EMBARGOED UNTIL THURSDAY 2 SEPTEMBER

ISSUE ANALYSIS

THE CENTRE FOR INDEPENDENT STUDIES

No. 51 2 September 2004

# Only 18%?

## Why ACOSS Is Wrong To Be Complacent About Welfare Dependency

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EXECUTIVE SUMMARY

A new report from the Australian Council of Social Service (ACOSS) recognises that welfare dependency has now expanded to cover 18% of working-age Australians, but it denies this is a problem. Arguing that Australia still spends less on welfare than many other developed countries, ACOSS thinks we should be expanding welfare rather than worrying about it.

But welfare dependency on this scale *is* a problem, not only financially, but in the debilitating effects on claimants themselves. The growth of long-term welfare dependency among competent and capable adults over the last 40 years has been a major policy failing.

The ACOSS report claims Australia is 'mean' because we spend less on income support payments than many other countries do, but the comparisons it draws are misleading. Australian welfare spending is lower than is common in the European Union, but higher than in the other two major world economies, America and Japan. Seen in this light, we are spending too much, not too little.

The claim that we are 'mean' also ignores the fact that Australia diverts a bigger proportion of its welfare budget to poorer sections of the population than almost any other OECD country. While we spend less in total than many EU countries, the poorest 30% of the population gets a bigger net share of welfare spending than is the case even in Sweden.

The ACOSS report claims that welfare benefits are insufficiently generous to allow families and individuals to meet their 'essential living costs'. But it bases this claim on a measure of 'minimum budget standards' which is hugely inflated. Nearly all welfare payments are above the very generous Henderson Poverty Line, which ACOSS used to use as a measure of adequate income. This means benefit levels are adequate to keep claimants out of poverty even when poverty is generously defined.

It is unfortunate that ACOSS should publish a report complaining that Australia is not spending enough on benefits when the pressing policy challenge is to *reduce* welfare dependency, not to expand it. We need stronger work incentives, not higher benefits. We need more people leaving welfare, not increased welfare spending. The aim of social policy should be to get as many people as possible living at a decent standard through their own efforts without relying on government income transfers. ACOSS appears to have lost sight of this basic objective.

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ISSN: 1440 6306
www.cis.org.au

## Introduction

A new report from the Australian Council of Social Service (ACOSS) claims that the problem of welfare dependency among working-age Australians has been exaggerated.[1]

The report does not deny that more than one in six adults of working-age now depends on welfare as their sole or main source of income. Indeed, it accepts an OECD estimate of 18% equivalent full-time welfare dependency, which works out even higher than my estimate of around 16% of working-age adults depending wholly or mainly on benefits.[2]

Nor does the report deny that there has been a huge increase in this rate of welfare dependency in the last 40 years. In the mid-1960s, just 3% of working-age Australians relied on welfare. This proportion has increased five-fold since then, and this upward trend shows little sign of abating.

ACOSS does not deny any of this. It accepts the statistics and trends as accurate. It simply denies that there is anything here we need worry about.

## Don't worry if we're sinking, over there they're drowning...

ACOSS's complacency derives from its observation that Australia still spends less on welfare than many other OECD countries. The logic here is that, because others have been performing even worse than we have, we have nothing to worry about. Indeed, the lesson that ACOSS draws from its international comparisons is that we should be spending even more money on welfare to bring us into line with the higher-spending Europeans. In a waterlogged boat, ACOSS not only wants us to stop baling out the water, it thinks we should pull out the plug.

ACOSS seems to believe that the objective of social policy is to spend money and increase the number of people in receipt of government hand-outs. The higher the level of welfare expenditure, the better the system is thought to be. ACOSS believes Australia's performance on welfare compares adversely with the continental Europeans because they spend more (and tax more) than we do. If we were to double personal taxation, drive many more working households into hardship, and then rescue them with massive welfare hand-outs financed by their own taxes, ACOSS would, according to this logic, think we had made great progress.

Because Australia's total welfare expenditure is lower than in most EU countries, the ACOSS report criticises our system as 'lean and mean'. ACOSS would prefer it to be a lot fatter and more profligate. The report describes our 18% dependency rate among working-age adults as 'low',[3] and when he launched the report, the President of ACOSS was critical of the fact that Australia has fewer working-age people on welfare than other comparable countries.[4] In this Alice-in-Wonderland world, the bigger our welfare problem, the better ACOSS thinks we are doing.

