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16-17 February 1993

Income Support and Unemployment
Bruce Bradbury
With a Comment by James Cox
DISCUSSION PAPER NO. 295
June 1993

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Bruce Bradbury

Social Policy Research Centre
University of New South Wales

With a Comment By

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Government Pricing Tribunal of NSW

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Comment by James Cox
1. Introduction

Despite the move towards active labour market policies, income support remains the primary means by which the Australian Government provides direct assistance to unemployed individuals. The fundamental goal of this income support is the alleviation of poverty among the unemployed.\(^1\) As well as being subject to dispute over the optimal degree of redistribution that this implies, this objective is subject to both labour market and fiscal constraints. These require that unemployment assistance should have a minimal detrimental impact upon labour supply (and should encourage it if possible), and it should demand minimal government expenditure. The latter constraint stems ultimately from a requirement to minimise distortional taxes in other sectors of the economy whilst taking account of competing demands for public sector funds.

Whilst these considerations provide a normative framework for income support, the practical implementation of such support is very much influenced by political factors. Thus the existence of the labour supply constraint leads to difficulties in mobilising political support for the unemployed,\(^2\) and disputes over the allocation of the economic cake are crucial in determining the practical magnitude of the fiscal constraint.

Although most economic discussion of income support hinges on its relationship to the labour market constraint, it would appear that it is typically the fiscal constraint that is more important in determining the level of assistance to the unemployed. Unlike the fiscal constraint, the extent to which the labour market constraint is binding varies significantly and systematically over the economic cycle. When labour demand is manifestly slack, as at the present, incentive issues associated with the level of assistance paid to the unemployed are less important. If some people choose to remain unemployed rather than search for work, there are plenty of others to take their place. This might suggest grounds for increasing the level of assistance to the unemployed during recessions. That this does not happen, suggests either

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\(^1\) Other objectives which have been suggested (and which in other countries may be more important) include: improving labour market flexibility by encouraging job search; maintaining consumption (both at the individual and aggregate level); and even using this unemployment assistance to provide a floor for minimum wages.

\(^2\) This arises from the perception that people might choose to be unemployed (c.f. other categories of social need such as age) and so do not form part of the "deserving poor" (see Saunders 1987, Bradbury et al 1988 and the references therein for further discussion).
that decision makers consider the fiscal constraint to be most binding, or perhaps that the corresponding reduction in income support payments with economic recovery is not considered politically feasible.

There are many reasons why the fiscal constraint may be considered important. Fundamentally, it represents the political decision of how much support should be provided to those in need (and hence removed from those in less need). In addition, it reflects the desire to avoid the impact of distortional taxes on other sectors of the economy and the extent to which other expenditure policies may be more appropriate. In particular, public investment in either physical or human capital (i.e. labour market programs) may be considered a more appropriate direction for counter-cyclical expenditure.

Whilst these policies might be best for long term growth, they are unlikely to be as effective as income support in alleviating poverty.\(^3\) If the investment expenditure is spread across most unemployed (e.g. through widespread labour market programs) the fiscal constraint on income support for the unemployed forces a choice between short term vs long term gains. On the other hand, if the investment is concentrated on a few unemployed, the fiscal constraint requires a choice between a uniform but low level of support vs a higher level of support to some.

Such choices via the fiscal constraint represent the key policy decisions about income support during recessions. In the longer run though, the traditional concern of labour market economists with the labour market constraint on income support may be more important. This distinction between the short run/counter-cyclical and the long run/structural policy environment provides a natural division with which to divide the discussion of income support for the unemployed.

The next section of the paper thus takes up issues associated with cyclical variations in unemployment. Under this heading, two questions are addressed. The first is: how successful has income support for the unemployed been in addressing its primary objective – the alleviation of poverty? The second question looks (more speculatively) to the future. Will the internationalisation of the Australian economy lead to greater demands upon the income support system? What role can income support play in developing a framework of ‘domestic compensation’ to cope with the demands of trade flexibility?

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\(^3\) Investment expenditure would clearly be favoured if it would lead to the unemployed having a consumption level equal to that which they could obtain from income support, and yet would not have any additional net fiscal cost. Such a positive gain, however, is unlikely.
Section 3 then turns to the longer-term structural issues associated with unemployment assistance. Here the focus is on the tension between the poverty alleviation objective and the labour market constraint. Is the long-run trend towards greater unemployment and long-term unemployment due in part to the structure of the income support system? What should be done about it? These issues will become increasingly important as the Australian economy recovers from the current recession. Changes in the labour market over the past few decades pose important challenges for income support policy. Particular issues discussed in Section 3 include the growth in part-time and female employment, falls in real wages, and the problem of long term unemployment. It is suggested that a more flexible approach to the resolution of the problem of poverty traps may be required.

2. Cyclical/Short Term Issues

Poverty Alleviation

How successful are current income support policies in alleviating poverty among the unemployed? In answering this question, I avoid a detailed consideration of just what constitutes poverty or a poverty line, and work from two simple ideas. First that poverty means low income (or consumption) levels, and the lower they are the more severe is poverty, and second, that it is meaningful to consider poverty both in terms of a capability to buy goods and services, and in relation to the average living standard of the community. This latter consideration implies that we should examine the incomes of the unemployed relative to both prices and community average income levels.

I will also take it as self-evident, that at current and likely levels of income support, it is appropriate to attach the label ‘poor’ to the living standards of the unemployed, and that to be solely reliant upon unemployment income support for a long period of time constitutes extreme hardship. The question is thus not whether the unemployed are poor, but how their living standard fares against a range of yardsticks. The three yardsticks employed here are: changes in unemployment assistance (UA) over time (both in real terms and relative to community incomes),

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4 For discussion about the definition and measurement of poverty, see Saunders and Whiteford (1987 and 1989).

5 Unemployment assistance (or UA) is thus used to encompass Unemployment Benefit, Job Search Allowance and Newstart Allowance.
the level of UA compared to the incomes of other low income groups such as pensioners, and the level of UA compared to income support in other countries.

Changes over time

Figure 2.1 shows the trends in the real value of unemployment assistance since 1971. The largest changes were in the early 1970s when the Whitlam government introduced major increases in all benefit categories. The current level of benefit for single adults is now much the same as it was in 1975, whilst the base rate for married couples has increased slightly. Since 1975 the main changes have been an increase in the additional payments made to families with children, and a decrease in the rates of payments to youth.

These latter decreases have been motivated by concern over replacement rates, an integration of UA with educational allowances, and a growing assumption of parental responsibility. The last few years have seen an increased diversity of payments for young people as policy makers have tried to come to grips with the variations in the support provided by parents to their older children. Whether they have succeeded (or can possibly succeed) in this goal is unclear. It does however, seem reasonable to assume that the living costs of unsupported youth are not that different from those of single adults. This would suggest that the lower rates of payment for these youth are not likely to fulfil the poverty alleviation goal. The difficulty of targeting those youth most in need, does however, suggest a case for directing additional assistance to unsupported youth in the form of services (e.g. special housing services) rather than just income.

Apart from youth, however, these income support payment rates have generally maintained value, or increased in value, over the last 17 years. If we take a relative view of poverty, however, the picture is not so sanguine. Figure 2.2 shows the same payments as Figure 2.1, but here expressed relative to household disposable income per capita (HDIPC). Relative to the increases in real community incomes, the unemployed (without children) have fallen further behind. Given the slow growth in wages over this period, the main reasons for this increase in real HDIPC (particularly in the last decade) have been increases in capital incomes and the

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6 Family allowances are included where relevant. Rates of payment for 16-17 year olds are the maximum rate (since 1988 they have been subject to a parental income test).

7 See Wilson (1992) for a discussion of these issues.
Figure 2.1 Real Unemployment Assistance Rates, 1971 to 1992
Figure 2.2 Unemployment Assistance Relative to HDIPC, 1971 to 1992
increasing prevalence of the two earner family. We shall return to this latter phenomena in Section 3.

However the base rates of payment tell only part of the story. Over the last decade eligibility requirements and administrative procedures for unemployment assistance have changed dramatically. Overall, these changes have led to substantial reductions in government expenditures, suggesting that someone must be worse off. Whether this is relevant to the poverty alleviation objective depends very much on the nature of the changes. For example, many of these administrative changes have been motivated by a desire to reduce the incidence of fraud and overpayment.

Most of the administrative changes that were introduced over the last decade are shown in Table 2.1. This table shows these policy changes grouped into two categories, changes in administrative methods (such as increased use of review teams to check beneficiaries' bona fides), and changes in eligibility and entitlement conditions (though the distinction is not always clear). Changes in basic rates of payment are not included. The object of the table is thus to summarise the unemployment assistance policy changes since 1983 which do not influence the slopes of the curves shown in Figures 2.1 and 2.2. These policy changes are ranked according to estimates in the budget papers of the likely full year expenditure increase (negative figures represent reductions in expenditure).

