



Payment levels and employment outcomes for single parents and people with disabilities

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The proposed Welfare to Work Bill (2005) contains provisions to make significant reductions in payments to jobless single parents and people with disabilities who apply for payments after June 2006. As ACOSS has previously pointed out these payment reductions mean that:

- Jobless people with disabilities who have a 'partial capacity to work' will receive \$46 per week less
- Jobless single parents whose youngest child is 8-15 years old will receive \$29 per week less.
- An estimated 150,000 adults will be directly affected by these payment reductions.
- Those on the lower unemployment payments also have stricter income tests leading to higher effective marginal tax rates that reduce take-home pay from part and full time work.

It has been argued that these payment reductions will encourage more members of these groups to more actively seek employment, therefore joblessness will be reduced as will reliance on income support. The Department of Employment and Workplace Relations submission to the Senate Inquiry into the Welfare to Work Bill cites evidence from the OECD *Employment Outlook* (2005) that similar changes in payments for unemployed people in France and Denmark resulted in more rapid movement of recipients from welfare to paid work.¹ This paper considers international evidence on the effects of reductions in payments and other policies to progress people from welfare to work, their relevance to Australia and the effects of payment levels on unemployment levels here.

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¹ DEWR 2005, *Submission to Senate Community Affairs Committee inquiry into Welfare to Work Bill*, OECD 2005, *Employment Outlook*.

Evidence from France

The OECD report referred to in the DEWR submission argues that just before social insurance entitlements for unemployed people conclude after 14 months' unemployment, recipients increase their job search efforts and many obtain employment.

It should be noted that most European social security systems have two levels of payment: relatively high *social insurance* payments based on a percentage of previous wages or minimum wages, and much lower *social assistance* payments that act as a safety net when social insurance runs out. Social insurance payments are a form of unemployment compensation whereas social assistance payments are designed as a safety net to prevent poverty.

In France, social insurance payments for a single adult without children are typically 60-75% of previous earnings, but social assistance payments are flat rate payments equal to about half the level of social insurance (depending on the previous wage in each case).² The OECD report refers to people shifting onto the lower social assistance stream of payments after 14 months. Given the high level of social insurance payments, it is not surprising that they may discourage some people from seeking paid work. Given the large reduction in payments that occurs after 14 months, it is not surprising that many people increase their efforts to find a job before social insurance payments run out. However, it is important to note that the social assistance safety net remains in place to prevent poverty.

In overall terms, France has not been successful over the past decade and a half in reducing unemployment, especially long term unemployment. Its unemployment rate was 11.1% in 1993 and remains at 9.7% in 2004. Its long term unemployment rate (long term unemployed people in proportion to the labour force) rose from 3% in 1990 to 4% in 2004 (see international comparative data in table at end of this paper).

On the other hand, using a different measure of 'social welfare', rates of child poverty, France performs relatively well. Despite its relatively high unemployment, the rate of child poverty in France is relatively low at 7.9% of all children due to generous income support and family assistance payments.³

Evidence from Denmark

The OECD report refers to the 'motivation effects' of *compulsory participation in labour market programs* in Denmark – not, it should be noted, to any reductions in social security payments. Long term unemployed people in Denmark are required to participate in a range of labour market programs (typically a subsidised job, training, or a combination of the two) after 12 months'

² OECD 2004, *Benefits and wages*.

³ UNICEF 2000, *Child poverty in rich nations*. Poverty line set at 50% of median equivalent disposable income in each country.

unemployment. The level of compulsory participation has been progressively increased over the 1990s, from participation after 4 years' unemployment in 1994 to participation after one years' unemployment today. The report argues that many people increase their job search efforts just before they know they will be required to participate in a program.

Denmark also has a combination of social insurance and social assistance payments, and unemployed people also move from social insurance to social assistance after fixed periods of unemployment. The level of these payments is relatively generous, even by European standards. Social insurance payments for a single adult without children are typically around 90% of the previous wage. Although social assistance payments are much lower than this, they are more generous than in most other European countries.