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Although the report does not mention it, over the last 20 years Australia has actually been matching Europe's dismal performance. OECD figures show that welfare dependency in both Europe and Australia increased at the same rate (by 35%) between 1980 and 1999. In America, by contrast, welfare dependency fell by 18% in the same period.[5]

## Why mass dependency really is a problem

ACOSS's approach to the issue of welfare dependency reveals a disturbing failure on the part of our leading social policy advocacy body to understand why mass welfare dependency is such a serious and urgent issue for us to tackle.

The report focuses on the economic costs of our growing welfare habit, and argues that we can afford to pay these costs because other countries spend even more than we do. But even if this were true, this argument spectacularly misses the point, for the expenditure issue is only part of the welfare dependency problem.

Of course, the rising cost of welfare is of concern, for by driving up taxes on workers, we are reducing work incentives and contributing to even greater welfare dependency levels in the future. Forty years ago there were 22 workers for every working-age adult supported on welfare payments; today there are five. If we continue at this rate there will be just two workers for every dependent in 30 years time. This trend is clearly unsustainable.

But just as important as the economic effects of our growing welfare habit are the sociological, cultural and psychological effects on individuals and on society as a whole. Short-term reliance on welfare need not cause problems for claimants, but when people who are capable of earning a living come to rely long-term on the welfare system instead, they create resentment and mistrust among those who are working and paying taxes (particularly those on low pay) as well as undermining their own well-being. Long-term welfare dependency means capable people enjoy lower material living standards than they could achieve by working, they end up with lower self-esteem and a lower level of life satisfaction than if they were self-reliant, and they pass on a damaging cultural legacy to their children.[6] Seen in this light, welfare is not a good thing to be expanded, but a potentially destructive and debilitating thing which should be avoided wherever an alternative is possible.

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### Long-term welfare dependency rates

Working-age welfare dependency is concentrated among three principal groups of claimants—disability support pensioners, single parents drawing Parenting Payments,[7] and unemployed workers on Newstart or Youth Allowance. In all three cases, *long-term* dependency has become disturbingly common, even normal.

The average time spent on Disability Support Pension (DSP) is seven years, and once on the pension, very few come off it before retirement (only 10% of recipients ever rejoin the workforce). Many DSP recipients are, of course, incapable of working full-time, but as many as half probably are capable of holding down a full-time job. Many of them are low-skilled older males who find it difficult to find suitable employment and who sooner or later get signed off with 'bad backs' or 'depression'. This suits the politicians (who achieve lower unemployment figures) and the Job Network providers (who get the most difficult cases off their desks), but it does few favours for the claimants themselves.[8]

Long-term dependency rates among sole parents are even worse. Some single parents are economically self-reliant, and others use Parenting Payment to supplement part-time earnings, but one-third of all lone parents have no income other than Parenting Payment (Single), and another 20% rely on the payment as their main source of income. These claimants often move between different categories of welfare payments, with the result that the average time spent on PP(S) is only two years, but the average time they spend in the welfare system as a whole is nearer twelve years. By the time their youngest child reaches 16 (when they cease to be eligible for PP(S)), many have become effectively unemployable, which is why more than half are still on income support five years after their Parenting Payment eligibility terminates.[9]

Long-term dependency on unemployment benefits is also worryingly high. Although half of the people who claim unemployment benefits find another job within eight weeks, income support records suggest that more than half of those on unemployment allowances at any one time have been claiming more or less continuously for at least 12 months. The average time spent unemployed is more than two years,[10] and a recent report suggests that 126,650 claimants have been unemployed for five years or more (a 35% increase since 2001).[11]

Long-term welfare dependency is therefore common in all three of the main welfare benefit categories. Of the 16% of working-age adults who depend on welfare for most or all of their income, around two-thirds appear to be locked into the system long-term (i.e. for more than 12 months), yet many of these people are capable of working.[12] This growth of widespread, long term welfare dependency among competent and capable adults is not just cripplingly expensive—it is also hugely destructive for the personal and social wellbeing of claimants themselves.

Given these figures, for ACOSS to describe an 18% dependency rate as 'low' is very complacent. For it then to compare Australia unfavourably with other countries where the figure is even higher is simply perverse.

### Is our welfare system 'mean' in comparison with others?

Even if we take the ACOSS report on its own terms and assume that high levels of spending on welfare are somehow 'desirable', its core claims about Australian 'meanness' are unconvincing. ACOSS says Australia's welfare system is 'mean' because we spend less on income support payments than many other developed countries do, but this is misleading for two main reasons.

