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Social policy and social cohesion

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With apologies to John Lennon: "Imagine".

Imagine a country where welfare dependency has been going down rather than up; where the number of people on welfare has fallen by 60 per cent in five years and most former claimants are now in paid employment; where child poverty rates (though still too high) are at their lowest level since 1979.

Imagine a country where the rate of serious crime is not only lower than it is in New Zealand or Australia, but where crime has been dropping dramatically; where there are half as many households being burgled and people being assaulted as ten years ago, where robberies are down by two-thirds, and car theft down by three-quarters.

Imagine a country where the leader makes a speech to his nation's elected assembly in which he announces that a family of four with an annual income of NZ$72,500 will from now on pay just NZ$81 net in national income tax *per year*!

Imagine such a country – it isn't hard to do. In fact, it isn't hard at all, for such a country exists. It is called the United States of America.

The social revolution in America

For most of my adult life, first in Britain and latterly in Australia, I have taken for-granted rising rates of welfare dependency, rising crime rates and rising levels of personal taxation. These trends are so long-standing that, in common with many other people, I had come to think of them as 'normal' and therefore irreversible.

Even though I have lived through a period in which the western economies have grown almost every year for the last fifty years, I had until recently become resigned to the idea that the number of people claiming welfare support would continue to rise in all of these nations. Even though growing affluence has meant that increasing numbers of people have had enough money in their pockets to buy homes, cars, foreign holidays, I had nevertheless come to accept that government spending on income support would keep on going up. This in turn meant that personal tax rates would keep increasing too – I never really thought it would be possible to reduce the size of the government budget and to turn back the tide of rising personal taxation.

And then the Americans shook us all out of our complacency. In 1996, Congress passed President Clinton's bill which aimed to 'abolish welfare as we know it'. The bill set each state a target for reducing its welfare numbers – not marginally, but dramatically, by fifty per cent. It also limited people's eligibility for welfare – no more than two years in any one period, no more than five years over a whole lifetime.

Critics in and outside America were horrified! They forecast chaos and misery. There would not be enough jobs for all those people currently on welfare to do. Women and children would starve; millions would suffer. A group calling itself the

Children's Defense Fund forecast that child poverty would go up by 12 per cent, and Senator Daniel Patrick Moynihan called the welfare reform a "brutal act of social policy" and warned that those responsible "will take this disgrace to their graves."

But as things turned out, the critics were wrong. Totally wrong. Most claimants found jobs, and although they were often low-paid, they ended up better-off than before (single mothers who moved off welfare improved their incomes by an average of 60 per cent [1]). Follow-up surveys found that most former-claimants were positive about what had happened – they were pleased to be off welfare, and they reported that their lives were better for it.[2] Their children, too, seemed to benefit – the poverty rate among black children and single parents is at its lowest in recorded US history.[3] As for the fifty states, they saved so much money on welfare payments that they were able to increase spending on things like child care and one-to-one job counselling to support people as they moved from welfare to work.[4]

The critics have had to swallow hard and admit they were wrong.[5] Welfare reform in America worked, and nobody now is even debating whether to reinstate the old system. Indeed, the states' targets have just been tightened to get 70 per cent of welfare caseloads into work in the future.

Ignoring the lessons of America

We social scientists are not used to dramatic changes like this. When we see a statistical trend going upwards, we expect it to continue going upward. We are used to incremental, creeping change, and we have grown accustomed to change always occurring in the same direction – more welfare dependency, more crime, more taxes, more government control, provision and regulation. A fall in the welfare rolls of 60 per cent would have been inconceivable had the Americans not actually achieved it. By the same token, the extraordinary drop in American crime rates during the 1990s would have seemed implausible if not impossible to most social scientists – and to get to a point where low-to-middle income families pay no federal income tax at all would have looked like some free-marketeer's Utopian fantasy.

Hit between the eyes by the real-life achievements of the Americans – achievements which have turned our expectations upside down in the most dramatic fashion – you might think that we social scientists would sit up and take notice. You might think that a little humility was in order on our part and that we might start asking ourselves whether there is anything we could learn from what the US has done over the last five or ten years.

Not so! In Britain, in Australia, in New Zealand, the academics, the welfare activists and the social affairs journalists and commentators remain resolutely unimpressed by the social policy revolution in the USA. Indeed, most of them seem quite horrified by it, and they are intent on warning us against going down the American path. Their advice is that we should go off in precisely the opposite direction!

In Australia, for example, the latest book by the head of our leading government-funded social policy research centre – a man who, somewhat confusingly, shares the same name as me – suggests that Australia has little to learn from the USA. Rather than liberalising our labour market, cutting taxes and reducing rates of welfare dependency as the Americans have done, he sets out a vision for Australia based on higher taxes, an increased minimum wage, a reversal of recent labour market deregulation, an expansion of public sector employment and (most astounding of all) the introduction of an unconditional minimum welfare benefit payable to anybody who decides they do not want to work for a living.[6]

Similar thinking can be found among policy academics and advisers in New Zealand – not least in some of the papers delivered at *Knowledge Wave* 2001.

In her paper on 'Social cohesion and the knowledge divide', for example, Shalema Witten-Hannah of the University of Auckland suggested that America's "flexible labour market model" has been responsible for all sorts of social woes and has made the country "an extreme case of income inequality."[7] She warned New Zealanders against following the US example, and suggested instead that we should emulate the French and tackle unemployment, inequality, poverty and social polarisation by making it illegal for people to work more than 35 hours per week.[8]

But doesn't this seem a bit odd? There is no greater cause of poverty and social polarisation than joblessness. The French unemployment rate is currently 9 per cent – about half as big again as the American rate (currently 6 per cent). American unemployment levels have not been as high as France's current 9 per cent for twenty years; French unemployment has not been as low as America's current 6 per cent since the 1970s! Surely the Americans have been doing something right and the French have got something wrong? Why follow the French rather than the Americans?