These estimates need to be considered with caution for several reasons. First they are just that, estimates, and are likely to be subject to significant error. Second, the budget papers are not always explicit as to which groups are included in each item, and in some cases measures relevant to the unemployed are included with those for other groups. An approximate interpolation has been used in these latter cases (based on proportions of total expenditure on each group). Most significantly, the administrative changes are not necessarily cumulative. That is, whilst the government may announce policy initiatives designed to reduce fraud and overpayment in one year (with estimates of full-year savings in the future) the increase in overpayments which made these measures necessary in the first place is not recorded in the budget papers. This problem does not apply to the eligibility/scope changes.

Though limitations need to be kept in mind, this table does reveal some important facts about the transformation of unemployment assistance over the last decade.

\[8\] Other changes in rates of payments (particularly rent assistance) are also not included in Table 2.1.
Table 2.1: Selected Changes to Unemployment Benefit Coverage and Administrative Arrangements 1983-84 to 1992-93

<table>
<thead>
<tr>
<th>Administrative Changes</th>
<th>Implementation</th>
<th>Per Annum (in $1981-82)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amnesty period followed by increased computer cross matching of social security and</td>
<td>August, 1992</td>
<td>$-0.3</td>
</tr>
<tr>
<td>other agencies’ records to detect fraud and overpayments</td>
<td>December, 1989</td>
<td>$-10.3</td>
</tr>
<tr>
<td>Additional review procedures (e.g. closer monitoring of job search efforts, additional</td>
<td>July, 1987</td>
<td>$-51.7</td>
</tr>
<tr>
<td>mobile review teams etc.)</td>
<td>November, 1989</td>
<td>$-34.9</td>
</tr>
<tr>
<td>Increased compliance activity</td>
<td>September, 1987</td>
<td>$-60.7</td>
</tr>
<tr>
<td>Tightened administration of UB (e.g. scrutiny of work intentions)</td>
<td>September, 1990</td>
<td>$-4.8</td>
</tr>
<tr>
<td>Mandatory provision of Tax File number by beneficiaries</td>
<td>January, 1992</td>
<td>$-24.5</td>
</tr>
<tr>
<td>Review of eligibility and administration of payments (e.g. additional review teams,</td>
<td>October, 1992</td>
<td>$-19.7</td>
</tr>
<tr>
<td>employer reports)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accelerated claimant matching (ACM) to determine legitimacy of application</td>
<td>October, 1992</td>
<td>$-19.2</td>
</tr>
<tr>
<td>Continued funding of ten unemployment mobile review teams</td>
<td>July, 1989</td>
<td>$-16.7</td>
</tr>
<tr>
<td>Improved debt recovery by matching overpayment records with ATO’s Employment Declaration Forms</td>
<td>1988-89</td>
<td>$-14.9</td>
</tr>
<tr>
<td>Continued data matching of DSS and Tax File Number records assuming repeal of sunset clause in current data matching legislation</td>
<td>November, 1989</td>
<td>$-9.1</td>
</tr>
<tr>
<td>New work test arrangement and ‘new definition of suitable paid work’</td>
<td>January, 1991</td>
<td>$-8.2</td>
</tr>
<tr>
<td>Review of eligibility and administration of UB (e.g. additional mobile reviews,</td>
<td>July, 1992</td>
<td>$-8.0</td>
</tr>
<tr>
<td>computer matching etc.)</td>
<td>September, 1990</td>
<td>$-7.2</td>
</tr>
<tr>
<td>Introduction of 12 week waiting period for persons moving to low employment area</td>
<td>September, 1990</td>
<td>$-5.9</td>
</tr>
<tr>
<td>Closed administrative arrangements with the ATO</td>
<td>October, 1992</td>
<td>$-5.0</td>
</tr>
<tr>
<td>More intensive reviews of JSA recipients where there is high risk of noncompliant</td>
<td>Aug &amp; Oct, 1992 &amp; March, 1993</td>
<td>$-3.4</td>
</tr>
<tr>
<td>Compensation recovery administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tightened application of penalties for failing work test</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tightened administration of work test (e.g. increased use of work intention forms)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased collaboration between DEEIT and DSS to identify NSA recipients not complying with the Activity Agreement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Computer matching with records of the State Corrective Services and DILGEA extended</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| CES endorsement of certificate                                                        | February, 1991          | $-2.7                    |
| Matching records with DILGEA                                                         |                          | $-2.5                    |
| Matching records to detect undiscovered assets                                        |                          | $-2.4                    |
| ACM extended to all DSS regional offices                                             |                          | $-1.8                    |
| Local review teams established to investigate fraud in remote areas                  |                          |                          |
| Employment history requirement modified for 16-year-old JSA claimants                | March, 1993             | $-1.1                    |
| Work requirement amended for independent JSA by allowing CES registration as substitute| January, 1992           | $-0.9                    |

| Eligibility/Scope Changes                                                              | September, 1990         | $-0.5                    |
| At home rate for single beneficiaries aged 18-20 without children                     | September, 1989         | $-5.6                    |
| Determination of benefit for annual leave payments on termination of employment       | September, 1987         | $-5.2                    |
| Waiting period for urgent and intermediate UB extended                                | January, 1986           | $-35.9                   |
| JSA replaced UB for 16-17 year olds                                                   | December, 1987          | $-27.3                   |
| Assets test for 25+ years                                                             | January, 1990           | $-25.8                   |
| Waiting period of 22 weeks for JSA imposed for newly arrived migrants                 | September, 1990         | $-24.5                   |
| Four-week delay of benefit where liquid assets greater than $5000                      | September, 1990         | $-4.7                    |
| Assets test for under 25 year old beneficiaries                                       | July, 1997              | $-3.8                    |
| Incentives and assistance for 50-54 year old JSA/NSA recipients                       | March, 1993             | $-0.4                    |
| Parental assets test applied to JSA recipients                                       | September, 1990         | $-0.1                    |
| Young Parentless Allowance criteria broadened                                         | January, 1992           | $-0.1                    |
| Living away from home period reduced from 26 to 18 weeks for under 16 year olds       | March, 1993             | $-0.7                    |
| JSA extended to certain State Sectors not in receipt of State allowances              | January, 1992           | $0.9                     |
| Rent assistance extended to independent JSA recipients                                 | March, 1992             | 2.6                      |
| Break of entitlement period extended when assessing eligibility for rent assistance   | March, 1992             | 11.1                     |

Table 2.2: Summary Table of Estimated Savings and Expenditure 1983-84 to 1992-93 ($m 1991-92 per annum)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>-734.5</td>
<td>-78.8</td>
<td>-813.3</td>
</tr>
<tr>
<td>Eligibility/Scope/ Assets Tests</td>
<td>-270.9</td>
<td>-10.7</td>
<td>-281.6</td>
</tr>
<tr>
<td>Total</td>
<td>-1005.4</td>
<td>-88.5</td>
<td>-1094.9</td>
</tr>
</tbody>
</table>

Source: Table 2.1

Table 2.3: Maximum Rates of Payment for Adult JSA/Newstart Recipients and Pensioners, December 1992.

<table>
<thead>
<tr>
<th>Family Type</th>
<th>UA (JSA or Newstart) $/week</th>
<th>Pensioner (e.g. Age or Disability Support pension) $/week</th>
<th>Ratio (UA/Pensioner)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Adult</td>
<td>$140.95</td>
<td>$155.65</td>
<td>0.91</td>
</tr>
<tr>
<td>If aged &gt;60 and have received allowance for 6 months</td>
<td>$155.65</td>
<td>$155.65</td>
<td>1.00</td>
</tr>
<tr>
<td>Couple (both aged &gt;60)</td>
<td>$255.30</td>
<td>$257.90</td>
<td>0.99</td>
</tr>
<tr>
<td>If aged &gt;60 and have received allowance for 6 months</td>
<td>$257.90</td>
<td>$257.90</td>
<td>1.00</td>
</tr>
<tr>
<td>Couple +2 children (aged&lt;13)</td>
<td>$316.10</td>
<td>$318.70</td>
<td>0.99</td>
</tr>
</tbody>
</table>

Notes: Does not include family allowances.
The first is the sheer volume of policy changes. Since 1982-83, Table 2.1 identifies some 27 separate administrative changes designed to reduce fraud and overpayment, together with 16 changes in eligibility conditions. Though the above discussion implies the need for caution in aggregating the administrative changes, it is interesting to note that these total some $813m per annum (Table 2.2).

Of more interest for our concern with poverty alleviation⁹ are the changes in the eligibility conditions for UA. Table 2.2 indicates that since 1983-84 around $282m per annum has been saved as a result of the changes in the regulations under which people are able to obtain assistance. This comprises around 4 per cent of 1991-92 UA expenditure, or almost 9 per cent of the lower level of UA expenditure in 1989-90.¹⁰ It is interesting to note, however, that the only expenditure saving in this category after 1989-90 was due to an increase in the UA waiting period for newly arrived migrants. Other than this, the hardship associated with the recession (and possibly the lessening relevance of the labour market constraint) has led to some minor relaxation in eligibility conditions over the past few years.

