



Submission

Inquiry into the allowance payment system
for jobseekers and others

August 2012
ISSN 1836-9014

David Richardson

About TAI

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals, memberships and commissioned research. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

Our purpose—'Research that matters'

The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

The Institute is wholly independent and not affiliated with any other organisation. As an Approved Research Institute, donations to its Research Fund are tax deductible for the donor. Anyone wishing to donate can do so via the website at <https://www.tai.org.au> or by calling the Institute on 02 6206 8700. Our secure and user-friendly website allows donors to make either one-off or regular monthly donations and we encourage everyone who can to donate in this way as it assists our research in the most significant manner.

LPO Box 5096
University of Canberra, Bruce ACT 2617
Tel: (02) 6206 8700 Fax: (02) 6206 8708
Email: mail@tai.org.au
Website: www.tai.org.au

Introduction

On 26 June 2012 the Senate referred the following matter to the Senate Education, Employment and Workplace Relations Committees for inquiry and report—

The adequacy of the allowance payment system for jobseekers and others, the appropriateness of the allowance payment system as a support into work and the impact of the changing nature of the labour market.

(a) the adequacy of the allowance payment system for jobseekers and others, with particular reference to the adequacy of the Newstart Allowance payment as an income support payment for jobseekers and the adequacy of all other allowance payments that support a range of recipients who study or provide care;

(b) the appropriateness of the allowance payment system as a support into work, with particular reference to:

(i) the effectiveness of the payment as an incentive into work,

(ii) the effectiveness of the allowance payment system in facilitating transitions between working and other activities, such as studying, caring and retirement, or in the event of illness or disability, and in helping or hindering recipients to overcome barriers to employment, and

(iii) the impact of the differences between pensions and allowances on the transition between working and other activities; and

(c) the impact of the changing nature of the labour market, particularly the rise of insecure work and decline of unskilled jobs, on the:

(i) nature and frequency of individual interaction with the allowance payment system, and

(ii) over and underpayment of allowances to recipients.

The Australia Institute has undertaken a good deal of research in this area. Some of the important papers are attached as appendices and summarised in this submission. Also included are some points made in our newsletter and other papers as well as some new material for the present submission.

Adequacy of allowances

Paragraph (a) of the terms of reference goes to the issue of adequacy which is the subject matter of the Australia Institute report *Are unemployment benefits adequate in Australia?* We now summarise that paper with a full copy reproduced in an appendix.

1 Are unemployment benefits adequate in Australia?

The unemployment rate in Australia has been around 5 per cent for almost a decade. That is low by recent historic and international standards. However, a substantial number of people who are looking for work cannot find it. The Australian Bureau of Statistics (ABS) has reported that the number of people unemployed in March 2012 was 626,800. That is, for every 20 employed people in Australia there is around one unemployed person. Put another way, there are three times as many unemployed people in Australia as there are people employed in the mining industry.

The historically low levels of unemployment in Australia should not, however, be seen as an indicator of the stability of the modern labour market. Indeed, the official monthly statistics on changes in employment and unemployment tend to conceal the reality of the labour market. That is, while media and political attention is typically focussed on the 'net change' in total employment and unemployment the 'gross flows' of people into and out of employment are far larger.

The high degree of volatility in employment means the risk for an individual of experiencing a period of unemployment at some point in the next twelve months is significantly higher than the 5.2 per cent chance that an individual is unemployed today. It is also important to note that the risk of unemployment is significantly greater for some demographic groups, especially for younger workers, those who live in regional areas and those with lower levels of education. For example, in March 2012 the unemployment rate in Tasmania was 7.0 per cent, nearly twice the 3.7 per cent rate in the Northern Territory. Similarly, in March 2012 the unemployment rate for those aged 15-19 is 18 per cent, more than three times the national average.

Figure 1 in the paper shows that during 2009 an average of around 367,000 ceased employment each month and either became unemployed or left the labour market altogether. Fortunately, over the same period an average of around 372,000 people also moved into work each month.

The role of unemployment benefits is to insulate people from the severe financial hardship of going to work one day and discovering that they no longer have a job. Few people earning \$60,000 per year, raising children and attempting to repay their home loan can afford to remain unemployed for more than a few months before facing the likelihood of losing their home. Indeed, as discussed in the paper few people in Australia believe that the current unemployment benefit of \$245 per week is sufficient to cover even the most basic costs of living.

