion in sections 2 and 3 that Australia is steadily adopting US social norms and practices and that there are many

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reviewing the evidence, cast doubt on the view that generous unemployment, sickness and age benefits stifle economic growth and so make absolute poverty worse. Other writers such as Forbes 2000 put a contrary view.

major barriers to social mobility in Australia. Children of economically successful parents are gaining increasing advantages – in terms of capacity to spend on things which enhance their children’s labour market prospects (like education, retraining, health care, housing) and in terms of superior location and social networks. Earnings inequalities (before taxes and transfers), already among the largest of the OECD countries (Whiteford 2005), are set to widen further. Moreover the policy road currently being taken in Australia is more likely to lead to lower than higher social mobility.

The issues of *how extensively* and *by what means* governments should intervene are discussed in the next section.

## 6. Policy strategy to promote equality of opportunity

Over the past few years, Commonwealth and State governments have initiated programs which aim to improve the health, learning, and well-being of children, widen vocational training, improve job matching and placement, encourage individual responsibility and instill a work culture where it is lacking.<sup>125</sup> Concerns about inequality of opportunity are featuring increasingly in the political rhetoric and the HILDA longitudinal study will allow governments to closely monitor social changes.

These developments are welcome but, as we have argued, they are occurring in a policy and social environment which is becoming, in essence, more unfriendly to equality of opportunity and which is generating widening structural inequalities.

If governments are serious about addressing these structural inequalities, they need to consider a much broader social policy response. Section 6.1 outlines a strategy designed to lower some of the barriers to social mobility, and section 6.2 discusses the budgetary and economic constraints that will need to be overcome to make such a strategy viable.

### 6.1 Policy directions

‘Passive’ redistribution policies are usually unconditional and are targeted at *final* income inequality (final outcomes). They risk widening market inequality if they dampen incentives to work. On the other hand, ‘active’ social policies of the kind proposed here are targeted at *market* inequalities (improving market capabilities and incentives) and require reciprocal obligations to facilitate the long-term adjustment process.

One can view children’s eventual economic performance in adulthood as a function of (a) their inherited genetic endowments (b) their parents’ investments (in medical care, nutritious meals, good education and personal monitoring and tuition) and (c) society’s investments in public education, health, housing etc.<sup>126</sup> The strategy outlined below seeks to use (c) to at least partly offset the effects of (b).

#### *Early intervention*

Early intervention policies target children up to the age of nine and seek to break the vicious circle of family poverty leading to poor health, malnutrition, school failure, long term unemployment and sustained social and economic disadvantage (Byneer 2001; Vimpani 2005; Heckman 2006).

The health problems of low-income adults can often be traced to early childhood environments. Dealing with these problems early – through access to good antenatal,

<sup>125</sup> Examples include Victoria’s Best Start program and the Federal Government’s Communities for Children program and literacy programs. The Federal Government, although a very small overall spender on active labour market programs, has done much to improve Job Network and much more employment data will now become more widely available to employers (Karvelas in *The Australian*, 7 January 2006).

<sup>126</sup> This categorisation is suggested and discussed in Harding *et al.* 2001.

maternal and child health services and regular home visits – is not only fair; it is also financially rewarding to governments and society in the long term. Vimpani (2005) and Heckman (2006) note for example the long term-savings from the program of sustained home visiting by US child health nurses to first time, single disadvantaged teenage mothers. Yet only one Australian state – South Australia – has followed this example.

There is an even greater deficiency in early education (see section 4.5). Governments should try to ensure all three to five year old children have adequate pre-school and primary education (a time when children are in the early stages of brain development). One policy response might be to create additional government preschools and give priority in admissions to disadvantaged children. Ideally, every public school should have pre-school and day care centre facilities as part of building a uniform national system.

But it is not just a matter of more government money for schooling. Studies have underlined the importance of parental attitudes. The values and socio-emotional skills instilled, including the importance placed on education, by family, peers at schools and the surrounding community, are more crucial to education performance than teacher quality, class size or spending per pupil (Putnam 2004 and Heckman 2006). The evidence shows that poverty is not necessarily an impediment to children later achieving high incomes and high status jobs – provided they live in a cohesive family environment with high parental aspirations and interest in their children’s progress (Bynner 2001, p. 21). Many students from low-income families are among Australia’s top students because they are strongly motivated to study hard and succeed by their parents. This is notably the case with students of Chinese-speaking background (Duffy 2005).

Where suitable parental conditions are absent, sensitive and selective government or community-based intervention during the crucial years up to year 9 would pay off. The Blair Government’s early childhood initiative (Sure Start) and collaborative community projects in Melbourne (Brotherhood of St Laurence 2005a, p. 5) are demonstrating what can be achieved.<sup>127</sup> Parents of disadvantaged children (not just those who are ‘troublesome’) could be persuaded to attend parenting lessons, develop active links with teachers and community and become better educators in the home. Mentoring could also be facilitated. Such programs need to be handled sensitively to avoid paternalism.