In another paper from *Knowledge Wave* 2001, Charles Waldegrave of the Family Centre Social Policy Research Unit in Lower Hutt, and Nicholas Pole of the Ministry of Social Policy in Wellington, warned against learning from America.[9] They accepted that the American economy has been "extraordinarily robust in recent years", but like Witten-Hannah, they pointed to "the inequalities characteristic of the US social and economic policy mix." The Americans, they told us, have had no "comprehensive policy to address social cohesion," and they commend Finland to us as a "constructive model from which Aotearoa, New Zealand can learn."

As of December 2002, Finland's unemployment rate was 8.1 per cent.

Why are our intellectuals so keen to disparage the American successes and to embrace the continental European failures instead? The main reason, I think, lies in their assumption that the individualism that drives America is incompatible with social cohesion. They think that social cohesion can only be brought about and safeguarded by comprehensive government social planning and direction – something the USA is rather short on. They think America is a fragmented society which lacks social solidarity, and they think this has come about because the Americans tolerate wide gaps between higher and lower income earners and insist on keeping government welfare to a minimum.

Is there any truth in this very common argument?

American (and New Zealand) individualism

It is certainly true that American culture is individualistic and that Americans generally distrust big government. When Geert Hofstede compiled a survey of social-psychological characteristics across fifty different nations, the USA emerged as the most individualistic country in the world.[10] This, of course, is expressed institutionally in the commitment to a free enterprise economy.

America is an 'open system'. Americans believe that giving people their head and letting them fly or nosedive usually produces the best outcomes for everybody else. They believe that when an individual develops or discovers something, and makes a fortune as a result, this is something to be celebrated, for everybody else gains too. They therefore put their trust in individual initiative and learning from trial and error. They do not trust government grand plans and strategies, for they have no faith that governments will not screw up. As an 'open system' society, they do not need public agencies to map out where they are going and to plan how to get there. They do not know what the end results of all their activity will be, but they suspect it will all work out in the long run.

All this means that American culture is deeply antithetical to social engineering – the attempt to bring about pre-defined social goals by the use of government power. But social engineering is what social science is generally all about. Most of the social scientists I know in Europe or in Australasia do not really understand America. They think it is a socially disorganised country because there is so little top-down regulation and direction. They think America is reckless – a cowboy country – because it celebrates individual energy and enterprise and disparages the governmental path to risk minimisation.

Given their belief in engineering social outcomes, social scientists tend to feel much more comfortable with the dirigiste planning traditions of continental Europe than with the Americans' trust in individual initiative and free enterprise. Social scientists like blueprints, statements of aims and objectives, policy agendas, plans and strategies. They do not warm to the idea of an open system whose end-point we cannot predict or control. They prefer European-style, closed-system, tamed capitalism. They are suspicious of American-style, red in tooth and claw capitalism, even if it does bring results.

The two capitalisms

Some years ago, a French academic by the name of Michel Albert published a book called *Capitalism Against Capitalism* which analysed the divergence between these two different kinds of capitalist systems that have become sharply distinguished since the collapse of state socialism.[11] He referred to them as the 'neo-American model' and the 'Rhine model'.

The 'neo-American model' (in which he included Australia, New Zealand, Britain and Canada as well as the USA) is characterised by its emphasis on individual success, competition and short-term financial rewards. The 'Rhine model' (in which he included most of the continental countries of the European Union together with Japan) is, by contrast, characterised by a concern with collective success, cooperation, and longer-term rewards.

Albert once worked in the insurance industry, and he sees the difference between the two systems crystallised in the different ways they handle insurable risks. In the neo-American model, individual premiums differ according to actuarial risk assessments – if you are more likely to claim, you pay more up front. In the Rhine model, risks are generally pooled and all policy-holders pay the same amount. The first approach is individualistic; the second is collectivistic.

Albert shows there is a much stronger emphasis on training in the Rhine model; that the neo-American model relies heavily on stock markets for raising capital while Rhine model companies depend more on close ties with banks; that neo-American countries are 'credit' cultures while Rhine model countries are 'savings' cultures; and – most importantly of all for our purposes – that income distribution tends to be more unequal in the neo-American countries where the welfare state is much less fully developed than in Europe.

Albert leaves us in no doubt which system he thinks is better. The Rhine model is preferable because it is more socially cohesive. He tells us that American cities are full of homeless people, American public schooling is appalling, and drug abuse in America is rife. Like most Frenchmen, he clearly believes that Europe (and especially France) is civilised, and that America is barbaric. America, he says, is "an increasingly fragmented and uncaring society of dysfunctional families and spreading poverty."[12]

The neo-American model and the question of social cohesion

This brings us to the core concern of this conference. The reason why Albert dislikes the neo-American model, and the reason why so many other intellectuals agree with him, has to do with the widespread belief that America is socially fragmented and polarised. It may lead the world in technological innovation, it may keep the world afloat with its remarkably strong economy, it may have no challengers as the world's mightiest and most powerful military power – but the quality of the social life is so bad there because the country is so individualistic.

Albert contrasts America's commitment to individualism with the much stronger social and moral fabric that he thinks exists in the Rhine model countries. In the Rhine model, economic inequalities get flattened out by high taxation on higher earners, and a strong welfare state boosts the living standards of the less fortunate. Albert thinks this gives rise to a greater sense of social cohesion in these countries.