The full paper considers the adequacy of existing unemployment benefits in Australia. It provides data on the relative decline in the value of unemployment benefits and presents new survey evidence on community perceptions about the adequacy of unemployment benefits.

Further points on adequacy

We note that there is a general presumption that youth should be doing something useful and should not be unemployed. Some people would have them engaged in work-for-the-dole activities while others want to see them, if not in work, then in education or training. The fact that student assistance is below Newstart sends the wrong message. If anything assistance

for students should be greater than Newstart to provide an incentive to undertake education and/or training as an alternative to the dole.

In addition to addressing adequacy in its own terms it is worth making some international comparisons. Australia is well below the average of the other countries with which we like to make comparisons.

In Australia, based on research the Australia Institute undertook in 2009, an individual on average weekly earnings who becomes unemployed and winds up on the dole will find that they replace only 24 per cent of their after-tax income. A worker on an average wage would move from an income of \$1,196 a week to an NSA of \$228 a week. A couple will receive \$412 a week, but only if neither partner is working.

An international study (using a different definition of the average wage) suggests that single people in Australia who go on unemployment benefits replace 31 per cent of their after-tax income. Of the 29 OECD countries in the study, none had a lower replacement rate for singles. The next lowest was Greece with a replacement rate of 36 per cent. In the UK, the replacement rate was 40 per cent, in the US 56 per cent, in Germany 59 per cent, while in France it was 66 per cent. However, if you become unemployed in Luxembourg, 87 per cent of your income is replaced.

Just to keep pace with the average of the other 28 countries, Australia would require an increase in the dole of more than 80 per cent. Australia does not have the worst replacement rate when children are involved. For example, an Australian lone parent on average weekly earnings would replace 52 per cent of their income if they had to rely on unemployment benefits, a replacement rate that is better than in Turkey (40 per cent), in Greece (45 per cent) and in Korea (50 per cent). But the Australian replacement rate falls behind all of the other countries.

National averages in Australia can conceal a good deal. Someone on the retail-industry-average wage who loses their job will find that the dole replaces 31 per cent of their after-tax earnings. But someone in the mining industry on average earnings will replace only 15 per cent of their wage when they go on the dole. In between there is:

- manufacturing at 26 per cent
- construction at 23 per cent
- finance and insurance at 20 per cent.

These are just a few examples. But they show dramatically that Australia's dole is woefully inadequate when it comes to making up for the income that people used to earn before they lost their jobs.

Another recent paper discussed aspects of the labour market that have to be considered in formulating policy in this area with respect to casuals in the labour market. Again that paper is summarised here and reproduced in full in an appendix.

2 Casual Labour: A stepping stone to something better or part of an underclass?

In the title of the submission we posed the question as to whether casual employment is a stepping stone to something better or part of an Australian underclass. This is an important issue for the Committee. If indeed casual employment is a stepping stone on an upward career path then encouraging unemployed people to take any job will be useful. However, the unemployed may already be part of an underclass who move in and out of 'poor' jobs,¹ unemployment spells, and spend some time right outside the workforce. Getting them off benefits and into a poor job is unlikely to be any real assistance for the individuals concerned. When these people do come into contact with the government, mainly through Centrelink, the opportunity needs to be used to develop better skills that may assist the movement towards 'good' jobs with tenure, career paths and other desirable characteristics that a majority of the workforce still enjoy.

We think the evidence is strong enough to suggest casual employment is often not a stepping stone but part of a permanent condition associated with 'long-term hardship' in the labour market.

The ACTU discussion paper contains many suggestions that would enhance the industrial relations system so as to enhance the power of casuals in Australia. This submission looks at how government action in other policy areas might be brought to bear on the important issues behind casual labour. One of the themes of this submission is that Australia has a group of people who are better defined not by their particular circumstances now but by whether or not they experience long term hardship in the labour market. Policies need to embrace the total experience of these second class citizens suffering long-term hardship in the labour market.

Policy reforms suggested here in the areas relating to skills, superannuation, power imbalances and job guarantees would go a long way to address the burdens of those people confronted with long-term hardship in the labour market.

In addition to drawing the Committee's attention to this earlier body of the Australia Institutes' contributions, there are further observations to be put before the Committee. In some of what follows here we comment on some matters that were not addressed in earlier Australia Institute papers. We begin with an historical perspective.