Thus the stability (and in some cases increases) in real rates of payment shown in Figure 2.1 need to be viewed in conjunction with these eligibility restrictions, which have resulted in expenditure, and hence average payment, reductions of between 4 and 9 per cent of average UA. The greatest burden of these eligibility restrictions has fallen upon the young unemployed. To the extent to which these policy changes have removed benefits from youth who would otherwise gain support from their parents, they do not necessarily imply an increase in poverty. However it is clear that variations in parental support will mean that this targeting is far from perfect, and moreover many of the restrictions (such as increased waiting periods) have been spread across most groups of unemployed people.

Comparisons with Pensioners

An alternative yardstick that can be used to assess the adequacy of UA payments is to compare them with the level of income support available to other low income groups. Table 2.3 compares UA rates (USA or Newstart) with comparable rates of payment to pensioners, for families of different ages and compositions. For couples

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⁹ Administrative changes may also be relevant for poverty alleviation. For example, much of the savings for these policy initiatives come from removing people with low levels of job search from UA (as opposed to people working and receiving benefit for example). This will contribute to poverty, if poverty is defined as low living standards.

¹⁰ All figures calculated on a comparable price basis.
with and without children, the rates of payment are essentially identical, differing only in that pensioners are paid an additional pharmaceutical allowance. Single adult recipients, however, only receive 91 per cent of the corresponding payment received by pensioners (unless they are over 60). More significant is the fact that a much wider range of fringe benefits is available to pensioners than UA recipients. These vary from State to State and their value is difficult to quantify, but they are undoubtedly of great importance.

The conventional rationale for treating pensioners more generously than UA recipients is that pensions are usually of long duration, and so pensioners require a higher level of payment to alleviate poverty. Whilst this is generally a sensible position, it is of less relevance during period of high unemployment and long average durations of unemployment.

International comparisons

Finally, it is of interest to see how the Australian unemployment assistance scheme compares with that of other countries. Unfortunately this is a difficult question to answer because of the many variations in payment structures and conditions between countries. Most countries (unlike Australia) use a combination of unemployment insurance and residual income support schemes to help the unemployed. Eligibility conditions, waiting periods, maximum durations of receipt and supplemental benefits vary widely between countries. Table 2.4 represents an attempt to cover the most important of these variations.

This table shows replacement rates as estimated by the OECD for single and married people, according to whether they have had an interrupted workforce attachment (which reduces entitlement to unemployment insurance), how long they have been unemployed, and whether their spouse is working. The replacement rates are calculated relative to the gross wage of an ‘average production worker’. Whilst replacement rates are most commonly calculated to describe incentive effects, they are also relevant to the relative concept of poverty. Since many countries have important housing related benefits in addition to unemployment assistance, a simple indicator of the importance of these programs is also shown.

Of most interest here are the two lines of the table which show Australian replacement rates relative to those of other OECD countries. The relative position varies very much depending upon what type of person one considers. Generally speaking, the short-term unemployed in Australia are worse off than elsewhere,
<table>
<thead>
<tr>
<th>Country</th>
<th>Single Person</th>
<th></th>
<th>Married Person</th>
<th></th>
<th>Housing benefit availability</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Intermittent</td>
<td>Continuous attachment</td>
<td>Spouse working</td>
<td>Spouse not working</td>
<td>availability</td>
</tr>
<tr>
<td></td>
<td>work force</td>
<td>1st year employed</td>
<td>1st year</td>
<td>4th year employed</td>
<td></td>
</tr>
<tr>
<td></td>
<td>attachment</td>
<td>Replacement Rate (%)</td>
<td>unemployment</td>
<td>Replacement Rate (%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4th year</td>
<td></td>
<td></td>
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<td></td>
<td>1st year</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td></td>
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<td>0</td>
<td>62</td>
<td>0</td>
</tr>
<tr>
<td>Sweden</td>
<td>27</td>
<td>90</td>
<td>27</td>
<td>90</td>
<td>0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>34</td>
<td>63</td>
<td>0</td>
<td>63</td>
<td>0</td>
</tr>
<tr>
<td>UK</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td>USA</td>
<td>0</td>
<td>25</td>
<td>0</td>
<td>25</td>
<td>0</td>
</tr>
</tbody>
</table>

Australia relative to unweighted average: 0.85 0.49 1.38 0.00 0.50 0.81 1.50

Australian Rank (out of 20): High
RR=low rank: 12 19 9 3 13 4

Notes: From OECD (1991) Tables 7.3 and 7.3.1. Replacement rates are calculated relative to average production workers wage. Intermittent employment refers to a person with four months employment in the previous year. Housing benefits are not included in replacement rate calculations.
whilst the long-term unemployed are better off. Also, in Australia, the (full-time) employment of a spouse will generally make a person ineligible for benefits. Whilst this is also the case for the long-term unemployed in most other countries, the Australian treatment of married short-term unemployed in this regard is only shared by New Zealand.

Whilst this does have undesirable behavioural effects (see Section 3), and whilst the short term unemployed may have only half the replacement rate of those in other countries, I think this table should be interpreted primarily as illustrating the importance of the poverty alleviation objective of the Australian system. All of the important differences in replacement rates described here reflect the fact that unemployment assistance in Australia is primarily targeted according to need. This becomes clear when one notes the predominance of the consumption maintenance concern in other countries. Thus the OECD notes that,

*The positive labour market role of unemployment insurance is to minimise unnecessary disruption caused by unemployment, allowing persons who become unexpectedly unemployed to concentrate their time and energies on job search rather than costly adjustments to their life-style (e.g. the search for cheaper housing, a cheaper car).* (OECD, 1991, p.221).

Whatever the merits of this argument as a justification for unemployment insurance, it is clear that the same description cannot be made of the Australian system of income support for the unemployed. The focus of the Australian system is much more clearly on the alleviation of poverty. I think we can conclude that with respect to this goal at least, the structure of the Australian system is more appropriate. This structure means that during recessions, when average unemployment durations increase, the Australian system performs relatively well in alleviating poverty (though not quite as well as the last two lines of the table imply because of the significant housing benefits in some countries). On the other hand, when unemployment durations are short, the average level of unemployment assistance will be significantly lower in Australia than in other OECD countries—particularly for single people and married people with working spouses.11

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11 The case has been made that the structure and level of assistance are not independent, in that insurance schemes may make it politically possible to have a larger transfer to recipients than is possible under schemes financed from general revenue. However Table 2.4 provides little support for such a hypothesis, as Australian levels of assistance (apart from short-term single adults) are close to the middle of the distribution.


Poverty Alleviation: Conclusions

What overall conclusions about poverty alleviation can be drawn from these comparisons? Over the last decade and a half the living standard of unemployed with children has clearly improved, though the growth of the two earner family means that couples with neither member working are now more socially and economically isolated than before. In real terms, payment rates for single adults have remained roughly constant, though there have been significant restrictions on eligibility. The main losers however have been youth. Providing appropriate levels of support for unsupported youth (through income or services) must remain a priority for poverty alleviation.

The comparison with pensioners also suggests grounds for increasing assistance to single adults. Targeting this assistance on long-duration unemployed would have the advantage of addressing poverty alleviation goals whilst reducing average levels of benefit when the economy recovers. Incentive issues associated with long-term unemployment are discussed in Section 3.

From the perspective of poverty alleviation, I think that international comparisons reinforce the view that the structure of Australian income support is about right. From other perspectives, however, there may be grounds for change, and these are discussed below.

Finally, it is interesting to note the national basis of the Australian income support system. This has advantages and disadvantages. One disadvantage is that payments do not vary in line with differences in living costs (particularly housing) in different areas of Australia. The rationale for keeping policy constant across the nation is usually to ensure appropriate incentives for factors of production to allocate most efficiently. I do not think however, that this argument necessarily applies to unemployment assistance. Since high living costs tend to be associated with the areas of highest labour demand, it seems somewhat perverse to not provide incentives for the unemployed to move to these areas.

One simple way of introducing regional variation into unemployment assistance is via increases in rent assistance. This is currently set as half the rent paid over $25 per week, up to a maximum which varies with family size. The low maximum,

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12 There are administrative regulations which discourage (to some extent) UA recipients from moving to areas of higher unemployment, but there are no requirements to move away from high unemployment regions.
however, means that most recipients receive the maximum amount. If this maximum were increased, or if it were set with reference to average rent levels in the respondents' region of residence, then it could be used to provide an incentive to locate in high labour demand areas, as well as being more appropriate for the alleviation of poverty.

The Challenge of an Open Economy

Like all small economies, the Australian economy is extremely susceptible to external shocks. Francis Castles has described the response of the smaller European countries to this problem as one of domestic compensation – involving the active use of industrial and social policy to aid flexible adjustment and to compensate individuals who suffer the consequences of such adjustment (1998, see also Katzenstein, 1985). Australia, on the other hand, has historically employed a policy of domestic defence.

