WAGES AND WELFARE

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List of Abbreviations

ABS	Australian Bureau of Statistics
ACOSS	Australian Council of Social Service
ACTU	Australian Council of Trades Unions
AWE	Average weekly earnings
BLMR	Bureau of Labour Market Research
CES	Commonwealth Employment Service
DEET	Department of Employment, Education and Training
DIR	Department of Industrial Relations
DSS	Department of Social Security
EMTR	Effective marginal tax rate
EPAC	Economic Planning Advisory Council
IRC	Australian Industrial Relations Commission
PAYE	Pay-as-you-earn [taxation]
SSR	Social Security Review

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Foreword

Labour-market regulations and welfare programs are significant features of Australia's economic and social fabric. Many have been introduced with the laudable objective of ensuring at least minimal income levels for all Australians. Unfortunately, these regulations and programs frequently have unintended side effects that reduce the incentives and opportunities for people to look after themselves and improve their living standards. In extreme cases, these disincentives can be such that in the long run the well-being of people with low and undeveloped labour skills may be reduced.

P. A. McGavin provides a non-technical assessment of the operation and effects of Australia's present labour-market regulations and welfare programs. He pays particular attention to the interactions between the different programs over time. While the issues discussed are subjects of lively academic debate and some controversy, especially about the issue of quantifying effects, there is a growing consensus about the general principles discussed by Dr McGavin. A better appreciation of the secondary and longer-term effects of labour-market regulations and welfare programs provides a necessary framework for improved policies for the 1990s and beyond.

The simplistic view that minimum-wage regulations protect those on low incomes is deficient on two counts. First, if skills are low and yet to be developed, high labour costs result in fewer job opportunities and higher unemployment for lower-skilled people, including the young and those returning to the workforce. Second, if wages are high employers are less inclined to allocate even more resources to provide on-job training, especially in general skills. The important point is that many people would willingly accept low wages initially as a means of getting a foot into the labour market to gain experience and on-job training, which in turn leads to higher-paying jobs. Labour-market regulation should preferably focus on improving the operation of the labour market. Concerns about minimum living standards should be tackled more directly through income-tax and social-security arrangements.

Undesirable secondary effects flow also from universal flat-rate wage increases as opposed to percentage increases. While low-wage earners who keep their jobs gain, the increased cost of relatively unskilled labour results in reductions in these types of jobs and their substitution by more highly skilled labour and machines. That is to say, many low-skilled people are driven out of employment.

Australia's history of piecemeal and often ad hoc adjustments to income tax and social-security programs has created poverty traps. The essence of a poverty trap is that many low-skilled people find it financially more attractive to be unemployed and receiving social welfare benefits than to actively seek and accept work. Dr McGavin illustrates the importance of poverty-trap problems and the growth in the number of Australians dependent on welfare support. An additional undesirable side effect of increased welfare dependency is that even higher tax burdens and associated disincentives have to be loaded on to those who remain in employment. It is time for Australia to undertake the challenging task of developing a comprehensive restructured taxation and social-security system that explicitly recognises all these important interactions.

Dr McGavin explores the opportunities for a less centralised approach to the provision of welfare support. In particular, he argues for greater attention to be given to the opportunities for providing such support at the local community level.

This monograph provides a careful survey of important issues affecting government policies for ensuring at least minimum income levels for all Australians. The present arrangements are far from satisfactory. But Dr McGavin goes beyond this critique to recommend alternative arrangements that 'create conditions where people have more opportunities to help themselves, more rewards from helping themselves, and more support from society to help both themselves and their country'.

John Freebairn
Monash University

Preface and Acknowledgements

At first blush, one might think that the topic of the labour market and the welfare state in Australia could be treated with some definitiveness within the bounds of a small monograph. In fact, however, the topic encompasses a wide canvass of conceptual, empirical, and policy issues, not all of which can be treated definitively within the resources available for the present work. Treatment of these issues for an academic audience is particularly difficult, since the empirical processes become markedly complex, and precise quantitative results are elusive.

Despite the presence in academic circles of agnosticism concerning conclusions about complex issues of interaction between the labour market and the welfare state, there is a developing recognition among policymakers and the community generally (for example, Australia, 1990:59) of the major issues and conclusions treated in this work.

The purpose of this book is to sharpen this growing recognition, and to reinforce a direction of reform that has already begun. It aims to do this in ways that are accessible to the non-technical reader and to those actively involved in the policy processes. The book should also serve to bring this area of economic analysis and policy before undergraduate economics readers in Australia (and overseas).

The focus of this book has resulted in the neglect of important related areas of study. Notable among these is the growth of persons on Supporting Parent Benefits in Australia. Interested readers are referred to McDonald and Spindler (1987) and Bernstam and Swan (1986) for conclusions that support the analytical and policy perspectives of the present work. For recent work on pension schemes, incentives, and tax systems, readers may refer to Creedy and Disney (1989, 1990) and Apps (1989).

In preparing this book for publication, I am most grateful for assistance from manuscript readers and from Michael James, the Editorial Director of the Centre for Independent Studies. The Department of Economics and Management at University College, Australian Defence Force Academy, has supported the project by making available the occasional research assistance of Mr Y. Cao, Mr F. Parker, Mrs A. P. Daw, Ms J. Zhang, and Mr S. Jegatheswaran. Their help is gratefully acknowledged. Excellent typing support was given by Mrs J. Kenna. Mr M. Cashel, sometime student for the MMgtEc (NSW) degree, made some incisive contributions to this work (see Cashel & McGavin, 1990).

P. A. McGavin

About the Author

P. A. McGavin has recently returned as Senior Lecturer in Economics to University College (UNSW) at the Australian Defence Force Academy, Canberra, after a visiting appointment as Professor of Economics at the University of Papua New Guinea. He has a doctorate in Economics from the University of Melbourne. His previous books include *Wages and Whitlam* (1987); *The Labour Market in Papua New Guinea* (1986); *Enterprise Human Capital Formation: Papua New Guinea Case Studies and Policy Issues* (1990); and *Wages, Incomes, and Productivity in Papua New Guinea* (1991). Besides interests in labour economics, industrial relations policy, and welfare state issues in Australia, Dr McGavin is investigating economic perspectives of security analysis and policy for the island nations of the Pacific.

Chapter 1

Introduction

Australia has a long history of regulation of conditions of employment (including wages, standard hours of work, amenities of employment, types of work that may be undertaken, etc.). These regulations are chiefly expressed in the Awards of the Australian Industrial Relations Commission (until recently, the Australian Conciliation and Arbitration Commission). Recently, considerable market pressure has built up for increases in the rewards for certain types of labour services above the levels regulated by the Commission (for example, technicians employed by the Overseas Telecommunications Commission). This implies that award conditions are inferior to those that would obtain under market conditions.

Typically, however, such regulation has resulted in employment conditions **superior** to those that market conditions would generate. Protection of these regulated conditions of employment has partly been achieved by import protection that has insulated certain categories of labour use in Australia from competition by foreign producers using cheaper labour services. Reductions in tariff and quota protection in recent years have led to increased reliance on another form of 'protection': that of the welfare state.

The Welfare State and the Structuring of Production

It is argued that welfare-state 'income support' in Australia maintains rewards for employment above market-clearing levels. The welfare state thus becomes part of a system of labour-market regulation. Over time this system of protection leads to restructuring of the production of market goods and services, so that labour services are used in ways that respond to high labour costs imposed through labour-market regulation. This restructuring of production is evident in a shift towards high-technology production that employs proportionately less labour and more highly-skilled labour so that the contribution of labour to production is consistent with the high regulated cost of labour services.

The restructuring of production away from intensive use of labour is most evident in industries where the product is traded internationally (for example, steel and coal). But it also occurs in industries where the output is not traded internationally (such as waste disposal). For goods and services that are not traded internationally, the presence of monopoly power (usually deriving from government regulation) may frustrate the process of industry restructuring, at great cost to the nation (Australian port authorities, and the employment of waterfront labour are notable examples).

This results over time in a system of market production that gives little access to wage employment for Australians who have poor endowments or little development of labour-market skills: that is to say, 'the disadvantaged'. Policy debate tends to concentrate on the 'disadvantages' or deficiencies of these Australians from the viewpoint of labour-market requirements, but without recognising that these requirements largely stem from regulations.

Some Policy Responses

The two main policy responses to the problem have been 'adequacy of income support' and 'improvements in human capital'. Increased prominence is being given to policies of the Department of Employment, Education and Training (DEET) that attempt to improve and increase skills formation for the labour force (see DEET, 1988: ch. 2). Increased 'adequacy' of income support and improved links with the labour market (with a view to a 'more active system' of social security) are proposed by the Social Security Review (SSR) conducted within the Department of Social Security (DSS) (see SSR, 1988: ch. 16). These policy responses acknowledge the needs for improved human capital formation and better integration of welfare provision and the operation of the labour market.

These policies are defective, however, because they fail to recognise adequately the symbiosis of labour-market regulation and the welfare state in Australia. Labour-market regulation and the structure of systems of market production in Australia depend upon the existence of the welfare state. And the welfare state depends upon the existence of labour-market regulation and the consequent structuring of market production. Earlier Australian experience of high growth in *per capita* incomes and employment (as occurred during the 1960s, for example) meant that there was little scrutiny of the mutual dependence between the welfare state and market production and employment. The relationship between the two was not widely understood; they were assumed to be mutually beneficial. This was reflected in the union movement's support during the 1970s for the expansion of welfare-state provisions.

This relationship of mutual dependence is now more widely understood as **failing**. Analysis of this failing symbiosis is complicated by the influence of what has been called 'the Accord process' (see DIR, 1988, and Australia, 1990:3), as this influence may have achieved some slowing of the degeneration of the relationship between the labour market and the welfare state. But the efficacy of the Accord is increasingly in doubt and the failure of the symbiosis is increasingly evident.

Chapter 2

The Interaction between Labour-Market Regulation and the Welfare State

The government's attempts to dampen nominal wage growth through the Accord were strained by a consumer-led upswing in the economy, and are now threatened by the campaign of the Australian Council of Trade Unions (ACTU) to achieve pay rises under the Accord Mark VI. Effective implementation of 'award restructuring' leading to increases in workplace human capital formation and to continuing improvement in labour productivity is in doubt. The need for major adjustment in government policy is clear. Why, then, the inaction?