Yet despite these high levels of income support, Denmark has been very successful in reducing unemployment over the longer term. Its unemployment rate was 9.6% in 1993, but is down to 5.4% in 2004, despite a recent cyclical downturn in the economy. Its long term unemployment rate (long term unemployed people in proportion to the labour force) was 2.2% in 1990 and this is down to 1.2% in 2004. This result is all the more remarkable, given that labour market participation rates in Denmark have also increased over this period and they remain among the highest in the OECD. Further, these reductions in joblessness have not been achieved by cutting minimum wages or welfare payments, although wage restraint across the board has played an important role.

Most commentators point to the critical role of Danish labour market assistance programs in achieving a marked reduction in *long term* unemployment. The Danes invested very heavily in subsidised employment, training and employment counselling over the 1990s. They still spend around 1.6% of GDP on active labour market programs, among the highest level in the OECD. This is about three times the level of expenditure in Australia, in proportion to GDP. However, this investment has paid off by substantially reducing unemployment and social security outlays over the 1990s.

Child poverty outcomes for Denmark are also positive. The rate of child poverty in Denmark is among the lowest in the OECD - 5.4% of all children - due to a combination of generous income support and family assistance payments and low levels of joblessness among parents.

Evidence from the United States

Some argue that we should pursue welfare 'reforms' along the lines of policies introduced in the United States in 1996 to reduce reliance on payments among parents, especially single parents. These changes included intensified requirements to seek full time employment (in some States, once the youngest child reached 3 months of age), a 5 year lifetime limit on income support, investment by State Governments in labour market programs, and

an increase in the Earned Income Tax Credit which in effect subsidises low paid employment for parents. It should be noted that income support payment rates for parents were *not* cut across the board at this time, though their real value had been eroded over the years by a lack of adjustment for inflation and also due to the fact the US has no national family allowance system (like our Family Tax Benefit) that extends to jobless families. As a result, income support levels for jobless families were already very low by international standards.

The number of payment recipients fell by 60% between 1994 (two years before the changes) and 2000, and employment rates of recipients rose from 60% to 72% between 1994 and 1999. Thus, reliance on 'welfare' in the traditional sense fell.⁴

However, many recipients subsequently returned to payments because the jobs they obtained were not secure. The Urban Institute estimates that between 1995 and 1997, 29% of welfare recipients who left welfare for at least a month were back on payments by the end of the period (in 1997). Further, 25% of former recipients remained jobless, did not have an employed partner, yet no longer received welfare payments. This group faces a high risk of severe poverty and they often have barriers to work such as a disability. The Urban Institute study found that half of this group reported that their food supply sometimes or often ran out before they obtained money to buy more.⁵

The low level of minimum wages in the US is a significant factor. In purchasing parity terms, hourly minimum wages in the US are worth about 40% less than the Australian equivalent. It might be argued that one advantage of this low minimum wage level is that it has helped generate low paid jobs for the (largely) low skilled parents on welfare payments. However, the experience of other countries suggests that unemployment can be substantially reduced without minimum cutting wages to US levels. For example, although unemployment was lower in the US than in Australia over the 1990s, our unemployment rates are now roughly the same, at around 5%.

A key disadvantage of low minimum wages is that in many cases the jobs obtained by former welfare recipients do not pay enough to keep these families out of poverty. The Urban Institute study found that the median wage for those who left welfare and were in jobs was \$6.61 per hour in 1997, slightly above the minimum wage but still in the bottom 20% of hourly wage rates for all employees in the US. Thus, the Brooking Institution concludes that: 'Despite the high increase employment levels of women who have left welfare, their incomes increase only modestly after leaving the rolls.'⁶

Another problem with low minimum wages from the standpoint of welfare policy is that the US Government has had to subsidise low pay on a large

⁴ Moffit 2002, *From welfare to work, what the evidence shows*. Brookings Institution Policy Brief 13 January 2002.