History

Many people have made the point that Australia's labour market concepts and policies reflect an age in which the economy was at virtual full employment. Commonwealth Employment Service figures show that between 1950 and 1970 inclusive, unemployment averaged 1.2 per cent and ranged between 0.3 per cent in 1951 and up to 2.6 per cent following the Menzies Government credit squeeze in 1961.² The new post-war system of unemployment

¹ 'Poor' jobs are not easily defined but tend to be low paid casual jobs with few entitlements to annual leave, sick leave etc., minimal training opportunities, no hope of advancement, no security, no super, no representation, a disregard for occupational health and safety and often cash in hand, which means there is no paper record to show a job history.

² See Reserve Bank of Australia (1998) *Australian Economic Statistics 1949-1950 to 1996-97: Occasional paper no 8*.

benefits was designed to assist the family bread-winner in the brief episodes of unemployment.³

These conditions no longer apply—unemployment has not been below two per cent since 1974 and over the last two decades has averaged 6.7 per cent.⁴ Moreover, although we do not have figures for the earlier decades we can be confident that the duration of individual spells of unemployment last much longer today than they did in the 50s and 60s. According to an ABS survey in July 2011 the median duration of unemployment is 14 weeks, while 19 per cent of the unemployed had been unemployed for a year or more.⁵ Now those figures need to be treated with caution. If we survey the Australian population at large we will find an average age of around 38. But the average age is not a prediction of how long people will live. However, the average age should be approximately half the expected age. Likewise, if the average duration of unemployment is measured at 14 weeks the expected duration of an unemployment spell is likely to be approximately double that, i.e. 28 weeks or almost half a year.

An emergency scheme designed to assist with food and other of life's essentials for a short period of time is not adequate to maintain people in dignity through modern spells of unemployment. An emergency scheme certainly falls short of the schemes designed in other OECD countries that were keen on contributory 'insurance' models of unemployment assistance.

In addition to all those arguments it should be noted that when the global economy turns down those that become unemployed are typically the worst affected. The fiscal response to the global financial crisis was very important to save jobs, but the cost of the stimulus was well above the cost of increasing the value of Newstart. The cost of increasing Newstart by say \$100 per week is of the order of \$3 billion per annum⁶ which compares with the fiscal stimulus package of around \$99 billion.⁷ Note too that a fiscal stimulus may well create alternative jobs but that does not necessarily mean that those displaced by the downturn are assisted by the package. For example, we noted in *The impact of the recession on women*⁸ that many of the jobs created were in the construction industry and that outdoor manual work is not necessarily suitable for women who become unemployed. Likewise some of the new training schemes introduced after the global financial crisis required the production of a redundancy certificate, a concept that does not apply to casual workers who are told not to come to work anymore.

³ The unemployment benefit scheme was intended to accompany a commitment to full employment. See Commonwealth of Australia (1945) *Full employment in Australia*, Parliamentary Paper No 11, 1945

⁴ ABS (2012) *Labour Force, Australia, Jun 2012*, Cat no 6202.0, 12 July.

⁵ ABS (2012) *Job Search Experience, Australia, Jul 2011*, Cat no 6222.0, 24 January.

⁶ Based on around 600,000 claimants, most of whom are assumed to be on the full rate.

⁷ That estimate is based on the value of the government's policy changes between the 2008-09 budget and the 2009-10 budget, including the measures in the latter based on Australian Government (2009) 'Budget strategy and outlook', *Budget Paper No 1, 2009-10 Budget*.

⁸ Richardson D (2009) *The impact of the recession on women*, Background paper, The Australia Institute, August

Reducing the ‘natural’ rate of unemployment

The ‘natural’ rate of unemployment is taken to be the equilibrium rate of unemployment to which the economy will return after it has been disturbed.⁹ At the moment the natural rate of unemployment is taken to be around five per cent. Clearly that natural rate must have drifted up substantially since the 1950s and 60s when the actual rates averaged 1.2 per cent. The movement in the natural rate has been ascribed to hysteresis effects beginning with an American economist, Edmund Phelps, in the 1970s.¹⁰ With the hysteresis effect a temporary increase in unemployment may have permanent effects. Hence, if unemployment increases to a higher level for a fair length of time then it is less likely that we will return to the initial lower levels of unemployment.

To explain this effect economists have pointed to such things as the atrophy of skills, the work ethic, work habits, motivation, confidence and the like that affects people the longer they are out of the workforce. An especially important aspect of this is the effect on young people. Young people tend to experience higher unemployment for many reasons. However, a cohort of young people who arrive in the labour market when it is recessed may be permanently affected by the difficulties they face in such a labour market. Strong evidence is reported for hysteresis effects in Australia.¹¹ The hysteresis effects can be thought of as increasing the structural level of unemployment in Australia.