Albert admits that the relative 'disorganisation' and 'fragmentation' of the neo-American model countries does have its positive aspects. He accepts, for example, that because they are more tolerant of individualism, the neo-American nations are generally much more open and pluralistic, and are more accommodating to cultural change, than the Rhine model countries. Not only the 'new world' settler countries, like New Zealand, Australia and the USA, but also an old country like Britain, have all been more receptive to immigration than most of the continental European nations, and Scandinavia and Japan remain to this day remarkably homogenous in comparison. Mixed-race marriages too are much more common in, say, the USA and the UK than they are in Germany or Japan.

It is interesting to speculate, in passing, whether the unity of the Rhine model nations – the 'social cohesion' which makes them so attractive to many social analysts – is based on their greater cultural homogeneity. Because they distrust individualism, these more conservative national cultures tend to elevate the interests of the collectivity over those of the individual. This is seen, for example, in the existence until very recently of peacetime national service in almost every one of Albert's Rhine model countries when it had long been abolished in all the neo-American ones. Similarly, compulsory national ID cards are accepted without a shrug throughout continental Europe, but none of the neo-American model countries has one, and attempts to introduce them have often led to strong and effective opposition from civil libertarians. In the neo-American model, individuals are free to do anything not specifically proscribed by law; in the Rhine model, the State prescribes the rights and liberties that citizens enjoy.

Albert recognises all of this, and he seems to accept that their greater concern with social cohesion and egalitarianism might make the Rhine model societies somewhat less dynamic and exciting places to live. Indeed, he goes so far as to admit that: "Rhine capitalism suffers from an image problem: it looks out of date, it breeds neither dreams nor excitement, it is not fun."[13] He contrasts this with what he calls America's 'star quality' – it may be all style and no substance, but it has attracted poor immigrants in their millions over the years. It is telling that young people around the world today wear baseball caps sporting the names of American sports teams that they have only ever seen on cable TV, but nobody in the backstreets of Bangkok or the shanty towns of Rio is sporting the logos of Paris St Germaine or Borussia Muenchengladbach.

The Rhine model and the question of social cohesion

Culturally, historically, socially, constitutionally and economically, New Zealand is one of the neo-American model countries. What the intellectuals are suggesting, however, is that politically, we should now switch paths and start adopting Rhine model policies. If we want to ensure a socially cohesive society, they tell us, then New Zealand's future is French or Finnish, not American.

One reason why I am sceptical about this advice is that it takes social policy out of its cultural context. It assumes that what works in Helsinki or Stockholm can and will work just as well in Auckland or Dunedin. It forgets that welfare systems express the cultures of the countries in which they arise. If Scandinavia has one kind of welfare system while New Zealand has another, this probably has something to do with the social and cultural differences that exist between them that that predate their welfare systems by hundreds of years.

In a relatively homogenous, conformist and collectivist culture, the welfare state may be the expression of the social unity which *already exists* among the citizens (in Scandinavia, for example, it gives institutional expression to the idea of the *Folksheim*, the 'people's home'). But this means the welfare state in a country like Sweden is an effect, not a cause, of collectivist and nationalist sentiment. Strong collectivism gives you a strong welfare state – but it does not necessarily follow that the reverse is also true.

Indeed, a welfare state that might express or reinforce social cohesion in Scandinavia and continental Europe may have quite a different outcome if it were transplanted to a more individualistic culture. As I have argued elsewhere, comprehensive, generous welfare systems may be compatible with more collectivistic cultures while wreaking havoc in more individualistic ones. In countries which fiercely resist the notion that citizens should carry ID cards, and where compulsory national service strikes most young people as an outrageous suggestion, a free, generous and universal welfare state is more likely to generate feelings of resentment and suspicion among citizens than it is to foster a spirit of unity and fellow-feeling.

The welfare state and the fallacy of social cohesion

There is a strong argument to suggest that, in the individualistic Anglophone countries, the welfare state has contributed more to social fragmentation than it has to social cohesion. The reality of welfare state relations in the neo-American model countries is that the exchange between donors and recipients is not one that builds trust and mutual recognition. Rather, it results in mutual mistrust and the pursuit of narrow self-interest.

The experience of *receiving* aid from government welfare agencies tends to provoke one of two reactions. The first is shame. Putting oneself in the hands of state welfare agencies is widely recognised as being an alienative, stigmatising and disempowering experience. State agencies periodically try to disguise this by taking their cue from Orwell's 'Newspeak' and relabelling recipients. Over the last few years in Australia, for example, people who were once 'claimants' first turned into 'clients' and then later emerged as 'customers'. But nobody is fooled by such bureaucratic contrivances – customers exert power by purchasing services with their own money, but welfare recipients are given money by service professionals and are therefore at the wrong end of an inherently asymmetrical and demeaning exchange. Calling recipients 'customers' does nothing to alter the reality of an unequal relationship mediated through an impersonal and bureaucratic mode of organisation.

The other response of welfare recipients to the receipt of aid is an assertive demand for what they see as their real or imagined 'rights'. This response has become increasingly common over the last twenty or thirty years, and welfare pressure groups try to give it legitimacy, but this is no more real 'empowerment' than the first kind of response. It is a demand that others do something for you, not a decision to do something for yourself, and as such it is still based in weakness and dependency, even as it tries to pretend the opposite.

David Selbourne is one of many commentators to point out that this modern rights-based welfare rhetoric rarely recognises any serious corresponding responsibility on the part of claimants to fulfil social obligations as a condition of receiving support. The collectivity must give to you, but you need do little or nothing in return.[14] One by-product of this essentially amoral assertion of self-interest is what game theorists call the problem of 'free-riding' – the willingness to take whatever is available from the system while putting nothing back.

Neither of these responses – neither the shame-faced acceptance of hand-outs nor the assertive demand for them – generates the sort of sentiments that might be thought to produce and strengthen social cohesion. Neither involves a sense of trust or mutual respect, so it is difficult to see how giving out welfare benefits could ever have been considered a good way to build strong social bonds between people.

