

# What's next for Welfare-to-Work?

Jessica Brown

---

EXECUTIVE SUMMARY

No. 117 • 15 October 2009

---

In 2006, the Howard government's Welfare to Work reforms placed new eligibility requirements on recipients of the Disability Support Pension (DSP) and Parenting Payment (PP), with the aim of reducing their numbers. Since then, the number of people on PP has dropped by about 20%: a remarkable result. However, the number of people on DSP has marginally *increased*. This suggests that DSP should be the focus of future welfare reform.

Evaluating recent welfare reform is particularly important at a time of rising unemployment. When jobs are hard to find, the incentive for unemployed people to move to other welfare payments such as DSP grows. There is a real danger that rising unemployment could undo the recent gains in reducing long-term welfare dependence.

Several relatively easy policy changes can be made to DSP, such as extending work requirements to existing recipients who were 'grandfathered' from the recent changes. But this alone will not solve the problem of growing DSP numbers.

Some of the success of the PP reforms is undoubtedly due to the fact that the new jobs being created were suitable for many sole parents, such as part-time positions in female dominated industries. However, many DSP recipients are older, unskilled people who have work experience in areas where jobs are limited. A key component in reducing welfare numbers—both among DSP recipients and other payment types—must be removing structural impediments to greater unskilled job creation.

One solution is a system of 'in work' benefits that uses the tax-transfer system to top-up the disposable income of low-paid workers while letting the minimum wage fall. This strengthens both the incentive for employers to hire low-skilled workers and for welfare recipients to move into work. This type of system has some drawbacks but represents the best chance to reduce long-term welfare dependency and stimulate jobs growth.

Policymakers should draw lessons from both the successes and failures of past welfare reform to ensure that any short-term rise in unemployment is not the catalyst for an explosion in long-term welfare dependence.

---

**Jessica Brown** is a Policy Analyst at The Centre for Independent Studies. She would like to thank Roger Wilkins along with her colleagues at the CIS for comments on an earlier draft. Any errors remain her own.



## Introduction

In 2006, the Howard government introduced Welfare to Work: a reform package that tightened eligibility requirements for recipients of both Disability Support Pension (DSP), the income support payment for those unable to support themselves due to a physical or mental disability, and Parenting Payment (PP), the income support payment for sole parents and parents whose partner is not working or has a very low income. These far-reaching reforms were aimed at reducing the number of welfare recipients. In the case of DSP, anyone who was judged to be capable of working 15 hours per week was required to look for a job. PP recipients were required to look for part-time work once their youngest child reached school age.<sup>1</sup>

Despite these extensive reforms, there has been surprisingly little in the way of evaluation and analysis of their actual impact. This report investigates changes in the number of DSP and PP recipients since these policy changes. It finds that the number of people claiming PP has dropped substantially. However, the number of people claiming DSP has actually *increased* marginally.

These findings are particularly relevant in the current economic climate of rising unemployment and underemployment. There is a real danger that higher unemployment will translate into an increase in long-term welfare dependency. The experience of past recessions shows that as the jobless rate climbs, some unemployed people seek to move from payments with stringent job search requirements such as unemployment benefits to more generous payments such as DSP. The result is that while unemployment has dropped over the past decade, the number of people receiving welfare payments such as DSP has continued to grow.

This report suggests that—as the number of people receiving DSP has not dropped since the 2006 reforms—this payment should be the focus of future welfare reform. While there are some relatively simple modifications such as extending tighter eligibility requirements to existing recipients, a very difficult problem looms in the background. Given that DSP recipients tend to be older, relatively unskilled people—will there be suitable jobs available for them?

Future welfare reform will only be successful if it is accompanied by policies that lead to an increase in unskilled job creation. Using the tax-transfer system to provide a system of ‘in-work’ benefits would enable real minimum wages to fall without harming the living standards of low paid workers, and would provide an additional incentive for welfare recipients to join the workforce. With rising unemployment threatening to undo the recent gains made in decreasing welfare dependence, now is the perfect time to consider a strategic, new direction for unemployment and welfare policy.

The first section of this report looks at why policymakers should work to reduce welfare dependence and the lessons from past attempts at welfare reform. It looks at current trends in the labour market and welfare dependence, asking whether welfare reform is something policymakers need to worry about right now. The second section examines the changes in the number of DSP and PP recipients since the 2006 reforms and discusses some of the possible reasons for these results. It argues that while DSP should be the focus of future welfare reform, this will need to be accompanied by policies that reduce impediments to the creation of unskilled jobs.

## Why welfare reform is important

Should we even worry about reducing welfare dependence? After all, it will never be eliminated. There will always be people who—due to an acute disability or caring responsibilities—cannot work. As our economic fortunes improve and working becomes relatively more attractive, the number of people reliant on the public purse will naturally drop. The people left on income support are probably those who are least able to find a job anyway. Should we be heckling and cajoling them into expensive training programs or job search activities that might be expensive and have little chance of success?

**The number of people claiming PP has dropped substantially. However, the number of people claiming DSP has actually *increased* marginally.**

**There seems to be broad public agreement that people have a moral duty to work and contribute to society where possible.**

Or should we just accept that a life on welfare is the least worst option for some people who—because they have skills that are no longer in demand in the modern economy or because they have some personal shortcoming—will probably never gain sustainable and ongoing employment?

#### *A bipartisan consensus*

Regardless of the normative arguments in favour of welfare reform, a bipartisan consensus between the major parties suggests it is a policy area worthy of analysis.