It is the failing relationship between the labour market and the welfare state that explains the inaction. The equivalent marginal rate of taxation for a family with two dependent children with a one-person wage income at average weekly earnings (AWE) increased from about 25 per cent in 1968 to 40 per cent in 1988. (More recent reductions in AWE are commented on below.) Most wage earners earn less than the arithmetic mean AWE. Taking a one-person wage income at 75 per cent of AWE, the equivalent marginal rate of taxation increased from 20 per cent in 1968 to 29 per cent in 1986 (and to 50 per cent after allowing for the Medicare levy, and to approaching 100 per cent after allowing for the Family Allowance Supplement) (EPAC, 1988b:85f).

These long-period perspectives (such as between the 1960s and the 1980s) suggest a need for **substantial** reductions in marginal pay-as-you-earn (PAYE) rates of taxation. Significant reductions in marginal PAYE tax rates could deliver growth in nominal disposable income **and** reduction in the growth of nominal labour costs through 'social wage' negotiations under the Accord process. But given the need to increase the fiscal surplus, substantial reductions in the scale of PAYE taxation must be financed by larger reductions in government outlays and transfer payments.

Australian government outlays on public capital formation and on the delivery of economic services have declined over the long term (see EPAC, 1986b — a paper to which the present author contributed). Substantial reductions have occurred in payments to the States (in part offset by increases in direct State revenues). This implies that further reductions in government spending should be focused on welfare expenditure.

The Heart of the Conflict

The central conflict in Australian society is between, on the one hand, the demands of people engaged in market production of goods and services to retain a larger share of discretionary command over their incomes (through significant reductions in PAYE taxation), and, on the other hand, the demands for 'adequacy' in income support for those who do not gain access to the labour market. The conflict is quite evident at the political level. Reductions in welfare spending by the Labor government would cost it dearly in electoral support in areas where welfare dependency is concentrated (witness the shift in voting to independent candidates in electorates that had long been loyal to Labor). But equally, failure to deliver promised tax reductions would cost the Labor government dearly in 'swinging vote' electorates (already recently influenced by the impact of high interest rates on mortgage repayments), and would make it harder for the ACTU to maintain effective support for the award-restructuring formula of the 1988 and 1989 National Wage Cases. The conflict appears also in the different attitudes towards tax cuts displayed by the Australian Council of Social Service (ACOSS) on behalf of welfare recipients, and by the ACTU on behalf of their taxpaying members. For example, in the May 1989 EPAC publication *Strategy for the 1989-90 Budget: Business, Trade Union and Community Views*, ACOSS argues (p.16) for 'income tax cuts for all taxpayers averaging $8 per week at around average weekly earnings', while the ACTU argues (p.19) for 'tax cuts of around $20 per week'.

The conflict elaborated below between employed labour and welfare dependants is the key to the economic policy paralysis of the Hawke Government. It is a conflict that the government cannot resolve until it recognises that the relationship that has emerged in Australia between the labour market and the welfare state is **unsustainable**.

The Hawke Government has initiated changes, such as award restructuring and improved targeting of welfare transfers, that appear to be in the right direction. But the pace of these changes and their magnitude have been inadequate. An adequate policy response depends upon understanding that the big change in the international economy has been the growth in the application of new technology and in the formation of human capital. These changes have been most prominent in nations previously noted for both technological backwardness and low levels of labour-force skills (even including widespread illiteracy).

How Much Wage Restraint?

Much has been made of the 'wage restraint' allegedly delivered by the Accord and the ensuing reductions in real wages. In fact, these reductions have been small. Calculation of annual changes at September quarters shows that real AWE for full-time adult employees fell by 1.8 per cent in 1985, by 1.3 per cent in 1986, by 2.3 per cent in 1987, and by 0.5 per cent in 1988. They rose 0.2 per cent 1989, then fell by 0.1 per cent in 1990 (computed, ABS cats. 6302.0 and 6401.0). Reductions in real wages (though not in nominal wages) combined with improvements in technology (and perhaps also with improvements in 'work practices') have led to (small) increases in the hourly output of labour input. Consequent increases in estimates of hourly labour productivity and reductions in estimates of product unit costs of labour are found. Between September quarters 1985 and 1989, average real unit labour costs for the Australian non-farm sector are estimated to have declined by only about 1 per cent (see Table 2.1). These small but favourable changes of trends have also been the subject of congratulation.

Yet these figures remain incomplete indicators of performance, since, in a competitive world, it is **relative** performance that matters. Estimates of relative labour-unit costs (which compare Australian labour costs per unit of output with a weighted average for major trading partners) suggest that movements in these relative costs are aggravating the deterioration of Australia's external account and relative international economic performance. Relative real labour-unit costs for the Australian non-farm sector are estimated to have decreased substantially (by about 30 per cent) between September quarters 1985 and 1986, but to have **increased** substantially (by about 32 per cent) between September quarters 1986 and 1989 (see Table 2.1). Moreover, it is doubtful whether measures of labour cost are sufficiently comprehensive or adequately reflect changes in non-wage components of rewards to employment that nevertheless impact as directly upon costs as do wage increases.

Has Resource Use Really Expanded?

Even the most comprehensive relative measure of labour cost per product unit is still inadequate as a basis for assessing labour-market performance, since this depends not only upon more productive use of existing resources but also upon **expanding resource use**.

The Hawke Government has made much of the growth in wage employment, attributing it to government policies (see Australia, 1989a:3).

Table 2.1
Unit labour costs for Australia, 1984-89

Year	Real unit cost	Relative real unit cost
1984	102.3	117.3
1985	98.2	96.1
1986	103.2	66.9
1987	100.5	76.4
1988	96.4	86.2
1989	97.2	88.4

Data are for the non-farm sector, and for September quarters. The base for the Australian unit cost index is average 1966-67 – 1972-73; weights for the relative measure are average 1980-81 – 1984-85.

Source: Australian Treasury, *Economic Round-up*, various issues.

Much of the growth in Australia's wage employment has, however, been in part-time employment. Converting data on persons employed to data on hours worked per week rather modifies the picture. Where hours worked per week are divided by average full-time hours worked, an estimate of full-time-equivalent wage employment is derived. This shows a rather more modest growth in employment than that claimed by the government (see Table 2.2, below).

It was noted above that the Hawke Government's policies appear to have moved in the right direction, as with tighter targeting of welfare transfer payments. EPAC (1988b:50) shows recent declines in equivalent marginal rates of taxation for a family with two dependent children and a one-person wage income at AWE level. But, as noted above, these reductions in equivalent marginal rates of taxation do not reverse the long-period reductions in the ratio of family disposable incomes to earnings. Nor have recent tax cuts made much difference. For example, estimates of AWE for full-time adult males for the September quarter 1990 (the most recent available at the time of writing) were $620 (ABS cat. no. 6302.0). For this income level, the tax cuts effective from 1 July 1989 give a reduction in net weekly income taxation for a sole-income family with two dependent children of $25, and the change in the marginal rate of taxation is only 1 per cent (Australia, 1989a:33, 39). The amended scale that took effect on 1 January 1991 reduces the marginal income-tax rate for the income range of adult males on full-time AWE incomes by only a further 1 per cent to 38 per cent (Australia, 1990:38).

The aforementioned EPAC study shows (1988b:22) a recent trend of decline in the ratio of welfare recipients to persons in the labour force as an example of the favourable impact of government policies. The level of the 'dependency ratio' is, however, less favourable when expressed as the ratio of persons dependent upon welfare transfers to a measure of full-time-equivalent wage employment. It is of course true that a very refined analysis would make allowance for growth in part-time employment among welfare dependants (for 1978-79 estimates, see Whiteford, 1982). But the more important point argued below is that even where the direction of change has been favourable, the **magnitude** of change has been inadequate.

There is, moreover, evidence that a long-term contraction, in resource use has occurred. Although growth in the dependency ratio has been stalled, and even reduced, that ratio is still nearly twice as great in 1988 as 1972. Table 2.2 shows that in 1990 there was one person receiving welfare benefits for every 2.3 full-time-equivalent persons in wage employment, whereas in 1972 the equivalent ration was one to 4.7. (A very refined analysis would make allowance for changes in the age composition of the population as these affect eligibility for aged pensions; see EPAC, 1988a.)

So, contrary to the usual accounts that focus on recent **growth** in Australian wage employment, the above data on the long-period **rise** in the welfare dependency ratio tell a story of **contraction** in resource use. (Clearly this statement involves a complex point of comparison, or 'counterfactual'.) These data show the marked expansion in the way that the welfare state has operated to transfer command over goods and services from persons engaged in their production to persons who are not engaged in market productive activity.

In some cases, these transfers have displaced or diminished the operation of other ways of transferring the command over goods and services: for example, where the growth in Supporting Parent Benefits has displaced transfers that previously occurred within families. The emphasis here, however, is on the way that welfare state 'income support' has acted to divert people away from productive market activity. Thus it is that the corollary of the growth in welfare dependency relative to market productive activity is that wage employment is less than would otherwise be the case, and the performance of the Australian economy has been worse than it would otherwise have been. (The detrimental effects of these changes on other social institutions of Australian society, and especially the family, are not discussed.)

To bring the argument back to the theme of 'symbiosis': it needs to be recognised that this outcome is precisely what was intended by

Table 2.2

Employment, welfare dependency, and dependency ratio for Australia, 1972 and 1984-90

Year	FTE-employment (millions) (a)	Welfare recipients (millions) (b)	Ratio of (b) to (a) (c)	Dependency ratio (c), 1972 = 100 (d)
1972	5.2	1.1	0.22	100
1984	5.8	2.7	0.46	214
1985	5.9	2.7	0.45	207
1986	6.1	2.7	0.44	203
1987	6.2	2.7	0.44	201
1988	6.6	2.7	0.40	185
1989	6.4	2.9	0.42	191
1990	6.8	2.9	0.43	198

Employment is full-time equivalent (FTE), and estimates are derived by dividing aggregate weekly hours worked (full-time and part-time) by average full-time weekly hours worked per person. These estimates are reported as four-quarter annual averages. Column (d) shows the dependency ratio at 1990 to be almost 200 per cent of the 1972 ratio. The calculation of 2.3 FTE employees to welfare dependents for 1990 is col. (a) divided by col. (b).