The International Monetary Fund recently studied the analogous situation in the US and found that the long term unemployment in the US reduces the probability that the individual will find a job so that the experience of long term unemployment tends to increase the level of structural unemployment. The IMF recommended that:

*forceful measures should be introduced that reduce long-term unemployment and address the risks associated with long spells of unemployment, namely skills erosion and a weaker attachment to the labor [sic] force.*¹²

It should be pointed out that by ‘forceful’ the IMF did not mean using force on the unemployed but ‘policies to increase demand for the long-term unemployed in the short run’—active labour market programs that would get people back into work.

It seems that if we started the post war era with unemployment at less than one per cent but now have a higher natural rate we should be able to get back to the lower rates by reversing those increases in structural unemployment through labour market and education/training programs on the one hand and better income maintenance on the other. We earlier mentioned that students are effectively encouraged on to Newstart rather than student assistance because it has lower payment rates. That seems a particularly perverse incentive in the system that needs to be corrected.

We have recently become complacent about unemployment when it is around 5 per cent forgetting that official unemployment is really only the tip of the iceberg. Those figures

⁹ Sometimes people refer to the ‘non-accelerating inflation rate of unemployment’ or the ‘NAIRU’.

¹⁰ Phelps ES (1972) *Inflation policy and unemployment theory: The cost benefit approach to monetary planning*. New York: Norton.

¹¹ Røed K (1996) ‘Unemployment hysteresis – Macro evidence from 16 OECD countries’, *Empirical Economics*, vol 21, pp. 589-600.

¹² IMF (2012) ‘United States; Selected issues’, *IMF Country Report* No 12/214, August, p. 51.

ignored those out of the workforce who want to work but are either not available to work within the week or did not actively look for work within the last month. On top of that there are the underemployed. We can go through the official data that throws some light on this issue.

The official (seasonally adjusted) unemployment rate now stands at 5.2 per cent for June 2012.¹³ However, other labour market data released in March shows that the official figures hide the real extent of unemployment in Australia. To be recorded as unemployed by the ABS can actually be quite difficult for those who genuinely want to work. They have to have been 'actively looking for work' in the previous month and even if they have been actively looking they must be available to start work almost immediately—within the same week they were surveyed. That excludes many women with caring responsibilities who want to work but also have to find alternative care arrangements. Better known is the 'discouraged worker effect' that refers to workers giving up looking because they know there is nothing to be found.

While the number of those unemployed but still in the labour market at the moment is 631,300 people, the ABS survey of people not in the labour force shows that 1,301,800 of them still want to work.¹⁴ Overall then 1,933,100 people do not have a job but want one. Put another way, that means that less than a third of the people who want to work are actually defined as unemployed. If we include all those who want to work then the real unemployment rate should be 14.4 per cent of the workforce not 5.2 per cent.

There is also a substantial level of underemployment which the ABS defines as people who 'want, and are available for, more hours of work than they currently have'. A total of 786,800 people were underemployed in September 2011.¹⁵ Taking account of those people, the real rate of unemployment plus underemployment rises to 20.2 per cent. The official unemployment rate is just the tip of the iceberg in Australia.

This last point is critical. Our labour market definitions and categorisations are out of date. In the labour market decades ago a 5 per cent official unemployment rate may have indicated a similar real level of unemployment and little underemployment at a time when most jobs were full time. However, today the officially measured rate is a fraction of the total effective unemployment rate.