The Rudd government is committed to ‘social inclusion’: the conviction that individuals should have the opportunity to participate in economic, social and community life, including in the paid workforce. One of the goals of the government’s social inclusion strategy is to reduce the number of households where no one works.<sup>2</sup> For the Howard government, reducing the number of people reliant on income support was an explicit and central policy aim. A key contention of its *Final Report of the Reference Group on Welfare Reform* (2000) was that ‘joblessness, underemployment and reliance on income support remain unacceptably high.’<sup>3</sup>

Reducing welfare dependence also has wide public support. In both the 2003 and 2005 Australian Survey of Social Attitudes, more than 70% of respondents agreed with the statement ‘People who receive welfare benefits should be under more obligation to find work.’<sup>4</sup> There seems to be broad public agreement that people have a moral duty to work and contribute to society where possible.

#### *Welfare and individual responsibility*

There are other compelling arguments for reducing the number of people reliant on income support, which over the long term can have a devastating effect on individuals, families and communities.<sup>5</sup> Noel Pearson argues for welfare reform because it is in ‘the best interest of disadvantaged people.’<sup>6</sup> He points to the pernicious effects of passive welfare on many Indigenous communities, maintaining that what was intended as a support mechanism has become a straitjacket that keeps welfare recipients in an ongoing state of dependency and disadvantage and locked out of economic participation.<sup>7</sup> Children who grow up in jobless households have worse health, educational and developmental outcomes, and later in life become less likely to themselves be employed and more likely to have a low income.<sup>8</sup> Unlike other countries where working people are sometimes relatively poor, in Australia the main cause of relative poverty is being in a jobless—usually welfare dependent—household. The OECD cautions that work, not welfare, is the best defence against poverty.<sup>9</sup>

#### *The cost to society*

Despite a recent fall, income support reliance is at historically high levels. In the mid-1960s, about 3% of working-age people depended on income support as their main source of income. Over the subsequent four decades, welfare dependence has increased by more than 500%.<sup>10</sup> By 2006–07, 17% of working-age Australians received income support, and taxpayers were spending more than \$25 billion on income support payments to working-age Australians.<sup>11</sup> This represents a large opportunity cost: money that could instead be spent on tax cuts or public services. A high rate of welfare dependence in the community places an unfair burden on other taxpayers, who face ever-increasing tax bills to fund it. Furthermore, it may become unsustainable as an ageing population increasingly strains government budgets.<sup>12</sup>

Not everyone is able to work, and the aim of the welfare system should be to provide a safety net for these people. However, individuals benefit from work while society as a whole benefits from high levels of workforce participation. Therefore, policymakers should aim—as much as possible—to reduce the number of people reliant on income support and increase the number of gainfully employed.

**Table 1:** Income Support Payments

- **Parenting Payment:** In the 2006–07 financial year, nearly 150,000 people received Parenting Payment (Partnered), the payment available to parents whose partners are not in the labour force or have a very low income. Nearly 400,000 received Parenting Payment (Single), the payment for single parents whose children have not reached school age. These two payments are collectively referred to as PP in this report.
- **Disability Support Pension:** More than 700,000 were on the Disability Support Pension (DSP) in 2006–07.
- **Youth Allowance:** Nearly 70,000 collected Youth Allowance (Other), an income support payment for people aged 16–20 who are not working (or have very low incomes) and not in full-time study (2006–07).<sup>13</sup>
- **Newstart Allowance:** Unemployed people over 25 receive Newstart Allowance.
- **Other payments:** Several other payments are also available, including Carers Payment for those caring for a child, family member, or another person with a disability, and specific payments for veterans.

**Source:** Department of Families, Housing, Community Services and Indigenous Affairs<sup>14</sup>

### ***The effect of perverse incentives***

In theory, reducing the number of people on each income support payment should be as simple as solving the specific problem that the payment aims to remedy: reducing the level of disability in the community, for example, or creating more jobs. In practice, we know that it is more complicated than this. Rather than being seen as ‘stand alone’ payments for discrete groups of people, income support should be viewed as a single, overlapping system.<sup>15</sup> The success of past welfare reforms—such as the 2006 changes—should be evaluated with this in mind.

Welfare recipients often move between payments. Of particular concern to policymakers is the tendency for some people to move from unemployment benefits to other types of welfare payment, such as DSP. In 2005, Cai and Gregory found that about 60% of the people who moved on to DSP came from another payment, primarily from unemployment benefits. The longer people are unemployed, the greater the chances are that they would move to DSP.<sup>16</sup>

This is a major problem for welfare reformers. Once people move from unemployment benefits to other payments, they tend to stay there for a long time. In 2007, the average DSP recipient had spent nearly nine years on that payment and almost 11 years on all types of welfare combined. The average PP recipient had spent five years on that payment and almost seven and a half years on welfare in total.<sup>17</sup> For many people, a move onto welfare means they will never leave income support. More than half of the people who left DSP in 2007 did so because they were moving on to the Aged Pension.<sup>18</sup>

