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Dr Brendan Nelson
Committee Chairman
House of Representatives Standing Committee on Employment, Education and Workplace Relations
R1 116
Parliament House
CANBERRA ACT 2600

Dear Dr Nelson,

INQUIRY INTO ISSUES SPECIFIC TO WORKERS OVER 45 SEEKING EMPLOYMENT, OR ESTABLISHING A BUSINESS, FOLLOWING UNEMPLOYMENT.

I am writing in response to your letter of 26 November 1999 seeking comments on a number of suggestions most consistently proposed based on submissions and public hearings into the above inquiry.

Please find attached the Department's comments. As there are resource constraints placed on the Department due to the development and costing of upcoming Budget options, we are only able to give broad consideration on suggestions relevant to our portfolio.

Also, consideration of work incentives issues, the needs of older unemployed people and the review of the income support system for people of workforce age are being considered by the Reference Group on Welfare Reform.

I hope our comments are of assistance to the Committee in making their final recommendations. If you need to discuss our comments further, please call Peta Winzar, Assistant Secretary, Parenting Payment and Labour Market Branch on 6244-6521.

Yours sincerely

Signed

Barry Wight
Executive Director

7 February 2000

Encl.

House of Representatives Inquiry into issues specific to workers over 45 seeking employment, or establishing a business, following unemployment
Comments to the most consistently proposed suggestions

Proposal 1. Reverse the 1996-97 Budget decision which includes superannuation assets in eligibility assessments for Newstart payments for people over 55, who have received benefits for at least 39 weeks.

Background

In March 1993, a generous new social security means test exemption for all superannuation assets held by customers under age pension age was introduced.

The means test exemption resulted in an increasing number of cases where customers who were effectively retired reinvested their savings into superannuation in order to receive full income support payments.

It also resulted in concern that people between age 55 and age pension age with large amounts of superannuation savings were receiving income support payments. Superannuation investments can be accessed when a person has retired after reaching age 55. Some financial advisers were readily informing employers and older workers of this opportunity for retrenched people to get income support payments while sheltering substantial assets in superannuation.

In this environment the Government decided that superannuation savings for customers over 55 should cease to be exempt from means testing. The measure to give effect to this is referred to below as "the over 55 measure".

The measure improved the fairness and consistency of the means test, because customers no longer receive an advantage from holding their retirement savings in the form of superannuation, rather than in other types of assets. For example, under the previous rules, a 58 year old single homeowner pensioner with savings of $260,000 in a superannuation investment could receive a full pension. However, if the same pensioner had held the savings of $260,000 in term deposits, shares or bank accounts, no pension could be paid.

As a broad principle, it is not clear why those who have access to sufficient means to exclude them from payment should ask for income support from other taxpayers who may not be as well off.

Details of the Measure

The over 55 measure applies to the income support payments of people aged between 55 and age pension age who have received income support for a cumulative total of 39 weeks after reaching 55. Income support payments that can be affected include

Disability Support Pension, Mature Age Allowance, Newstart Allowance, Carer Payment and Parenting Payment.

The measure does not mean that customers are required to spend all of their superannuation before being eligible for income support. Rather, when superannuation assets are assessed because of the measure, they are treated under the means test in the same way as other financial investments:

- under the *income test*, superannuation assets are added to the value of other financial assets, and the total value is assessed under the deeming rules. The current deeming rates are 3% for the first $30,800 of a single pensioner's financial investments ($51,200 for pensioner couples); and 4.5% for financial investments above those amounts

- under the *assets test*, the value of these assets are added to the value of other assessable assets.

This means that customers with small or modest amounts of superannuation and little other income and assets are not affected by the measure, because they continue to be protected by the general means test "free areas". These free areas allow customers to have income and assets up to certain amounts before payment is reduced. These free areas mean, for example, that:

- a pensioner couple could have up to $121,000 (combined) in financial investments (including superannuation) in addition to their home and still receive full payments. The corresponding amount for an allowee couple is $43,200 each.

These free areas mean that many customers with superannuation have not been affected by the over 55 measure. The amount of income support reduces above these free area thresholds, up to limits that depend on whether the customer is receiving a pension or an allowance.

Where customers with larger amounts of superannuation have their income support payment reduced, some may choose to draw on their superannuation assets to compensate for this. However, there is no requirement that they draw on their superannuation:

- if they have non-superannuation assets (for example, deposits with financial institutions or shares) they may instead choose to draw on these; or

- they may decide that the reduction in income support does not warrant drawing on their superannuation or other assets.

If they decide to draw on their superannuation, in most cases the income generated from the superannuation assets would more than compensate for the reduction in income support. That is, these customers could draw on their superannuation earnings to supplement their income, without having to draw down their superannuation capital.