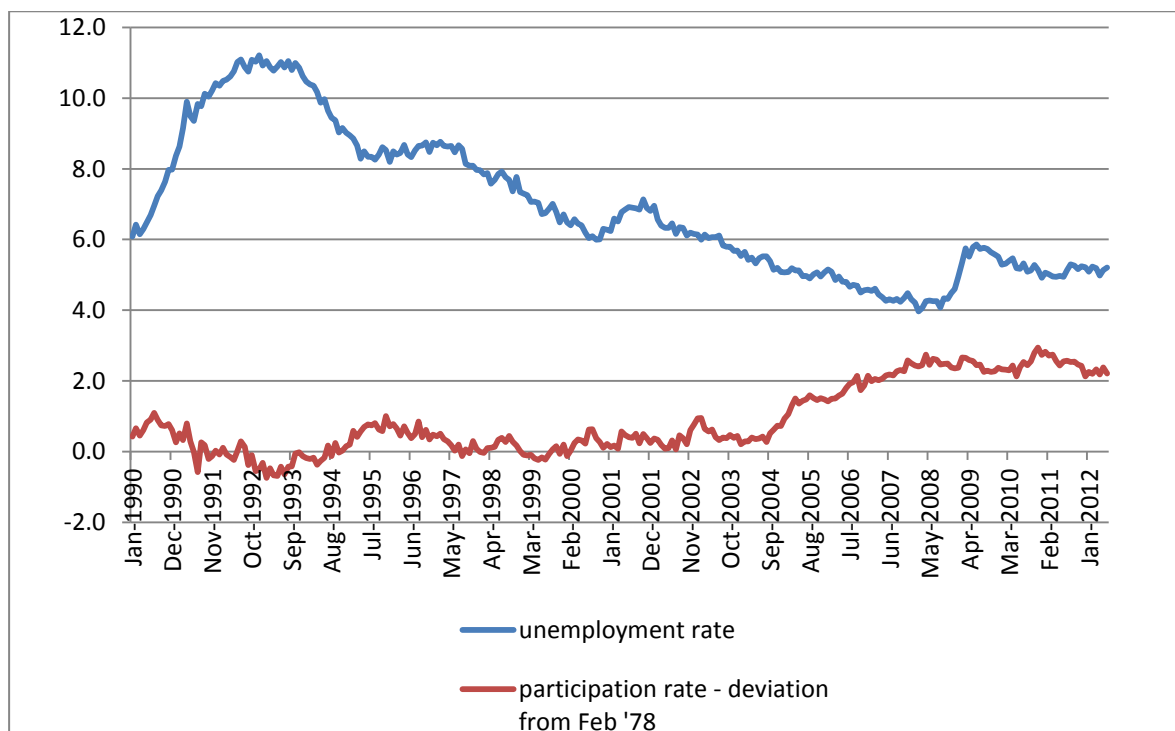
To some extent the discouraged worker and similar effects show up in the labour force participation rates. The participation rate refers to the proportion of the workforce over 15 who are either employed or unemployed. The relationship between the unemployment rate and the participation rate is shown in Figure 1.

Figure 1: Unemployment and participation rates – Per cent.

¹³ ABS (2012) *Labour Force, Australia, Jun 2012*, Cat no 6202.0, 12 July.

¹⁴ The latest figure we have at the moment refers to September 2011. See ABS (2012) *Persons not in the labour force, Australia*, Cat no 6220.0, 22 March.

¹⁵ ABS (2012) *Underemployed Workers, Australia, Sep 2011*, Cat no 6265.0, 2 March.



Source: ABS (2012)) Labour Force, Australia, Jun 2012, Cat no 6202.0, 12 July.

Figure 1 clearly shows that increases in unemployment tend to be associated with falls in the participation rate and vice versa. As unemployment increased in 1990 so the participation rate fell until both reversed direction around mid to late 1992. Subsequently there was a long decline in unemployment that was eventually associated with an increase in the participation rate until unemployment worsened again with the global financial crisis.

Figure 1 is consistent with the workings of the hysteresis effect whereby low unemployment encourages more people to enter the workforce so that both measured unemployment and hidden unemployment are both reduced.

It will be recalled that recent Federal Governments and Treasury have emphasised the need to address participation rates in the context of the aging population. That means policy has to be set so as to maintain strong demand at the macroeconomic level as well as assisting people to move away from structural unemployment.

International comparisons

While Australia's unemployment rate remains near pre-crisis levels, it is important to note that there are presently a number of countries that have outperformed Australia. For example, Table 1 lists those countries that are recorded as having an unemployment rate at three per cent or less.

Table 1: Countries with low unemployment rates: Unemployment rates (%)

| | |
|--------|-----|
| Norway | 3.0 |
|--------|-----|

| | |
|-------------|-----|
| Switzerland | 2.9 |
| Malaysia | 3.0 |
| Singapore | 2.1 |
| Thailand | 1.0 |
| Ukraine | 1.6 |

Source: *The Economist*, 21 July 2012.

It goes without saying that the countries in Table 1 have very different labour markets and very different arrangements for unemployment benefits. Indeed, among high unemployment countries there are also vastly different systems. To explain the different unemployment experiences among countries we have to look at factors such as their history and their commitment to full employment.