The Howard Government recently took some welcome steps to increase its investment in early childhood programs<sup>128</sup> but it deserves much higher priority in the overall social spending budget.

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<sup>127</sup> Vimpani 2005 notes the establishment in Britain of Children’s Centres in every community and a right to 15 hours of free preschool education for all three and four year olds and similar developments in Canada and NZ. Although the Blair Government’s Sure Start failed to show substantial benefits after the first three years, the prognosis is good for the longer term.

<sup>128</sup> Mr. Howard, speaking to an ACOSS Congress, (Impact Summer 2006) acknowledged that “opportunities to improve the chances of a child born into a disadvantaged family exist well before he or she begins school” and pointed to the initiatives taken in 2005 to identify local gaps in early childhood development and to assist local organisations to deliver services on the ground. He also noted his government’s efforts to help separating couples and assist families experiencing relationship difficulties, rightly pointing out that family breakdown is a key cause of low income in Australia. In his later address

### *Access to high quality public services*

Everyone needs to have adequate access to high quality public services throughout their life cycle.

There is a crying need to improve the quality of state schooling and teaching. This requires more investment of resources, increased transparency of results achieved and greater incentives for good teachers to teach in the poorest neighbourhoods (Keating 2004, p. 108). It also requires a reorientation of federal and state school funding to take greater account of socioeconomic need.<sup>129</sup> Low-fee private schools could also be given greater financial incentives to improve access and widen opportunities for low-income youth, bringing them more into the public school sphere, as in the UK: a study of Colorado's schoolchildren found that poor children who go to richer schools do much better (on standardised educational tests) than poor children who go to poorer schools.<sup>130</sup> A generous system of high school vouchers could be used to assist students, especially the bright, motivated ones, to finish their secondary education with a Year 12 or equivalent qualification.<sup>131</sup> Well targeted spending on public education will produce better national education outcomes and can do so in a cost-effective way (Barrow and Rouse 2005).

Post-secondary education should also be made more affordable and accessible. This is done best not through universally applicable concessions to universities and technical colleges (which would be costly and poorly targeted) but through additional university scholarships for bright young people of low socioeconomic background. More broadly accessible training institutions, increased pressure on employers (public and private) to provide in-house training and the establishment of government-subsidised learning accounts could all help make continuous training more widely available.

In Australia the less-educated adult workers have very limited access to continuous training: the costs of training act as a deterrent, employers prefer to train higher skilled workers and in most cases there are no effective trade unions or works councils and workplace consultation bodies to negotiate with employers on their behalf. Various longitudinal studies (discussed in Ok and Tergeist 2002 and Gleeson 2005) have found that when people low in numeracy or other skills participate in additional education or

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at his 10<sup>th</sup> anniversary dinner, Howard said "Australia needed new ways to break the vicious cycles of poor parenting, low education, high unemployment and health problems among individuals and Australian communities" (Denis Shanahan, Unity, equality, prosperity: Howard's latest priorities, *The Australian*, 3 March 2006).

<sup>129</sup> The deficiencies in the federal system have been widely discussed and were noted earlier in this paper. But there are also problems at the state level. A report commissioned by the NSW Government criticised the Government's funding mechanism for private schools on equity and transparency grounds and recommended that the allocation of funds for private schooling should be more tightly linked to need (Burke 2005).

<sup>130</sup> Denver Post article, [www.denverpost.com](http://www.denverpost.com).

<sup>131</sup> The evidence is clear that children from low-income households, especially the unemployed and under-employed, face an acute educational disadvantage. Dr. Richard Teese has shown that the greater education success of rich children is in good part based on social class advantage. And as noted earlier, the OECD has found that students' socioeconomic background is a more reliable predictor of achievement in Australia than in other parts of the developed world.

training (general or job-specific) they enjoy wage increases to at least the same extent as their higher-skilled, more numerate counterparts.

Other governments – notably the Nordic ones and more recently UK governments – are making great efforts to equalize education opportunities (Blanden *et al.* 2002, p. 3) and we could learn from their experience.

While education is a key element of any strategy to make key public goods and services more generally available, it is only one of many. In health, for example, there is a pressing need to increase investment in public hospitals, improve health services in regional areas, increase the supply and improve the affordability of dental treatment, apply more resources to community-based sickness-preventative activities and to review the equity of present financing arrangements. As well, there could be handsome social and economic rewards from an expansion in public transport services in areas badly serviced or from transport subsidies that reduce the travel costs of people in disadvantaged regions (Department of Family and Community Services 2005). Similarly, there is a need for much more public provision and encouragement of low-cost housing.