Related Changes to Superannuation Regulations to Assist Customers

Changes to superannuation regulations have ensured that customers affected by the measure who do not consider themselves to be retired can, if they wish, access their superannuation on grounds of financial hardship. That is, they can access their superannuation without having to advise they have retired. This means that people are not required to make conflicting declarations about their retirement status to superannuation funds and to Centrelink.

Implications of Introduction of a Capped Exemption for Superannuation Assets

There have been some suggestions that only superannuation assets above a certain threshold should be assessed. Some comments on this follow:

- as outlined above, there are already 'free area' thresholds which allow customers to have a substantial amount of income and assets before their entitlement is affected. These thresholds protect customers with smaller amounts of superannuation. Hence, there would be duplication in introducing an additional threshold specifically for superannuation assets. Inequities would arise, because there would be a large increase in the effective 'free area' thresholds under the income and assets tests only for customers who held their retirement savings in the form of superannuation assets;

- customers who can still contribute to superannuation would be able to maximise the social security advantage created by the threshold, through making additional contributions up to the level of the capped threshold. For example, they could increase their income support payments simply by transferring their savings from a bank account to a superannuation fund operated by the same financial institution;

- it would produce a 'lock-in' effect that could be detrimental to the interests of customers. For example, customers who have retired might elect to continue to hold superannuation investments until they reach age pension age, not because of the merits of the investment, but because it would give them a social security advantage. This might include, say, delaying the start of an income stream until age pension age, despite it being in the person's best interests to start earlier; and

- finally, the introduction of new thresholds would further complicate means testing arrangements and make them more difficult for customers to understand. We should not add complexities without a very sound rationale for any divergent treatment.

Implications of Reversing the Measure for Newstart Customers

The proposal mentions an exemption only for Newstart customers. Some comments on this follow:

- there would be significant horizontal equity implications. For example, a person with significant superannuation assets who had disability or caring responsibilities could be unable to receive Disability Support Pension or Carer Payment.

However another person in the same financial circumstances who qualified for Newstart Allowance could receive income support;

- there would be incentives for customers in receipt of other types of income support payments to attempt to transfer from these payments to Newstart Allowance even though it is an activity tested payment.

Proposal 5. Provide greater incentives for unemployed mature age people to accept and report casual and part time work by allowing tax credits and/or easing the withdrawal rates of benefits.

General comments

Australia's current system for basic allowances is designed in conjunction with the income tax and family payments system. Changes to individual components can have flow-on effects due to the interactions between these different systems. Hence, any changes need to be made with this in mind. These interactions also make it difficult to estimate the 'cost' of any proposed changes.

A customer's eligibility for payment is subject to satisfying the income and assets test. Under the income test, an individual's personal income first reduces entitlement to their own benefit, then their partner's benefit. The various parameters of the income test are carefully formulated to ensure that there remains a financial incentive to work by minimising any 'stacking' of effective marginal tax rates.

Any changes to either free area or taper rates for allowances would extend the cutout point under the income test. This in turn would lead to an overlap of benefit withdrawal with family allowances and higher personal marginal income tax rates (including the Medicare levy), leading to a deterioration of incentives to both take up work and increase work effort over particular income ranges. Additionally, the extension of the cutout point would make many more people eligible for a part benefit and any add-ons, thereby significantly increasing costs.

These difficulties illustrate a fundamental point about income support payments that is often ignored. For a given level of payment it is not possible to ease means tests and improve incentives without spending more money. But spending more money implies higher taxation on others, which worsens incentives for them. The challenge for the policy maker is thus to balance the incentives and levels of support for different groups - if we give extra money to those who have the means and incentive to support themselves, we may have to take it away from others who are not so placed.

It should also be noted that the Government's New Tax System which will come into effect from 1 July 2000, includes measures that will help improve effective marginal tax rates for people with children. These changes include increased rates of Commonwealth payments and increases to the amount of income and assets pensioners, allowees and families can have before their payments are affected.

Effectiveness in getting people into paid jobs

The recent departmental analysis of the *Working Nation* income test changes introduced in 1995 found that "Encouraging unemployed people to take part-time work is, however, an effective strategy for assisting many unemployed people to maintain labour market contact and to find better paying, more enduring work." The conclusion of the analysis also noted that there was "…strong evidence that part-time employment does act as a 'stepping stone' to more *enduring* employment and reduces dependence on income support."

This finding would seem to indicate that any changes that encourage part-time work would lead to an improvement in the unemployment situation. While there is little doubt that encouraging part-time work is worthwhile for many reasons, the analysis did qualify the findings in "…that it is often not just one particular characteristic that explains outcomes for customers, but the total combination of their characteristics… The possibility of these 'unobserved' characteristics affecting the results cannot be ruled out." That is, the part-time work may not of itself make the person more employable, and thus more likely to secure full-time work at some point; rather it may simply signal that the person was employable in the first place.

