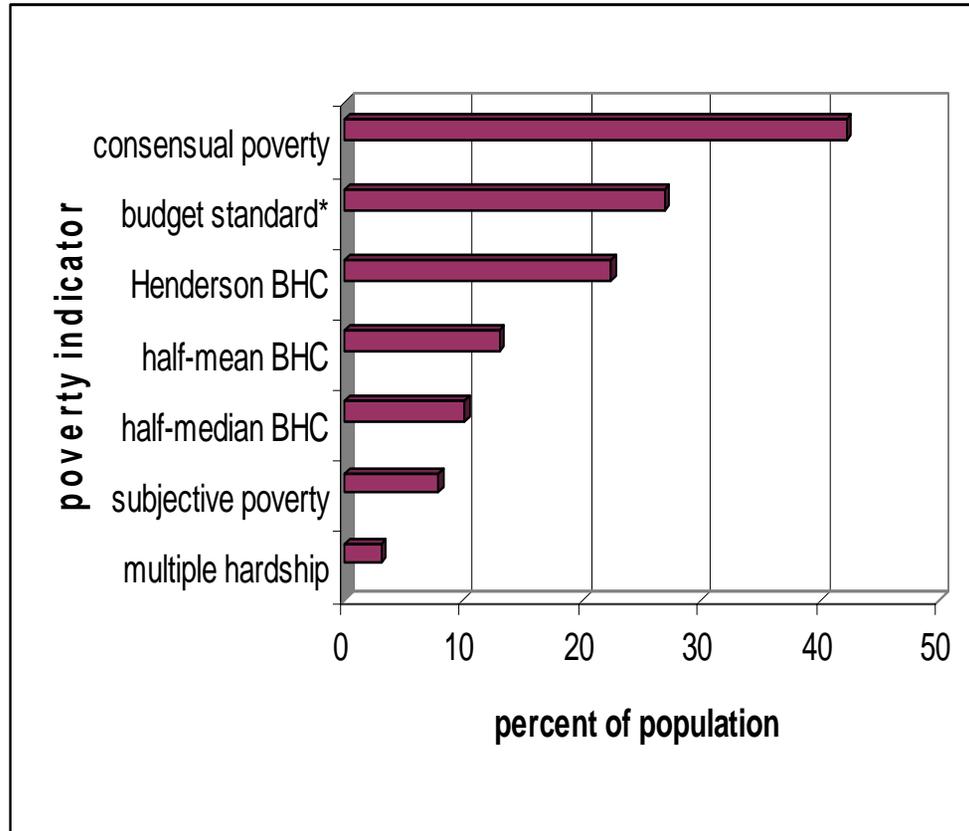


# TAX, WELFARE AND JOBS: A FIRST STEP TO REFORM

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# Do we have a poverty problem in Australia?



**Sources:** Ann Harding, Rachel Lloyd and Harry Greenwell, *Financial Disadvantage in Australia 1990 to 2000* (Smith Family 2001)  
 Peter Saunders, *The Ends and Means of Welfare* (Cambridge University Press, 2002);  
 Peter Saunders 'A new poverty line?' *SPRC Newsletter* No.69, May 1998;  
 Rob Bray, *Hardship in Australia* (Dept of Family & Community Services Occasional Paper No.4, 2001).  
 \* estimated at an average of 1.2 times Henderson

Income Support system justified by need to avoid 'poverty'.

But 'poverty' is a highly politicised and essentially contested concept.