### *Employment enhancement*

An active policy agenda should seek to enhance the employment opportunities of the unskilled jobless (mature-aged, non-English speaking migrants, disabled persons, single mothers etc.) and school-leaving youth during their transition from school to work – and to ensure they remain responsive to labour market needs. The recent reforms to the Jobs Network have been helpful in encouraging employment agencies to devote more time and resources to youth and older workers who are hard-to-employ and in widening the availability of case-managed, customised, intensive support. But governments need to do more.

We have already stressed the importance of “remedial” adult training, retraining and lifelong learning across the life cycle as a means of promoting upward wage and job mobility. Yet employer practices such as poor training, induction and retention strategies and over-reliance on casual labour have the effect of raising mobility barriers for many young people (Brotherhood of St Laurence Bulletin November 2005, p. 7).<sup>132</sup> There is also a growing tendency for employers to recruit ‘guest workers’ from overseas to deal with local labour shortages rather than facilitating relocation from other parts of Australia or providing more training.<sup>133</sup>

Governments have a major role to play – both as a direct financier and as a catalyst. They need to widen the availability of vocational education and reduce its cost to low-income workers through a system of tied vouchers or similar vocational training

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<sup>132</sup> Partly as a result of globalisation, privatisation and outsourcing, expenditures on structured training by private employers has been falling steadily. Businesses have been abandoning training in droves. In the past few years, expenditures on structured training by private employers has fallen further from 1.7 to 1.5 per cent of the payroll.

<sup>133</sup> Officially there is no guest worker program but in practice the short stay/business visa program is providing a ready source of supply for employers. Almost 700,000 foreigners were allowed to work in Australia for limited periods in the year to June 2005.

subsidies.<sup>134</sup> And, to reduce the endemic ‘free rider’ problem, governments should use financial incentives and moral suasion to encourage employers to expand their own in-house training and review their own practices where they create barriers for young people (Marsh 2005).

But upgrading of workers’ skills is useless unless there are suitable jobs available at the end of the road. A major requirement here is a reasonable degree of downward wage flexibility. But to rely just on that policy option is socially painful and even perhaps counter-productive. So consideration should be given to adopting some ‘active labour market programs’ – those which, on the experience of the Netherlands and various Nordic countries, have achieved good results. These programs have three aims:

First they seek to *improve the efficiency of the job-matching process*, through intensified job search and placement efforts, especially directed at vulnerable youth, and greater assistance for geographical mobility.

Secondly, they seek to *enhance the work experience* of the more difficult-to-place jobless, through selective, temporary employer subsidies and assistance for personal career development.

Thirdly, active labour market programs seek to *create new jobs tailored to the needs of the under-utilised work force*. In small part, this could be done by providing incentives for entrepreneurial start-ups and through regional employment programs. More importantly, the community service sector could be used as direct employer and trainer in sectors of the labour market where demand is not being fully met such as child care, aged care, nursing and teaching (AIHW 2005, p. 385), thus alleviating a social gap and helping jobless workers gain valuable work experience in a growth industry.

Australia has been lifting its game on the job-matching front. But it is not doing enough to enhance skills, work experience and create jobs (other than through labour market flexibility). These latter programs have their critics. And it is true that might not always have a high benefit cost ratio in economic terms.<sup>135</sup> But if they are carefully targeted at specific labour market groups, implemented early in the jobless spell (before the erosion of confidence and motivation) and supplemented with action to improve literacy and employer attitudes, they can improve both individual and aggregate employment outcomes.<sup>136</sup> And the economic returns from can be further improved over the long term

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<sup>134</sup> The recently announced ALP initiative to contribute towards apprentices Skills Accounts and subsidise TAFE fees is a useful first step. Lifelong Learning Accounts have also been proposed by many.

<sup>135</sup> See Heckman 2006 and Andrew Leigh, Investing in early childhood. On Line Opinion 27 February 2006. The OECD is also agnostic. See OECD 2005.

<sup>136</sup> See for example OECD Employment Outlook 2004; OECD (assessing the jobs strategy) 2005; DSF 2005: National Returns (2005), Keating 2004 pp. 124, 143-9, and Dawe and Elvins 2006. The European Commission has also recently released a Report on Employment in Europe (Europa web site, 19 October 2005) which makes three key points (a) economic growth is not sufficient by itself to ensure good overall employment outcomes: it also needs the right mix of employment and active labour market policies (b) active labour market programs (such as lifelong learning, investing in skills and training, personal career coaching, youth placement) do work, as demonstrated by the experience of Members such as Netherlands, Denmark, Ireland, Sweden and Belgium relative to Old Europe and (c) active labour market policies can achieve good employment outcomes without an increase in earnings inequality.

if such programs are coupled with early intervention policies and flexible and accessible child care.

At the very least, it can be said that training and active labour market programs can contribute to lower levels of income inequality and higher levels of social mobility, without significantly damaging long term economic performance.