Sources: ABS, cat.no. 6203.0 and DSS, *Statistical Summary*, various issues, and computations on these data.

proponents of the welfare state. The whole concept of the welfare state rests on the assumption of a 'right' to a certain standard of living that is independent of one's contribution to the productive activity of society. Closely allied to this assumption is a disdain for menial labour ('dead-end jobs'). This disdain makes it agreeable that people should be priced out of menial jobs, and that the production system should adapt to displace menial wage employment. So it is that income support by the welfare state is part of a system of labour-market regulation that in turn leads the economy to adapt so as to diminish opportunities for menial wage employment. Over time, wage employment becomes largely of a non-menial-labour kind, while those who gain access to the labour market receive higher rewards. Those unable to gain access to the labour market are given the modern equivalent of the bread and circuses of ancient Rome in decline. Over time, this 'solution' becomes a non-solution, and the symbiosis fails.

Chapter 3

The Emergence of Long-Duration Unemployment

A pressing indication of the failing symbiosis between labour-market regulation and the welfare state in Australia is the emergence of long-duration wage unemployment. The duration of unemployment is important for assessing the welfare significance of unemployment. Short durations of unemployment indicate that the labour market is functioning efficiently. Long durations suggest the presence of deficiency of demand (or excess of supply) and a mismatch between supply and demand for different types of labour, and indicate failure or inhibitions in labour-market functioning. They also have adverse welfare implications, since these indicate resource under-utilisation, and material and social deprivation for the unemployed.

Measured Average Durations of Unemployment in Australia

Australian data on the distribution of durations of unemployment usually show that long-duration unemployment is common. Data most frequently cited are from *The Labour Force* published by the Australian Bureau of Statistics (ABS). For August 1987 the average (arithmetic mean) duration of unemployment was 49 weeks: almost a year. Data on unemployment from the DSS show average (arithmetic mean) durations for unemployment beneficiaries for August 1987 of 64 weeks: in excess of a year.

The 'snapshot' sample used for these long-duration averages highlights extended duration experiences of unemployment. In fact, short-duration experiences of unemployment are more numerous, and there is not a normal distribution of observations around the sampled mean duration. For this reason, median durations of unemployment are commonly also published. The median duration for August 1987 published in *The Labour Force* was 23 weeks, while that for unemployment beneficiaries was 31 weeks. The median duration for recipients of unemployment benefits has been in the order of 29 to 32 weeks since 1983. These data indicate a sustained experience of dependency by recipients of unemployment benefits that is typically of about eight months' duration.

This sustained typical experience of long-duration unemployment has not fallen with the growth in employment and the reduction in measured unemployment (falling between August 1983 and August 1987 from 9.9 to 7.8 per cent). Thus, government policies appear to have had little impact upon the continuing grave welfare problem of long-duration unemployment. Note that because these duration estimates measure the length of unemployment spells **at survey dates**, they understate the actual durations for the sample population, since these surveyed spells of unemployment are incomplete spells, and **completed** spells of unemployment are still longer.

Long-Duration Unemployment and Alleged Market Failure

The prevalence of long-duration dependency on unemployment benefits has led the SSR to stress 'income support' for long-duration unemployed persons and seek to improve the 'adequacy' of that support (SSR, 1988:271). This emphasis on income support is related to proposals for integrating social security and labour-market programs to achieve what the Review calls a 'more active system' (1988:267). Although there are useful elements in these proposals, the premise from which the SSR (and most commentators on unemployment) argue should first be examined. This premise is that those experiencing extended durations of unemployment are victims (the 'disadvantaged') who have been consigned to poverty because of market failure (1988:54).

The **fact** of market failure (in part induced by government regulation of the labour market and the influence of welfare-state provisions) is not disputed. Yet it is nevertheless possible that much extended-duration experience of unemployment has been **chosen** by the unemployed. According to a search model of unemployment, the experience of unemployment may be expected to sort people by labour-market characteristics, so that those with less desired labour-market characteristics should tend to remain unemployed and increasingly unlikely to become employed. Sophisticated econometric studies have, however, been unable to attribute strong significance to labour-market characteristics other than the duration of unemployment itself in explaining unemployment. Research has tended to confirm a finding of 'state dependence': that it is unemployment that causes unemployment (for example, Hui & Trivedi, 1985).

The problem with this research (apart from its not explaining much) is that it assumes that unemployed persons are searching for wage employment, and that it is objectively measured labour-market characteristics that mainly explain the sorting process and the duration of unemployment. In fact, the unemployed may be seeking to satisfy preferences that are more complex than 'job/no job'; the main explanatory factors may be less open to inspection, and may be related to the motivational characteristics of persons in wage unemployment.

The Emergence of Poverty Traps

Poverty traps occur where the interaction of welfare-state provisions and labour-market regulation leads to poor or perverse incentives for persons to increase market labour activity. A graphical exposition of this interaction is found in Annex 3A (pp. 23–27 below) that supports the simpler treatment of this chapter.

The starting point of the analysis is choice between labour activity inside the market and labour activity outside it. Non-market goods and services are gained by the allocation of time rather than of money. Market goods and services are gained by wage income (hours devoted to market labour services multiplied by the hourly wage rate).

At one extreme, all available time may be allocated to market labour activity so that wage incomes and access to market goods and services are maximised. At the other extreme, all available time may be allocated to non-market activity and to the maximisation of goods and services that are gained in this way (examples include non-market leisure activities or production for direct household consumption). Between these extremes, persons choose between a range of market and non-market labour activities that gives access to a range of market and non-market goods and services.

Provision of state transfer payments means that eligible persons may enjoy certain levels of market goods and services without any diminution in time available for non-market activity. Eligibility provisions usually include a 'free area' where wage incomes up to a certain level may be earned without reduction in welfare transfers.

Allocation of time to market labour activity that increases wage income beyond the 'free area' results in progressive withdrawal or 'shading out' of state welfare transfers. Over the shading-out area, the incentives to market labour activity are reduced because money incomes giving command over market goods and services increase at the net rate of wage earnings minus the withdrawn welfare transfers. PAYE taxation intensifies the reduction of incentives to market labour activity over the shading-out range, especially where steps of marginal rates of taxation occur.

This interaction between withdrawn state welfare transfers and progressive income taxation results in a range over which increased market labour activity (and reduced non-market labour activity) leads to only small increases in disposable money incomes. The choice between market and non-market activity involves a rather flat range over which the incentives to substitute market for non-market activities such as leisure or household production are small. In Australia, this flat section is called the 'poverty trap', since it represents an income range over which there is little incentive to move out of low-income welfare dependency.

This situation is aggravated where labour-market regulations fix wages above scarcity valuations for the relevant labour services. Where wages do not reflect the interaction of market supply and demand, expected wage incomes are determined by hours devoted to market labour services multiplied by the hourly wage rate, this sum in turn being multiplied by the probability of gaining wage employment (that is, [hours x wage] x [probability of wage job]).

This means that persons in wage employment face a steeper trade-off between market and non-market labour activity than do persons without a wage job. The result is that expected wage incomes from job search by unemployed persons are reduced, and persons in wage employment expect smaller increases in command over market goods and services as reductions are made in time devoted to non-market activity and hours of wage employment are increased.

The effect of minimum-wage regulation, then, is to flatten the trade-off between market and non-market labour activity, thus reinforcing poverty traps caused by shading-out and progressive PAYE taxation. Incentives to shift from welfare dependency to market labour activity are further weakened.

Preference Configurations between Market and Non-Market Activity

The interaction of welfare transfers and taxation outlined in the previous section means that there is no simple linear relationship between reduction in time allocated to non-market activity and increase in command over market goods and services. The key features illustrated in the figures in Annex 3A are the influence of welfare transfers in raising the area of command over market goods and services and the flat section of the poverty-trap range.

The choice in allocation of available time between non-market and market labour activity involves interaction between the possibilities set as described and the preferences of those making choices.

Where increases in hours devoted to market labour activity give little increase in expected disposable money incomes, possibilities and preferences are likely to result in choices against market labour activity and in favour of continuing welfare-state dependency. This is illustrated in Annex 3A, which shows that in the presence of poverty traps a marked preference for wage employment is required for full-time-equivalent hours of wage employment to be chosen (see Figure 3A.2 and preference function Pw1). In this case, unless there is a marked skewing of preference toward wage employment, combinations of market and non-market activity are likely to cluster around the limit of the 'free area'. That is, most available time will be allocated to non-market activity, with access to market goods and services gained by welfare transfers and part-time wage earnings that do not involve withdrawal of welfare transfer payments. In short, in the absence of strong preference for wage employment, poverty traps may be expected to lead to choice of welfare dependency (see Figure 3A.2, preference function Pn2, and point B).

The problem of inadequate or perverse incentives that discourage the undertaking of market labour activity is aggravated by increased income-support policies that are not conditional on recipients' market labour activity, and by the interaction of taxation and withdrawal of state-welfare transfers. The effect is to make persons who would otherwise be employed at low wages more likely to choose welfare dependency supplemented by limited labour-market activity. The next section considers some evidence concerning choices of this kind.

Evidence of Choice between Market and Non-Market Activity

Since so many relevant influences are not constant, an analysis involving multiple causes may be sought (see Bradbury, 1989). The long history of failure to reach agreed conclusions by this method (see Dunlop & Williams, 1983, and Beenstock, 1987), and the complexity and costliness of this research suggests that the debate will not be resolved by greater sophistication in research methods. Moreover, the lack of variation over time in key data (in particular, in most relevant 'replacement rates' between welfare transfers and wage earnings) makes it unlikely that statistically significant estimated coefficients will be derived.

Declared other income of welfare recipients. Data from the DSS on declared income for recipients of welfare-state transfers show a marked clustering of declared other income of welfare recipients in the lowest class interval ($00.01 – $30.00 per week): the 'free area'. For example, for 1990 24 per cent of unemployment benefit recipients declared other income. Of these declarations 45 per cent were for the lowest two of twelve class intervals, and 59 per cent were for the lowest of twelve class intervals (computed from *Quarterly Survey*). The most common reason given by the DSS for termination of unemployment benefits as a result of administrative review is undisclosed wage employment (DSS, 1988:106).