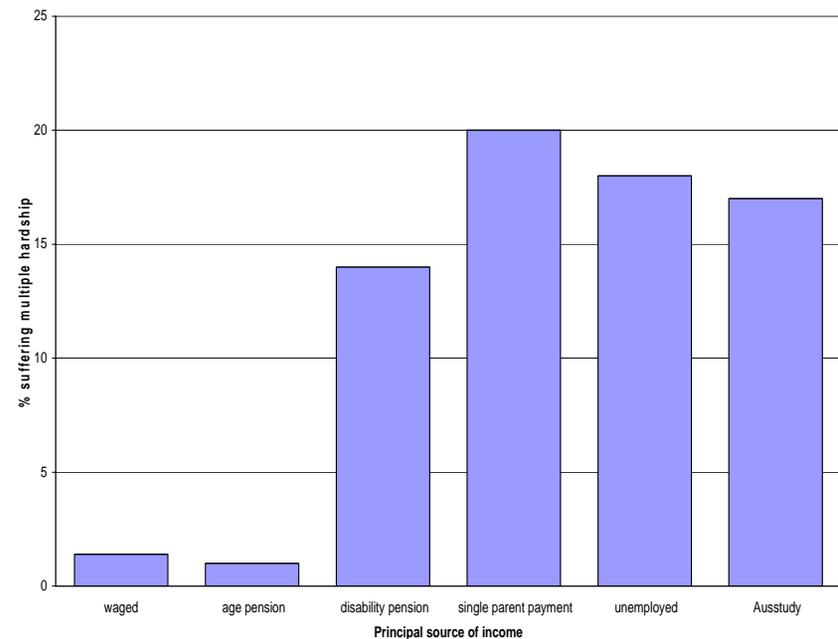
All poverty measures should be treated with extreme caution.

# ‘Poverty’ almost entirely a function of joblessness

Low income (or ‘poor’) households are overwhelmingly those where no adults of working age are employed.

True in all surveys (e.g. NATSEM/Smith Family finds 31% welfare households ‘poor’ cf 3% waged households)

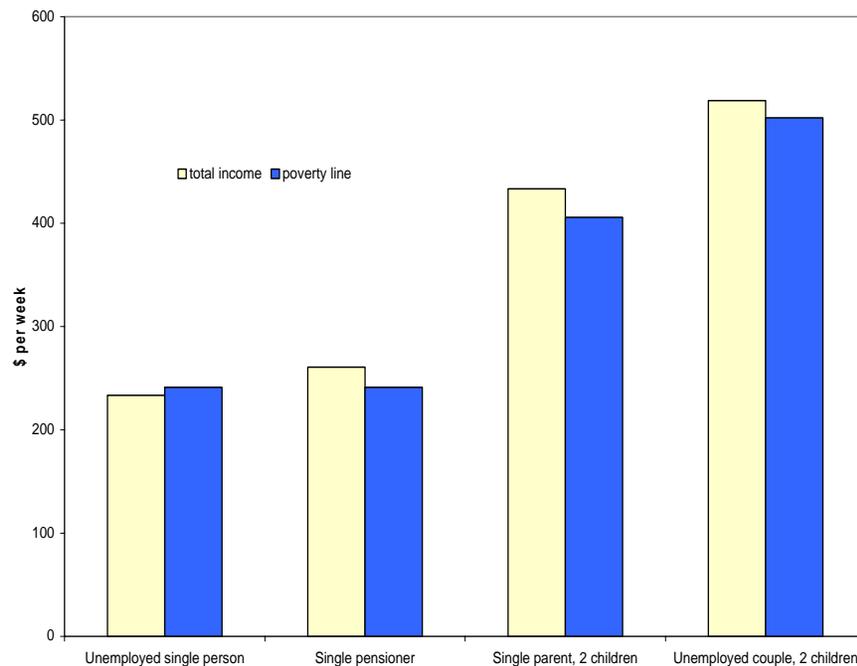
Principal source of household income and ‘multiple deprivation’



Source: Rob Bray, *Hardship in Australia* (Dept of Family & Community Services Occasional Paper, No.4, 2001, Table 15)

## No case for raising value of benefits

Welfare payments compared with the Henderson poverty line



Source: Melbourne Institute of Applied Economic and Social Research, *Poverty Lines: Australia* (March Quarter 2003)

- Henderson poverty line has become increasingly generous— today it would buy 37% more than it would have done in 1973.
- Yet the value of benefits is still above the Henderson line in nearly every case.
- Increased benefits would weaken work incentives, increase taxes, increase EMTRs for those leaving welfare.