However, while encouraging part-time work has its place, income tests need to be carefully balanced to ensure that unemployed people take up full-time work and become self reliant where possible but are not discouraged from working part-time when full-time work is not available. There can be some tension between these two objectives.

In addition, increasing incentives to work for those people aged 45 years and over seeks to address only the supply side of the issue. Without also addressing the demand side of the employment market including any negative perceptions of older workers held by employers, tax and social security incentives for older workers may be of little benefit. It is quite likely that any improvements in incentives would also draw in those older persons not on social security and not currently in the labour force. While this may be desirable in itself it would mute any impact on unemployment amongst those on income support, especially those with little labour market experience.

When considering the incentive/cost trade-offs available, more general measures lead to lower cost effectiveness. Targeted measures are likely to be more effective. This implies that changes to the allowance income test or the introduction of an earnings credit scheme are likely to be more effective than changing personal income tax rates.

Policy implications of specific suggestions

<u>Adjusting the income test (or lowering tax rates) to increase work incentives</u>

This is discussed above under General Comments.

Lowering tax rates or introducing tax credits

As noted earlier, lowering tax rates is a more general solution that would not be overly cost effective compared to other mechanisms available, as it is difficult to target correctly. Presumably the Committee would not wish to see the lower tax rates confined only to the over 45s as this would create inequities relating to taxes paid based on age.

The alternative of introducing targeted tax credits suffers from most of the same problems that targeted payments have. The choice of whether to deliver assistance via direct payments or via such tax credits essentially comes down to administrative and presentational considerations, rather than incentive issues.

Re-introducing the earnings credit scheme for averaging out casual earnings over the year

The earnings credit scheme for allowees was introduced in March 1994. It was a response to the growth in casual and part-time work opportunities and the increasing level of long-term unemployment. The scheme was intended to provide an incentive for allowees and their partners to take up part-time, casual and temporary work opportunities in order to maintain contact with the workforce and to improve their skills. Adjustments to the scheme to more effectively target the initiative were implemented in March 1996.

In March 1997, the earnings credit scheme was abolished as at that time there was little evidence that it had increased take-up of casual work.. Since then there has been a sustained decline in allowees reporting earned income (from 15.7 per cent of unemployed allowees declaring income to 12.1 per cent in August 1998). The decline in the number and proportion of earners reversed a 12-year trend increase in allowees reporting earnings.

It is not clear that the abolition of earnings credit was solely responsible for the decrease in the number of customers with reported earnings. It is also not clear to what degree the decrease represents a reduction in reporting as distinct from an actual reduction in earnings. As discussed earlier, a large number of factors influence a person's decision to take up casual work. However, financial returns from working become a stronger influencing factor for taking up small amounts of casual work, where the fixed costs of working are important. Therefore some form of increasing the financial return for this end of the labour market has considerable merit, particularly for those customers with little or no recent attachment to the labour market.

Proposal 6. Reduce the waiting time for unemployment benefits for unemployed mature-age people with savings, from 13 weeks to 8 weeks and raise the threshold amounts to $3500 for a single person and $7000 for a couple.

Background

The liquid assets test waiting period (LAWP) reflects the view that people with reasonable levels of liquid assets should support themselves from those assets before turning to other taxpayers for assistance through the social security system.

For the purposes of the LAWP, "liquid assets" mean the person's cash and readily realisable assets, including shares, bank deposits and amounts due from former employers. "Liquid assets" do not include eligible termination payments or, for Youth Allowance and Austudy recipients undertaking a tertiary course of education, the reasonable costs of undertaking that course.

Allowance payments are targeted to people at times when they have little or no other resources available. The community's expectation is that social security funds are targeted to those most in need and that these funds are distributed in a fair and reasonable manner.

The LAWP is designed to encourage self-reliance and provide incentives for people to find work in the early days of unemployment when their prospects for successful job search are better. It prevents the phenomenon, common in overseas unemployment insurance schemes, where people use benefits for a voluntary short-term break from working and employers, aware of their existence, use them for temporary layoffs.

The suggested change

This suggestion is to increase the thresholds from $2,500 to $3,500 for single people and from $5,000 to $7,000 for couples. The suggestion also includes reducing from 13 weeks to 8 weeks the maximum length of time the LAWP is served.

Currently, a 13 week LAWP is served by a single person with liquid assets of $9,000 or more. An increase in this threshold to $3,500 and decrease in length of LAWP would mean that a single customer would serve the maximum 8 week LAWP if they had liquid assets of $7,500 or more.

For couples, the maximum LAWP is currently served when liquid assets are $18,000 or more. If the threshold were increased to $7,000, then the maximum LAWP of 8 weeks would be served when liquid assets were $15,000 or more.