Rather than rolling with the punches of economic fluctuation, the chosen response was to seek a defensive strategy to block their impact. Basically, the politics of domestic defence consisted...of four closely interrelated policies: the protection of manufacturing industry through tariffs and other trade restrictions, the conciliation and arbitration of industrial disputes, the control of immigration, and a residual system of income maintenance...(Castles, 1988, p. 93)

But now, as a result of product and labour market liberalisation, the first two of these defences are disintegrating. Reductions in tariffs and the deregulation of the labour market, it is argued, will lead to a more outward-looking Australian economy – and are essential to maintain economic growth. These changes will ultimately have major impacts over a wide range of social and economic policy. Here I will focus on two implications for income support policy.

The first is the impact of trade liberalisation on wages. The removal of trade barriers will mean that unskilled and semi-skilled workers in the traded goods sector will increasingly be in direct competition with their counterparts in the third world. This may well be one of the explanations for the steady increase in wage inequality in Australia over the last 15 years. The long run implications of this increasing wage inequality for income support policy are taken up in the next section.

An issue more related to cyclical policy issues is the increased vulnerability of the labour market to the external shocks that this increased liberalisation may bring.
Figure 2.3 Unemployment Variation vs Export Orientation

Source: Derived from Foster and Stewart (1991)
Whilst this relationship must remain speculative, it does have some empirical support. Figure 2.3 shows for nine OECD countries the standard deviation of the unemployment rate over the two decades before 1989, plotted against the average ratio of exports to GDP over this period.

If Sweden is excluded, there is a clear association between export orientation and the variability of unemployment levels (r=0.71). The favourable performance of Sweden in stabilising unemployment (at low levels) can be ascribed to the strong Swedish commitment to ‘domestic compensation’ — in particular the large expenditure on active labour market policies. In 1988, for example, Sweden spent over 12 times as much per unemployed person on LMPs than did Australia (see Table 3.3 below).

Whilst trade liberalisation may bring increased economic growth and (possibly) lower unemployment on average, it does have the potential to increase the variability of unemployment. This will demand a response in terms of income support and/or structural adjustment policies. Since it is the exposure of export industries to external shocks that will influence these policies, it may be appropriate to ensure that these industries bear some of the fiscal burden (despite current views on encouraging exports). In the context of income support policy, one way of achieving this goal could be via the introduction of unemployment insurance, with industries making contributions in accordance with their unemployment variability.

Note that the suggestion here is not that we should abandon the current system of unemployment assistance, but rather that there may be grounds for encouraging (or forcing) industries in the traded goods (and services) sector to develop supplementary income support schemes for redundant workers in their industries. A high level of (short term) income replacement, combined with a fiscal commitment to re-training programs, will assist in maintaining the labour market flexibility needed for a significant commitment to world markets. It should not be surprising if the sea change in industrial policy which has occurred over the last two decades will need to be accompanied by a corresponding change in income support and labour market policies.

3. Structural/Long Run Issues

Turning now to more general issues of the long-run nature of income support for the unemployed, we focus on the labour market constraint and the long-run and
structural labour market issues facing unemployment assistance. At first glance, the
labour market constraint on income support payments might seem straightforward
enough – if payments relative to disposable incomes when employed (the
replacement rate) are too high then they might provide excessive incentives for the
unemployed to reduce their job search effort. That is, particularly in times of
economic growth, the pursuit of the poverty alleviation goal of income support may
actually cause unemployment.  

But is this issue relevant when unemployment has been high for the last 15 years –
even when the economy has been growing strongly? As Atkinson and
Micklewright note, a concern with incentive effects when demand for labour is
weak might be seen by some to be ‘further evidence of the propensity of economists
to be found re-arranging the deck chairs on the Titanic’ (1985, p.2). However (as
they go on to note) labour is not homogenous, and so it may be reasonable for such
incentive effects to be relevant at some positive level of unemployment – even if
perhaps not in the middle of a recession.

There is mixed evidence as to whether the labour supply effects of unemployment
assistance are a significant problem in practice. Australian estimates of the effect of
benefit levels (or the replacement rate) on aggregate unemployment levels (or
durations) have ranged from elasticities of zero (McMahon and Robinson, 1984), to
0.4 (Gregory and Patterson, 1983). The most comprehensive study has probably
been that of Trivedi and Kapuscinski (1985) who estimated elasticities of between
0.2 and 0.3, which they considered lower bounds. Recent analysis by the present
author has found no apparent behavioural impact of the decrease in replacement
rates associated with the introduction of family payments for low wage workers,
though this could be due to the unemployed not being fully aware of these changes
(Bradbury, 1992a).

In the United States, the consensus of research is that the level and duration of
unemployment insurance payments does have a substantial influence on
unemployment (Danziger et al., 1981), though conclusions from the UK (where the
income support system is more similar to that of Australia) are more mixed
(Atkinson and Micklewright, 1985). In a survey of the international literature,
Layard et al (1991) conclude that the elasticity of unemployment duration with
respect to benefit levels is probably between 0.2 and 0.9, though as Atkinson (1987)

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13 More precisely, the incentive effect may be to increase effective non-participation (or reduce
the degree of participation of those still maintaining some job search), among those
conventionally defined as unemployed.
notes, none of the empirical results in this area can be considered particularly robust. This lack of robustness stems principally from the difficulty of observing variation in replacement rates that is independent of other supply and demand influences. Thus in Australia the main changes in benefit levels occurred at about the same time as the first oil shock, whilst cross-sectional studies have to contend with the strong association between replacement rates and labour supply factors (such as family size).

Whilst it is nonetheless likely that there is some relationship between replacement rates and behaviour, any policy changes need to keep in mind first, the fundamental goal of income support payments, and second, that there are other administrative options available to increase job search effort if this is considered a problem. These can involve both 'carrots' (expansion in training and job subsidy programs, mobility assistance etc) as well as 'sticks' (increased supervision, requirements to take on reduced-wage employment etc). The Swedish experience is often held up as an example where large 'carrots' are combined with some 'sticks' and high (short term) replacement rates to yield low unemployment rates.

In general, low replacement rates, attractive labour market programs and increased administrative supervision can be seen as alternative mechanisms for encouraging labour supply. Any one of these can be relaxed provided the others are maintained or strengthened. From the point of view of the labour market constraint, therefore, low replacement rates are not essential. The picture is of course different with respect to the fiscal constraint. It is clear that the cheapest way to maintain labour supply (if we are not particularly concerned about skill levels) is to have very low replacement rates with minimal labour market programs and minimal administrative supervision.

It is also interesting to note that replacement rates do not appear to be the main unemployment policy difference between the current government and opposition. Rather the issue is more one of the appropriate balance between the carrots and sticks mentioned above. Since these disputes are primarily about the appropriate form (and extent) of the labour market programs that should be employed, they are not considered in detail in this paper (though some related issues are dealt with later).

But there are several important policy challenges facing income support for the unemployed. The first of the three areas considered here is the increase in long-term unemployment (LTU). Is the rise in LTU due to the Australian structure of
unemployment assistance? Is limiting the duration of benefits a viable approach to reducing LTU? A second challenge is the change in the Australian labour market away from full-time male employment towards increased female and part-time employment. Very much related to this is the issue of poverty traps, and the question of whether the current income test should be changed to allow beneficiaries to take advantage of these new forms of labour market participation. Finally, is the question of the growing inequality of wages in Australia, and the impact of this on the administrative systems of unemployment assistance. Dealing with this issue may mean a major realignment of the income support system for the unemployed.

Long-Term Unemployment and Benefit Duration

It has been of great concern to many commentators that, despite the strong economic growth between 1983 and 1990, the number of people unemployed for over one year (LTU) fell only slowly. This concern is for several reasons. First, given the low level of income support available for the unemployed, this must constitute extreme hardship. Equity issues are thus of central importance. Second, LTU may be expected to lead to deterioration in the skills and motivation of the unemployed – to both their own and society’s detriment. Third, insider/outsider theories of wage determination suggest that as a result of either: these sorts of actual skill deterioration, or because of ranking phenomena, the LTU are seen by employers as poor substitutes for the currently employed. Hence their presence has no influence upon wage bargaining, and hence there may be a higher ‘non-accelerating-inflation rate of unemployment’ (NAIRU). All these reasons suggest that for a given level of unemployment it is best to have many people with short durations than a few people with long durations.\(^\text{14}\)

Some long-run trends in unemployment and LTU are shown in Table 3.1. In order to abstract from cyclical impacts, this table shows unemployment patterns in the year prior to each of the last three recessions. At the end of the ‘long boom’ in 1973 the unemployment rate was just 1.8 per cent, and only 5.3 per cent of unemployed had been looking for work for more than 39 weeks. Following the recession of the mid 1970s, the resources boom only managed to reduce unemployment to 3.6 per cent before the next recession hit in 1982. By 1989 (just before the current recession) the unemployment rate was almost back to the 1981

\(^\text{14}\) There is a substantial literature on this topic. For Australian and international introductions see Chapman, Junankar and Kapuscinski (1992) and Layard, Nickell and Jackman (1991) respectively.
### Table 3.1: Long Term LTU Trends