#### *‘Mutual Obligation’*

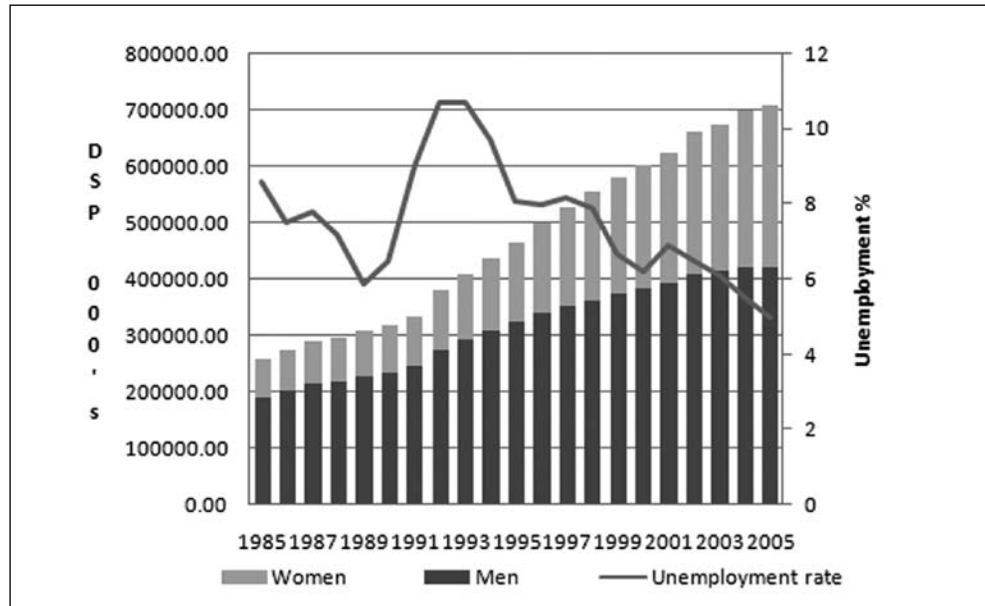
Recent experience of welfare reform has demonstrated just how interwoven the system is. The Howard government’s Mutual Obligation policy, introduced in the late 1990s, placed more onerous requirements on jobseekers such as Work for the Dole. This inadvertently increased the incentive for people to move from unemployment benefits to other payments.<sup>19</sup> Although the unemployment rate dropped, the number of people on payments such as DSP skyrocketed as some recipients ‘substituted’ from one payment to the other.<sup>20</sup> While the number of people claiming unemployment benefits (Newstart Allowance and Youth Allowance [Other] in Figure 2) fell between the mid-1990s and the mid-2000s, the number of people claiming many other types of welfare payment increased.<sup>21</sup> This makes it important to monitor not just the

**Once people move from unemployment benefits to other payments, they tend to stay there for a long time.**

unemployment rate but also the number of recipients of other welfare payments such as DSP and PP. The success—or otherwise—of the 2006 reforms tells us a lot about the overall health of the labour market.

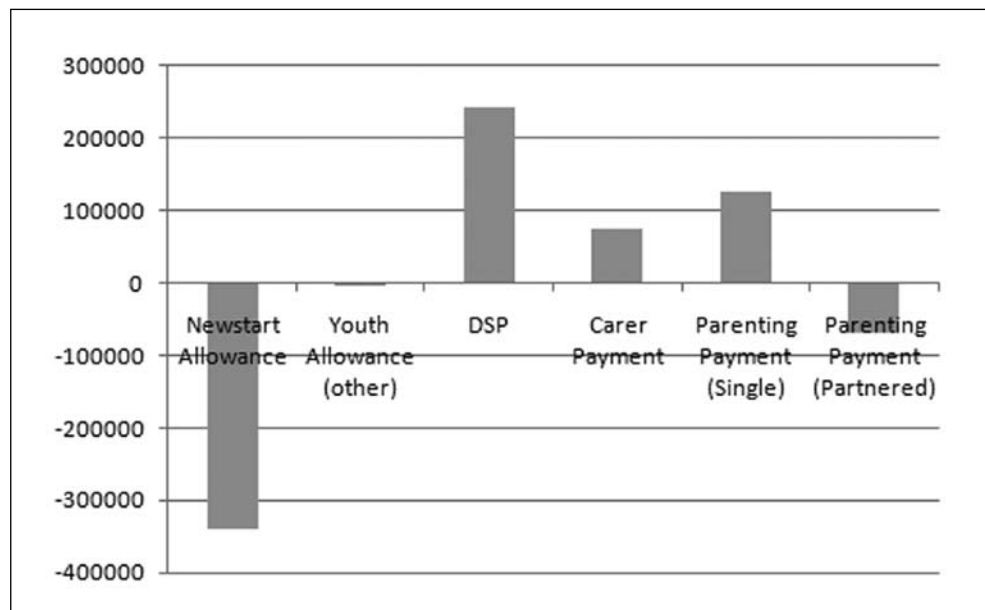
**Figure 1:** Disability Support Pension recipients and unemployment rate, 1985–2005

The success—or otherwise—of the 2006 reforms tells us a lot about the overall health of the labour market.



**Source:** Australian Bureau of Statistics, Department of Families, Housing, Community Services and Indigenous Affairs<sup>22</sup>

**Figure 2:** Changes in the number of recipients receiving selected welfare payments, 1995–2005



**Source:** Author's own calculations using data from Department of Families, Housing, Community Services and Indigenous Affairs<sup>23</sup>

## **Welfare and the labour market today**

It is especially useful now—at a time of rising unemployment—to monitor changes in welfare numbers and evaluate the success of recent reforms. The experience of past recessions shows that as unemployment goes up, so do other types of welfare receipt.<sup>24</sup> Nevertheless, Australia's job market has performed remarkably well so far during this recession with the unemployment rate dropping marginally to 5.7% in September. Rather than taking us back to the Great Depression, in terms of unemployment this recession has only taken us back to the not-so-horrifying depths of 2003.<sup>25</sup> Australia has performed well compared to much of the developed world: the average unemployment rate across the OECD in July was 8.5%, with the European Union and the United States nudging 9% and 10% respectively.<sup>26</sup> While the news is not all good in Australia—there has been a steep rise in underemployment—the positive result suggests that Australia's jobs market is holding up well.

### *Welfare numbers dropping*

This positive story is further underscored by recent data that show that after rising inexorably for several decades, the proportion of households reliant on government income support has dramatically *dropped*. In 1994–95, 28.5% of households relied on income support payments for all or part of their income. By 2007–08, this had dropped to 23.2%.<sup>27</sup> A large part of this fall was caused by fewer retired households relying on the pension, but there were also significant drops among working-aged households. In the mid-1990s, about one in six 'prime' aged households (in their mid-30s to mid-50s) relied primarily on welfare. By the late 2000s, this had dropped to about one in 10. With all this positive data, is it even worth worrying about welfare reform?