Similarly, the experience of *contributing* to the welfare system does not generally foster values of altruism or mutuality either. Rather, it creates suspicion of one's fellow citizens. The rhetoric of 'bludgers' and 'scroungers', which social policy intellectuals like to explain away as the product of media scare campaigns, is better understood as an expression of frustration and anger by people of modest means who look around their own immediate neighbourhoods and think they see others taking advantage of them. This then provokes one of two reactions – either people get angry and resentful at being forced to pay taxes to support others who could and should be supporting themselves; or they decide to join in, intent on getting as much of their own money back as they can by taking the system for all they can get.

Again, therefore, the sentiments that are likely to be generated by the welfare state are quite the reverse of those which its defenders claim are produced. They say it is an altruistic system, yet it encourages self-interest. They say it is a compassionate system, yet it generates hostility and suspicion.

Social cohesion and the 'little platoons'

The argument that the modern welfare state fosters social cohesion rests on a fundamental misunderstanding of where social cohesion comes from. As sociologists like Peter Berger have long argued, and as 'third way' political revisionists like Mark Latham and Peter Botsman in Australia have also now come to accept, cohesion develops from the bottom-up, not the top-down.[15]

A sense of common identity and mutual empathy cannot be expected to develop on the basis of state bureaucracies reallocating compulsorily-levied tax revenues from one group of citizens to another. Such a top-down strategy of state patronage *may* work in more collectivistic cultures (although even there one suspects that cohesion persists despite rather than because of the welfare system), but it is most unlikely to work in more individualistic ones where the values of self-reliance and personal responsibility constantly undermine it.

The real source of social cohesion or 'social capital' in individualistic cultures comes not from the government but from the 'little platoons' of civil society. Social cohesion cannot be created by bureaucrats or planned by social policy experts. It emerges when families, workmates, neighbours or even ten-pin bowlers come together in formal or informal organisations and networks to share common interests and to solve problems in common.

Far from the welfare state strengthening these social bonds, it has weakened them by taking over responsibilities from these smaller agencies of civil society and leaving them with nothing to do for themselves. The best advice for any government seeking to build social cohesion is to stop doing so much and as far as possible to get out of the way so that people can do things for themselves. For New Zealand, this means learning, not from the French or the Finns, but from the Americans.

Social cohesion and economic inequality

But what of the inequality in America? Both of the *Knowledge Wave* papers quoted earlier made much play of the widening income gaps in the USA and the effect this is thought to have had for conflict and social polarisation in that country. Even if the welfare state does no build close links that bind us all together, surely a free market system that tolerates wide inequalities must divide us from each other and create deep fissions and fractures?

Again, this is an assumption more often repeated than analysed. Empirically and theoretically, it is simply not true that conflict necessarily flows from economic inequality.

Consider what has been happening to some of the obvious indicators of social fragmentation that sociologists and social commentators continually warn us about – things like rising crime rates, rates of substance abuse, suicide rates or rates of depression and mental illness.[16] It is certainly the case that many of these indicators have been increasing quite alarmingly over the last thirty or forty years in many western countries – but there is no evidence that this has been associated with increased inequality of incomes. In Australia, where I have looked at the trends in some detail, most of these indicators started worsening markedly from around the 1960s, but income inequalities were actually *reducing* at this time as a result of higher taxes and a massive expansion in targeted government welfare spending which continued right up until the 1980s.[17] New Zealand and the UK do not appear to be very different. In all three countries, greater equality went hand-in-hand with *more* conflict and fragmentation, not less[18].

But what about America? There is no doubt that income and wealth is more unequally distributed in the USA and that inequalities have widened since the 1980s. Despite this, however, American crime rates (other than homicides) are today *lower* than in Australia or Britain. Furthermore, during the 1990s, when the Americans dramatically cut back on welfare spending and income inequality increased significantly, crime rates in the United States plummeted while Australia's continued to rise. Egalitarian sociological orthodoxy would have predicted quite the reverse effect.[19]

Nor does sociological theory support the idea that greater equality should result in enhanced social cohesion. True, Marx and Engels believed that widening inequalities would generate unrest and ultimately ferment revolution, but later and more sophisticated theorists argued convincingly against this proposition. Emile Durkheim, for example, showed that it is a fallacy to assume that people will only get along with each other if they are all alike, and he showed that an unequal but open society with high rates of social mobility can achieve high levels of political legitimacy and social cohesiveness provided people recognise and take advantage of the opportunities that exist for them and their children to better themselves (i.e. the self-help strategy).[20] It may be true that social cohesion requires a 'fair' society, but this is not the same thing as an equal one.

The traditional left has always assumed that inequality of outcomes necessarily generates class envy and social divisiveness, but the opposite may actually be more likely. As with the welfare state, so too with a tax system bent on equalizing people's incomes, nothing is more likely to ferment conflict and resentment in society than one group using the power of the government forcibly to expropriate the legitimately-held earnings and assets of another.

The scope for self-reliance

New Zealand stands at a crossroads. The country has a choice to make between two models of capitalism.

Most of the expert advice around nowadays seems to favour a switch towards the continental European 'Rhine' model with its high levels of welfare spending and high taxes (as well as high unemployment and relatively low economic growth). It will be clear by now that I think this would be a major mistake. The only conceivable reason for doing it would be to ensure greater social cohesion, but there are good grounds for believing this would not work. I have argued that high levels of welfare spending are more likely to undermine cohesion than to build it, and that income inequality need not lead to conflict and fragmentation provided it reflects individual differences of effort and ability as against in-built privilege[21].