⁵ Loprest 2003, *Families who left welfare: who are they and how are they doing?* Urban Institute Discussion Paper 99-02

⁶ Moffit 2002, *From welfare to work, what the evidence shows*. Brookings Institution Policy Brief 13 January 2002.

scale to prevent child poverty from rising and to maintain incentives for low paid parents to work. It does so through the Earned Income Tax Credit, which is only available to families in low paid jobs – not to jobless families. Nevertheless, low pay is so prevalent in the US that expenditure on the Earned Income Tax Credit now exceeds outlays on traditional income support.

Thus, the 1996 changes (and previous welfare policies in the US) have effectively replaced a ‘traditional’ welfare payment system for families out of work with a new ‘in work’ welfare system for families in low paid jobs. At the same time, a substantial minority of parents still have to rely on ‘traditional welfare’ for at least part of the year and another group of jobless parents appear to have ‘fallen out’ of the system entirely.

At this stage, it is difficult to judge the effects of the ‘time limits’, as it is still too early for their effects to fully emerge in national data, and States have some discretion to waive the time limits. However, arbitrary time limits have could have a severe and unintended impact on poor families if there is a prolonged downturn in the economy.

The US strategy appears to have been effective in boosting employment and labour force participation and reducing reliance on ‘traditional welfare’. It does not appear to have dramatically reduced the unemployment rate, which was already relatively low. The unemployment rate was 6.9% in 1993, and this fell to 5.5% in 2004 (though it was lower prior to the latest recession in the US).

However, due to low minimum wages and the other reasons identified above, the intended beneficiaries of the strategy – poor families – do not appear to have enjoyed substantially improved living standards. In addition, they face the extra costs associated with working, including much less time to spend with children as young as three months old. These time limits, and the ‘drop out rate’ from payments among jobless families also give rise to concerns about the severe impoverishment of children in those families that remain jobless.

The US performs very poorly on child poverty compared with other OECD countries. A recent study of child poverty in wealthy nations commissioned by UNICEF found that the rate of income poverty among children in the US was 22%. Of 23 OECD countries surveyed, only Mexico had higher child poverty rates than the US.⁷

⁷ UNICEF 2000, *Child poverty in rich nations*. Poverty line set at 50% of median equivalent disposable income in each country.

Relevance to Australia

Australia has a dissimilar system of income support to the European countries above, and different systems of income support and minimum wages to the US. This limits the relevance of these international comparisons to Australia.

The shift from social insurance payments to lower social assistance payments in France and Denmark after a period of unemployment may have an effect on workforce participation in those countries, but this of limited relevance to Australia, and to the current Welfare to Work Bill, since:

- Social insurance payments in those countries are much higher than Australia's income support payments, as a proportion of minimum wages. A single adult with no children on Newstart Allowance receives just 46% of the income of an equivalent low paid full time wage earner (after tax). Of 21 countries surveyed by the OECD, Australian income support payments were the seventh lowest in comparison with the wages paid to production workers.⁸
- Pension rates (such as DSP) are higher than Newstart Allowance, but any work disincentives arising from the higher rates of payment are counter balanced by the more liberal pensions income test and thus lower effective marginal tax rates (see below).
- In overall terms, our income support payments are therefore much less likely to give rise to work disincentives than the European social insurance payments described above.
- Australia's income support arrangements are more akin to the social assistance safety net which people fall back onto once their social insurance entitlement runs out in other OECD countries. Because these are viewed as a 'last line of defence' against poverty, to our knowledge neither France nor Denmark has cut their social assistance payments.

Welfare policies along US lines are unlikely to be publicly acceptable in Australia since:

- The time limits leaves disadvantaged families without any payments or financial assistance from the Government.
- Child poverty levels are much higher.
- Parents are required to seek work when their children are still very young, whereas the Australian system has always recognized the importance of care for young children through income support payments.