**Table 2:** Percentage of households reliant on income support as their primary source of income

	<b>1994–95</b>	<b>2007–08</b>
15–24	19.5	9.5
24–35	16.1	12.0
35–44	14.7	9.4
45–54	14.9	10.0
55–64	39.0	17.4
65+	77.0	65.5
Total	28.8	23.2

**Source:** Australian Bureau of Statistics<sup>28</sup>

### *So why bother with reform?*

In spite of these positive results, there is a real danger that the recent gains in reducing welfare dependence will be reversed. Since 2007–08, when the survey in Table 2 was taken, the economy and the jobs market have deteriorated. The experience of previous downturns is that some workers who lose their jobs never return to the workforce again.<sup>29</sup> The unemployment rate was steady in July and August at 5.8%, yet this was only because the participation rate—the proportion of people who are working or looking for work—dropped by 0.2%. This meant that while the number of people looking for work decreased marginally, the number of people actually in work also decreased—by almost 30,000.<sup>30</sup> As it becomes harder to find a job, fewer people continue looking for one.

The challenge for policymakers now is to ensure that, unlike in past recessions, large numbers of these 'discouraged jobseekers' don't end up being long-term welfare dependent. Reviewing the success of past welfare reform, and taking from it lessons for future changes, is now imperative to ensure these recent gains are not lost.

**In the mid-1990s, about one in six 'prime' aged households (in their mid-30s to mid-50s) relied primarily on welfare. By the late 2000s, this had dropped to about one in 10.**

**Table 3:** A concise history of welfare reform in Australia

<b>1910</b>	The first Invalid Pension is introduced.
<b>mid-1940s</b>	The first federally funded unemployment benefits and widows pensions are introduced. Unlike the contributory social insurance schemes that had been introduced in the United States and Europe, Australia's payment was means-tested and paid at a flat rate. Few changes were made until the mid-1970s when some eligibility requirements were tightened.
<b>1973</b>	The Supporting Mothers Benefit (later Supporting Parents Benefit) is introduced to cover single mothers or other mothers not covered by the Widow Pension.
<b>mid-1980s</b>	The first 'activity tests' are introduced for unemployed people.
<b>1989</b>	Supporting Parents Benefit and Widows Pension are combined to form the Sole Parent Pension (called Parenting Payment from 1998).
<b>1991</b>	'Newstart Allowance,' the current unemployment benefit, is introduced.
<b>1991</b>	The Invalid Pension is replaced by the Disability Support Pension.
<b>1994</b>	The Keating government's 'Working Nation' white paper introduces reforms to unemployment benefits as part of a larger suite of 'active' labour market policies designed to assist the unemployed to find work.
<b>1997</b>	The Howard government takes these reforms further by introducing its Mutual Obligation package for jobseekers. A major part of this package was the introduction of Work for the Dole, based on the idea that unemployed people should have some responsibilities in return for the payment of their unemployment benefits. Initially confined to young jobseekers, Work for the Dole and other mutual obligation activities were eventually extended to older unemployed people and other income support recipients such as some sole parents.
<b>2006</b>	The Howard government introduces Welfare to Work, which tightens eligibility for some payments such as DSP and PP to increase the workforce participation of these groups. DSP recipients who were deemed to be able to work at least 15 hours per week and PP recipients whose children had reached school age were transferred onto Newstart Allowance <sup>31</sup> and had a part-time work test applied.

**Source:** Parliamentary Library<sup>32</sup>

### Evaluating the 'Welfare to Work' reforms

As discussed above, from 2006 DSP and PP recipients faced tough new eligibility requirements that forced many to look for work. The aim of this change was to reduce the number of people relying on these payments. But did it work?

**Table 4:** Changes in DSP and PP numbers after 2006 Welfare to Work reforms

	<b>DSP</b>	<b>PPS</b>	<b>PPP</b>
June 2006 (reforms implemented)	712,163	433,370	159,719
June 2007 (1 year after reform)	714,156	395,495	144, 427
July 2009 (latest data)	746,629	342,344	130,344
Percentage change	+4.61%	-21.00%	-18.39%
Actual change	+34 466	-91 026	-29 375

**Source:** Author's own calculations, using data from Australian Government Labour Market Information Portal, DEWR 2006–07 Annual Report, Department of Families, Housing, Community Services and Indigenous Affairs<sup>33</sup>

As Table 4 shows, there has been a marked decline in the number of PP recipients since the introduction of the Welfare to Work reforms. The reforms were designed to push some recipients onto unemployment benefits, indicating that some of the change may be due to recipients moving onto Newstart Allowance. However, the reforms occurred at the same time as unemployment was dropping. This suggests that the positive result achieved was not simply due to PP recipients being shuffled from one payment to another but instead moving off welfare altogether. Lending weight to this conclusion is ABS data showing that the overall proportion of sole parents who are jobless has been dropping for quite some time (from 56% in 1996 to 47% in 2006).<sup>34</sup> While it is not possible from the available data to conclude that the 2006 reforms *caused* the drop in PP recipients, the positive change since the introduction of the reforms is marked.

In contrast, the number of DSP recipients has actually *increased* since the Welfare to Work reforms were enacted. Moreover, the proportion of people who came to DSP from unemployment benefits—about one-third—was the same in both the year before and after the reforms were enacted.<sup>35</sup> Judging by evidence that the long-term unemployed are more likely to move onto DSP than the short-term unemployed<sup>36</sup> and predictions that long-term unemployed will grow over the next few years,<sup>37</sup> it is fair to assume that this figure will continue to grow. Again, these figures don't prove causation, but it seems safe to conclude that the 2006 reforms have had little effect in halting the flow from unemployment onto DSP.