But if New Zealand steers clear of Paris and Helsinki, where should it steer? Let me finish by outlining part of what an alternative social policy strategy might involve over the next ten or twenty years.

The starting point is to recognise the revolution in living standards that has occurred over the last few decades in all western countries. New Zealand is justly proud of its history as one of the world's earliest welfare state pioneers – but this also helps remind us just how old the welfare state is. The mass welfare state was basically a late-nineteenth/early twentieth century response to mass problems brought about by urbanisation and industrialisation – poor housing, poor health, mass illiteracy, poverty in old age, and so on. Since then, growing affluence has helped resolve or minimise many of these problems.

Even a modest rate of economic growth – say 3 per cent per year – will double people's real living standards every thirty years or so. This is precisely what has happened across many western countries since World War II, and the result is that the majority of their populations no longer need the government to provide services on the sort of scale that was necessary to support our parents' and grandparents' generations.

The mass welfare state is in a process of long-term decline. This has been brought about by four main factors: escalating costs (what Marxists have called the 'fiscal crisis of the state'[22]); increasing affluence (ordinary people can now afford to buy services which had in earlier times been prohibitively expensive); expanded popular aspirations for private ownership (the convenience of car ownership, the autonomy of home ownership, the security of a retirement annuity); the sheer momentum of change (the more people who move to privatized provision, the more those they leave behind want to follow them, thus reinforcing the stampede to exit the State system).

This does not mean that we are returning to the nineteenth century pattern where people were expected to make provision for their basic needs through market transactions and self-provisioning, and where charity, philanthropy, mutual aid and a rudimentary system of official poor relief patched up the gaps. Having come to occupy such a central place in the life of modern societies during the twentieth century, the democratic State cannot and will not abdicate final responsibility for the material support of its citizens – modern political expectations and civic sensibilities would never allow it. What we are witnessing, therefore, is not a move back in time, but is rather the emergence of a new set of arrangements in which the role of government is changing from that of provider to enabler.[23]

In this newly-emerging 'privatised' system, direct provision of state-owned, state-run services is gradually wound down and subsidies and tax incentives are used instead to allow more people to access private health care, private schooling, home ownership or retirement saving schemes. The overall level of government social expenditure might not fall very much as a result of this transition, but what does change very visibly is the *form* in which services are produced and consumed. Increasingly, property rights are vested, not in government authorities, but in the final consumers themselves, and the implications of this for personal autonomy, as well as for the role of the State in civil society, are profound.

Of course, not all poverty and deprivation has disappeared from the developed capitalist countries, and some residual welfare state system will always be needed to care for a small minority of people who cannot achieve self-reliance. Their numbers, however, are likely to be small (elsewhere I have estimated that between 3 and 5 per cent of the working-age population in Australia might need long-term welfare support, and the figures in New Zealand are probably similar).[24]

Significantly more than 5 per cent of the population experiences *periods* of relative hardship as they go through life – as students, when they start a family, when they buy their first home, when they are between jobs, and so on. But in most cases, these periods of relative hardship do not last for long, and most of those who find the going tough at one time are on a trajectory which soon leads to a more comfortable situation. Throughout the western world, longitudinal income surveys consistently find that between half and two-thirds of those who appear under any given 'poverty line' in one year are no longer there just a year or two later.[25]

This means that many of those identified in one-off surveys as 'relatively poor' are actually in transition between periods of relative affluence. Over their whole lifetime, they will earn more than enough to get by on; it is just at certain short points in the life cycle that they struggle.

The policy implications of this are crucial, for income shortfalls in these transitional periods could in principle be covered by savings and investments (e.g. for retirement), loans (e.g. for periods in higher education) or insurance (e.g. to provide an income during periods of sickness or unemployment) funded from earnings during the more affluent periods of people's lives. This means that taxpayer-funded income transfers are no longer necessary to keep most people's heads above water, even in periods of relative hardship.

The welfare state and income churning

The proof of this can be found in evidence of what is called 'income churning' in modern welfare states. As total welfare spending has grown over the years, so it has had to be funded increasingly by taking money from all sections of society, not just the wealthy or high income earners. This means that many people now pay with one hand and receive the money back with the other, and that most beneficiaries end up paying for most or all of what they receive.

Income churning can be analysed at any one point in time ('simultaneous churning') or over a full lifetime. In both cases, we find that much of the money that people pay into the system gets paid back to them in the form of benefits or services.

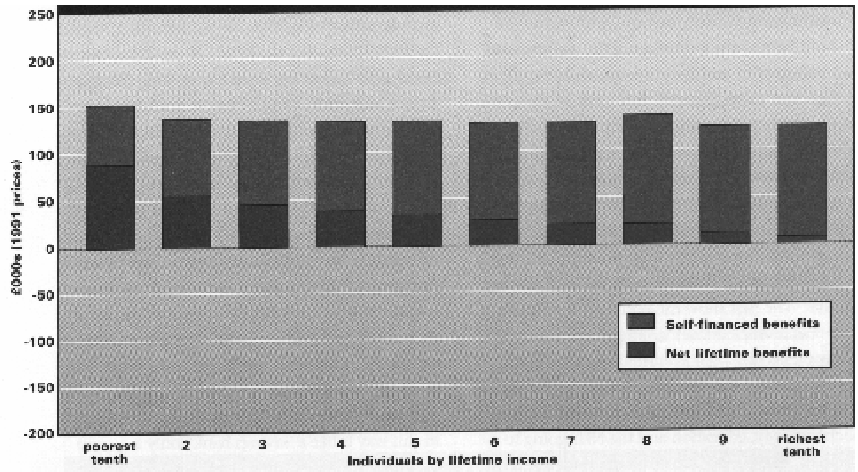
James Cox has analysed *simultaneous churning* – the way people pay taxes only to receive the money back straight away in the form of welfare – in the context of New Zealand.[26] He estimates that the top 60 per cent of New Zealand income tax payers receive in cash or in kind 46 per cent of all social expenditure. They get more than their share (71 per cent) of the money spent on public education, plus 55 per cent of the health expenditure, 39 per cent of income-tested benefits, 38 per cent of family assistance and 25 per cent of superannuation assistance. Cox argues that the government has over time boxed itself into a corner by constantly buying off different sections of the electorate with their own money. The result is that today, many New Zealanders are paying high rates of tax to finance provisions which they could afford to buy for themselves if left to their own devices.