<table>
<thead>
<tr>
<th>Year</th>
<th>Unemployed/ Labour Force (%)</th>
<th>LTU/ Unemployed (%)</th>
<th>LTU/ Labour Force (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>1.8</td>
<td>5.3</td>
<td>0.1</td>
</tr>
<tr>
<td>1981</td>
<td>5.6</td>
<td>21.1</td>
<td>1.2</td>
</tr>
<tr>
<td>1989</td>
<td>5.7</td>
<td>23.1</td>
<td>1.3</td>
</tr>
</tbody>
</table>

**Note:** For 1973 LTU defined as 39 or more weeks.


### Table 3.2: LTU in 1989

<table>
<thead>
<tr>
<th></th>
<th>LTU/Unemployed (%)</th>
<th>LTU/Labour Force (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Males:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15-24</td>
<td>19.2</td>
<td>1.9</td>
</tr>
<tr>
<td>25-54</td>
<td>30.6</td>
<td>1.2</td>
</tr>
<tr>
<td>55-64</td>
<td>49.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Total</td>
<td>28.0</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Females:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15-24</td>
<td>16.9</td>
<td>1.8</td>
</tr>
<tr>
<td>25-54</td>
<td>16.3</td>
<td>0.8</td>
</tr>
<tr>
<td>55-64</td>
<td>31.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Total</td>
<td>16.9</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15-24</td>
<td>18.0</td>
<td>1.9</td>
</tr>
<tr>
<td>25-54</td>
<td>24.2</td>
<td>1.0</td>
</tr>
<tr>
<td>55-64</td>
<td>46.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Total</td>
<td>23.1</td>
<td>1.3</td>
</tr>
</tbody>
</table>

level. (For men unemployment was higher, whilst for women it was lower in 1989, see Table 3.4 below). The proportion of the unemployed who were LTU had now almost reached a quarter, and they comprised almost as large a fraction of the labour force as did all unemployed in 1973.

Further details of the pattern of LTU in 1989 is shown in Table 3.2. As a proportion of both the unemployed and the labour force, LTU is greater among men than women. This is because women are more likely to leave the labour force. The probability of an unemployed person being LTU increases with age, with almost half of the unemployed men aged 55-64 having been unemployed for over a year. In this year of strong economic growth, over two per cent of the labour force in this age range had been unemployed for over a year.

It is interesting to note that the proportion of the labour force who were LTU in 1989 is not all that different to the total unemployment rate of 1973. This might suggest that the LTU in 1989 are similar to those people who could not obtain jobs in 1973 — a year of 'full employment'. Whilst there is some truth in this — the LTU prior to the current recession mainly comprised those people with particularly low skill, English language, motivation or health status — this does certainly not mean that they should be written off as 'unemployable'. For a start, a good deal of unemployment in 1973 was clearly frictional — people in-between jobs — and those people who might sensibly be described as 'unemployable' probably comprised only a small fraction of the unemployed then. In 1973 only 0.1 per cent of the labour force had been unemployed for over a year. It is unlikely that the nature of work has changed so much that the proportion of people who are 'unemployable' under any circumstances is 13 times this.

Another reason why it would be inappropriate to 'write off' the LTU is indicated in Figure 3.1. Even though probabilities of exit from unemployment are low for persons of long duration, they are not zero. People do exit from long term unemployment, and not just by leaving the workforce. Figure 3.1 shows the probability of leaving LTU for full-time employment over a one month period (for people in private households).

Whilst the long-term unemployed do have a much lower probability of gaining employment, many do nonetheless find jobs. In 1989, around 5 per cent of the people under 35 who had been unemployed for between one and two years in June, were working full-time in July. This is an overestimate because the matched labour force sample excludes non-private dwellings (where the more disadvantaged
Figure 3.1: Exit Rates to FT Employment From LTU, 1989 and 1992
workers would be concentrated), and is not matched by older workers and those with longer durations, but is still very encouraging. Of course we do not know how long these jobs lasted.\textsuperscript{15} It is also interesting to note that the fall-off in exit rates with the recession is concentrated on the short-term unemployed. Exit rates for the long-term unemployed have stayed relatively constant (overall).

The key question to be addressed here, however, is how the design of unemployment assistance can influence LTU. A commonly advanced argument is that the unrestricted duration of unemployment assistance in Australia contributes to the current high proportion of people long term unemployed. The federal opposition, for example, proposed in its 'Fightback!' document the exclusion of a large proportion of the unemployed from assistance after a 9 month period of unemployment. Though this policy has been retracted in the face of continuing low labour demand, if the government should change, such policies will clearly be on the agenda as economic growth returns.

It cannot be argued that there is no logic to this argument. In the absence of other policy changes, the withdrawal of income support is sure to encourage many unemployed to find some means of support, be it low wage non-award employment in ‘peripheral’ jobs, marginal self-employment, support from other family members, begging or crime. However the policy options are really more complicated than this. The best way to illustrate these is in a cross-national context.

Examining a range of OECD countries, Layard, Nickell and Jackman (1991) argue that benefit duration is important in reducing LTU (and indeed unemployment in general), but note that there are two distinct policy regimes under which this can be achieved. As in many social policy areas, the two archetypal examples are Sweden and the USA. Both of these countries have limited durations of unemployment assistance (though Sweden also has a general supplementary assistance program\textsuperscript{16}) and both have low LTU proportions. However Sweden also has an extremely active labour market program. This involves mobility assistance, training, and if necessary placement in public sector employment.\textsuperscript{17}

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\textsuperscript{15} The publication of matched data from the LFS over a larger number of periods would be useful in this context. It is also important to know the extent to which these full-time jobs were obtained as part of labour market programs (e.g. through Jobstart).

\textsuperscript{16} This appears to have been overlooked by Layard et al.

\textsuperscript{17} The last option obviously comes under severe fiscal stress during recessions, but the emphasis here is on policies appropriate to periods of economic growth.
### Table 3.3 Unemployment and LTU, Selected Countries (ranked by LTU %)

<table>
<thead>
<tr>
<th>Country</th>
<th>Unemployment Rate % (average 1983 to 1988)</th>
<th>LTU as % of Unemployed, 1988</th>
<th>Duration of Unemployment Insurance (years), 1985</th>
<th>Duration of All Forms of Income Support (years), 1985</th>
<th>LMP Expenditure per Unemployed Person, 1987</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>11.3</td>
<td>78</td>
<td>1</td>
<td>indefinite</td>
<td>7.4</td>
</tr>
<tr>
<td>Italy</td>
<td>7.0</td>
<td>69</td>
<td>0.5</td>
<td>0.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Ireland</td>
<td>16.4</td>
<td>66</td>
<td>1.25</td>
<td>indefinite</td>
<td>5</td>
</tr>
<tr>
<td>Spain</td>
<td>19.8</td>
<td>62</td>
<td>0.5</td>
<td>3.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10.6</td>
<td>50</td>
<td>2.5</td>
<td>indefinite</td>
<td>2.7</td>
</tr>
<tr>
<td>Germany</td>
<td>6.7</td>
<td>47</td>
<td>1</td>
<td>indefinite</td>
<td>10.4</td>
</tr>
<tr>
<td>France</td>
<td>9.9</td>
<td>45</td>
<td>3.75</td>
<td>3.75</td>
<td>3.9</td>
</tr>
<tr>
<td>UK</td>
<td>10.7</td>
<td>45</td>
<td>1</td>
<td>indefinite</td>
<td>4.6</td>
</tr>
<tr>
<td>Denmark</td>
<td>9.0</td>
<td>29</td>
<td>2.5</td>
<td>2.5</td>
<td>7.9</td>
</tr>
<tr>
<td>Australia</td>
<td>8.4</td>
<td>28</td>
<td>none</td>
<td>indefinite</td>
<td>2.8</td>
</tr>
<tr>
<td>Japan</td>
<td>2.7</td>
<td>21</td>
<td>0.5</td>
<td>0.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Finland</td>
<td>5.1</td>
<td>19</td>
<td>indefinite</td>
<td>indefinite</td>
<td>12.9</td>
</tr>
<tr>
<td>Austria</td>
<td>3.6</td>
<td>13</td>
<td>0.6</td>
<td>indefinite</td>
<td>11.3</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.2</td>
<td>8</td>
<td>1.2</td>
<td>1.2?</td>
<td>34.6</td>
</tr>
<tr>
<td>Canada</td>
<td>9.9</td>
<td>7</td>
<td>0.5</td>
<td>0.5?</td>
<td>4.3</td>
</tr>
<tr>
<td>USA</td>
<td>7.1</td>
<td>7</td>
<td>0.5</td>
<td>0.5</td>
<td>2.4</td>
</tr>
<tr>
<td>Norway</td>
<td>2.7</td>
<td>6</td>
<td>1.5</td>
<td>1.5?</td>
<td>9.8</td>
</tr>
</tbody>
</table>

**Source:** Layard, Nickell and Jackman (1991), Table 5 and Table A1.

**Notes:**

(2) LTU is 12 months or more

(4) 'All forms of income support' includes means tested assistance valued at over $120 a month (for a single adult). Items have been denoted with a question mark where they appear to conflict with Table 2.4.