#### *Minimisation of work disincentives*

The 2004/5 Budget initiatives did reduce the effective marginal tax rates (EMTR) faced by mothers who wish to rejoin the paid workforce (by raising the income test and softening the withdrawal rates to allow more access to part-time work for the Family Tax Benefit B payment). But they left largely intact many other much worse tax/welfare poverty traps at the lower end of the income spectrum. Many people wanting to move from welfare to work face an EMTR of around 50 cents or more in the dollar. This is among the highest in the OECD. This disincentive problem is likely to worsen after the workplace and welfare reforms are implemented (because of the combination of lower benefits, with the move to Newstart, and an eroding minimum wage).

There are many ways of alleviating EMTRs, including for example earned income tax credits for low-paid workers or other income supplements to make work pay<sup>137</sup> coupled with changes in the welfare withdrawal rates. The alternative of relying solely on punitive welfare measures, such as forcing people to come under Newstart work requirement rules and benefits, is not only cruel but much less likely to lead to lasting improvements in income mobility.

#### *Policies to reduce asset poverty*

It takes more than a decent income support system and a buoyant labour market to break the cycle of inter-generational asset poverty (Caner and Wolff 2005). Complementary measures (through grants and incentives) are needed to help low-income families build up savings and access credit for entrepreneurial and innovative ideas.<sup>138</sup> Such measures would widen the options available to the relatively poor and enhance long-term income mobility. At the same time, they would (as noted in 5.3) help correct a well-known market failure in credit markets.

One idea proposed in the US is a ‘baby bond’, whereby a special savings account would be created by the Government for each new baby born and would accumulate through regular annual government contributions matching the individual parent’s contribution – similar to the Federal Government’s baby bonus and co-contribution superannuation scheme but more generous *and much better targeted at low-income families*. There

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<sup>137</sup> A recent study by three American economists finds that an equi-proportional EITC produces a much higher social welfare gain and is a more effective way to reduce poverty (through employment and income effects) than a higher minimum wage (Leigh ‘Three ideas on tax reform’ 2006).

<sup>138</sup> ANZ’s Saver Plus launched in 2003 is a matched saving program designed to help low-income earners with educational expenses and to help them develop a culture of saving. It has been evaluated and found to be reasonably successful (Weekes in *The Age* 3 November 2005) – but of course covers only a tiny segment of those who need it.

would have to be restrictions on withdrawal and some rules would have to be set about how the accrued growth of this account could be used in adulthood.

Schemes of this kind have to be fairly generous to make any real impact. The former Leader of the Opposition, Mark Latham, had the right ideas on the subject but because of his obsession with public debt reduction, the amount he proposed to invest in reducing asset poverty at the last federal election proved laughably inadequate.<sup>139</sup>

*Regulation to protect disadvantaged workers (those lacking market power)*

A minimum core of regulation is required to protect disadvantaged workers from potential workplace exploitation – in particular ensuring they have control of their working hours and working environment and adequate access to trade unions. Unless workers have a voice in the workplace on matters affecting their wellbeing, they cannot possibly have equal chances of advancement with their better endowed fellow-workers.

While economists generally prefer direct instruments of intervention (taxes and cash and non-cash transfers), there are several good reasons why regulation should also continue to play a significant social role. One practical political reason is that community hostility to tax increases or even to foregoing tax reductions is generally more intense than it is to regulation.

Another practical reason is that while fiscal measures can compensate for wage inequalities, they cannot effectively make up for a decline in workers' quality of life due to loss of workplace control and family time. There is already growing community concern about family-work stresses.<sup>140</sup> A recent book by three leading women professionals warns that Australian society has turned its back on children by letting economic priorities dictate 'a harsher, tougher workplace' and high labour participation rates, thus weakening the family unit (Stanley *et al.* 2005). It urges the embrace of paid maternity leave, full childcare availability and more predictable and secure hours of work. Such goals cannot be achieved solely or even mainly through fiscal intervention; they require a strong core of regulation.

As for the potential economic returns from further labour market deregulation (such as attacks on trade union rights and on independent industrial tribunals), they are surely diminishing after the major changes of the past three decades. And while the economic returns decline, the social costs increase. So can the budgetary costs increase because of the increased pressure deregulation puts on the social security system.

There are four simple tests which should be applied before deciding whether or not to claw-back existing social regulations:

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<sup>139</sup> In his Diaries (2005) he states his aims as being 'to democratise power and spread the benefits of ownership as widely as possible ... the devolution of economic power through a system of stakeholder (asset-based) welfare' (p. 161). These sentiments are very pertinent but the ALP's desire to run even bigger fiscal surpluses than the Howard Government and to cut taxes and net debt (pp. 263, 286) considerably limited its room for manoeuvre.

<sup>140</sup> Australian surveys show growing preferences for quality of life and environmental issues relative to economic growth and a widening gap between these preference and expectations (what they see as likely to happen to quality of life in the future). See Eckersley 2006.

- How effective are the regulations in achieving their social goals?
- Do the regulations have adverse by-product effects on economic efficiency?
- Are there alternative, equally effective policy alternatives which can achieve the same social goals more efficiently?
- If alternatives are not available what are the relative costs and benefits of lowering regulation?