### ***The difference between PP and DSP reforms***

Since the 2006 reforms, determining which PP recipients are required to look for work and which are not has been based on a simple and objective measure: the age of their youngest child. This measure is easy for administrators to determine and for recipients to know what to expect. In contrast, determining which DSP recipients face work requirements is much more subjective. Individuals vary in their capacity to work, and doctors vary in their assessments of their patients' capacity to work. Adopting a more objective and better defined benchmark for which DSP recipients are required to look for work and which are exempt should lead to improved outcomes.

Another difference between the reforms to DSP and PP was the treatment of existing recipients. All PP recipients whose children reach school age have some part-time work requirements placed on them, even if they were on PP prior to the reforms being enacted. Not only do the reforms act as a disincentive for *new* recipients of PP to stay jobless for many years but they are also designed to actively encourage *existing* recipients into work. This means that the pool of existing PP recipients is gradually diminishing.

In contrast, existing DSP recipients were 'grandfathered' from the 2006 reforms. While new recipients had a work-test applied, existing recipients do not face such a test. The result is that the pool of people who received DSP prior to the reforms is not being reduced at all. If work tests are applied to new applicants, then it is fair and equitable that existing recipients face the same test. To achieve the same sort of results that the PP reforms achieved with DSP, work tests will need to be applied to existing recipients.

### *Orientation to work*

The 2009, the Harmer report on pensions argued that the DSP needed to be reconfigured to reflect a more active orientation to work rather than being a passive source of income. The review suggested 'improved assessment procedures to ensure that people are not inappropriately placed on Disability Support Pension,' stronger support for the employment of disabled people, and a more 'proactive' approach to existing DSP recipients who are able to work.<sup>38</sup>

It is also worth noting that the markedly different results for PP and DSP may not be solely due to the effect of these reforms. It would be unwise to conclude simply that the PP reforms 'worked' while the DSP reforms did not. The number of PP recipients who were employed prior to the 2006 reforms was much greater than the number of

**The positive result achieved was not simply due to PP recipients being shuffled from one payment to another but instead moving off welfare altogether.**

**Beyond welfare reform, a secondary policy challenge is to ensure that there is a pool of low-skilled jobs available for recipients.**

DSP recipients with jobs, suggesting that many would have become ineligible for PP under the new regime without any change in their employment level. In the 2005–06 financial year, just before the reforms were enacted, about 12% of DSP recipients were employed. In contrast, nearly 40% of PPS recipients were employed with more than 5% being employed full-time.<sup>39</sup> This means that some of the positive effects of the 2006 reforms on the number of PP recipients could simply be a reflection of the already greater participation amongst sole parents than other types of income-support recipients.

Moreover, we can only hypothesise what would have happened if these reforms had not been introduced. Perhaps the number of people on DSP would have risen even further. Just because the numbers on DSP increased slightly, we cannot conclude that the reforms were a complete failure. Conversely, just because the number of PP recipients fell dramatically we cannot conclude the reforms were a complete success. Nevertheless, as the number of DSP recipients is continuing to grow while the numbers on PP drops, it seems safe to argue that DSP should be the focus of future welfare reform.

#### *The changing labour market*

There may also be some lessons to be drawn from the types of jobs being lost and created during this downturn. Many of the jobs being created are part-time and in the female-dominated service industries. These jobs are well suited to PP recipients (most of whom are relatively young women), suggesting that part of the reason why the welfare to work reforms have been so successful in this area is because there are plenty of jobs available for PP recipients. While about 40,000 manufacturing jobs were lost in the year up to August 2009, more than 100,000 were created in health care and social assistance in the same period.<sup>40</sup>

DSP recipients are largely older, unskilled people (the Harmer Review says that their 'low levels of labour market attachment are frequently associated with low levels of individual human capital'<sup>41</sup>), many of whom have experience in industries such as manufacturing where jobs are being moved overseas, indicating a structural rather than cyclical shift in the labour market. Many laid-off full-time workers in the manufacturing industry will be unsuited to and unskilled for the new—often part-time or casual—jobs being created in the service sectors.<sup>42</sup> Beyond welfare reform, a secondary policy challenge is to ensure that there is a pool of low-skilled jobs available for recipients.

#### *Political will*

In the 2009 Budget, the Rudd government increased the weekly pension for DSP recipients by \$30 but not for PP recipients. This increases the incentive for sole parents to work but also increases the disincentive for those on the DSP to work. This, along with the different conditions applied to DSP and PP in the 2006 reforms suggests that both the Howard and Rudd governments view DSP and PP recipients differently. There is a political will to move PP recipients off welfare and into work, and this view has been borne out in the successful reduction in PP numbers. It appears that there is not as much political will when it comes to reducing DSP numbers.

Some of the measures discussed above—introducing a more objective measure of who is subject to a work test and making the test apply to existing recipients—would be difficult politically but could provide a relatively easy win in terms of policy success. However, the gaps in the unskilled labour market present much more of a problem. If thousands of unskilled people are pushed off DSP, they will have nowhere to go. The only way to successfully reduce welfare dependence is to also consider far-reaching reforms of labour market policy.

#### ***Increasing unskilled jobs***

Tightening welfare eligibility is useless if there are no jobs available. The economic success enjoyed by Australia over the past few decades has brought new skilled job opportunities, but the downside of this is the weakening of unskilled job opportunities.

Discouraged jobseekers, the long-term unemployed, or welfare dependent are often those with the fewest skills and those who find it most difficult to compete for jobs. Long-term welfare dependency can only be reduced if new unskilled opportunities are created.