Position and length of poverty traps. It was remarked that policies that lift the inflection point and that lengthen and reduce the gradient of the poverty-trap section of budget constraints make persons who would be employed at low wages more likely to choose welfare dependency, supplemented where possible by limited labour-market activity (that is, by part-time wage employment). Tables 3.1 and 3.2 show that the wage income range over which wage employment offers

Table 3.1

Range over which wage employment offers no increase in gross wage incomes for recipients of unemployment benefits, January 1990

	Recipient type	Gross weekly wage ($)
Unmarried		
	aged 18-20 yrs	70 to 154
	aged 21 yrs and over	70 to 175
Married		
	no children	70 to 272
	1 child	70 to 296
	2 children	70 to 320
	3 children	70 to 344
	4 children	70 to 368

Data for married recipients are for those with a dependent spouse. The increases in the range over which wage earnings offer no increases in gross incomes reflects the fact that additional benefit payments are made for children ($24.15 per week for each child under 13 years, and $35.25 per week for each child aged 13-15 years). These additional payments for children are non-taxable. This can lead to the situation where increases in (taxable) wage income leads to losses of (non-taxable) additional welfare-state transfers, and, thereby, to reductions in total disposable income (see Table 3.2).

Sources: Computed from, DSS (1990a), Australia (1989b, Statement No. 1), and Australia (1990) — see Cashel and McGavin (1990, Attachment E).

no increase in the command over market goods and services is longer for married than for unmarried persons. The position for married persons in early 1990 gave a poverty trap section between other gross income of $70 – $272. Because of the effects of taxation expenditure and other transfers for dependent children, this poverty trap section is lengthened when reckoned in terms of net disposable income as family size increases (see Table 3.2). It follows that growth in recipients of welfare transfers should be expected to be greater for recipients with dependants (spouse and/or children) than for recipients without dependants.

Table 3.2

Range over which wage employment offers no increase in disposable wage incomes for married recipients of unemployment benefits, January 1990

Number of children	Non-benefit weekly income ($)	Gross weekly income ($)	Net (after tax) weekly income ($)
None	70	272	259
	272	272	259
1 under 13 yrs	70	296	287
	273	296	287
	296	296	279
2 under 13 yrs	70	320	311
	273	320	311
	320	320	296
3 under 13 yrs	70	344	335
	273	344	335
	344	344	315
4 under 13 yrs	70	368	359
	273	368	359
	368	368	335

Where non-taxable state welfare transfers are lost as a result of a DSS income test, effective marginal tax rates (EMTRs) rise to over 100 per cent and reductions in disposable incomes occur (see Cashel & McGavin 1990, Attachment E).For example, non-benefit earnings (such as wages) by a recipient of unemployment transfer payments who is married with a dependent spouse and four children under 13 years of age faces EMTRs of 133.5 per cent, 121 per cent, and 129 per cent for various ranges of non-benefit income between $273 and $368 a week. That is, such a state welfare recipient encounters **reductions** in disposable incomes over a significant range of wage earnings.

Sources: See Table 3.1.

Composition of recipients of state welfare transfers. Table 3.3 shows that during 1981-87, recipients of unemployment benefits with dependants increased at a faster rate than recipients without dependants; and during 1987-89, recipients of unemployment benefits with dependants fell at a slower rate than recipients without dependants. (Significant compositional change between recipients with and without dependants does not occur for 1989-90 data.) Table 3.4 gives another view using the same data sources and shows that the share of persons with dependants in receipt of unemployment benefits increased by more than a third between 1981 and 1990: from 23 per cent to 31 per cent. Table 3.5 shows that at August 1987 recipients of unemployment benefits with dependants accounted for only 13 per cent of persons receiving benefits for less than six months, but 38 per cent of persons with unemployment durations in excess of two years.

Since these data could be affected by the changing age composition of recipients of unemployment benefits, disaggregation using DSS data by age was undertaken. Between 1981 and 1990 no clear tendency for growth was found in the proportion of 'prime age' recipients (aged 25-44 years) with dependants (see Table 3.6). Further disaggregation was undertaken for persons in receipt of unemploy-

Table 3.3

Index of recipients of unemployment benefits by recipient type, May 1981 to 1990

	Recipient type		
Year	Without dependants	With dependants	All recipients
1981	100	100	100
1982	122	130	124
1983	195	251	208
1984	182	227	192
1985	177	214	186
1986	178	211	186
1987	171	213	180
1988	141	205	156
1989	111	173	126
1990	127	187	141

Base period data for columns (left to right) are 231295, 70599, 301894. Data are four-quarter averages.

Source: Computed from DSS, *Quarterly Survey*, various issues.

Table 3.4

Composition of recipients of unemployment benefits, by recipient type, May 1981 to 1990 (per cent)

Recipient type	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Without dependants	76.6	75.5	71.5	72.3	72.9	73.4	72.4	69.3	67.7	68.9
With dependants	23.4	24.5	28.4	27.6	27.0	26.5	27.5	30.7	32.3	31.1

The data 'without dependants' are for single beneficiaries; the data 'with dependants' are for single beneficiaries with dependants and married persons with dependants (spouse, plus any children). Between 1981 and 1989, beneficiaries 'with dependants' increased by 38 per cent. For further analysis on these compositional changes, see McGavin, 1990:24.

Sources: Computed from, 1988-89 = DSS, *Quarterly Survey,* various issues. 1981–87 = SSR, 1988:77, using data from Whiteford, 1986:32, and computations on these data.

Table 3.5

Composition of recipients of unemployment benefits by short and long duration, August 1987 (per cent)

Assessment basis	Receipt of benefit terminated within 6 months of starting	Receipt of benefit continuing after 2 years duration
Single rate	86.7	61.8
Married rate	13.3	38.1

Married rate data includes half married rate.

Source: SSR, 1988:184.

Table 3.6

Composition of recipients of unemployment benefits aged 25-44 years, by recipients with and without dependants, May 1981 to 1990 (per cent)

Recipient type	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Without dependants	58.5	58.0	55.0	57.4	59.4	60.8	60.4	59.0	59.5	60.2
With dependants	41.5	42.0	45.0	42.6	40.6	39.2	39.6	41.0	40.5	39.8

See Notes to Table 3.4.

Source: Computed from DSS, *Quarterly Survey*, various issues.

ment benefits for less than three months (13 weeks) and persons in receipt of unemployment benefits for more than three months (see Table 3.7). Between 1981 and 1990 and for **short-duration** receipt of unemployment benefits (less than three months), the data show no clear tendency for growth in the proportion of recipients with dependants. But for **long-duration** receipt of unemployment benefits (more than three months), there is clearly a tendency for the proportion of recipients with dependants to grow, with the share of recipients with dependants increasing by more than a third (from 25 per cent in May 1981 to 34 per cent in May 1990).

Table 3.7
Composition of recipients of unemployment benefits by duration of unemployment and by recipient type, May 1981 to 1990 (per cent)

Recipient type and duration	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
<13 weeks										
Without dependants	79.2	78.1	73.2	76.2	78.0	78.0	77.4	75.7	75.6	74.9
With dependants	20.8	21.9	26.8	23.8	22.0	22.0	22.6	24.3	24.4	25.1
>13 weeks										
Without dependants	75.1	74.1	71.2	71.0	71.1	71.6	70.5	66.7	64.4	65.7
With dependants	24.9	25.9	28.8	29.0	28.9	28.4	29.5	33.3	35.6	34.4

See Notes to Table 3.4.

Source: Computed from DSS, *Quarterly Survey*, various issues.

Behaviour as an indication of preference. The foregoing evidence does not directly show the preferences of persons who experience long durations of wage unemployment. For this, reference may be made to recent work on data from the Australian Longitudinal Survey, now conducted by the Australian Council for Employment and Training, as undertaken by Miller and Volker (1987). The two key variables are the wage rates at which employment would be accepted ('reservation wages') and search strategies. Miller and Volker find that young people (aged 15-24 years) entering unemployment have reservation wages of about 75 per cent of predicted market wages, a figure that further decreases to about 64 per cent of predicted market wages over the first six months of unemployment, but with only minor decreases thereafter. The stability of reservation wages among the sampled young persons in long-duration unemployment suggests the influence of labour-market regulation through minimum-wage provisions. Second, Miller and Volker find that those experiencing shorter durations of unemployment more actively pursue job search by visiting places of employment. Those experiencing the longest durations of unemployment tend to be those who make most recourse to passive means of job search: through the Commonwealth Employment Service (CES) and newspaper advertisements. They also find that placements through the CES are associated with shorter durations of employment, so that work-force entry via the CES in turn results in higher job separations and multiple experiences of unemployment. These results identify behaviour of young unemployed persons that may indicate the motivational characteristics of persons in long-duration unemployment. Passive job search could be consistent with unemployment as a chosen labour-market outcome (chosen, that is, within the available alternatives, as represented by the relevant budget constraint).

Wrong inference by the Social Security Review. The SSR suggests that welfare dependency for recipients of unemployment benefits as a constrained optimisation is unlikely. In *Income Support for the Unemployed in Australia* (1988), the SSR observes (p.104) that few full-time employees with dependants earn less than the maximum income for retaining full unemployment benefits at the married rate. This very small fraction (p.82) of less than 2 per cent of persons in receipt of full-time wage incomes of less than $243 for 1987 (p.119) means that any supposed 'moral hazard' in practice rarely applies (p.90). The Review concludes that there exists 'no firm evidence of a measurably large disincentive effect' on work-force entry by persons in receipt of state welfare transfers (p.110). In consequence, perseverance in welfare state dependency is overwhelmingly attributed to labour-market 'disadvantage'. What the SSR fails to recognise is that perverse incentives faced by only a very small proportion of persons entering wage unemployment can over time lead to a cumulation in the numbers of persons experiencing long-duration wage unemployment. This phenomenon is explained in the following section.

The Process of Cumulation in Long-Duration Wage Unemployment

The papers published by the SSR employ data on the unemployment population at census dates. These 'snapshot' sample data especially capture those who have been cumulating in unemployment (the long-duration beneficiaries). Data presented in *Income Support for the Unemployed in Australia* clearly reveal this cumulation: 72 per cent of unemployed males had benefit durations of less than six months in 1977, and only 43 per cent in 1987. Whereas in 1977 only 2 per cent of unemployed males had benefit durations of more than two years, in 1987 the proportion was 21 per cent (p.74) (see Table 3.8). The data reveal the inducement of this process among secondary labour-market workers: they show that the replacement ratio of unemployment benefits at the married rate to after-tax earnings is in excess of 70 per cent for the lowest decile of full-time wage income for married males for August 1986 (p.89) (see Table 3.9).