Even if US-style policies were accepted here, they would be unlikely to succeed in substantially reducing joblessness among social security recipients unless secure, low paid jobs were readily available across Australia. Although

⁸ OECD 2004, *Benefits and wages*.

the official unemployment rate in Australia has fallen to 5.1%, the number of such jobs likely to be offered to the groups targeted by the Welfare to Work Bill – especially people with disabilities, very long term unemployed people and mature age jobless people – are still very limited in most parts of the country. The number of part time jobs suitable to the principal carers of children, that offer both regular employment and flexibility to fit with school and child care schedules, is also limited especially in rural and regional areas where service industry jobs have not grown as strongly as they have in capital cities.

Australian evidence on the effects of income support payments on unemployment

The following two studies by Reserve Bank economists and others provide evidence based on Australian experience and data that the level of income support payments is not a major factor behind the growth in unemployment in Australia over the past few decades.

First, Gruen, Pagan and Thompson examined data comparing maximum rates of income support payments with wages from the 1960s to the 1990s to establish whether the level of income support payments was a significant factor in the increase in unemployment over the long term in Australia.⁹ They concluded that there was no statistically significant relationship between the ratio of payment rates to wages and the level of structural unemployment over this period.

Second, Heath and Swann examined data on the level of wages sought by unemployed people and the number of job offers they received in the mid 1990s, from the ABS *Survey of Employment and Unemployment Patterns*.¹⁰ They concluded that:

- Most unemployed people were prepared to accept full time jobs offering low wages, even below minimum wage levels in many cases. Only 7.5% of job offers were rejected on the grounds that the job was unsuitable.
- The main reason for their continued unemployment appears to be the limited number of job offers they received rather than a rejection of low paid work.

Although receipt of unemployment payments was associated with longer spells of unemployment, they commented that this could be due to the relatively low skills and general employability of those people who received payments, rather than the welfare system itself.

⁹ Gruen Pagan & Thompson 1999, *The Philips curve in Australia*. RBA Research and Discussion Paper No 1999/01. See page 29.

¹⁰ Heath & Swann 1999, *Reservation wages and the duration of unemployment*, RBA Research and Discussion Paper No 1999/02. See pp22, 27-28, 30.

The effect of the *Welfare to Work Bill* on labour market participation in Australia

In our view, the proposed reductions in payments for people with disabilities and single parents in the *Welfare to Work Bill* are more likely to *inhibit* effective job search than they are to encourage it. The reasons for this are that:

- *Pension payment rates are already so low that recipients have more than enough financial incentive to seek employment to the extent that they are able*

In 2006, the maximum rate of DSP for a single jobless adult will be around \$254 per week. A survey of DSP recipients conducted for FACS found that almost one quarter said they could not afford medications or had to pawn or sell something to get by, and one in five said they went without meals.¹¹

A jobless single parent with two school age children on Parenting Payment will receive about \$468 per week (including Family Tax Benefits) in 2006. All of this is needed by a typical jobless single parent family just to buy the essentials. More than half of their income is typically spent on rent, food, and household utility bills alone, compared with about one third of income spent on these essentials by a typical Australian family.¹²

- *Cutting their payments to a lower level will further constrain them in their efforts to find employment or improve their skills.*

People with disabilities often face special expenses that are not faced by other Australians when they enter the workforce, including higher medication costs for people with mental illness and extra transport and equipment costs in other cases. The \$50 per week increase in Mobility Allowance is welcome, but it is likely to meet only a fraction of these extra costs, and only for a minority of people with disabilities on Newstart Allowance.

Single parents also have the cost of raising children, often without much financial assistance from the other parent. They often lack resources to help them find work, for instance, only half of all single parents own a car, a major drawback if they have to look for work in the outer urban or rural and regional areas where they typically live.¹³

¹¹ Nucleus Group (2004), *Survey of new disability support pension customers* (conducted for the Department of Family and Community Services).

¹² Smith Family 2003, *Barriers to participation*.