(5) LMP expenditure is expenditure on 'active' labour market programs per unemployed person, expressed as a percentage of output per person.
Table 3.3 shows these different policy approaches in the context of a wider range of countries. In 1988, a year of relative economic prosperity, both the level of unemployment and the proportion who were LTU varied widely. As well as these indicators, the table also shows the maximum duration of unemployment insurance (generally paid at a high replacement rate), the maximum duration of all forms of public income support for the unemployed, and an index of ‘active’ labour market program expenditure per unemployed person.

By the standards of this table, Australia—with its indefinite benefit entitlement—fares relatively well, with a lower LTU rate than most European countries. However of those countries with lower LTU proportions than Australia, all have either short total durations of assistance, high expenditures on LMP, or both. All the countries with higher LTU proportions have relatively long total benefit durations, with the exception of Italy (which is exceptional in also having a particularly low coverage of income support payments for the unemployed).

Whilst there are clearly many factors influencing the patterns shown in this table (and definitional differences in the defined variables must be one candidate), it does provide some support for the argument that limited benefit durations restrict durations. It also emphasises the wide variations in LMP expenditure. Sweden here is clearly an outlier, with LMP expenditure per unemployed over twelve times that of Australia, but there are many other countries with higher levels. Indeed only Italy, Spain, the Netherlands and the USA spent less than Australia in 1988 (according to this index).

On the other hand, limited durations of benefit entitlement will imply poverty unless they are so successful in encouraging job search effort that the potential LTU actually find (well paying) work. The example of the US, with its high poverty rate, suggests that this is unlikely.

The conclusion we can draw from all this is simply that, when there is economic growth, restrictive income support policy can be used to get LTU rates down. But the only way to decrease LTU without fundamentally compromising the poverty alleviation goal of income support is via increases in LMP expenditure. This may in turn involve increased restrictions and compulsory participation requirements (as

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18 This must be qualified by the possibility that in countries with unemployment insurance, many short term unemployed youth may not be included in the unemployment statistics because they are not eligible for income support.

is the case in Sweden), but with a sufficient fiscal commitment need not involve abandonment of the poverty alleviation objective.

Labour Market Transformations and Poverty Traps

There are three main areas of labour market transformation that have important long run implications for unemployment assistance. They are, the increasing employment of married women, increasing part-time employment, and growing wage inequality.

The first two of these are illustrated in Table 3.4. The employment rates of women aged 25-54, for example, grew from 46 to 62 per cent between 1973 and 1989. This growth was in part-time employment up to 1981 (full-time employment actually declined marginally), but equally in full-time and part-time employment thereafter. The proportion of employment that was part-time also grew for males, and so between 1973 and 1989 part-time employment expanded from 12 to 21 per cent of total employment.

For some groups the proportion of population that was employed fell over this period. This was due to increased educational retention, higher unemployment rates, and the increase in early retirement. The fall in the employment rates of men aged over 55 is particularly noticeable. (though it should be noted that Table 3.4 includes men over 65 as employed, but not as part of the population, and hence overestimates the employment rates of older people).

Part-time Work and Poverty Traps

A feature of the Australian income support system that is often noted is the way in which the income test and taxation systems can combine to produce situations where there are very high effective marginal tax rates (EMTRs). The EMTR is defined as

\[
EMTR = 1 - \frac{\partial D}{\partial Y}
\]  

where \(Y\) is non-transfer income and \(D\) is disposable income \((Y + \text{transfers} - \text{income taxes})\). A high EMTR thus implies a small gain (or a loss if EMTR>1) in disposable income for each dollar increase in market income (such as from part-time or casual employment).
### Table 3.4: Long Term Labour Market Trends

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<th>Year</th>
<th>MALES 15-24</th>
<th>Unemployed/ Labour Force (%)</th>
<th>Unemployed/ Population * (%)</th>
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* Population excludes persons aged over 64.

Figure 3.2 Disposable Incomes and EMTRs for a Married Couple with Two Children Receiving Newstart Allowance or FAS, 1992.

Disposable Income as a function of Private Income

EMTRs as a function of Private Income

Note: Assumes no rent assistance.
Source: Gallagher and Ryan (1992)
Figure 3.2 shows a typical disposable income and EMTR schedule for a family receiving unemployment income support (Gallagher and Ryan, 1992). It is assumed that the couple has two children and that the head's income is constant in the range $0 to $1000 per week. The 120 per cent tax rate around $350 per week results from the combination of the withdrawal of the not-taxed child allowance, together with the first tax rate. From 1993 the integration of FAS with allowances will remove this high EMTR.\textsuperscript{21} With regard to the high EMTRs due to the FAS income test, it should be noted that the delayed nature of FAS entitlement assessment means that the present value of the disposable income loss will be less than implied in this figure.\textsuperscript{22}

Nonetheless, it would be surprising if the high EMTRs shown in this figure did not have an impact upon employment decisions. Given that workforce decisions are usually made in more discrete units (e.g. an extra day's work or not) a more useful concept may be the effective 'discrete' tax rate, defined as

\[
EDTR = 1 - \frac{\Delta D}{\Delta Y}
\]  

It can easily be shown that the EDTR will equal the weighted average of the EMTRs over the income range in question. Hence what matters is the presence of high EMTRs over a wide range of incomes. Even if the FAS withdrawal rate is discounted, it is clear that in many cases EDTRs will be higher than the top marginal tax rate.\textsuperscript{23} This situation is accentuated when the income tests associated with many government services are included.

It seems a fairly common perception that having a higher EMTR for low income groups than for those with high incomes is inequitable. Why should the poor face a higher effective tax burden for each additional dollar than the rich? This question, I

\textsuperscript{20} The 'head' in this context is the person who is receiving the allowance on account of their job search. The marginal tax rate pattern is slightly different when it is the spouse's income that increases because of the dependent spouse rebate. Also if both incomes increase equally then a wider free area applies. See Gallagher and Ryan (1992) for the detailed assumptions underlying this figure.

\textsuperscript{21} Corresponding to this 120 per cent EMTR is a point of negative EMTR when benefit ends and eligibility for FAS begins (not shown on the figure). The integration essentially averages these two EMTRs.

\textsuperscript{22} See Bradbury (1992a) for a description of the (complex) administration of FAS entitlements.

\textsuperscript{23} There is a close relationship between the EDTR and the replacement rate (RR). Letting D(w) equal the disposable income when the person has a wage of w, the EDTR between a wage of 0 and a wage of w is 1 - [D(w) - D(0)]/w. The replacement rate is D(0)/D(w) = 1 - [D(w) - D(0)]/D(w). For sufficiently high wages D(w)/w and so RR < EDTR. There is no particular reason for preferring one measure over the other when measuring incentive effects.
think, is based upon a misleading view of distributional equity. What counts for
equity is the distribution of disposable incomes — and these depend not on the
marginal, but on the average tax rate (which is negative for income support
recipients).

If we are to keep total expenditure constant (and assume no change in behaviour),
EMTRs can only be reduced by reducing the base rate of payment. Alternatively, if
expenditure is to be increased, it is not at all obvious from an equity perspective
whether it is best to direct that expenditure to those with the lowest private incomes
by increasing the base rate (whilst holding withdrawal rates constant), or to direct it
to those with some private incomes by reducing EMTRs.

Equally, it is also not obvious that high EMTRs are an inefficient solution to the
distributional objective of income support. One rationale for high EMTRs for the
unemployed (as opposed to pensioners for example) has been to reinforce the search
for full-time rather than part-time work. That is, the goal is to place high marginal
tax rates where people would not be expected to locate in the absence of transfers,
whilst using optimally redistributive average tax rates at other income points.
Indeed from this perspective, Bascand (1987) outlines some welfare advantages in
having infinite ‘sudden death’ withdrawal rates, where people lose all their benefit
at a given income level. As Bascand notes, however, such an extreme system could
discourage employment which might otherwise be undertaken for the development
of human capital. In addition, we might note the uncertainty costs associated with
sudden death benefit withdrawals.\footnote{These costs are most apparent for pensioner fringe benefits, where there may be uncertainty about the value of the fringe benefit, as well as the question of whether a particular work or savings choice might place the pensioner over the limit.}

Whilst the conventional arguments in favour of high marginal tax rates may thus
have merit, the problem now is that the assumptions about the incidence of these tax
rates are breaking down. In particular, the increase in part-time and low wage work
means that the assumption of the non-relevance of part-time work within the high
EMTR bands is breaking down. That this transformation implies potentially major
efficiency burdens is most apparent in the case of married women whose husbands
are receiving unemployment income support. Some issues associated with
unemployment assistance for married couples are considered next, prior to a more
general discussion of alternative income testing policies.
Married Women's Employment

The growth of married women's employment poses particular challenges for the design of income support systems for married (or de-facto) couples. In particular, these changes raise fundamental questions about the appropriate definition of the unit for income support payments. The present system is predicated upon the traditional husband breadwinner, plus dependent spouse and/or children. This has elements of both individual and family entitlement assessment. Thus eligibility for income support is assessed on the basis that one individual is looking for work, but the assessment of the amount of income support they receive (which I will term entitlement) depends upon their family composition and income. There is no restriction on both husband and wife looking for work (e.g. they can both seek assistance from the CES) but from the point of view of UA assessment the labour force status of the second member is irrelevant (though their income is not).