Recent research by McGavin et al. (1989) using unpublished ABS data shows that of the population becoming unemployed, only a small proportion (1-2 per cent) experience **completed** durations of unemployment exceeding six months (p.20). Even among males aged 55 years and over (the 'growth category' for long-duration unemployment), less than 5 per cent of those becoming unemployed during 1986-87 experience **completed** durations of unemployment exceeding six months (that is, long duration).

In terms of the budget constraint and the preference configurations already considered (and illustrated in Annex 3A figures), the presence of a section of the budget constraint with a small gradient and preference functions not displaying a skewness towards wage employment need apply only to a **small proportion** of persons entering wage unemployment in order to derive an outcome like that found for August 1987, where 53 per cent of persons in wage unemployment and seeking full-time jobs experienced durations of wage unemployment exceeding six months (computed from ABS cat.no. 6203.0). This proposition is explained more fully by McGavin (1990) using hypothetical data to show the familiar pattern (first noted in Australia by Professor R. G. Gregory in 1982 [Gregory, 1984]) that while only a small proportion of wage unemployment **spells** are of long duration, when unemployment spells are weighted by duration of unemployment a large proportion of wage unemployment **experience** is long duration (see McGavin, 1990: Table 5).

Where the interaction of low expected wage rates and welfare transfers creates incentives to continue in wage unemployment, compositional changes occur in the stock of unemployed persons (McGavin, 1990: Table 7). These are reinforced by differences in preference for wage employment (McGavin, 1990: Table 9). These compositional changes build up over time, with the result that snapshots of the stock of unemployed persons at given dates show most persons in wage unemployment to have been in that state for a long duration (see Table 3.8). Thus, persons without strong **incentives** for wage employment and without strong **preferences** for wage employment tend to cumulate in the stock of unemployed persons, and form the majority of sampled persons in receipt of unemployment benefits.

As shown by McGavin (1990), this cumulation can occur under conditions amounting to a steady or stationary state. In actual experience, steady-state conditions will at best apply only approximately. Flows out of jobs and into wage unemployment may increase while flows out of wage unemployment may decrease. Increases in flows to wage employment may be drawn largely from outside the market labour force rather than from among the unemployed. Thus, variations in steady-state conditions such as a decline in escape rates from wage unemployment may over time reinforce a process of cumulation that may occur under steady-state conditions.

The purpose of this steady-state discussion has been to explain the role of incentives and preferences in the determination of outcomes, and not to deny the incidence or the significance of disturbances to steady-state conditions. The next chapter focuses on ways to improve the incentive structure by the removal of poverty traps and the expansion of market opportunities for persons in welfare dependency.

Table 3.8

Composition of male recipients of unemployment benefits by duration, selected years, 1977 to 1987 (per cent)

Year	<6 months	6<12 months	12<24 months	24> months
1977	72.0	16.4	9.3	2.3
1980	59.4	18.0	12.7	9.8
1983	45.2	26.4	18.3	10.0
1985	41.0	19.7	17.5	21.8
1987	42.7	19.3	17.0	21.1

Source: SSR, 1988:74.

Table 3.9

Replacement ratio of unemployment benefits to net wage earnings for married males in full-time wage employment, August 1986 (per cent)

Earnings measure	Replacement ratio
arithmetic mean	48
median	53
lowest decile	72

Source: SSR, 1989:89.

ANNEX 3A

Poverty Traps and Activity Choice: A Graphical Exposition

This annex shows how the possibilities set between market and non-market activity are altered by welfare transfers, their tapered withdrawal, and PAYE taxation. The result is that the budget constraint assumes the non-linear form shown in Figure 3A.1, with the familiar 'poverty trap' or high effective marginal tax rate (EMTR) section. The annex also shows how preference sets interact with the possibility set to determine choice. In the absence of strong preference for wage employment, budget constraints with a section showing high EMTRs result in choices for welfare dependency (Figure 3A.2), thereby contributing to the cumulation of persons in long-duration welfare dependency. Exposition of these figures follows.

The Budget Constraint

Figure 3A.1 shows the effects of interaction of welfare state, taxation, and labour-market regulation on available command over goods and services. Market goods and services are gained by wage income, and given hours and a given wage rate derives a maximum of G1, where all labour activity occurs in the market. Non-market goods and services are gained by the allocation of time (rather than by the allocation of money), with a maximum of H where all labour activity occurs outside the market. The budget constraint **G1H** thus represents the possible combinations of market and non-market labour activity, deriving possible combinations of command over market and non-market goods and services.

Welfare-state transfer payments of T1 are shown as available to persons who are not in wage employment and who satisfy certain eligibility conditions. These state welfare transfers shift the budget constraint of Figure 3A.1 from **H** to **A**. With full retention of transfer payments (such as 'unemployment benefits' or 'job-search allowance'), so long as wage income is less than m1, a section of the budget constraint moves up and becomes **AB** as shown in Figure 3A.1 (where, for convenience, m1 = T1). In Australia, earnings at a wage of w1 up to h1H hours are termed the 'free area'. Any further wage employment takes welfare recipients into the 'shading out' area, where welfare state transfers progressively diminish from **T1** to zero. In Figure 3A.1, this is represented by the triangle **CBL**, which shows that as hours wage employment at a wage of **w1** are increased from **h1H** to **h13H**, transfer payments progressively diminish to zero at point **L**. Welfare state provisions thus alter the budget constraint to **G1LBAH**.

This outcome is, however, further altered by the effects of PAYE taxation. The **BL** section of the budget constraint shows how before-tax wage earnings are increased over the shading-out region. For simplicity, three rates of PAYE tax are shown, with tax bracket changes occurring at incomes of **m1** and **m12** in Figure 3A.1. This means that as wage employment is increased from **h1H** to **h13H** hours involving a movement up the before-tax budget constraint from **B** to **L**, higher income taxation applies that reduces disposable wage income as shown by the triangle **LKC**. Deducting this tax incidence over employment hours **h1** to **h13** reduces the section of the budget constraint **BL** to **BK**. The illustrated top tax rates for wage employment exceeding **h13H** hours means that the **G1L** section of the budget constraint is altered to **G1'K** after-tax. Putting these sections together, the before-tax budget constraint of **G1LBAH** becomes the after-tax budget constraint **G1'KBAH** as shown in bold print. (The prime sign ' indicates the after-tax budget constraint throughout this work.)

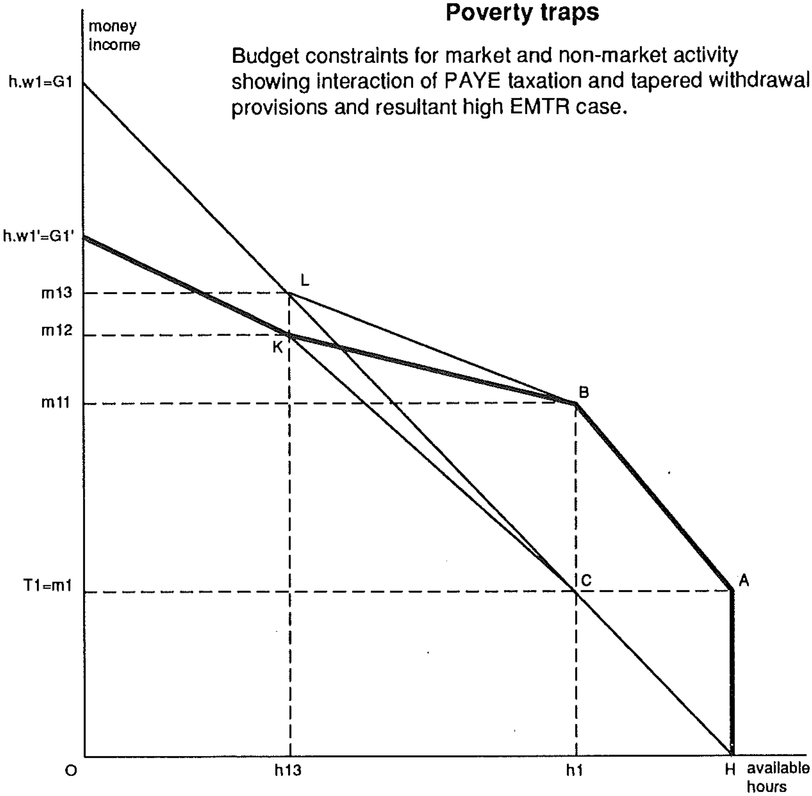
This bold-print budget constraint shows a flattish section **KB** where the interaction of state welfare transfer provisions and the taxation system result in a small rise or slope of the budget constraint. This means that there is a range over which increases in hours wage employment give little increase in command over market goods and services (shown in Figure 3A.1 as **m12m11** for increase in hours employment of **h13h1**). In Australia, this flattish section has been called the 'poverty trap', since it represents an area where there are only small incentives to move out of low-income welfare dependency.

Labour-market regulation is not directly represented in Figure 3A.1, but the main influence may easily be imagined. Wage unemployment is increased where labour-market regulations fix wages above scarcity valuations for the relevant labour services. The result, as it might be illustrated in Figure 3A.1, is that the vertical axis of the budget constraint is not (H . w1), but this sum multiplied by the probability of wage employment (prob.): that is, [(H . w1) (prob.)]. This means that labour-market regulation may give the illustrated budget constraint for those who secure wage employment, but persons searching for wage employment may reckon a budget constraint with a lesser gradient than that shown in Figure 3A.1. That is, minimum wages that are above scarcity valuations may achieve a steepening of budget constraints as these are reckoned by those with jobs, but not achieve a steepening as reckoned by persons contemplating job search. How these influences affect the chosen outcome depends upon preference configurations between market and non-market activities. These are considered with reference to Figure 3A.2.

Figure 3A.1

Poverty traps

Budget constraints for market and non-market activity showing interaction of PAYE taxation and tapered withdrawal provisions and resultant high EMTR case.



The **initial budget constraint** between market and non-market activity (G1H) is formed by the G1 intercept, showing maximum possible wage income (available hours multiplied by the relevant going or expected wage rate), and the horizontal axis intercept showing normally available hours, H. The budget constraint after welfare state transfers (T1) and their tapered withdrawal is G1LBAH. Adjusting this budget constraint for the effects of PAYE taxation gives maximum expected after-tax wage income of G1' and an after-tax budget constraint of G1'KBAH.