¹³ Smith Family 2003, *Barriers to participation*.

In any event, *other aspects* of the current Welfare to Work Bill, apart from the proposed reduction in income support payments, are likely to have a greater effect on labour market participation than the cuts in income support payments.

First, the policy *compels* recipients to participate in the labour market and in labour market programs such as the Job Network. If recipients are compelled to participate, it is doubtful that reductions in payments would make a great deal of difference to their job search efforts. Job Network providers are required to interview recipients regularly to ensure they are making efforts to find work, or participating in other programs.

As the above OECD report notes in its discussion of the French income support system: 'Insofar as activation requirements are partly equivalent to the elimination of benefit entitlements for individuals who are able to find market work, they will have [similar] motivation effects.'¹⁴

On the other hand, the shift from pension income tests to the tighter (albeit liberalised) income test that will apply to Newstart Allowance recipients will sharply *reduce* financial incentives for people with disabilities and single parents to seek low paid part time or full time work, as we demonstrated in our submission to the Senate Inquiry.¹⁵

Examples of the effects of the tighter income tests on effective marginal tax rates include:

- If a jobless person receiving *Newstart Allowance* enters a low paid part time job their disposable income will increase by much less than it would if they received a *pension* payment (such as Disability Support Pension or Parenting Payment Single).

If they get a job offering 15 hours work at minimum wages, we estimate a person with a disability would enjoy a 52% increase in disposable income on DSP compared with just a 38% increase on Newstart Allowance. We estimate that a single parent would enjoy a 32% increase in disposable income on PPS compared with just a 19% increase on Newstart Allowance (see graphs below).

- If a jobless person receiving a *pension* payment (such as DSP or PPS) enters a low paid full time job, they continue to receive a part payment of pension until their earnings exceed about \$700 per week. In this sense, pension payments act as 'in work payments' (akin to the US Earned Income Tax Credit), thereby boosting incentives to move from joblessness to a low paid full time job. Unfortunately, as noted in the ACOSS submission, this does not apply to Newstart Allowance recipients, so their incentives to take up such employment are lower

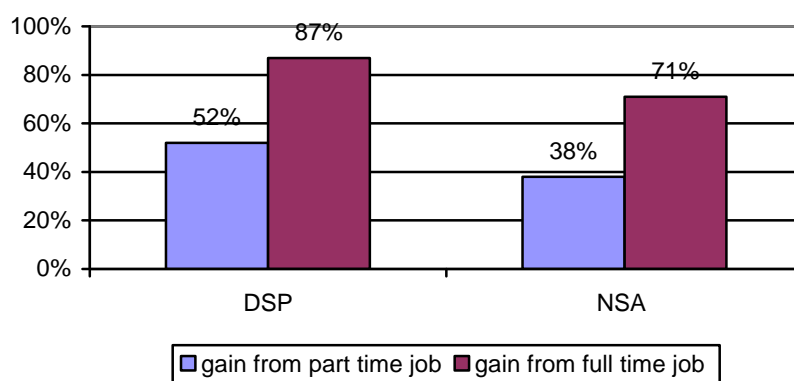
¹⁴ OECD 2005, *Employment Outlook* p179.

¹⁵ ACOSS 2005, *Submission to Senate Community Affairs Committee inquiry into Welfare to Work Bill*

than for pensioners.