Australian and international experience shows that it is expensive for the government to directly create jobs in the public sector or subsidise jobs in the private sector—and doing so typically provides few long-term benefits.<sup>43</sup> But there *are* policy settings that government can put in place to stimulate the creation of low-skilled jobs. There is a general acknowledgement that a high minimum wage acts as a disincentive for employers to increase low-skilled employment. If the productivity of workers is less than the cost of their wage, it is simply uneconomical for a business to hire them. Reducing the real minimum wage should therefore result in a low-skilled jobs growth.<sup>44</sup>

#### *Reducing the minimum wage*

There has been relatively little study of the relationship between the minimum wage and low-skilled employment in Australia.<sup>45</sup> In one study, published in 2003, Andrew Leigh found that after each of the six minimum wage rises in Western Australia between 1994 and 2001, the employment to population ratio fell relative to the rest of Australia. For every 1% rise in the minimum wage, the demand for labour fell by 0.29%.<sup>46</sup> Using these results, John Humphreys estimates that the number of jobs either lost or not created due to the 2008 minimum wage rise was 16,000.<sup>47</sup> In 2004, Don Harding and Glenys Harding were commissioned by the Department of Employment and Workplace Relations to evaluate the effect of Safety Net adjustments—including the federal minimum wage and various minimum award rates—on employment demand. They found that not adjusting the safety net for five years would result in employment demand for almost 250,000 more jobs. How much this demand would actually translate into employment growth would depend on the incentive provided by the tax and transfer system to take up these job opportunities.<sup>48</sup>

There is a reasonable amount of evidence to show that increases in the minimum wage have a negative effect on youth employment, and moderately low youth wages in Australia have meant that youth unemployment is lower than in many other developed countries.<sup>49</sup> However, the effect of minimum wages on the employment outcomes of other groups has become more contested. In 2007, Neumark and Wascher conducted an extensive review of US and international (including Australian) studies on the effect of minimum wages on employment. They found that while minimum wages have a negative effect on employment overall, for ‘the least-skilled groups most likely to be adversely affected by minimum wages’ the evidence is ‘especially strong.’<sup>50</sup> International evidence suggests that high minimum wages mean that low-skilled workers find it harder to gain employment compared to skilled workers.<sup>51</sup>

#### *Poverty and low-income workers*

Despite this evidence, dropping the minimum wage could cause as many problems as it solves. Australia’s high minimum wage has become a de facto pillar of its social welfare system. Australia is one of the few developed countries where a full-time worker on the minimum wage can support a spouse and two children without slipping below the relative poverty (defined as 50% of median income) line.<sup>52</sup> Most of the relative poverty in Australia occurs in jobless households where no one is working; in fact, Australia has the lowest rate of ‘in-work’ relative poverty among families in the OECD.<sup>53</sup> Allowing the real minimum wage to fall too far might stimulate low-skilled employment opportunities, but it could also have adverse consequences for the welfare of low-paid workers and their families and lower the incentive to opt for a minimum-wage job over welfare. Despite this, the minimum wage is a very blunt instrument for raising the living standards of the poorest people. Minimum-wage earners often live in households with other higher paid workers, and the poorest households tend to have no workers at all.<sup>54</sup>

**The minimum wage is a very blunt instrument for raising the living standards of the poorest people.**

**The need for a new strategic direction for unemployment and welfare policy is clear.**

A policy intervention that removes impediments to low-skilled employment growth—such as letting the minimum wage fall—can be accompanied by other policy measures that actually do a better job of alleviating hardship than a high minimum wage.

*'In-work benefits'*

One way to achieve this is to introduce a system of 'in-work' benefits that uses the tax-transfer system to compensate low-paid workers for the drop in minimum wages, ensuring they maintain their standard of living. In the United States, the Earned Income Tax Credit (EITC) is available to all low-paid workers who earn their income through a paying job (not through welfare).<sup>55</sup> The value of the EITC looks like an inverted 'U'—meaning that very low paid workers get a larger credit as they increase their earnings, such as by moving from part-time to full-time work.

A similar proposal was put forward in Australia in 1998 by the 'Five economists' who argued that allowing the real minimum wage to decline in value and compensating workers through an Earnings Credit would stimulate both the supply of low-skilled jobs and the demand for them.<sup>56</sup> Already, the Low Income Tax Offset (LITO) effectively gives anyone with an income of \$30,000 or less a tax-free threshold of \$15,000, boosting the incomes of the low paid. But the LITO is paid to anyone with a low income, regardless of whether it was earned through work or received as welfare. Making the LITO conditional on work would provide a greater incentive for welfare recipients to join the workforce.<sup>57</sup> Another option is to simply increase the tax-free threshold, which increases the incentive for all taxpayers to increase their income (either through work or some other means).

*Drawbacks*

Any credit or offset that is phased out will inevitably result in higher marginal tax rates for middle-income earners (as the current LITO does).<sup>58</sup> This could provide a disincentive for low-income workers to increase their hours or move into better paid jobs for fear of losing their earnings credit. While it may increase the number of people in jobs, an 'in-work' credit such as an EITC would inevitably increase the number of people who make a claim on the taxpayer for part of their income—despite its aim being to decrease the number of people reliant on income support. The income support system would necessarily expand to encompass the low-paid as well as existing welfare categories. If a US style system, where some of the benefit is paid regularly through workers' wages, is established, 'churn' would increase as government taxes workers and pays the money back in cash. The administrative cost of this would simply add to the extra burden faced by other taxpayers who must fund the policy.<sup>59</sup> These are all drawbacks of this type of policy initiative.

While the relative merits of each policy proposal can be debated, the need for a new strategic direction for unemployment and welfare policy is clear. Allowing the minimum wage to fall will remove structural impediments to low-skilled jobs growth. At the same time, the tax-transfer system can be used to protect the living standards of low-paid workers and their families.