A similar pattern can be found in Australia. The heavy reliance on targeting and means-testing in the Australian income support system means that direct, cash benefits are steeply progressive (while the lowest income quintile receives 27 per cent, the highest receives only 5 per cent), but the distribution of benefits in kind, such as government education and health services, is much flatter and somewhat regressive (the lowest income quintile receives 15 per cent by value as compared with 21 per cent going to the highest quintile).[27] Putting direct and indirect benefits together, the ABS confirms that the highest gross income quintile receives almost as much on average each week in government payments and services as the lowest (A$221 against A$286).[28]

This 'churning' of money through the welfare system is even more marked when we look at income flows over an individual's entire *lifetime*, rather than at just one point in time. There is to my knowledge no New Zealand data on this, but the pattern in both Britain and Australia is very clear, and much the same picture undoubtedly applies to New Zealand too.

Lifetime churning is particularly marked in social insurance systems, where entitlement to income support is established through personal contributions. In the UK, John Hills and Karen Gardiner find that, while people with higher lifetime earnings pay more tax over a lifetime into the welfare system, the overall allocation of benefits (cash income from social security, plus the value of government health and education services) is remarkably flat. Every income decile receives more-or-less the same (around UKL133,000 at 1991 prices), and on average, UKL98,000 of this is self-financed. Remarkably, even the 10 per cent of the population that earns least in the course of a lifetime self-finances getting on for half of what it receives, and the next decile up self-finances two-thirds of its receipts. The authors conclude: "Nearly three-quarters of what the welfare state does looked at in this way is like a 'savings bank'; only a quarter is 'Robin Hood' redistribution between different people."[29]

Figure 1: Self-financed lifetime benefits: UK (Hills and Gardiner)



In Australia, where the government-financed income support system is more tightly targeted, and where eligibility for cash benefits is on the basis of 'need' rather than contributions paid, this pattern of lifetime churning is less marked, but it is still strong. Taking 1986 as her base year, Ann Harding calculates the total lifetime value of direct federal taxes (but not indirect taxes) that people pay into the welfare state, and compares this with the total value of cash and education services (but not, initially, health services) that they receive back. She finds that: "A significant proportion of income taxes paid during the lifetime are returned to the *same individuals* in the form of cash transfers during some other period of their lifecycle. Over the lifetime there is thus significant 'churning' as taxes paid to government at some point in the lifecycle are returned to the same individuals at some other point."[30]

Taking men and women together, Harding calculates that the bottom income decile in Australia receives 21 per cent of its entire lifetime income as welfare cash transfers. This poorest section of the population is therefore remarkably self-reliant, receiving only one-fifth of its lifetime income from government pensions and allowances. Even more surprising is the fact that this same group also pays 12 per cent of its lifetime income to the government in income taxes. Of course, as Harding points out, not all of these taxes go to pay for welfare, and looking only at what she calls 'adjusted income tax' (i.e. that portion of their tax devoted to welfare expenditure), she shows (figure 2) that they take much more cash out than they put in. What is most significant as regards future tax and welfare policy options, though, is that even at the very bottom of the lifetime income distribution, cash benefits account for only one-fifth of lifetime income, and half of this is cancelled out by income tax paid.

When Harding includes the value of welfare services in kind, she finds that lifetime churning is even more marked, and that richer individuals often end up taking more value out of government-funded services than poorer ones do. For example, the highest decile of lifetime income earners receives $45,000 of taxpayer-funded schooling at 1986 prices, while the lowest decile takes only $38,600. Similarly in health care,[31] even the bottom decile pays for $30,000 of its $86,000 lifetime health benefits, and on average, Australians end up paying in their taxes for 73 per cent of the government health care they receive.

All of this evidence suggests that over a lifetime, most of us end up paying for most of the welfare benefits and services we consume. How could it be otherwise? The welfare state has now grown to such proportions that, inevitably, substantial contributions have to be levied on lower income groups as well as higher ones.

The result is that for most citizens today, the welfare state is merely a bureaucratic, non-responsive, compulsory 'piggy bank'. By taking taxes away from us during the more prosperous periods of our lives and returning the money to us during the leaner years, the government is ensuring that we save enough to cover our lifetime needs, but we exert precious little control over this process and the administrative cost of all this churning is very high.

It is important, of course, that individuals should 'smooth out' their lifetime income flows, but the same outcome can be achieved more efficiently and equitably by developing instruments like Personal Savings or Investment Accounts which allow people to accumulate funds in their own personalised accounts and to play an active role in how they are managed.

An 'enabling state' would require or encourage wage earners to save and invest in their own personal accounts (which might be supplemented where necessary by means of 'matched savings', as in various UK and various experimental US schemes). The Australian compulsory superannuation scheme is one example of such a strategy, although this system needs reforming as well as expanding. In Singapore, personal accounts are much more ambitious and can be used to fund house purchase, education and new business formation as well as retirement, and in Chile, personal funds have recently been extended to provide unemployment insurance as well as retirement annuities.[32]

Conclusion

All of us have grown up with the welfare state. It therefore seems inconceivable to many of us that we could or should even think about dismantling it.