If these tests are ignored and ideology is allowed to prevail, a nation can end up with too much or too little social regulation. At present the danger is too little. The welfare and workplace reforms of December 2005 fail the four tests. They removed regulations which served a useful social purpose and for which there was no efficient and effective alternative. And any economic benefits look small relative to the social costs.

#### *Policies targeting Indigenous Australians*

Indigenous people present unique problems for policy-makers. This is particularly evident in employment. In principle, it is usually better to apply employment policies equally to all disadvantaged youth (along the lines discussed earlier). But there is a case for special treatment of aborigines. The 50 per cent of aborigines living in remote and regional areas have exceptional location disadvantages and a special connection with the land which reduces their geographical mobility. More generally, aborigines start well below the rest of the field in work attitudes and suffer from a long history of alienation and discrimination. So a case can be made for adopting – at least for a time – affirmative action rules in the public sector<sup>141</sup> and putting more pressure on private employers to offer apprenticeship opportunities. The policy response should also include special mobility incentives and employment and training subsidies.

The health impediments of Aborigines were highlighted in 4.6 and these clearly need specific attention. Likewise, the education standards of indigenous Australians are so far behind the rest of the field that it is not enough to rely on general need-based scholarships or education vouchers, given the special cultural problems. Greater moral pressure needs to put on parents to ensure children attend pre-school and primary education. At the same time, parents could be given financial incentives such as better quality schools and other amenities. Progress is being made on these fronts but the pace of change is alarmingly slow.

#### *Policies targeting geographic disadvantage (locations where jobs and key amenities are scarce)*

The problem of location disadvantage (where jobs and key amenities are scarce) will require improved regional infrastructure services (health, education and transport access), with at least some of the cost debt-financed. It will also require tax incentives to entice jobs to areas of high joblessness (as the NSW Government has recently done). Nor should governments turn their backs on old fashioned interventionist industry

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<sup>141</sup> Ethnic based preferences did work for a time in the US, although they eventually became politically unpopular because of the anomaly problems they created.

policies to widen regional employment opportunities. Apart from their positive effects on social mobility, such policies can help correct a clear failure in the employment market and offer important economic spin-offs such as reduced traffic congestion in the metropolitan areas and a better structural match between job vacancies and job seekers.

Where a region is no longer viable, generous mobility assistance should be provided to facilitate relocation to other regions.

#### *Requirement for reciprocal obligations*

If an equal opportunity policy agenda is to be politically viable,<sup>142</sup> it needs to include some reciprocal obligations to ensure it is compatible with community values and preferences.

As discussed in section 5 of this paper, Australians firmly and overwhelmingly believe that all citizens should have an equal opportunity to develop their capacities to the full. That is in essence what they mean by a ‘fair go’. However they are also strong on self-reliance and individual responsibility. They want people to ‘have a go’ – make every effort within their capability to improve themselves – and they are contemptuous of shirkers. This belief in self-reliance is if anything on the increase because of the rise of self-employed contractors (formerly employees). They form a new middle class of economic independents.

To be acceptable to voters, any social strategy must take account of this deep-seated cultural commitment to individual responsibility. Recipients of government benefits (individuals or communities) need to recognise their responsibilities. For individuals, this means they should be expected to search very actively for work and (to the extent feasible and humane) to take up opportunities for retraining or relocation. And they need to participate in various work and community employment schemes – with some penalties for failure to comply. Such measures would complement those (outlined above) which seek to improve the incentive to work. In the same vein, transitional adjustment assistance or long-term developmental support to disadvantaged regions – such as through special tax treatment or new infrastructure – would need to be conditional on a corresponding local community effort.

Well designed and sensitive mutual obligation policies clearly have a role to play. The Howard Government has been a strong and eloquent exponent. One might not like many of its initiatives: the penalties for non-compliance seem much too harsh. But in moderation, mutual obligation policies reflect community values and concerns. The earlier Latham proposal for a Youth Guarantee – with governments providing the training and work opportunities ‘so that all young Australians are either learning or earning, with no third option of sitting around doing nothing’ (2005, p. 286) – may have more appeal to the Australian sense of fair go than what the Howard Government is currently offering.

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<sup>142</sup> Some also believe – and it was acknowledged in some of our own earlier argumentation – that there are good *economic* arguments for making income support conditional on some change in behaviour, so as to discourage welfare dependence.

## 6.2 Alleviating budgetary and economic concerns

As noted earlier, an ambitious agenda could be disruptive for budget processes, especially when the revenue effects of the commodity price boom start to wear out and the effects of an ageing population start to bite. More importantly, there are legitimate concerns about the longer-term economic sustainability of an increase in the scale of redistribution because of effects on economic efficiency and incentives.

Set out below are a set of ‘golden rules’ which, if observed by policy makers, would help minimise the budgetary and economic risks.