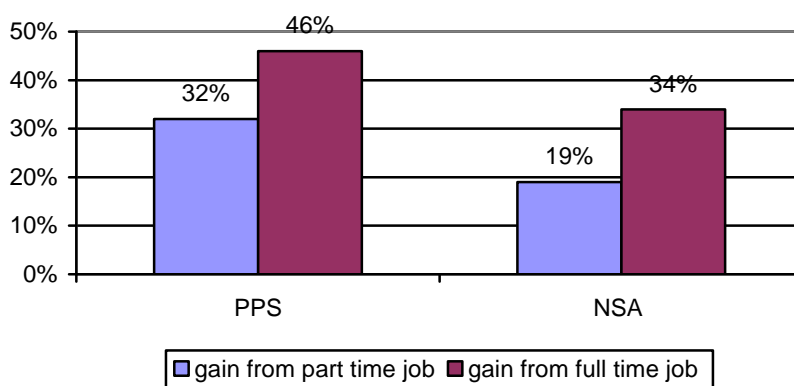
A person who moves from payments to a full time job on minimum wages, if they have a disability would enjoy a 87% increase in disposable income on DSP compared with just a 71% increase on Newstart Allowance. A single parent would enjoy an estimated 46% increase in disposable income on PPS compared with just a 34% increase on Newstart Allowance (see graphs below).

Gain in disposable income for a single jobless person with disabilities working 15 hours or 38 hours a week at minimum wages (2006)



Source: NATSEM 2005, *Distributional impact of welfare to work reforms upon Australians with disability* and ACOSS calculations.

Gain in disposable income for a jobless single parent with 2 school age children working 15 hours or 38 hours a week at minimum wages (2006)



Source: NATSEM 2005, *Distributional impact of welfare to work reforms upon single parents* and ACOSS calculations.

Conclusion

We conclude that there is no credible Australian or international evidence to suggest that a reduction in the level of income support payments for people with disabilities or single parents in Australia of the order proposed by the

Welfare to Work Bill would significantly increase their participation in the labour market or their efforts to find employment.

The payment cuts are more likely to inhibit effective job search by reducing the already limited resources available to recipients to do so. Other aspects of the package are likely to have a greater impact on workforce participation. First, the fact that many parents and people with disabilities would be compelled to look for paid employment is likely to overshadow any effect from payment reductions. At the same time, the tighter Newstart Allowance income test (compared with that applying to pensions) would *discourage* both part and full time employment.

Reducing payments, as proposed by the Bill, would needlessly increase poverty, including poverty among children, when there are less severe alternatives available. This is reinforced by the international evidence. Despite the relatively low level of joblessness among parents in the US, child poverty there is very high due to a combination of low minimum wages and a very stringent welfare system.

On the other hand, the Danish experience suggests that a more substantial investment in well designed labour market assistance to help people overcome barriers to employment would substantially reduce joblessness and reliance on income support, without the need to cut basic welfare payments or minimum wages. Such an investment would be socially beneficial and fiscally responsible. Australia has not consistently pursued this strategy in Australia in the past. ACOSS urges that the Government consider such strategic investment to make sure that the most disadvantaged Australians have a better chance of securing employment and enjoying the benefits of current national economic growth.

Attachment

Labour market, social security and child poverty indicators

	Australia	France	USA	Denmark
Benefits, wages and labour market program expenditure				
OECD 'summary measure' of benefits as a % of a production workers wage	25%	44%	14%	51%
Minimum wages ¹⁶	57.9%	60.8%	36.4%	
Spending on active labour market programs (% of GDP in 2000)	0.46%	1.32%	0.15%	1.58%
Labour market and poverty indicators				
Unemployment 1993 ¹⁷	10.6%	11.1%	6.9%	9.6%
Unemployment 2004	5.5%	9.7%	5.5%	5.4%
Long term unemployment 1990 ¹⁸	1.4%	3.0%	0.3%	2.2%
Long term unemployment 2004	1.1%	4.0%	0.7%	1.2%
Child poverty rate	12.6%	7.9%	22.4%	5.1%

¹⁶ Keese & Puymoyan 2001, *Changes in earnings structure*, OECD Labour market and social policy occasional papers.

¹⁷ 1993 is chosen as the base year because this was roughly the peak of the recession in most countries, thus illustrating the progress in various countries in reducing unemployment from its cyclical peak.

¹⁸ 1990 is chosen as the base year due to data restrictions, and because it represents a similar point in the business cycle to 2004. Trends in long term unemployment between these years therefore give an indication of whether structural unemployment has risen or fallen in each country.