We have grown used to the idea that the welfare state is needed to protect us, and we think of high levels of welfare spending as a sign of our level of civilisation and a guarantor of social cohesion and stability. We criticise America for its failure to develop a comprehensive, European-style welfare system, and we suspect that this explains why American society is coming apart at the seams.

But we have become complacent. In particular, many of us are failing to see the lessons in the recent American experience, in which welfare dependency rates have been rolled back while poverty has been reduced and rates of social pathology, such as crime, have been falling. This shows us that a mass welfare state may not after all be essential to protect people from want, still less to ensure a cohesive society.

Instead of reflecting on recent development in the US, we are still being encouraged by many social affairs intellectuals to look for inspiration to Europe in general, and to Scandinavia in particular, even though these countries have much higher levels of unemployment than America and are mired in long-term sluggish rates of economic growth which partly reflect the heavy tax burden of their ever-burgeoning welfare systems.

New Zealand has a clear choice to make. There are two models of capitalism from which it can choose. Burned by the experience of the rapid upheavals of the 1980s and early 1990s, it is perhaps understandable that many commentators warn against further liberalisation and urge a more European focus. In this paper, however, I have tried to show why emulation of Rhine-model welfarism would prove to be a deeply flawed strategy.

The key point is that the circumstances that brought the welfare state into being a century ago have long since disappeared. Most people are now effectively funding their own welfare benefits. This means that most of us no longer need a welfare state; we would be better off using savings, loans and insurance to do the job of smoothing our life cycle of earnings that the welfare bureaucracies and tax office currently do for us.

Some analysts accept this economic argument, but they still maintain that the mass welfare state is needed to deliver the social and cultural benefits of a cohesive and unified society. Again, however, the argument no longer stands up. Not only is it untrue that the market system necessarily drives people apart,[33] but the welfare state certainly does not pull them back together again. We have seen that the reality of welfare state relations between beneficiaries and recipients is more one of mutual mistrust and the pursuit of narrow self-interest than one characterised by the trust and reciprocity needed for social capital to emerge and flourish.

A truly cohesive society cannot be created from the top down. People come together when they have a reason to do so. If the welfare state takes care of every need, there is nothing left for us to do for ourselves. The pre-requisite for social cohesion is not a population of welfare dependents; it is a population of self-reliant, socially-responsible individuals. Given the economic growth of the last fifty years, such a society is certainly now possible. It would be richly ironic if we were to look to the foundering European welfare systems for inspiration when their time has now so clearly passed.

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[1] S. Danziger and others, 'Dies it pay to move from welfare to work?' *Journal of Policy Analysis and Management* vol.21, no.4 (2002), 671-692

[2] P. Loprest and S. Brauner, 'Where are they now?' *New Federalism* No.6 (1999) Urban Institute, Washington; L. Mead, 'Welfare reform and the family: lessons from America' In P. Saunders (ed), *Reforming the Australian Welfare State* Australian Institute of Family Studies, Melbourne, 2000.

[3] *Wall Street Journal* 13 May 2002; B. Riedl and R. Rector, 'Myths and facts' *Backgrounder* Heritage Foundation, July 12 2001

[4] Federally-funded child care spending by states increased from $2.1 billion in 1997 to $7.4 billion in 2000. M. Gray and D. Stanton, Lessons of US welfare reforms for Australian social policy' *Research Paper* N.29, November 2002, Australian Institute of Family Studies

[5] "Many progressives, ourselves included, fought hard against the program that passed in 1996…So far, the evidence reveals that many of our fears have not been borne out" J. Bernstein and M. Greenberg, 'reforming welfare reform' *The American Prospect* January 1-15, 2001, pp.10-11.

[6] P. Saunders, *The Ends and Means of Welfare* Cambridge University Press, 2002, chapter 9. I have written an extended critique of this book in *Policy* vol.18, no.3, Spring 2002

[7] S. Witten-Hannah, 'Social cohesion and the knowledge divide' Paper delivered to *Catching the Knowledge Wave* conference, August 2001, p.16

[8] A law limiting the working week to 35 hours was introduced in France in 1999. It caused havoc for employers and was repealed in December 2002.

[9] C. Waldegrave and N. Pole, 'Taking our Opportunities' Paper delivered to *Catching the Knowledge Wave* conference, August 2001 (quotes from p.14)

[10] The study is discussed in P. Smith and M. Bond, *Social Psychology Across Cultures* London, Prentice Hall, 1993

[11] M. Albert, *Capitalism Against Capitalism* London, Whurr Publishers, 1993

[12] ibid, p.53

[13] ibid, p.204

[14] "The 'empowered citizen'…can lay claims to rights of every description… In this (amoral) Utopia, the state has correlative obligations to meet its Empowered Citizens' large-scale demands and expectations… But of citizen duties and state rights there is rarely more than a token mention" (D. Selbourne, 'Who would be a socialist citizen?' In G. Andrews (ed) *Citizenship* (London, Lawrence & Wishart, 1991, 95-6). The continuing resistance of most of the welfare lobby to compulsory work requirements attached to welfa re benefits suggests that little has changed since Selbourne wrote this. In Australia, most social policy intellectuals are willing to endorse the *principle* of 'mutual obligation', but their main emphasis is placed on the obligations owed *to* welfare recipients by the government or by 'society' in general. They support those aspects of a 'mutual obligation' approach that require government to spend more on things like training (to prepare those without work with the skills they are thought to require before looking for employment), job search (to help them find employment once they have adequate skills) and childcare (to help single parents who want to work get back into employment), but they do not generally favour imposing compulsory work requirements on recipients, and they are highly critical when the authorities penalise claimants who persistently breach the conditions of their benefits by failing to turn up for training, or by failing to apply for the jobs for which they have so painstakingly been prepared.