### *Rule 1: Temper the speed and scale of social reform*

Reform should be implemented gradually over a period of time and timed to fit in with the economic cycle (more in periods of slack and less in periods of boom).

### *Rule 2: Use revenue and spending instruments that are well targeted and financially cost-effective*

Instruments of redistribution should be simple to administer and to comply with; well targeted (with goals clearly defined); transparent (so they can be later reviewed and re-evaluated); and delivered efficiently, e.g. open to competitive tender and on a decentralized basis where practical.

These are simply standard public management principles and in the last couple of decades, much progress has been made in implementing them. But, while ‘churning’ is not a major problem in Australia, many existing social spending programs have goals which are not well specified and poorly targeted. This is true for example of many child care, maternity and family payments (which are received by nine out of ten families), the health insurance rebate, the child care rebate and the subsidies (state and federal) given to well-endowed non-government schools and for school student transport. As well, one could point to various poorly targeted State and Federal concessions to new home-buyers, farmers, nursing home residents, pensioners with very high net worth and self-funded retirees (Argy 2003, pp. 77, 84, 142, 157 and 179). These programs should all be reviewed to see if they can be gradually reduced in coverage without losing their social rationale or accentuating work disincentives.

### *Rule 3: Give preference to instruments of redistribution which supplement rather than replace markets*

This has already been discussed. As a general rule, indirect methods such as regulation and protection (apart from being less transparent and less well targeted) have more by-product efficiency costs than direct budget transfers because they interfere more with the price mechanism, shifting the relative prices of various goods and services in ways which are unrelated to the social opportunity cost of producing those goods and services and generating ‘deadweight losses’.<sup>143</sup> Australia has already moved well away from the

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<sup>143</sup> For example, there are better ways to assist low income working families than by sharply raising present minimum award wages relative to median earnings or using financial controls to channel cheap housing funds to them. In both cases governments can achieve their social goals through more market-

old practice of relying heavily on indirect instruments of redistribution, and that is a good thing. But as argued earlier, sometimes regulation is the most effective way to pursue a particular social goal.

*Rule 4: Choose revenue instruments which do not unnecessarily distort economic choices and which have the least impact on economic incentives*

The most economically efficient method of raising revenue is through ‘base-broadening’ measures. These seek to correct anomalies – where similar forms of income and expenditure face different tax burdens, thus distorting the economic choices of households and businesses and impairing productivity.

There are, for example, many special tax exemptions and deductions which have economically distorting effects yet are poorly targeted and inequitable. In the income tax area, frequently mentioned examples are work-related expenses, fringe benefit concessions for vehicles, capital gains concessions, the treatment of many forms of lump sum remuneration to employees (other than super), income averaging for farmers and tax privileges for primary producers and remote tax concessions.<sup>144</sup> These alone cost \$9 to \$10 billion a year in lost revenue and if they were merely capped, taxpayers could save a portion of this money.<sup>145</sup> Other tax concessions that could be capped are the home savings grant, superannuation and negative gearing where it applies to all ‘other income’.

Tax shelters such as through artificial income-splitting, family trusts and corporate structures and some of the employee shares and rights schemes could also be clawed back.<sup>146</sup> They are another source of inefficiency and inequity.

The GST could be broadened to remove the many exemptions now in place, subject to appropriate compensatory action where low-income people are adversely affected. The States’ payroll tax base, currently restricted to larger businesses, could also be broadened. States levy land taxes and a range of property transaction taxes and these could be rationalised through a broad-based national tax on immovable wealth which would not only raise additional net revenue but lessen the distorting impact on people’s decisions about where to live or invest. The States could consider a broad ‘betterment tax’ to capture the improvements conferred by public works and services and land-use planning decisions.

And, if a federal inheritance tax is too hard politically, it might be at least possible to introduce full taxation of accrued but unrealised capital gains transferred by inheritance.

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friendly devices such as taxes and transfers. Indirect instruments lead to a reduction in either ‘consumer surplus’ or ‘producer surplus’ and hence in social welfare

<sup>144</sup> Most of the items on this suggested list come from Professor John Freebairn, Melbourne Institute.

<sup>145</sup> It has been estimated for example if deduction claims for work-related expenses could be limited to say \$1000, the revenue savings would be considerable. And it would mainly affect well-off managers and professionals.

<sup>146</sup> The Australian Council of Social Service argues that \$400 million a year could be saved in tax foregone by either taxing the income of discretionary trusts fully at corporate tax rates or at least taxing it fully when it goes out of a trust (at least at the capital gains tax rate).

*Rule 5: Give preference to revenue devices which have positive externality effects*

It makes economic sense to tax activities with adverse ‘spill-over’ effects such as on pollution, congestion and health. For example it has been estimated that smoking was responsible for almost 3000,000 hospital visits between 2001 and 2002, costing the health care system some \$700 million.<sup>147</sup> This justifies the tobacco tax. Governments could raise additional revenue through environmental and ‘sin’ taxes. While these tend to be socially regressive in the short term, their effect could be more than offset on the spending side. A congestion tax such as the one introduced in London makes a lot of sense – as does the recent Victorian Government levy on inner urban parking and its doubling of the poker machine tax.