Obviously we should be thankful that we managed to get through the global financial crisis without a large increase in unemployment. However, the five per cent unemployment rate we seem to regard as now normal is below many of the rates achieved by other countries just as it is also well above our recent lows before the global financial crisis, and above our early post war history.

Incentives

Paragraph (b)(i) of the terms of reference goes to the incentive to work for Newstart recipients.

Economists tend to focus on financial incentives and so the dole is seen as an alternative to work and therefore something that should be kept low compared with wages. If the dole were to increase relative to wages then it is thought there would be too large an incentive to opt for the dole rather than work. Hence any increase in the value of Newstart is thought to be associated with a higher level of unemployment. What this view fails to appreciate is that the work test is designed to ensure that the people who receive the dole are genuinely unemployed. It also has to be pointed out that there is little direct evidence, either in Australia or overseas, that the unemployment rate is associated with the level of unemployment benefits. By contrast there is overwhelming evidence that the unemployment rate follows the business cycle. Put differently, even if a higher unemployment benefit at any particular time increases the level of unemployment, that relationship is overwhelmed by movements in aggregate demand.

Anyone who assumes the dole acts as a disincentive to work is effectively saying that the work test is failing. However, there is no evidence for that. Indeed, contributions from other commentators suggest that the work test is often too severe. The danger in the work test is that it goes too far in forcing people into poor jobs with irregular hours, poor conditions and even failure to meet legislated requirements with respect to OH&S, workers' compensation, superannuation, payment records, and so on.

Another important relationship needs to be emphasised. The unemployment benefits are administered in the same way throughout Australia and so provide the same incentive

pattern to all Australians. Yet in June 2012 the unemployment rate ranged from 2.2 per cent for males in non-metropolitan WA to 10.6 per cent for females in the Gosford-Wyong statistical region of NSW.¹⁶ Any explanation of unemployment that includes the unemployment benefit must find it hard to explain the wide regional variations in unemployment rates in Australia.

We note that there is a general presumption in society that youth should not be unemployed as traditionally conceived. Some people would have them engaged in work-for-the-dole activities while others want to see them, if not in work, then in education or training. The fact that student assistance is below Newstart sends the wrong message. If anything assistance for students should be greater than Newstart to provide an incentive to undertake education and/or training as an alternative to the dole.

A low payment can be counter-productive if the aim is to get people back into employment and low payments can be one of the mechanisms perpetuating unemployment. The impact of poverty worsens the individual's job prospects. Gradually they present less well at interviews, they cannot afford transport to interviews, and others cannot obtain transport to work or training/education. Poverty can also force people into accommodation far from where employment is located.

In considering the effect of incentives in this area we can acknowledge the theoretical point that a lower reward for something reduces its attractiveness. However, that ignores all of the real world complications, the international experience, let alone the undesirability of poverty itself.

Concluding remarks

The committee has chosen a very large topic that impinges on a host of other considerations. Australian economic policy seems to want to maintain official unemployment rates at around 5 per cent of the workforce which in reality means around 14 to 15 per cent with an additional 5 or 6 per cent of the workforce who work less than they want to work. We know that a policy of keeping official unemployment at 5 per cent dooms a large proportion of the workforce to unemployment and poverty. We also know that that experience of poverty and unemployment will be disproportionately borne by a small proportion of the Australian working-age population. Individuals presently part of the Australian underclass are likely to be the same ones in a year or five years' time. And those will tend to be people who have had less opportunity to develop their life skills. It seems doubly cruel to deliberately idle a significant proportion of the Australian population and then refuse to compensate them adequately on the grounds that they need incentive to work.

Essentially the adequacy question is about equity in Australia and how we go about addressing poverty. That would be a problem if we had to trade off economic efficiency and

¹⁶ ABS (2012) *Labour force Australia, detailed – electronic delivery, June 2012*, Cat no 6291.0.55.001, 19 July. There were even smaller recorded rates of unemployment including a zero, but they were excluded here because the ABS warned that those particular observations contained sampling variabilities that were too high for practical purposes.

equity. However, there is not a strong case suggesting higher unemployment benefits are at the expense of economic efficiency. If there is a relationship it is weak and overwhelmed by other factors such as the state of the economy. Hence there is a case for significantly boosting unemployment benefits but at the same time directly addressing the demand for labour through employment generation schemes, education and training programs and, above all, setting an unemployment target well below the 5 per cent we presently take to be the normal rate of unemployment.

Appendix

Are unemployment benefits adequate in Australia?

Casual labour: A stepping stone to something better or part of an underclass?