*(i) Comparing giants and minnows*

First, the crude use of OECD country rankings to compare Australia's spending profile with that of other nations weights tiny European countries like Belgium, Denmark or the Netherlands equally with huge and much more significant non-European countries like Japan and the USA. For example, in Graph 1 of the ACOSS report, Australian social security spending as a proportion of GDP is shown to be the fourth-lowest out of 16 selected OECD countries, the implication being that we are badly out of line with normal international practice. The report cites this ranking to justify its 'key finding' (highlighted in bold at the top of page 1) that 'Australia spends less on social security payments than most wealthy countries'.

But two of the three countries ranked lower than Australia in this graph are the two world giants, Japan and the USA, while 10 of the 12 countries ranked higher are EU member states. Not only are many of these EU countries very small, but the EU as a whole increasingly forms a single bloc with similar or common policies. Ranking Australia against a lot of small EU member states to make the case that we are low-spenders makes no more sense than ranking us against a selection of US states and concluding we are high spenders.

The real story from the OECD comparative data is not that 'most wealthy countries' spend more than we do, but that Australian welfare spending is lower than in the EU yet higher than in the other two major world economies, America and Japan (and is also higher than most other countries in our region).[13] Seen in this light, the message to take from the OECD data may be that we are spending too much on welfare by international standards rather than too little.

*(ii) Ignoring the way the money is raised and spent*

The second reason why the report's claim about Australian 'meanness' is misleading is that it takes total welfare expenditure as its indicator of how 'generous' or 'mean' a country is, but ignores the much more important question of how this money is raised, and how it is then distributed across the population. It is true that Australia spends less *in total* than many EU countries, but this is because we give less money to the middle classes than they do. The proportion of net aid flowing to the poorest third of the population is actually higher here than almost anywhere else in the developed world, for we target aid more than other countries do.

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The ACOSS report admits that Australia operates a very different kind of social security system than most other countries, and that 'one reason' why we spend less than most EU countries is that 'our social security payments are targeted according to need, instead of being based on a proportion of people's previous wages as is usually the case in other OECD countries.'[14] But the report never goes on to explain how significant this difference is. Far from being 'lean and mean', this makes our system lean but very generous to those with no or low incomes.

In most of Europe, workers and employers contribute a proportion of weekly earnings to state-run 'insurance funds'.[15] When they are out of work, people draw down on these funds, and the payments they receive reflect the contributions they have made. This means that higher earners often receive higher benefits than lower earners (at least until their eligibility period expires)[16] because they have made bigger contributions.

The Australian system is different. As the ACOSS report explains, our system is 'non-contributory' (meaning that welfare payments are funded directly out of taxation rather than through specific social security contributions). This in turn means that benefits are flat-rate rather than earnings-related (everybody gets the same because nobody has established an individual contributions record). We also apply a much tighter means-test to welfare claimants than in many other countries. In Europe, for example, retired people who have paid social insurance contributions during their working lives receive a state pension irrespective of whether they have any other income. In Australia, by contrast, the age pension is only available to those on low incomes.[17]

Because welfare benefits in Australia are funded out of general taxation, and because income tax is steeply progressive (the more you earn, the higher the marginal rate of tax you pay), the people who earn the most money inevitably pay the lion's share of the welfare bills. The top quarter of income earners today contribute nearly two-thirds of all the income tax that is collected by the federal government.[18]

But because welfare benefits are flat-rate and tightly means-tested, those who pay most often end up getting very little back. Unlike their European counterparts, the middle classes establish no privileges as a result of their higher payments, and they may even be disqualified from claiming as a result of means testing. The result is a strongly redistributive system of income transfers.

A 2002 report from the Department of Family & Community Services spells out the consequences of this. It shows that while we spend less than most other OECD countries on total welfare payments, only Norway and Finland transfer more money (net of tax paid) to the poorest 30% of the population than we do. The report concludes: 'The degree of targeting is apparently so pronounced that the level of net redistribution to the poorest 30 per cent is significantly higher than in many other countries with much higher spending.'[19] Measured in terms of net transfers, Australia turns out to be operating a more generous welfare system than even Sweden!

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ACOSS fails to acknowledge this in its report. Focusing on the total amount spent, it ignores the crucial questions of where this money goes and who pays it. In Europe they spend more in total because the middle classes take money out of the system as well as putting it in. In Australia, we spend less overall, but most of the cash goes to the poorest third of the population. This means ACOSS is right that we run a 'lean' system, but it is certainly not a 'mean' one. In the sense of getting 'something for nothing', it is actually one of the most generous payments systems in the OECD.

## Are welfare benefits too low?

The bottom 30% in Australia may be paying comparatively little for the benefits they receive, but are these benefits high enough for them to live on? ACOSS thinks not. It has long argued that welfare benefits in Australia are too low, and this latest report returns to this theme, arguing that many jobless families are experiencing 'financial stress' as a result of inadequate payments.