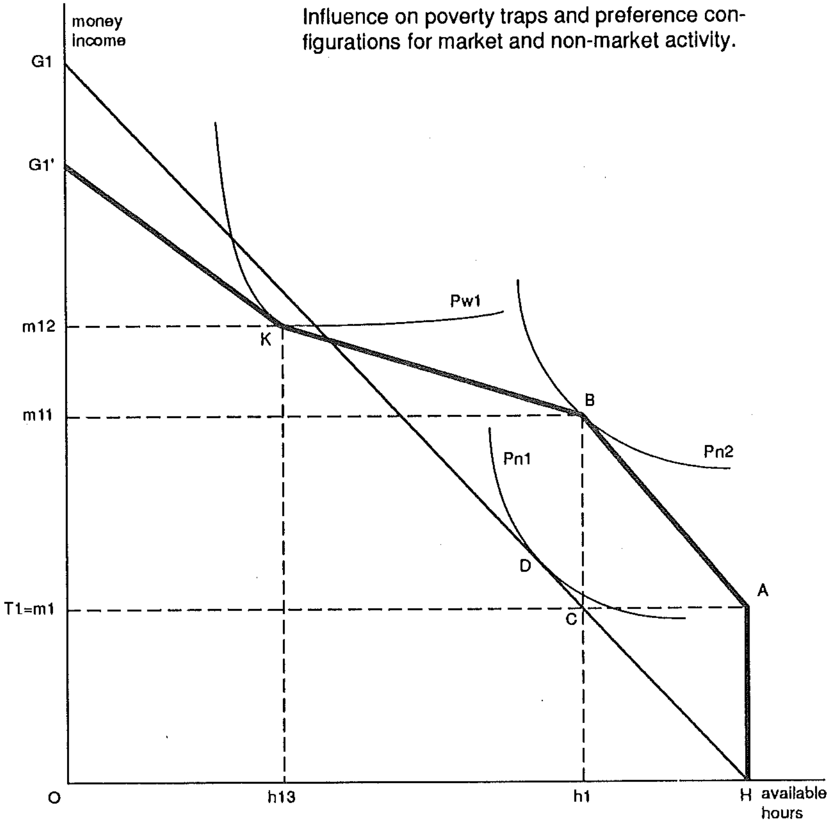
Preference Configurations and Interaction with the Budget Constraint

Figure 3A.2 simplifies the budget constraints of the previous figure and shows only the possibilities available without welfare and taxation provisions (that is, **G1H**), and the **G1'KBAH** budget constraint showing the combined effects of welfare and taxation transfers on the command over goods and services. Into this map are introduced preference functions ('indifference curves') that show the various combinations of market and non-market goods and services that are assessed as deriving given levels of welfare. It is seen from Figure 3A.2 that a marked preference **for** wage employment (illustrated by preference function Pw1) is necessary for a choice involving wage employment within the poverty-trap area. Preference functions labelled Pn show the influence of personal valuation different from that shown in function Pw1, and represent preferences for persons not having a marked preference for wage employment (or not having a marked preference for non-market activities such as leisure). The requirement of consistency in choice means that the preference functions of individuals do not cross, with the result that where persons do not have a preference map that is skewed towards wage employment, more preferred combinations of market and non-market activity are likely to be found near B. This is shown in Figure 3A.2 where preference function Pn2 touches the budget constraint at B, which is the most preferred position attainable where choice is so constrained.

Persons making the choice illustrated at **B** contribute relatively little to market activity (only h1H hours, deriving m1 wage income), and make a relatively large allocation of hours to non-market activity. Policies that lift the **B** inflection point and that lengthen and reduce the gradient of the **BK** section have the effect of increasing the likelihood that persons who would be employed at low wages will choose welfare dependency supplemented by limited market labour activity. Figure 3A.2 illustrates this choice as giving a market income of m11 (from welfare-state transfers and part-time wage earnings) and a large share of available hours devoted to non-market labour activity. Evidence concerning choices of this kind were treated in Chapter 3.

Figure 3A.2
Activity choice

Influence on poverty traps and preference configurations for market and non-market activity.



The **G1H** and **G1'KBAH** budget constraints for market and non-market possibilities without welfare-state interventions and with welfare-state interventions are introduced from Figure 3A.1. The possibilities (or constraints) interact with **preference functions** to derive outcomes of constrained optimisation. The curve Pw1 represents some given level of preference for a person with a strong disposition for wage employment. The Pn1 and Pn2 curves represent ordinal rankings of given levels of preference for a person whose dispositions are relatively neutral as between market and non-market activities (outcomes on Pn2 are preferred to outcomes on Pn1). Point **K** represents the **choice** of a person facing the **G1'KBAH** budget constraint and having a strong disposition to wage employment. Point **B** represents the **choice** of a person facing the same possibilities and with relatively neutral dispositions between activity inside and activity outside the market. The **B** choice involves dependency on welfare transfers of T1 supplemented by m1 wages from h1H hours part-time wage employment, giving a total monetary income of m11 and most hours (namely, Oh1) being devoted to non-market activity.

Chapter 4

Expanding Employment Opportunities: Policies to Reverse the Failing Symbiosis

The analysis of the preceding chapters suggests the need for an agenda of policy change. This chapter treats a wide range of relevant policy issues and proposals that would contribute to the expanded use of Australia's labour resources and to increased command over market goods and services for all Australians.

Before the policy proposals are discussed in detail, consideration is given to some general issues relating to the framing and pursuit of economic policy, and the general case for labour-market deregulation is canvassed.

The Theory of Economic Policy

During his opening speech for the 1988 Conference of Economists, Prime Minister Hawke explained the success that he attributed to the Accord in terms of the government's recognition that 'wages are both costs **and** incomes'. The theory of economic policy normally stipulates that each economic target requires a separate and distinct policy instrument. The Hawke Government's 'recognition' involves using a **single** policy instrument, wages, in order to achieve **two** targets: employment outcomes and income-distribution outcomes. Failure to match instruments and targets makes failure of economic policy virtually inevitable (see Tinbergen, 1952).

At times, the Hawke Government seems to recognise the theory of economic policy. For example, it has argued against growth in nominal wages, while implementing reductions in rates of PAYE taxation. The consequent reductions in real before-tax wages have been an instrument for the policy objective of growth in employment; while the PAYE tax cuts have been an instrument for the policy objective of maintaining after-tax wage incomes. But overall, the Hawke Government has failed consistently to match policy instruments and policy targets, and to assign correctly each policy instrument to the target upon which it most strongly impacts. For example, every government submission before National Wage Cases since March 1987 has sought a flat-rate component in wage increases in order to help those earning low wages. This position is repeated in the February

1990 'agreement' of the government and the ACTU, in which a wage is viewed as 'both a cost **and** an income' (Australia, 1990:39). This confusion has contributed to compression of wage increases flowing from National Wage Cases between high-skilled and low-skilled workers, and is an example of how Hawke Government policies have been detrimental to the objective of employment growth.

Implementation of the various policies considered below requires their ordering within a policy framework where there are at least as many policy instruments as there are policy targets, and where each policy instrument is assigned to the policy on which it has greatest impact. Thus, policy instruments that reduce before-tax real wages are not policies **against** low-wage earners: they are policies targeted to increasing employment for low-wage earners. Wage policy is thus assigned to the employment objective, for it is here that it has its greatest and most direct impact.

The General Case for Labour Market Deregulation

Not all labour-market regulation is unnecessary. Government responsibilities for public safety should, for example, give rise to continued policing of certain skill competencies associated with certain jobs. In particular cases the question of what is and what is not necessary regulation may be difficult to resolve. And where regulation is judged necessary, the appropriate and efficient method of regulation may be difficult to resolve. Such issues of practical judgment involve weighing of costs and benefits, and choices between alternatives, to achieve the most favourable net results. It is not complete deregulation that is proposed, but the removal of inappropriate regulation or the adoption of more appropriate regulatory processes.

It was argued in Chapter 1 that minimum-wage regulation is central to the welfare state as it has developed in Australia. Over time, this has resulted in a system of market production that gives little access to wage employment for Australians with poor endowments or little development of labour-market skills. These people are trapped in poverty through dependence upon state welfare transfers that are inappropriately designed, together with only casual or part-time access to wage employment.

The casual jobs are very largely confined to a segment of the 'secondary labour market' that involves little on-job skills formation, job insecurity, and poor job career prospects (compared with those available to persons who gain full-time wage employment). This has led to growing numbers of welfare dependants, some of whom have marginal labour-market attachment of a kind that leaves them especially vulnerable to loss of employment, and that rarely gives opportunity for labour-market mobility. In short, the harmful influences of the existing system of welfare-state and labour-market regulation are more pervasive than the narrow concept of poverty trap as explained in Chapter 3 and amplified in Annex 3A.

Supporters of minimum-wage regulation in Australia would argue that its removal would result in a reduction in the area of command over market goods and services in line with falls in regulated minimum wages. This could be the case for some currently employed people, but not necessarily for those searching for wage employment. As was explained in Chapter 3, for persons searching for wage employment, the maximum before-tax and maximum after-tax weekly wage incomes that are obtainable on available weekly hours are determined by the going hourly wage rate multiplied by available hours, this sum then being multiplied by the probability of obtaining wage employment.

Persons with poor endowments or little development of labour-market skills tend to be clustered in insecure part-time or casual wage employment partly because various non-wage costs of employment (labour 'on costs') are lower than for full-time jobs. This means that although hourly wages may be constant as hours employment increase, increases in hours employment may be associated with increases in labour 'on costs', leading to increases in hourly labour costs. As a result, hourly labour costs for part-time and casual wage employment of a given class of labour services may be lower than for equivalent full-time wage employment.

These lower hourly labour costs help explain the attractiveness of part-time and casual jobs to employers, and also the higher probability of success in search for these kinds of jobs for people with poor labour-market skills. This helps explain the tendency for clustering of these people in marginal labour-market attachment with restricted opportunities for on-job skills formation and consequent labour-market mobility.

The deregulation of minimum wages (plus appropriate adjustments in regulations affecting labour 'on costs') may be expected to improve employment prospects for job seekers with poor market skills. Hourly wage rates for such persons may fall, but expected hourly earnings may not fall (or may not fall as much), because the probability of successful job search is increased. That is, the area of command over market goods and services for low-skill job seekers will not necessarily fall as wage deregulation occurs. At the same, the process of minimum-wage deregulation may be assisted by expansion in labour-market absorption of persons who previously had weak labour-market attachment.