One implication of this is that the wives of unemployed men face the very high effective marginal tax rates described above. This is particularly important because of the prevalence of part-time work and/or low wage rates among married women. These high marginal tax rates are undoubtedly one reason for the low level of employment among wives of unemployed men. In 1989, for example, 59 per cent of married women with children and with employed husbands were employed. Where the husband was unemployed, however, only 17 per cent of wives were working.25

If the expansion of labour demand continues to be in traditionally female areas of work then this pattern could imply a major efficiency burden. Moreover, there are also important equity issues associated with this concentration of non-employment. That is, as the two earner family becomes the norm, the income gap between the average family, and the family with neither husband nor wife working has been increasing. This implies a greater economic and social isolation of the unemployed (particularly the long-term unemployed). Similarly, it means a decrease in the main replacement rate facing employed married people (i.e. the ratio of a disposable income based on one wage to an income derived from two wages will usually be less than the corresponding ratio of income support to one wage). Unemployment assistance will be even less effective in maintaining the consumption level of

25 The corresponding figures for women without children are 67 and 26 per cent. See Bradbury (1992b) and Bradbury and Doyle (1992) for further details and a discussion of the impact of these patterns on income distribution trends. Other possible reasons for this association are also discussed in these papers.
families. (See also Table 2.4 for the different outcomes under insurance type
schemes).

Since the essence of this problem is the family based unit of assessment, is an
adoption of an individualistic assessment procedure a possible solution? This might
also foster a greater degree of integration with the (primarily) individually based
taxation policy. Generally, this issue has been considered in terms of a move away
from the family as the unit of analysis for the assessment of *entitlement*. That is, to
apply the income (and asset) test to the income of the individual only. This would
mean, for example, that an unemployed husband could receive full income support
irrespective of his wife’s income (and vice versa). This would mean that the high
marginal tax on wives’ earnings would be removed.

The key problem with such proposals, however, has always been seen to be one of
cost. However, entitlement is only half the story. Moving towards a fully individual
basis of assessment for *eligibility* could lead to fiscal savings. Indeed, this seems to
be the direction in which policy is heading. Since 1990 eligibility for UA payments
for young married recipients has been assessed on an individual basis. Where both
husband and wife are aged under 21 (and have no children) both must satisfy the
work test in order to receive full benefits. Entitlement, however, is still assessed
jointly. This combination of individual and family assessment is of course the one
which implies least government expenditure, and undoubtedly there will be
pressures in the years ahead to extend this to all UA recipients.

However, there are some problems with such a policy shift. The most important is
that the pattern of division of labour within the household is still very much in a
state of flux, with widely differing expectations held by different parts of the
community. However, I suspect that the growing commodification of female labour
means that a shift towards an individual basis for the assessment of income support
eligibility is inevitable. Under such a system individuals would be eligible for state
income support on the basis of certain specified characteristics such as age (children
and the elderly), ill-health, job search or caring responsibilities. If it is desired to
maintain the targeted nature of the current income support system, however, (the
assumption of) income sharing within the household implies that the assessment of
entitlement will still remain family based.

This means that for married men and women without children, the work test will
ultimately be extended to both members of the household, whilst the income test
would remain similar to its current structure. This would imply that greater
consideration would need to be given to the lower (full-time) wages of married women. The general issue of low full-time wages is discussed below.

Whilst such a change will remove what will increasingly seem to be an anomaly (that only one member of a couple need look for work), it does not of itself address the question of the high EMTRs for people such as married mothers (or increasingly fathers) for whom part-time work may be the norm. The key to dealing with this problem lies in the structuring of income tests to suit the most likely patterns of labour force participation.26

One possible scenario might be for one member of a couple to be designated as a 'primary carer' on the basis of workforce experience prior to the receipt of UA. The work test would not apply to this person. The base level of income support would be determined with reference to family composition and characteristics as at present. The income test however would be individually based and would work as follows. For the non-carer an income test would apply in a similar fashion to the present system. The primary carer would, however, have a much wider free area (or possibly an income range with a low withdrawal rate), followed by a 100 per cent (or higher) withdrawal rate at higher wages. This would be structured so as to make part-time work worthwhile, but so as to fully taper out at a low full-time wage.27 Couples with children could choose to be assessed under either this system or the one applying to couples without children.

Such a revised income support system for married couples will increase the incentives for married women to work part-time, and if the work test is applied to both members of a couple, to an increase in the job search of married women without children. However it is very much a marginal change, and does not address the fundamental issues of a general trend towards part-time employment, nor the increasing prevalence of low wage employment. Some policy responses to these issues are considered next.

Part-time Employment

Part-time work is now by no means confined to students, married women and people near retirement (though these groups continue to form the bulk of part-time

26 It should be clear that this very 'tailored' approach is thus quite the opposite of the uniform approach suggested by guaranteed minimum income (GMI) proponents.

27 The thresholds might vary with numbers and ages of children.
workers). Even before the current recession in 1989, and among men aged 25 to 54, some 3.4 per cent of workers were working part-time. This compares with 2.9 per cent in 1981 and 1.5 per cent in 1973. Should unemployment assistance be changed to cater for part-time work in all demographic groups?

If we believe that part-time work will become important, then it will be inappropriate to maintain income and job search tests predicated upon the search for full time work. My feeling however is that things have not changed so much, nor are they likely to change, as to justify a wholesale reorientation of income support in this way. Irrespective of the increases in firms' demand for casual and part-time labour, part-time work remains essentially a supply response. After all (particularly in a tight labour market) people can often combine several part-time jobs to reach full-time earnings (though there are costs in doing this).

More relevant is a partial re-orientation of unemployment assistance to allow for part-time employment as a transition to full-time employment. This will be particularly relevant if a substantial proportion of the workforce of the future does have to match several part-time jobs to attain an adequate income. For the long-term unemployed in particular, this seems to offer a means of re-integrating such people into the workforce. How can the income test be altered to remove the poverty trap which currently makes such employment not worthwhile (or forces the unemployed to attempt to deceive the Department of Social Security)?

The problem is clear. If it is desired to maintain the base level of assistance, but ensure that full-time employees do not receive assistance (this assumption is discussed below), then there is only limited scope for a poverty trap alleviation. For example, in August 1990, the after-tax income of a married man (with no children) and with a wage at the 10th percentile was $326 per week. That is, 10 per cent of married men had disposable incomes below this level. Unemployment benefit for the same man expired when private income reached $273 per week, or $293 per week if they were receiving rent assistance. To have people eligible for assistance under the income test, but ineligible under the job search test (they must be searching for a full-time job rather than in one) would impose severe administrative stress.

Whilst there is some scope for an easing of the income test, this could only be minor, unless there were a major re-orientation of income support policy to allow

26 That is the 10th percentile of wages for married men working full-time. This estimated is derived from the calculations in Bradbury (1992a).
full-time workers to receive benefits (see below). In the absence of this, the most appropriate liberalisation might be to change the time basis of the income test rather than the actual thresholds. This could involve the introduction of an earnings credit for the long term unemployed—as currently applies to pensioners. This scheme works by permitting recipients who have no other income to accumulate their free area allowance (up to a maximum of $1000 for single people or $2000 for couples). When the person does have some part-time or casual employment this accumulated allowance is deducted from assessable income before the income test is applied. The objective of the earnings credit is thus best seen more as encouraging casual work rather than permanent part-time work. (Consequently its introduction will imply a need for some relaxation of casual work rules). This is probably more in keeping with the full-time job search goal of unemployment assistance.

This discussion is based on the assumption that we might wish to encourage the unemployed (particularly the LTU) to undertake some part-time or casual work. The logical alternative is to leave the income test as it is (or tighten it) but to require the unemployed to engage in part-time work. That is, to 'work for the dole'. Whilst such a scheme does have merit in maintaining workforce attachment, it does need to be seen clearly for what it is. Unless the unemployed are manifestly irrational, a compulsion to work for no or little increase in income must mean a decrease in welfare (if it were not they would choose to work). This indeed is seen by some supporters as a positive feature, lessening the attraction of income support and hence encouraging (full-time) job search.

Whilst there are many factors to be taken into account in determining the cost/benefits of this approach, the key issue is distributional. Making income support receipt as unpleasant as possible may lead to efficiency gains, but ultimately it is little different than reducing the level of assistance to the unemployed, and needs to be assessed in terms of the same distributional concerns (and associated negative externalities).