Although the value of benefits paid to childless claimants in Australia is below the OECD average, we come out very close to the average when looking at the benefits paid to claimants in households with children.[20] In terms of international comparisons, therefore, our benefit levels do not look mean, which is why the ACOSS report switches to a different basis of comparison altogether.

Until recently, ACOSS has argued that benefit levels are inadequate because they fall below the Henderson Poverty Line (HPL). However, most poverty researchers now regard the HPL as badly flawed, for it has become increasingly generous since it was developed in the 1970s, and it now generates an absurdly high poverty estimate of around 22% of the Australian population. Furthermore, it turns out that nearly all welfare claimants are eligible for benefits that place them *above* the HPL. This means that, even when using an inflated and discredited measure of the poverty line, Australian welfare payments turn out to be more than adequate.[21]

In this latest report, ACOSS has responded to these weaknesses in its central claim by junking the old HPL in favour of a new measure which produces the findings they want. The 'low cost budget standard', developed by left-wing researchers at the Social Policy Research Centre (SPRC), allows ACOSS to claim that unemployment allowances fall short of a minimum adequate income by up to one-third, and that pensions fall short by up to one quarter. On this basis, the report concludes that: 'Australian social security payments do not provide enough income for families and individuals to meet their essential living costs.'[22]

This conclusion, however, rests entirely on the validity of the minimum budget calculations on which it is based. The ACOSS report does not explain how the SPRC calculated 'essential living costs', but when we investigate this it becomes clear that the new measure is even more compromised than the HPL that it replaces.

The SPRC's 'low cost standard' was derived by compiling a list of thousands of items which most people buy or are deemed to need. Items were included if they were recommended in official standards (e.g. minimum nutritional and housing standards) or if they were purchased by 75% of the population (which is how VCRs, cars, walking boots, swimming goggles and a pet the equivalent of a neutered tomcat all made it onto the list). Having compiled the list, the price of every item was ascertained, and the total income which households of varying compositions require in order to pay for all of these items was calculated. The result is the low cost budget standard.

One obvious problem with this procedure, however, is that, while a majority of people may buy *each* of the items included on the list, it does not follow that a majority buys them *all*. For example, if three-quarters of us own walking boots, and three-quarters of us own a swim hat, there is nothing to say that these are the same three-quarters in each case. The SPRC authors recognise this problem, noting that there may be an 'upward bias' in their minimum income estimate because 'it does not allow sufficiently for the choices that are made between items that meet similar needs'.[23] But having noted the problem, they do little to resolve it. They are reluctant to allow extensive substitution between similar items because the more substitutions and trade-offs that are allowed, the more arbitrary and subjective their list of 'necessities' becomes.

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In real life, however, all households make multiple substitutions and trade-offs. This means the SPRC's calculation of a minimum low cost budget is lot higher than what people actually require to maintain a reasonable living standard. Not surprisingly, therefore, the low cost standard works out in most instances to be even more generous than the old and largely discredited HPL. For households with children, for example, the new measure is up to *40% higher* than the old one,[24] which is probably why ACOSS adopted it for this latest report.

## Conclusion

The aim of social policy should be to get as many people as possible living at a decent standard through their own efforts and without relying on income transfers from other people. This being the case, it is unfortunate that ACOSS sees fit to publish a report complaining that the Australian welfare system is not spending enough on benefits. It is all too easy for governments to jack up welfare spending—they have been doing it for 40 years. The biggest change in the federal budget since John Howard came to power has been the increase in welfare spending from 41% to 44% of the total budget (this at a time when the economy has been booming and the need for government aid should have been falling).[25] The hard task is to *reduce* welfare dependency, not to extend it.

ACOSS has been in the policy advocacy business for so long that it appears to have lost sight of this fundamental truth. Its criteria of success—higher spending rather than lower dependency rates, and more people on benefits rather than more people leaving welfare—are now the opposite of what policy should be trying to achieve. Its latest report makes for depressing reading, not because of what it says about the purported 'inadequacy' of Australian welfare spending, but because of what it reveals about the way our social policy experts and activists think about these matters.