**Conclusion**

The lessons of past welfare reform—including the 2006 Welfare to Work policy—should guide future change. Since this strategy was enacted, the number of PP recipients has *fallen* by about one-fifth. This is a dramatic result. However, the number of people claiming Disability Support Pension has *risen* marginally.

This can be explained by some differences in the details of the reforms. If existing and not just new DSP recipients face work requirements, numbers will probably fall. A more uniform and objective standard to decide which recipients face work tests will probably also result in DSP numbers dropping. Whatever measures are taken, it is quite clear that DSP is a candidate for further reform.

This, however, presents a larger problem. If large numbers of older, unskilled people are pushed off DSP: where will they go? Any reform will only be successful if it is accompanied by efforts to remove impediments to low-skilled job creation. Far-reaching reform of welfare and employment policy should be under consideration. Allowing the real minimum wage to fall will result in job creation, and a complementary system of in-work benefits will ensure that the living standards of low paid workers are maintained. While this type of policy response is not without its drawbacks, sweeping reforms such as this must be on the table if welfare dependency is to be reduced.

This discussion is particularly pertinent in the current economic climate of rising unemployment and underemployment, which creates a real danger of growing long-term welfare dependence, undermining the gains made in recent years. The relationship between the labour market and welfare dependence cannot be underestimated. A time of rising unemployment is a dangerous time to abandon welfare reform.

## Endnotes

- 1 'About Welfare to Work reforms,' workplace.gov.au.
- 2 'Social Inclusion,' Australian Government (2008).
- 3 Patrick McClure, 'Participation Support for a More Equitable Society: Final Report of the Reference Group on Welfare Reform' (Canberra: Australian Government, 2000).
- 4 Shaun Wilson, Gabrielle Meagher, Rachel Gibson, David Denemark, and Mark Western (eds.), *Australian Social Attitudes: The First Report* (Sydney: UNSW Press, 2005); David Denemark, Gabrielle Meagher, Shaun Wilson, Mark Western, and Timothy Phillips, *Australian Social Attitudes 2: Citizenship, Work and Aspirations* (Sydney: UNSW Press, 2007).
- 5 See Charles A Murray, *Losing Ground: American Social Policy, 1950–1980* (New York: BasicBooks, 1994).
- 6 Noel Pearson, *Up from the Mission: Selected Writings* (Melbourne: Black Inc., 2009).
- 7 'Noel Pearson at the Brisbane Writers Festival,' ABC Radio National *ForaRadio* (16 September 2009).
- 8 Jessica Brown, *Breaking the Cycle of Family Joblessness in Australia*, CIS Policy Monograph No. 95 (Sydney: The Centre for Independent Studies, 2009).
- 9 'Growing Unequal? Income Distribution and Poverty in OECD Countries' (Paris: OECD Publications, 2008).
- 10 Peter Saunders, *Australia's Welfare Habit and How to Kick It* (Sydney: The Centre for Independent Studies, 2004).
- 11 Jeff Harmer, Pension Review Background Paper (Canberra: Department of Families, Housing, Community Services and Indigenous Affairs, 2008).
- 12 *Intergenerational Report 2007* (Canberra: The Treasury, 2 April 2007).
- 13 Note that Youth Allowance (Student) is also available for full-time students aged 16–24. Austudy is available for full-time students over 25.
- 14 Jeff Harmer, Pension Review Background Paper, as above.
- 15 Income support payments in Australia fall into two categories: allowances and pensions. Allowances, such as Newstart Allowance (unemployment benefits) and Parenting Payment Partnered, have lower rate of pay, more stringent participation requirements, and taper out more quickly as other income is earned. In contrast, pensions (such as DSP or Parenting Payment Single) have higher rates of pay, less stringent participation requirements, and a shallower taper rate which allows recipients to more easily work part-time and claim a part-payment. These differences mean that there is a clear incentive for an individual on an allowance to seek to move to a pension. Although Parenting Payment (Single) is a pension and Parenting Payment (Partnered) is an allowance, this report will continue to refer to them collectively as PP for simplicity.
- 16 Lixin Cai and Bob Gregory, 'Unemployment Duration and Inflows onto the Disability Support Pension Program: Evidence from FaCS LDS Data,' *The Australian Economic Review* 38:3 (2005), 233–252.
- 17 Jeff Harmer, Pension Review Background Paper, as above.