*Rule 6: Hypothecate new revenue raisings*

An ambitious social strategy would be more likely to gain public acceptance if the specific objectives of each new spending programs were clearly defined and if revenue collections were linked to the objectives (hypothecation). Such an approach would inflate administrative costs and reduce fiscal flexibility but it would help reconnect citizens to their tax system and contribute handsomely to a well-functioning democracy.

*Rule 7: Select social expenditures that are self-funding in the long term*

One way to limit budgetary costs in the long term is to give preference to ‘active’ social programs which facilitate structural adjustment, invest in the capabilities of the people being assisted and puts obligations on benefit recipients to change their behaviour. The strategy outlined in section 6.1 is designed with that golden rule in mind.

*Rule 8: make greater use of income-contingent loans in lieu of outright grants*

Where the activity being assisted has a reasonable chance of yielding good productive returns in the longer term, it would make sense to use the Government as banker rather than as direct spender. There is no reason why the concept of income contingent loans (i.e. the idea of providing loans to persons with low or irregular incomes, subject to repayment through a future income-related tax liability) could not be applied more widely than university funding. For example, it could be used to fund other areas of education and training, to help the jobless and under-employed with the costs of starting a new business or to relieve the housing costs of moving to a new area offering better employment opportunities. And schemes similar to the Higher Education Contribution Scheme (HECS) could be used to widen home ownership opportunities or kick start development in particular communities or regions.

*Rule 9: Don’t let ideology interfere with sound budgetary and economic principles*

In Australia today, there are many examples of how ideology is unnecessarily adding to the budget burden and impeding the application of sound economic principles.

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<sup>147</sup> Report in *Medical Journal of Australia* reported by ABC News 2 January 2006.

One is in the area of labour market regulation, where ideology often triumphs over reason. The principles which should guide governments on regulation policy have already been discussed.

Another example has also been mooted but not fully discussed. It is the tendency of Australian governments (federal and state) to finance all spending, whether of a recurrent or capital nature, out of revenue instead of debt. In the UK, one of the most successful economies of the last decade, the fiscal rule is to keep the *current* budget in balance or surplus over the cycle and borrow to invest – subject to a public debt limit of 40 per cent of GDP.<sup>148</sup> In Australia, all governments (state and federal) now have, on any reasonable international criteria, strong balance sheets with net debt at historical lows mostly below 2 per cent of State and national GDP. Yet political leaders on both sides still see it as prudent to bind themselves to large fiscal surpluses over the cycle (of at least 1 per cent of GDP) and to further reductions in net public debt (e.g. see Latham 2005, p. 263) – as if these were a desirable ends in themselves.

Behind this fiscal straight-jacket is an obsessive fear of global financial market retribution and higher interest rates if governments were to add to their already low debt levels. In truth, the fear (which has spread from politicians to the community at large) has always been much worse than the reality. The actual behaviour of financial markets to public and external debt movements is really quite restrained (Gruen & Stevens 2000, pp. 60-63; Gruen and Sayegh 2005) – provided there is no obvious risk of accelerating inflation (a risk which would only arise in exceptional periods of domestic and world ‘boom’).

This is not surprising. Key institutional players in financial markets know it is irrational to consistently use recurrent revenue to pay for long term ‘capital-style’ spending which is expected to produce a stream of economic returns in the long term. By doing so, governments are overloading the budget and unnecessarily denying themselves the opportunity to respond to the preferences and priorities of the community.<sup>149</sup> And they are creating economic efficiency distortions because they are allowing the private sector a free rein on borrowing and investment while arbitrarily restricting government borrowing and so biasing the system against public goods, especially social infrastructure which is so vital to equality of opportunity. Nor does the present ‘zero net borrowing’ (or worse still zero debt) fiscal target do anything for inter-generational equity as it focuses only on the liabilities we bequeath to our children and ignores the assets side of the balance sheet.

Three key questions need to be asked before deciding whether a medium term spending program should be funded out of borrowings or revenue over the business cycle:

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<sup>148</sup> The European Union has a fiscal deficit limit of 3 per cent of GDP over the cycle and a public debt level equal to 60 per cent of GDP.

<sup>149</sup> It is clear that Australians want better infrastructure especially health, education, public transport and local roads etc. and are prepared to pay for it. This was noted in 5.1. Further evidence comes from the Inquiry set up by the Local Government and Shires Association of NSW which surveyed residents and found that a majority want something done to upgrade the deteriorating local infrastructure (notably local roads and footpaths) and were prepared to pay higher council rates (Duffy 2006; Gittins 2006). Gittins expresses the hope that ‘borrowing to finance long-lived public works will come back into fashion’.