[15] P. Berger and R. Neuhaus, *To empower people* (Washington, American Enterprise Institute, 1987); P. Botsman and M. Latham, *The Enabling State*.

[16] See, for example, Richard Eckersley, 'Redefining progress', *Family Matters* (vol 51, 1998, pp.6-12)

[17] Peter Travers and Sue Richardson (*Material Wellbeing in Australia*, Oxford University Press, Melbourne, 1993, p.73) report that the distribution of incomes became increasingly equal right up to 1981, after which inequality increased slightly. Most indicators of social pathology started moving upwards long before the 1980s, however – property crimes, for example, lurched upwards from the 1950s and male youth suicides started rising significantly in the 1960s (J.Buckingham, L.Sullivan and H.Hughes, *State of the Nation* CIS, Sydney, 2001, pp. 96 and 57). The start of the pathologies thus predates any increase in inequality by about 20 years.

[18] The Gini coefficient, a summary measure of income inequality in which a lower figure indicates greater equality, fell in New Zealand from 0.36 in 1958 to 31.4 in 1966 and reached 30.0 in 1975. Since then it has increased to 35.8 in 1985 and 40.2 in 1990. Thus, income inequality reduced from the mid-fifties to the mid-seventies at a time when crime rates, for example, were rising steeply (from around 300 crimes per 1000 population in the mid-fifties to about 700 twenty years later – see P. Saunders and N. Billante, 'Does prison work?' *Policy* Vol.18, no.4, Summer 2002-2003, 3-8).

[19] Evidence from the International Crime Victim Survey shows that Australia has one of the highest rates of crime of all the industrialised countries. In 1991, 29% of Australians reported having been a crime victim as compared with 26% of Americans, and trends in the two countries have been going in opposite directions ever since. See http://rulj287.leidenuniv.nl/group/jfcr/www/icvs/data/i_VIC.HTM. I have discussd these trends in more detail in P. Saunders and N. Billante, op cit.

[20] E.Durkheim, *The Division of Labour in Society* (Macmillan, Toronto, 1933).

[21] I have discussed the role of meritocracy in generating social cohesion in P. Saunders *Unequal But Fair?* London, Institute of Economic Affairs, 1996. Asked about what is a fair social arrangement, about half of the British population expresses some support for egalitarianism and half supports the idea that market exchange produces fair outcomes, but 90 per cent think it is fair if people are rewarded according to effort and ability.
[22] J. O'Connor, *The Fiscal Crisis of the State* (St Martins Press, New York, 1973
[23] This idea of the state as enabler has recently been developed as part of a "Third Way' political agenda – see, for example, P. Botsman and M. Latham, eds., *The Enabling State* (Pluto Press, Annandale, 2001).
[24] P. Saunders 'Do we still need the welfare state?' Paper to Australian Institute of Family Studies conference, Melbourne, February 2003
[25] C. Whelan, R. Layte, M. Maitre, B. Nolan. 'Persistent income poverty and deprivation in the European Union' *European Panel Analysis Group Working Paper* No 17 (Dublin, Economic and Social Reearch Institute, 2001).
[26] J. Cox *Middle Class Welfare* (Wellington, NZ Business Round Table, 2001).
[27] ABS, *Government benefits, taxes and household income 1998-99* (ABS Catalog 6537.0, 2001).
[28] Ibid. Of course, even if higher earners take almost as much out of the system as lower earners do, it is still true that they pay more in, so the system overall does redistribute money between them. The ABS calculates that the highest quintile in Australia pays an average of A$661 per week in taxes into the welfare system (leaving this group with a net 'loss' on its welfare transactions of A$439) while the lowest pays an average of just A$40 (realising a net gain of A$246). Nevertheless, it is clear that much of the money that goes into the welfare system is effectively returned to the same people.
[29] R. Hills and K. Gardiner, *The Future of Welfare* (York, Joseph Rowntree Foundation, 1997), p.19.
[30] A. Harding, *Lifetime Income Distribution and Redistribution* (North-Holland, Amsterdam, 1993), p.168, emphasis in original. See also Harding, 'Lifetime versus annual tax-transfer incidence', *The Economic Record* (vol. 69, no.205, June 1993, 179-91).
[31] Health is modeled in a later paper – A. Harding, R. Percival, D. Schofield and A. Walker, 'The lifetime distributional impact of government health outlays' NATSEM *Discussion Paper* number 47 (February 2000).
[32] On American experience with personal savings initiatives, see M. Sherraden, 'From research to policy: Lessons from Individual development Accounts' *Journal of Consumer Affairs* vol.34 2000, 159-81, and M. Schreiner et al, 'Savings and asset accumulation in IDAs, Centre for Social Development, Washington, February 2001. On recent UK initiatives, see HM Treasury, *Saving and assets for all*, London, April 2001. On recent developments in Chile, where individual investment accounts to cover retirement have now been extended to provide personal unemployment insurance as well, see W. Conerly, 'Chile leads the way with Individual Unemployment Accounts' *Brief Analysis* No.424, National Centre for Policy Analysis, Dallas, November 2002.
[33] Market transactions do not produce social disaggregation – quite the reverse, market relationships and private property rights create the conditions in which an active civil society can flourish. As Michael Novak suggests, "Markets draw individuals out of isolation and into reasoned, civil, voluntary interchange with their fellows."[33] Classic sociological indicators of social malaise (divorce, crime, drug abuse, mental illness, etc) were all much lower during the market mode of consumption in the late nineteenth century and increased as the welfare state expanded. Clearly, then, there is no inherent link between market-based social life and social atomism. Indeed, the capitalist market system has historically co-existed with both individualistic and communalistic cultures.