- 18 'Characteristics of Disability Support Pension Recipients June 2007,' Department of Families, Housing, Community Services and Indigenous Affairs (2007).
- 19 See Peter Saunders, 'Mutual Obligation, Unemployment and Well-Being,' in *Social Policy and the Labour Market: Papers from the 2007 Australian Social Policy Conference*, *Australian Journal of Labour Economics* 10:3 (2007), 167–184.
- 20 Bob Gregory, 'The challenges for social policy in financial crisis and recession,' Australian Social Policy Conference 2009 (University of New South Wales: Social Policy Research Centre, 9 July 2009).
- 21 It is worth noting that recipients of many income support payments such as DSP and PP are able to (and in some cases are required to) work part-time. However, for the large majority of recipients income support is their sole or major source of income. See Jeff Harmer, Pension Review Background Paper, as above.
- 22 DSP data is from 'Income support customers: a statistical overview 2005,' Statistical Paper No. 4, Department of Families, Housing, Community Services and Indigenous Affairs. Unemployment figures come from 'Labour Force, Australia, July 2009,' ABS Cat. No. 6202.0 (6 August 2009). Please note the unemployment rate stated here is for the month of June in the corresponding year.
- 23 Please note that this is only a selection of income support payments made to working age Australians. These payments were chosen because they have the highest number of recipients. A full list of payments is available at 'Income support customers: a statistical overview 2005,' as above, 3.
- 24 David Uren, 'One in four workers to go on welfare,' *The Australian* (31 March 2009).
- 25 'Labour Force, Australia, September 2009,' ABS Cat. No. 6202.0 (8 October 2009).
- 26 'Harmonised Unemployment Rates (HURs), OECD—Updated September 2009,' (OECD, 2009).
- 27 'Household Income and Income Distribution 2007–08,' ABS Cat. No. 6523.0 (20 August 2009).
- 28 As above; 'Income Distribution Australia 1994–95,' ABS (14 October 1996).
- 29 See following:
- Andrew Southcott, 'Address to the CIS—Rising unemployment and the risk of long-term welfare dependency' (Sydney, 28 July 2009);
  - Robert Gregory found that while household joblessness grew during the 1980s and 1990s recessions, each time it failed to recover to its pre-recession levels. See Robert G Gregory, 'Children and the changing labour market: joblessness in families with dependent children,' Discussion Paper No. 406 (Canberra: Centre for Economic Policy Research, Australian National University, 1999).
- 30 'Labour Force, Australia, September 2009,' ABS, as above.
- 31 Or Youth Allowance if they were under 25.
- 32 Dale Daniels, 'Social Security Payments for the Aged, People with Disabilities and Carers 1909 to 2003'; 'Social Security Payments for People Caring for Children, 1912 to 2006'; and 'Social Security Payments for the Unemployed, the Sick and those in Special Circumstances, 1942 to 2003' (Canberra: Parliamentary Library, 2006).
- 33 See following:
- 'Characteristics of Disability Support Pension Recipients June 2007,' as above;
  - 'Characteristics of Disability Support Pension Recipients June 2006,' Department of Families, Housing, Community Services and Indigenous Affairs (2006);
  - 'Centrelink and Job Services Australia Working Age (15–64) Customer Populations by Allowance, July 2009,' Australian Government Labour Market Information Portal (2009);
  - 'DEWR 2006–07 Annual Report—Employment,' Department of Employment and Workplace Relations.
- 34 For further information, see Jessica Brown, *Breaking the Cycle of Family Joblessness in Australia*, as above.
- 35 'Characteristics of Disability Support Pension Recipients June 2007' and 'Characteristics of Disability Support Pension Recipients June 2006,' as above.
- 36 Lixin Cai and Bob Gregory, as above.
- 37 Adele Horin, 'Long-term jobless list tipped to hit 140,000,' *The Brisbane Times* (17 August 2009).
- 38 Jeff Harmer, 'Pension Review Report,' Department of Families, Housing, Community Services and Indigenous Affairs (Canberra, February 2009).

- 39 Jeff Harmer, Pension Review Background Paper, as above.
- 40 'Labour Force, Australia, Detailed, Quarterly, Aug 2009,' ABS Cat. No. 6291.0.55.003 (17 September 2009).
- 41 Jeff Harmer, 'Pension Review Report,' as above.
- 42 Mark Davis, 'Back to work, sooner or later,' *The Brisbane Times* (15 August, 2009).
- 43 John P Martin, 'What works among active labour market policies: evidence from OECD countries' experiences,' Labour Market and Social Policy Occasional Paper No. 35 (OECD, 1998).
- 44 For an explanation of this in practice, see 'Wage-Setting Decision and Reasons for Decision,' Australian Fair Pay Commission (July 2009).
- 45 As above.
- 46 Andrew Leigh, 'Employment Effects of Minimum Wages: Evidence from a Quasi-Experiment,' *Australian Economic Review* 36:4 (December 2003) 361–73;  
Andrew Leigh, 'Employment Effects of Minimum Wages: Evidence from a Quasi-Experiment—Erratum,' *Australian Economic Review* 37:1 (March 2004), 102–105.
- 47 John Humphreys, 'Workers on low incomes are losing out,' *The Canberra Times* (29 June 2009).
- 48 Don Harding and Glenys Harding, 'Minimum wages in Australia: an analysis of the impact on small and medium businesses' (Canberra: DEWR, March 2004).
- 49 *Jobs for Youth: Australia* (Paris: OECD, 2009).
- 50 David Neumark and William Wascher, 'Minimum Wages and Employment,' The Institute for the Study of Labor (IZA) Discussion Paper No. 2570 (Bonn: IZA, 2007).
- 51 *OECD Employment Outlook 2007* (Paris: OECD, 2007).
- 52 'Growing Unequal? Income Distribution and Poverty in OECD Countries,' as above, 136.
- 53 Peter Whiteford, 'Transfer issues and directions for reform: Australian transfer policy in comparative perspective,' Paper for Australia's Future Tax and Transfer Policy Conference (Melbourne: Department of the Treasury and Melbourne Institute of Applied Economic and Social Research, 18–19 June 2009).
- 54 Mark Wooden, Roger Wilkins, and Seamus McGuinness, 'Minimum wages and the "working poor",' *Economic Papers* 26:4 (December 2007), 295–307.
- 55 Steve Holt, 'The Earned Income Tax Credit at Age 30: What We Know' (Washington, D.C.: The Brookings Institute, 2006).
- 56 Peter Dawkins, 'Welfare Reform and Jobless Households in Australia,' *Australian Journal of Labour Economics* 5:4 (2002), 531–547.
- 57 Jessica Brown, 'LITO to is a good place to start tax reform to keep people employed,' *The Age* (17 June 2009).
- 58 John Humphreys, 'Revealing Australia's Real Income Tax Rates,' *Policy* 25:2 (Winter 2009), 32–34.
- 59 Kayoko Tsumori, 'Some Reflections on the "Earnings Credit",' Paper presented at 8th AIFS Conference (Melbourne, 2003); Australian Institute of Family Studies, 'Steps Forward for Families: Research, Practice and Policy,' 8<sup>th</sup> AIFS Conference (2003), 13.