There is no case in justice for keeping minimum-wage regulation in order that those with jobs can earn above-market wages (in economic jargon, so that these persons may gain 'economic rents'). Firms engaged in market production of goods and services are unlikely to pay employees more than their market valuations. Instead, they will reduce employment until the cost of labour services at least equals its incremental value to employing firms. Alternatively, firms will alter the way that labour is combined with other factors of production so that the values of labour services are increased at least to the costs of those services. In short, the system of market production will adjust to the regulatory framework.

Under the present arrangements, the price of that adjustment is unjustly borne by those who are excluded from wage employment by labour-market regulation. Even where the exclusion from wage employment does not occur, labour-market regulation may act to increase the proportion of 'secondary labour-market' jobs. The result is a higher proportion of people in insecure wage jobs, and in jobs that do not provide on-job skills formation and the possibilities of careers and of enhanced labour-market mobility. Inappropriate labour-market regulation thus works against spontaneous market processes that increase the on-job skilling of the market workforce.

It is not 'exploitation' to allow people to work for unregulated low wages. People may be expected to search for the most favourable market opportunities available to them. (If they fail to do so, then better opportunities may be brought to their notice by public agencies operating at local levels.) Firms that offer conditions of employment that are inferior to the marginal product value of the relevant employees increase their market vulnerability, because they thereby forgo opportunities to increase profits. Market competition thus induces expansion of employment until the additional value of production approaches additions to labour costs. Sometimes, wage employment may not expand because the conditions of employment offered are unattractive. (For example, complaints by employers that they 'cannot get tradesmen' mean that they cannot get tradesmen at the conditions of employment that are offered.) The 'exploitation' cry is actually an emotional smokescreen for maintaining unjust labour-market regulations that discriminate against the 'disadvantaged'.

The central argument for the deregulation of minimum wages is that it brings more people into the labour market, thereby lifting production. As a consequence, rewards to wage employment are over time likely to **increase** rather than to decline. And people are likely to have better jobs and to be able to buy more market goods and services because lower taxes allow higher disposable incomes. Where economies are able to make dynamic adjustments, it is mistaken to conclude that removal of minimum-wage regulation will put more people on lower incomes.

Government Withdrawal from National Wage Cases

Monopoly power is not confined to the labour market and to the influence of ACTU affiliates, but occurs also in the corporate sector. Indeed, strong corporate interests have crucially assisted the implementation of the alliance of the ACTU and the Labor government through what has been called the 'Industrial Relations Club'. Members of the Club, both union and company bosses, recognise that established regulatory practices maintain a protected environment whereby competition from non-unionists and from other companies is reduced. Job-seekers cannot offer their services on conditions other than those specified in awards promulgated from the 'Club's Rooms' (the Australian Industrial Relations Commission, and its State equivalents). Firms seeking to enter markets for goods and services are similarly constrained in the conditions of employment they can offer. In short, competition is reduced. Labour and capital remain idle, and employment regulations that fail to reflect contemporary market conditions, including supply of resources, technology of production, and product demand, continue in force.

The government should cease to intervene in National Wage Cases. It should instead make clear to firms that protection and rescue bids will not be forthcoming: no reversals of tariff reductions, no more 'Kodak rescues', no more fiddling with fiscal policy to enable companies to pass on cost increases. The government should make clear to unions that firms, employees, and associations of employees that enter voluntary agreements will receive government protection of their rights to negotiate and implement voluntary decisions. Freedom of association, Section 115 of the Industrial Relations Act 1988 (allowing for Certified Agreements), and Section 45D of the Trade Practices Act 1977 (prohibiting secondary boycotts), as well as common law remedies, should be upheld as government policy. In this environment, unionists who force wages above their market levels would have to reckon with job losses.

Reduced Funding for the IRC

It is far from clear that the Industrial Relations Commission and its State equivalents deliver public benefits commensurate with their funding. Firms and employees or employee associations that enter voluntary arrangements incur the costs of negotiating and of policing those arrangements. Contraction of government funding for regulatory tribunals should be accompanied by the requirement of fee-for-service by these tribunals. Only thereby will users begin correctly to assess the costs and benefits of recourse to tribunal regulatory processes, and to decide whether or not to use regulatory tribunals for industrial-relations purposes.

Public Education about Labour Productivity

Although governments should cease formal interventions to National Wage Cases, the public education function of government should be sustained where it helps the adjustment process. The 'two-tier' arrangements under the Accord, as it applied in 1987 and 1988, may have usefully served as transition arrangements. Second-tier wage increases focused attention on the workplace changes needed to finance the increases: on 'work practices', 'productivity offsets', and 'productivity improvements'. These arrangements involved 'increasing the cake' by improving labour productivity at the point where the changes had to occur: at enterprise level and at places of work. This public education has had a significant impact on union leaders, company leaders, and employees.

The original intention as expressed in the IRC *Reasons for Decision* (ACAC, 1987:12) was 'that no [wage] increases should be paid before a restructuring and efficiency exercise is implemented'. This intention has been gravely compromised in its implementation, especially by award increases since 1989 under the 'structural-adjustment principle'. Nevertheless, there remains a valid role for the government to contribute to public acceptance of the need for structural changes that enhance productivity performance. There should, however, be a clear 'sunset' on funding for these programs of public education, since success should diminish their necessity.

Public Commitment to Human Capital Formation

Structural adjustments that improve labour productivity improve the formation and renewal of labour-market skills. Once firms and employees experience the benefits to be gained from on-job human capital formation and renewal, market formation and renewal of work skills and processes should occur spontaneously.

However, it is applied and firm-specific skills that tend to be formed and renewed in this way. Formation of general skills tends to occur off-job, and general skills are often a prerequisite to successful on-job formation and renewal of skills. Basic deficiencies in literacy and numeracy are unlikely to be rectified within the labour market, and access to and success in on-job skills formation usually depends upon good foundations of general skills. Certain general skills are more effectively formed off-job and in dedicated educational institutions (whether public or private). But the applied development of these skills usually only occurs on-job. An obvious example is in the use of computers, where full development of computing skills presupposes workplace exposure to their applications.

Governments can best commit themselves to human-capital formation in Australia by reinstating objective standards of educational performance, so that young Australians gain the general skills of literacy, numeracy, and social poise that are so necessary to workplace performance and productivity.

The Impact of Labour-Market Reform on the Young and the Disadvantaged

Minimum-wage regulation most seriously impacts upon persons having few or undeveloped labour-market skills and deprives them of opportunities for forming on-job skills. The Kirby Report of 1985 proposed circumventing union resistance to labour-market entry by young and less skilled people with a 'training wage'. The Hawke Government attempted to implement this through the National Training System policy (Australia, 1985b). But this and other initiatives have been frustrated by union resistance. As a result, firms prefer to recruit experienced people, and those who would most benefit from on-job skills formation are unable to secure employment on terms agreeable to themselves and employers. The resulting suppression of human-capital formation reduces national economic performance, and reduces market opportunities especially for young and unskilled persons (see Chapman & Stemp, 1989).

Labour-Market Programs that Favour Older Workers

Most labour-market programs financed by the federal government have been directed to younger persons (see, for example, Australia, 1986). There are good reasons however, for focusing labour-market programs on older people.

At a time when technical changes are leading to increased obsolescence of labour-market skills, there is evidence that employers seek means of shedding workers with obsolete skills (see Howe et al., 1984, and McCallum, 1987) while still satisfying implicit contracts of employment formed under different market conditions. The consequent growth in early-retirement arrangements has led to an increase in the movement of older persons (mainly males) out of wage employment. For lower-skill employees who tend not to be covered by implicit employment contracts leading to early retirement provisions, the shedding of workers leads to an increase in the transition of older persons from employment to wage unemployment. This is followed by an increase in the transition of older persons from unemployment to the labour force outside the market. The availability of state welfare transfers to persons (largely in the form of invalid pensions) is presumably significant for the transition from unemployment to the labour force outside the market (BLMR, 1983).

The SSR (1986a) has lent support to the view that access to state welfare transfers should be increased for older persons who have experienced long-duration unemployment, and the DSS has relaxed its scrutiny of job-search requirements for unemployed persons aged 55 years and over (DSS, 1987:21).

Older workers will usually need to be paid higher wages during training periods and will usually be expected to have shorter durations of pay-off for skills formation, thereby increasing the reluctance of firms to invest in the reskilling of older people. Arguably, labour-market programs for older workers should be governed by efficiency criteria for optimal intervention in the labour market (see Brooks & Volker, 1986).

Reservations may be expressed about government labour-market intervention through labour-market programs (see Sloan & Wooden, 1987, and Mangan, 1990). Nevertheless, present transfer payment arrangements allow older persons to demand market goods and services without contributing to market production. State welfare transfers to firms for labour-market programs that are targeted at older workers help these people to continue to contribute to market production. Targeting labour-market programs to older workers makes good sense where the net value of contributions to market production (after deducting outlays on labour-market programs) still exceeds state welfare transfers that would otherwise be made to persons receiving unemployment transfer payments or invalid or aged pensions. In short (and setting aside reservations about such programs), labour-market programs that increase the readiness of firms to hire older workers could achieve net reductions in government transfer payments. These changes should, of course, be combined with other policy changes that increase the readiness of older persons to seek continuing market workforce attachment.

Reforms Promoting Readiness for Market Workforce Attachment

Some researchers continue to promote the view that long-duration welfare dependency by able persons should not be regarded as voluntary. A recent example of this view was encountered during a seminar presentation of Junankar and Kapuscinski (1990), which included the results of a multiple-regression estimate of the relationship between a number of causal variables and number of recipients of unemployment benefits. The introduction of a dummy variable to capture the effects of tightened administration of unemployment benefits by the DSS (see Australia, 1987:168) was reported to be statistically insignificant, and this was cited as evidence that 'dole bludger' claims by newspaper journalists and conservative politicians were without foundation.

Policy debate seems, however, to have overtaken the agnosticism of researchers, and there is growing recognition that structures of incentives have not helped to integrate able people into the market workforce. This is reluctantly and implicitly recognised in the SSR report, *Income Support for the Unemployed in Australia* (1988), where the need argued throughout for a 'more active' policy necessarily acknowledges that previous welfare administration had allowed able people to remain in welfare dependency. Both the DSS (1988:106) and the Hawke Government (see Australia, 1989b: 3.10) have evidently concluded that the tightening of welfare administration reduces welfare outlays substantially more than it raises costs of welfare administration, and frequently claim that tightened administrative procedures produce welfare savings. For example, the restructuring of assistance to unemployed persons included in the *Economic Statement February 1990* is 'expected . . . [to] lead to significant reductions in outlays on unemployment benefits as more unemployed people are encouraged by training and by other means to find work' (Australia, 1990:34). These claims would have no substance if the administrative changes were not, in fact, altering the incentive structure for persons in long-duration welfare dependency.