29 A limited earnings credit has now been proposed by the Labor government as part of its 1993 election commitments.

30 Current regulations mean that people with casual work for up to four weeks can remain registered for JSA or Newstart (though with payments reduced via the income test). Longer periods of casual employment mean that they have to reapply for benefit. This means serving a one week waiting period unless: 1) they had been receiving benefit for 12 months, and the casual work is less than 13 weeks or 2) they have already served a waiting period in the previous 13 weeks.
Low Pay and Wage Subsidies

The 1980s have been notable for both decreases in average real wage rates, as well as increases in wage inequality. Indeed wage inequality has been increasing for at least the last two decades (King, Rimmer and Rimmer, 1991, Gregory, 1992). Like the growth in part-time employment, the prospect of further decreases in the real wages of those at the bottom of the distribution has important consequences for income support policy.

Falls in wages will mean increases in replacement rates, and increases in the EMTRs required to ensure that full-time workers are not eligible for benefits under the income test. Whilst replacement rates are for the most part still relatively low, the possibility exists that these developments may place increasing pressure on the poverty alleviation objective of unemployment assistance.

The most straightforward way of addressing this issue would be via policies to directly address this increase in wage inequality. Alternately, it has been suggested that in a deregulated wage environment, unemployment assistance may be used to place an effective floor on wages. That is, to reverse the interpretation of the labour market constraint. Such an approach does not seem particularly realistic, as there would undoubtedly continue to be pressures to reduce benefits as employers complain that they cannot obtain workers at the 'going' wage.

Finally, it may be necessary to move more towards a negative income tax (or GMI) form of income support. The fundamental difference between the current Australian system of income support and a negative income tax, is that eligibility for income support under the current system is heavily circumscribed rather than universal. People must fall into defined categories of need, such as unemployment. One possible extension is the inclusion of low-wage (full-time) employment as an additional category of need.

That is, individuals could receive income support either if they were engaged in job search (possibly combined with part-time work) or if they were employed full-time. A (semi) unified income test would apply, similar to the test applying to FAS recipients. Such a 'wage support' could be administered in a similar fashion to

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32 The income test is unified in that it provides a smooth progression of income support levels as non-transfer incomes increase. It is only semi unified because the time period for income
the FAS system. It would have the goals of either increasing the living standards of low wage workers, or, if this income support were ‘shifted’ onto employers, of increasing the demand for low wage workers. In some respects such a scheme would be similar to the Jobstart system, except that the legal incidence of the payment would be different, and it would not be so tightly targeted. An extension of the Jobstart scheme could thus be a half-way policy.

An alternative, and in some respects preferable, way of achieving this goal would be to simply raise the tax threshold. The main difference between these two approaches is that the wage subsidy would be withdrawn in a similar fashion to FAS, and so lead to higher EMTRs at low points in the wage distribution. A general raising of the threshold could be financed by marginal tax increases at higher levels. Determining which of these two strategies would be socially optimal would not be a simple undertaking.

4. Conclusions

What suggestions for income support policy can be drawn from this survey? It is useful to group these according to time-frame.

In the short term, with continuing low labour demand, the extent to which UA can be used to alleviate poverty is essentially a fiscal question. If it is desired to commit more funds to unemployment assistance, then the discussion of Section 2 identifies unsupported youth and LTU single adults as the groups who fare most poorly in comparison to available yardsticks. However incentive and targeting concerns mean that it may be appropriate to direct additional assistance to youth in particular via services (such as housing and labour market programs) rather than income support.

Moving to a slightly longer perspective, where labour demand is assumed to pick up, and labour supply issues are also important, two main suggestions have been raised. These are to increase the regional variation in UA—most feasibly through increasing the relative importance of rent assistance, and to introduce some relatively minor reductions in effective marginal tax rates. Whilst there is probably

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35 Apart from ‘technical’ issues such as the time period and unit of assessment.
some scope for general increases in free areas, a more appropriate policy initiative would be the introduction of earnings credits (perhaps of a large magnitude than those proposed by new government), as this would be more consistent with the full-time job search assumption of unemployment assistance.

In the long run, however, there are many important social and economic changes to which unemployment assistance must adapt. The increasing prevalence of the two-earner couple and consequent changes in concepts of dependency will cause pressures for major alterations to the unit of assessment. The discouragement of secondary earners because of the income test is a problem that already exists. It has been suggested here that a package of measures involving a broadening of the work test accompanied by a liberalisation of the income test for primary carers, may be an appropriate response. The best response to increasing wage inequality, is however, less clear. Finally, with the increasing international orientation of the Australian economy, there may be grounds for introducing special measures to assist the adaptation of the traded goods sector to external shocks. It is plausible that these may ultimately include some form of unemployment insurance scheme for selected industries.

In this paper the focus has been on the system of income support for the unemployed, rather than the whole system of government unemployment assistance. This focus has been deliberate, but does not imply a disregard for other aspects. There are innumerable areas in which improvements in unemployment assistance could be made, and the labour force is vitally in need of careful study.
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Income Support and Unemployment
Comments by
James Cox
Government Pricing Tribunal of NSW

This paper reviews, in a sensible way, many of the issues concerned with income support policies for the unemployed and makes a number of suggestions for changes. These suggested changes are in response to social and economic developments such as the increasing prevalence of two earner couples, growing inequality in the distribution of wages, and the increasingly international orientation of the Australian economy. Bruce Bradbury also considers, but only briefly, the question of whether the Australian system of unemployment assistance has contributed to the problem of long-term unemployment, and whether there are changes to unemployment assistance that might help to reduce long term unemployment. On the whole he seems to think that the consequences in terms of increased poverty of policies such as limiting the duration of receipt of unemployment benefits more than outweigh the reduction of unemployment that might result, which can be estimated only with considerable uncertainty. But others may choose to weigh the issues differently.

An important point, which I think that Bruce Bradbury does not sufficiently emphasise, is that there is a close relationship between the approach to labour market regulation and unemployment and the system of income support for the unemployed.
unemployment assistance policy is the result of an uneasy compromise between the objectives of equity and efficiency and it is hard to think of changes that do not offend one or other of these objectives. It may seem fair and reasonable to revise the income test to make it easier for the unemployed to take up casual work or for their spouses to work part-time. But the duration of unemployment may be unnecessarily prolonged if receipt of unemployment benefit is made more attractive by enabling it to be combined with casual or part-time earnings. Although the econometric evidence is ambiguous (as it often is), I believe (on the basis of my experience of life) that these are reasonable concerns.

Bruce Bradbury indicates that there may be grounds for introducing special measures, including an unemployment insurance scheme, to assist the adaptation of the traded goods sector to external shocks. This would be in addition to the existing programs of income support for the unemployed. I am not persuaded that this would be a desirable innovation.

First, the necessity for it can be questioned since not all countries which are heavily involved in trade have high short-term replacement rates of benefits for earnings (see Bradbury, Table 2.4). Secondly, employees in risky industries may be able to maintain consumption during a temporary period of low income by borrowing or drawing on past savings. It is not clear that governments are better able to provide such protection, except for the poorest. Thirdly, Bradbury seems to have in mind an unemployment insurance program in which firms in risky industries pay higher than average premiums. I suspect that, in practice, the degree of actuarial fairness that is consistent with political realities would be found to be strictly limited, and that the riskier industries would be subsidised by other contributors or taxpayers. Fourthly, most people would agree that there should be 'safety nets' to protect the poorest in society from the adverse effects of structural changes in the economy. But it is not clear how far such protection should extend. In particular, an unemployment insurance program could result in the worse-off in society subsidising the better-off.

Bruce Bradbury draws attention to the increasing inequality in wages during the 1980s. This trend, if it continues, will undoubtedly cause problems for income support policy. As Bradbury makes clear, the disincentives inherent in a system of income support for the unemployed depend largely on the ratio of maximum rates of benefits to wages in low-paying occupations. If inequality in the distribution of wages continues to grow, so will concern about disincentive problems. Bradbury's suggested solution is for the taxpayer to subsidise the
income of people in low wage, full time employment—a return to the
Speenhamland system. Assistance under such a program would be phased out
over a heavily populated part of the income distribution and a substantial
proportion of the working population would face high effective tax rates from
the combined effects of taxation and benefit withdrawal. Because of this, such a
program would be introduced, if at all, only on a limited scale.

An alternative proposal, also suggested by Bradbury, would be to change the
balance between the basic benefit and additions for special needs within the
maximum rate of benefit. An improved trade-off between equity and efficiency
might result from reducing the basic benefits and increasing additions for special
needs such as housing. This change would reduce any tendency for income
support payments to encourage people to remain in depressed areas where the
cost of housing tends to be lower than in more prosperous regions where
employment opportunities are most likely to be present. The link between the
amount of payment and differences in need would also be closer than at present.

In summary, the level of unemployment benefits and the conditions under
which they are paid affect the extent of long term unemployment. The
consequences of possible changes (given present labour market arrangements) for
incentives and the distribution of income will strictly limit the extent of the
changes which it is possible to make. If there is to be an 'answer' to long term
unemployment it is likely to result form a better understanding of how labour
markets work and, if only we can work out how to achieve it, from the better
design of labour market institutions. The design of income support policies may
need to be reconsidered in the light of any changes to labour market institutions
which result.
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