## Endnotes

1 Australian Council of Social Service, *Australia's social security system: International comparisons of welfare payments* (ACOSS Info 360, August 2004)

2 My estimate appears in P. Saunders, *Australia's Welfare Habit, and how to kick it*, Duffy & Snellgrove/Centre for Independent Studies, 2004. In this book I rely on a Department of Family & Community Services estimate of 16% of the working-age population relying on benefits for all or most of their income. The 18% figure used by ACOSS appears to be based on OECD international comparisons which measure welfare dependency in terms of full-time equivalents (the OECD calculates the rate of working-age welfare dependency in Australia at 17.5%, excluding recipients of Parenting Payment, Partnered – see OECD, *Employment Outlook*, Paris, 2003, Table 4.1). The OECD estimate is higher than the FaCS one because it takes account of people relying on welfare to top up their earnings (e.g. a person whose income is 75% earned and 25% from benefits will count as one-quarter of a full claimant)

whereas my figure excludes anyone who does not derive more than half their income from welfare payments. As many as 30% of working-age adults receive some income from the welfare system.

3 *Australia's social security system* p.1

4 "'Australia's social security system is lean and mean,' ACOSS President Andrew McCallum said. 'The payments are low, and fewer people receive them than in other comparable countries'" (quoted in M. Shaw, 'Australia lean on welfare payments' *Melbourne Age* 24 August 2004)

5 OECD, *Employment Outlook,* Table 4.1. The increase in Europe was concentrated mainly in the 1980s, while Australia 'caught up' during the 1990s.

6 American research finds people leaving welfare for work report improved rates of wellbeing. Australian research has documented significant rates of intergenerational dependency for children growing up in long-term dependent households. See *Australia's Welfare Habit, and how to kick it*, chapters 1 and 4.

7 Some coupled parents whose partners are unemployed or on a very low income also qualify for Parenting Payment (Partnered).

8 *Australia's Welfare Habit, and how to kick it*, p.111; E, Healy, 'Disability or disadvantage?", *People and Place* vol.10, 2002, p.70

9 *Australia's Welfare Habit, and how to kick it*, pp.97-102; R. Gregory, *Keynote Address*, Australian Institute of Family Studies conference, Melbourne 2003

10 *Australia's Welfare Habit, and how to kick it*, p.84; Department of Family & Community Services, 'Income Support Customers: A statistical overview 2001' *Occasional Paper Number 7,* Canberra, March 2003, Table 30.

11 P. Karvelas, 'Blowout in young stuck on dole' *The Australian* 24 August 2004.

12 The two-thirds estimate is based on the fact that up to a half of unemployed people, nearly all disability pensioners and most PP(S) claimants are in the welfare system for years rather than months. This estimate is also supported by early results from the Housing, Income and Labour Dynamics in Australia (HILDA) longitudinal survey. Bruce Heady indicated during a Melbourne Institute seminar on 10 August that about 10 per cent of the sample was reliant on benefits in both waves 1 and 2 (which were 12 months apart).

13 It is also important to remember that high levels of welfare spending are causing major problems in many EU countries where governments are now struggling to cut back in an effort to re-energise their economies and bring unemployment down to something closer to US or Australian levels.

14 *Australia's social security system: International comparisons of welfare payments*, p.3

15 Strictly speaking, there are no funds as such, for the money is not ring-fenced and invested on behalf of current contributors, but is merged with tax revenues and spent immediately in payments to existing claimants. Nevertheless, the insurance principle holds insofar as people establish entitlement on the basis of their contributions and are paid out accordingly.

16 Eligibility is time-limited, and when it expires, claimants revert to a lower flat-rate payment. In Germany, claimants with a full contributions record receive 60% of their previous net earnings for a minimum of six months; in France, they receive at least 57% of earnings for a minimum of four months; in the Netherlands they receive 70% of earnings for at least 6 months. See P. Saunders, *Australia's Welfare Habit, and how to kick it*, pp.88-9.

17 One unintended but crucial consequence of this is that there is a huge incentive not to save for one's old age in Australia.

18 S. Davidson, *Who pays the lion's share of personal income tax?* CIS Policy Monograph, No.63, 2004

19 P. Whiteford and G. Angenent, 'The Australian system of social protection: an overview' (2nd edn) Department of Family & Community Services *Occasional Paper No. 6* (Canberra, 2001).

20 The basis for comparison is the benefit payable in a country as a proportion of an average production worker's wage in that country.

21 I have discussed these issues in more detail in *Australia's Welfare Habit,* chapter 2, and in P. Saunders and K. Tsumori, *Poverty in Australia: Beyond the Rhetoric* (CIS 2002)

22 *Australia's social security system*, p.5

23 P. G. Saunders (SPRC), 'Budget standards and the poverty line', *The Australian Economic Review* March 1999, p.41

24 P. G. Saunders (SPRC) 'A new poverty line?' *SPRC Newsletter* No.69, University of NSW, 1998

25 *Weekend Australian* 8-9 May 2004

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ISSN: 1440 6306
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