The suggestion would decrease the length of the LAWP served by all customers who serve a LAWP. The length of the LAWP would be reduced by a maximum of two weeks for those with moderate liquid assets due to the increase in the thresholds. For those with more substantial liquid assets, the reduction in the LAWP could be as much as 5 weeks (from 13 weeks to 8 weeks). Therefore, the policy suggestion has some in-built inequities in that those with more substantial liquid assets would get a greater reduction in the LAWP than those with less substantial liquid assets.

Cost

Any reduction in LAWP for customers would have financial implications for the social security budget. The increased costs to outlays of a LAWP reduction would need to be offset by reductions in expenditure elsewhere in the system.

Proposal 7. Early or immediate access to job Search Training (Flex 2) or Intensive Assistance (Flex 3) for unemployed mature-age workers.

Job Search Training (JST)(Flex2)

Access to JST is currently restricted to people who have been on income support for 3 months. This limitation has been imposed to maximise the use of available resources, as a large percentage of new customers go off payment within the first 3 months, without the need for JST. Where customers are identified as likely to become long term unemployed and in need of JST, it may be possible to allow access earlier. JST could be included as an option and discussed at the initial claim interview. To be consistent with the current targeted approach, referral to JST could be voluntary in the first 3 months but remain compulsory for those with an income support duration of 3 months or more.

This change would likely result in a small increase in Centrelink running costs, and the cost to the Department of Employment, Workplace Relations and Small Business of having the Job Network provide the additional JST places.

Intensive Assistance (IA) (Flex 3)

Access to IA is currently regulated by the Job Seeker Classification Instrument (JSCI) score a customer receives and not a qualifying duration on income support. The JSCI, which is a tool administered by the Department of Employment, Workplace Relations and Small Business, is used to estimate the relative labour market disadvantage of job seekers. The JSCI identifies those job seekers most in need of Intensive Assistance and classifies them into appropriate funding levels. There is currently no impediment to mature-age unemployed people accessing IA at claim, provided their JSCI score is sufficiently high. If it is found that assistance is not being provided early enough, the Department of Employment, Workplace Relations and Small Business could be asked to examine the JSCI rating and increase the weighting given to the most common barriers faced by this group.

The cost would be limited to the additional IA places funded by the Department of Employment, Workplace Relations and Small Business and a small increase in Centrelink running costs to cover the increased numbers being referred.

Proposal 8. Ease the earning requirements for those starting small businesses through New Enterprise Incentive Scheme (NEIS) so that deductions to benefits are made after receipt of business income.

The operational and eligibility requirements of the NEIS program fall within the responsibilities of the Department of Employment, Workplace Relations and Small Business. However, the following general comments are provided.

The taper rates for people on the NEIS program are more generous than the taper rates which are provided to recipients of Newstart Allowance. This is to provide additional incentives and assistance with cash flows to those participating in NEIS. To allow assessment of income at time of receipt would present similar problems as identified with the provisions when assessing income to determine eligibility for Newstart Allowance. These include providing encouragement to:

- delay receipt to improve cash flows and reduce interest payments; and
- structure receipt of earnings in such a way as to minimise impact on NEIS payments ie, receiving payments in lumps so that only individual fortnights are affected.

Proposal 9 Expanding the NEIS program to include people with redundancy assets.

The operational and eligibility requirements of the NEIS program fall within the responsibilities of the Department of Employment, Workplace Relations and Small Business. However, the following general comments are provided.

Extending access to NEIS to people not receiving income support appears reasonable but consideration needs to be given to assure that these groups do not receive an unfair advantage over people running established businesses or establishing business without the support of NEIS. In addition, there are already a wide range of organisations and programs, both at a Federal and State level, established specifically to assist people to establish and run a business.

Proposal 10. Expanding the NEIS program to target people from non-English speaking backgrounds.

The operational and eligibility requirements of the NEIS program fall within the responsibilities of the Department of Employment, Workplace Relations and Small Business. However, the following general comments are provided.

As a general principle language problems should be addressed by specific targeted programs rather than NEIS. However, in the situation where a lack of language proficiency would not hinder the operation of the planned business, the NEIS scheme should be flexible enough to provide assistance/advice that can be understood by the customer. This could be achieved through the use of an interpreter or multi-language information products.

Proposal 11. Expanding the NEIS program to include people with redundancy assets wishing to purchase existing businesses or franchises.

See general comments for suggestion 9.

Proposal 15 Additional funding for personal counselling for retrenched mature-age workers and their families.

Substantial funding has been provided by the Government for family counselling under the Family Relationships Services Program. Proposals for additional funding may be better targeted at personal counselling for the retrenched mature-age worker, including, where appropriate, referral to existing family counselling under the Family Relationships Services Program.