Bringing Local Knowledge to the Administration of Welfare

Recent changes in youth-welfare administration, in combination with changes in the level of state welfare transfers per person, have been accompanied by dramatic falls in measured youth unemployment. On 1 January 1988 the 'unemployment benefit' for unemployed persons aged 16 and 17 years was replaced by the 'job search allowance' (DSS, 1988:43). Measured wage unemployment for persons aged 15-19 years declined from 18.7 per cent for August 1987 to 15.6 per cent for August 1988, and to 13.7 per cent for August 1989 (during the same period, declines in measured wage unemployment were much smaller for persons aged 20 years and over) (computed, ABS cat. 6203.0). The *Economic Statement February 1990* (Australia, 1990:11) identifies these changes in welfare provision as having 'produced marked declines in the number of young unemployed receiving [state welfare] income support'.

This recognition that incentive structures have not helped to integrate able people into the market workforce is now so widely accepted that the Hawke Government announced proposals for a fundamental restructuring of state welfare transfers to unemployed persons prior to the 1990 federal elections (Australia, 1990). This involves the replacement of 'unemployment benefits' with a 'job search allowance' for all age groups during the first year of wage unemployment, and the implementation of a 'new-start' program with more restrictive entry conditions and with increased obligations on persons unemployed for more than a year. These programs came into effect on 1 July 1991.

These changes go in the right direction. Further, they do not incorporate the pervasive argument of the SSR for improved 'adequacy' in the levels of state welfare transfers. The new proposals focus on administrative changes to incentive structures for welfare recipients. Except for youths, there are no marked changes in the relative rewards as between welfare dependency and wage employment or skills acquisition.

The DSS has greatly expanded its network of regional offices, thereby improving the access of clients to departmental services and improving departmental contact with and assessment of clients. The administrative changes emphasise the eligibility requirements of able recipients of state welfare transfers; the term 'client obligations' now receives prominence in departmental and ministerial statements (see Australia, 1990:63). These moves are also very much in the right direction, and help bring home to able welfare recipients that continued entitlement to social-security cheques is not unconditional. Rather, access to market goods and services through the job-search allowance involves clear obligations actively to seek employment, and access to new-start transfer payments involves clear obligations to engage in programs that improve the labour-market skills of recipients. Nevertheless, this administration of welfare still relates poorly to local labour-market opportunities and to local knowledge of the actual circumstances and opportunities that welfare recipients face.

The best remedy for this is not the multiplication of federal welfare administration units at regional and local levels. Rather, welfare administration should be devolved to regional and local levels. This does not mean that welfare should be (wholly or mainly) funded locally. In periods of population movement, certain States, regions, and localities of Australia are likely to have lower wages and proportionately more people seeking welfare-state income support. This implies the use of federal general revenues to tip the distribution of incomes towards such areas. But even if welfare programs continue to be funded by the federal government, they could nevertheless be administered at regional and local levels. The transfer of client servicing and supervision to local government would facilitate the use of local knowledge. Local networks of information, social relations, and economic relations could be applied to improve the integration of able people into market economic activity. For this to succeed, local governments would require incentives to maximise local initiatives in the personal, community, and economic development of their areas. (Increased interest in community-based welfare may be noticed in Australia, 1990:78-84.) The next two sections suggest in a preliminary way how these incentives may be structured.

Incentives for Efficient Local Administration of Welfare

If local government authorities acted simply as agents for the distribution of federal funds, they would have little incentive to police the administration of welfare and to direct funds to local community and economic development. Indeed, this could encourage them to establish havens for people in continuing welfare-state dependency.

So that local knowledge and social and economic networks can be used for increasing the movement of able people from welfare dependence to market productive activity, local-government authorities need to benefit directly from savings in welfare outlays. For example, local governments could become eligible for, say, half the annual savings resulting from reduced state welfare dependency within their jurisdictions. These savings could be used for supporting local community development initiatives, and thereby provide incentives for the use of local information and local initiative to minimise welfare abuse.

Use of Local Administration for the Expansion of Local Market Opportunities for Welfare Recipients

The expansion of market opportunities for persons with poor labour skills should not involve only opportunities to enter wage employment. Substantial opportunities exist for other kinds of gainful economic activity. Much of this lies in the 'informal economy', where services such as child minding, house cleaning, and lawn mowing are undertaken on a cash basis by recipients of state welfare transfers, who thereby also avoid income taxation of these earnings. People who pay cash for these services would have an incentive to require official receipts if these outlays were deductible from personal taxation at some minimum rate.

Local governments issue licences for street vending and hawking, and certain other services that are intensive in the use of low-skilled labour and that, unless controlled, could lead to congestion of public places, or deterioration of public health standards. It would, in principle, be a simple matter for local-government authorities in liaison with their local welfare administration departments to issue receipt books for specified personal services. So, for example, receipt books bearing a local-authority imprimatur and number could be issued for domestic services, gardening services, vending services, trades services, etc.

Where persons using these services failed to fulfil contracts (for example, a parent was dissatisfied with the standard of child minding), the local authority could receive complaints and reserve the right to withdraw official receipt books. Receipts should specify both hours of services rendered and price paid. Users would want the actual price paid recorded, as this would bring reduction in taxes at the minimum rate (say, 10 per cent of the outlay). The transfer of these activities from the informal to the formal economy would mean some expenditure of federal taxes by persons claiming taxation deductions. It would, however, reduce abuses of undeclared incomes by recipients of state welfare transfers. Allowing for multiplier effects, it is reasonable to expect that state welfare transfers would be reduced.

It should be noted that these proposals differ from the 'workfare' programs promoted in the United States of America (see SSR,1986b).

Such programs are essentially 'make-work' schemes, under which welfare recipients are required to undertake labour services for public (especially local) authorities in return for state welfare transfers. Under workfare arrangements, there is no guarantee that the value of the work is related to state welfare transfers, and work is supervised at public expense. Under the proposal canvassed here, work would be undertaken in response to the real market for labour services: it is not 'make work' but productive work. And in the administrative form proposed, quality control for labour services comes directly from the users who pay directly for the services.

The next section examines the application of these proposals for the benefit of disabled persons.

Expanding Labour Market Opportunities for Disabled Persons

It was argued in Chapter 3 that labour-market regulations distort market productive activity so as to limit access to wage employment for able persons with poor labour-market skills. This discriminatory influence of labour-market regulation is particularly marked for persons who are disabled, whether mentally or physically. The practical impact has been to reinforce the institutionalisation of social and economic life for disabled persons, which either excludes them from market productive activity or confines them to such activity in the ghetto environment of 'sheltered workshops'. This institutionalisation has led to increased welfare dependency by disabled persons and diminished their opportunities to contribute to the economic life of the society.

The Disability Services Act 1986 is presented as an attempt to reverse this situation for persons whose disabilities are not severe. A recent report by Barber et al. (1990) shows the economic problems that arise in implementing this particular legislative attempt to integrate disabled people into the market workforce. Under present Australian labour-market regulation, this entails charitable subsidisation by firms or government subsidisation of employing firms.

A strong case can be made for deregulating wages for able persons, on the grounds that people may be expected to choose the most favourable available options. But disabled persons may face restricted information concerning options and have only limited abilities to assess them; and their search costs may therefore be increased. The case for a public labour-market information and counselling agency thus becomes stronger in the case of disabled persons. An organisation of these agencies that draws on national and local knowledge would be appropriate, and it seems likely that local resources, knowledge, and community commitment would best be achieved by local government and community administration under federal guidelines and partial federal funding.

The system of receipt books issued by local-government authorities could be adapted to the needs of disabled persons, assessed individually. The market value of goods and services produced by disabled persons under such arrangements could well be small. Nevertheless, some contribution is better than nothing, and opportunities for disabled persons to engage in productive work and in the economic life of the society may be expected to have beneficial effects on the quality of their lives. Provisions of this kind would need to be administered with some rigour to ensure that welfare provisions for disabled persons were not extended to able persons.

Productive Work and Quality of Life

Writers on social policy since the emergence of the welfare state tend to refer to menial wage occupations as 'dead-end jobs', with the implication that such labour is demeaning. Menial labour may often be boring or arduous or both. But neither repetitiousness nor arduousness is in itself demeaning, as anyone who knows fine and dignified people who have long so worked can verify. Further, although much menial wage employment does not lead to a career (for example, the dwindling occupation of bus and train conductors offers no career path), menial jobs often allow entry to on-job training and the expansion of labour-market opportunities.

Every opportunity to increase labour-market opportunities should be encouraged, but menial jobs that do not lead to career paths should not attract the description 'dead end'. The real dead end is continuing welfare dependency. Only a society that seriously respects and encourages all contributions to productive activity can be expected to flourish. A society that deprecates lowly labour will lead people to desultory and dissatisfied work lives, and to a drift from productive labour-market activity to dependency upon state welfare transfers.

In recent years many resources have been devoted to promoting the 'status of women' and other 'anti-discrimination' causes. To the extent that governments have a valid role in influencing public attitudes, similar public efforts should arguably be directed to cultivating personal and family economic independence and the responsibility to contribute to the productive life of the nation. A program of public-attitude formation of this kind necessarily means a reversal of the earlier programs, which have encouraged able people to believe they have a 'right' to a certain standard of material living regardless of their level of contribution to the productive activity of the society.

Yet the thrust of this reform agenda is not one of public education or rhetoric. The key policy issue is getting the incentive signals right, so that people are rewarded for productive effort. There will always be some people whose disabilities place particular obligations of support upon their families, communities, and the wider society. The problem of social misfits will probably always be present, whatever the efforts to limit its incidence. But the vast majority of people will respond to opportunities that bring their own rewards. The thrust of this policy agenda is to expand opportunities that have been limited by inappropriate labour-market regulation and to improve incentives that have been damaged by inappropriate state welfare arrangements. It is a policy agenda directed to creating conditions where people have more opportunities to help themselves, more rewards from helping themselves, and more support from society to help both themselves and their country. The policy agenda is a positive one designed to foster the dignity and personal responsibility of Australians. The proposals are practical and achievable. The assessments necessary for their efficient implementation should be undertaken without delay.

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