- Is the starting level of public debt low by international and historical standards?
- Will new money be used for programs which, while they might generate short term budgetary costs, also help improve the long term productive base of the economy, for example, by building up the future stock and quality of human capital or by lifting employment rates relative to population and reducing the risk of welfare dependence in the long term?
- Can the economy bear the extra demands on the nation's real productive resources without an inflation risk?<sup>150</sup>

If the answer is yes to all three questions, the spending program should be funded out of debt, not current revenue. Many of the spending programs proposed in section 6.1 meet this test comfortably, subject to the other golden rules outlined in 6.2.

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<sup>150</sup> This condition can be met at times only through an increase in interest rates which *crowds out* some private spending. But at times it makes good sense to shift the nation's spending mix away from private housing, consumer durables and marginal business investment to make room for more productive public spending.

## 7. Conclusion

One's life chances depend in good part on one's innate qualities and character but they depend at least as much on the circumstances into which one is born. This general observation applies almost universally across countries, whatever their political, institutional and economic arrangements. But we know that some countries enjoy more income and occupational mobility than others and that mobility is highly sensitive to the scale and mix of policy instruments used by governments. Countries enjoying relatively high levels of mobility tend to have governments which encourage free, competitive markets, regulate labour markets relatively lightly and engage in active social redistribution. The first two alone will not deliver optimal equality of opportunity. Indeed, without active social intervention by governments, free markets run the risk of creating a vicious cycle of *worsening* social mobility at the lower end of the income spectrum, denying the more disadvantaged children the same chance to succeed in life as the richer ones.

Looking back on the last thirty years, Australia's policy of economic liberalization and labour market deregulation combined with social activism has been fairly successful. It has delivered a strong economy with moderate but stable income and wealth inequality and, it appears, a reasonably high level of social mobility (at least relative to the US and UK).

But Australia's social policy environment is changing in very fundamental ways. Increasingly, we are embracing American social norms – and the American experience suggests that these norms lead to less, not more, social mobility. Already, the interaction of market forces and policy developments in Australia is creating a two-tier society in employment, health, education, housing and public transport, as well as wide regional disparities in opportunities and growing poverty traps. And the outlook is more of the same. For people with individual market power, the recent spate of workplace and welfare reforms will offer wider choice and greater scope for income and occupational mobility. But for the more disadvantaged in our community, the new policy environment will mean *less* choice and *less* scope for upward income mobility. Without countervailing social initiatives, this might lead to profound community disillusionment with the realities of equal opportunity.

What sort of social initiatives are needed? Governments can, as they have done in the past, use social security transfers to temper the harsh effects of rising market inequalities. Such passive redistribution would ease the pain for some but do little to alleviate the underlying structural barriers to mobility. If we want both economic prosperity *and* substantive equality of opportunity, we need more 'active' forms of social intervention – the kind which develops human capabilities and mobility at the low end of the income spectrum while at the same time putting obligations on benefit recipients to change their behaviour.

In section 6.1, we drew out the broad elements of an active social strategy targeted at the major barriers to social mobility – children's early development, public infrastructure deficiencies and inequalities of access to employment, health, education,

training and housing. If it is to gain public acceptance, such a strategy would need to be preceded by a campaign of public education. The campaign would have three aims.

First, it would explain why the proposed strategy would be *a worthwhile investment in a better society* – one more consistent with Australians’ sense of fair play. The argument it would put is that market income inequalities are both morally defensible and economically desirable only so long as they reflect differences in talent, risk-taking and hard work. But increasingly, the life chances of young Australians are becoming dependent on the circumstances of their birth (other than innate qualities and character) and their degree of access to essential public goods. This is producing market inequalities which are not easy to defend, either morally or economically. The proposed social strategy is needed to remove some of the underlying structural factors which are now distorting the present distribution of market incomes – to ‘level the playing field’ so to speak – thus making the observed market inequality fairer, more economically rational, more politically legitimate and more socially acceptable. There would still be a need for passive redistribution through the social security system, as too much inequality makes a mockery of equality of opportunity.<sup>151</sup> But that need would gradually diminish.

Second, the education campaign would seek to convince a cynical electorate that the proposed measures would be *effective in achieving their social objectives*. This should not be too difficult. On all the evidence, ‘active’ social policies – such as those which lift early childhood education, improve parenting and widen access to essential public goods – do work.<sup>152</sup>

Third, the Government would have to forcefully explain to the electorate that its policy reforms *would not harm the economy* – and indeed that, on balance, they would improve the economic fundamentals in the long term by making the work force more productive and occupationally and geographically mobile.

This paper has provided the building blocks for such a three-pronged public education campaign.

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<sup>151</sup> See section 4.2.

<sup>152</sup> This assumes sensible and efficient implementation without the kinds of ‘government failure’ which concern many opponents of intervention – such as ideological or political bias or capture by industry interests.

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