## Welfare treats the symptom, paid employment treats the cause.

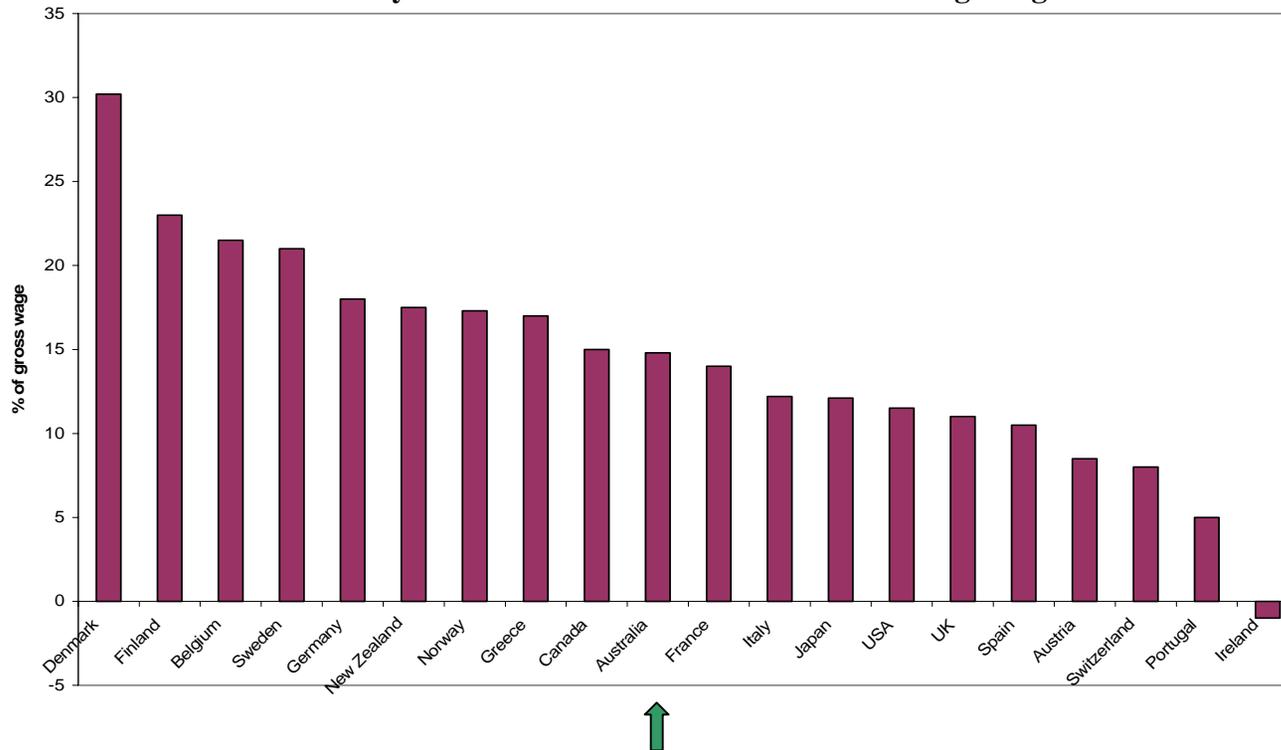
This implies a three-fold package:

- *Tax reform* to improve work incentives
- *Labour market reform* to generate more jobs (especially for lower-skilled workers)
- *Welfare reform* to reduce dependency and encourage self-reliance

# (1) TAX REFORM:

## Not true that tax on incomes is ‘low’ by international standards

Net income tax and social security deductions (after receipt of cash benefits) for family of two adults and two children on average wage



Source: OECD, *Taxing Wages 2002* (OECD Paris 2003)

# Bracket creep

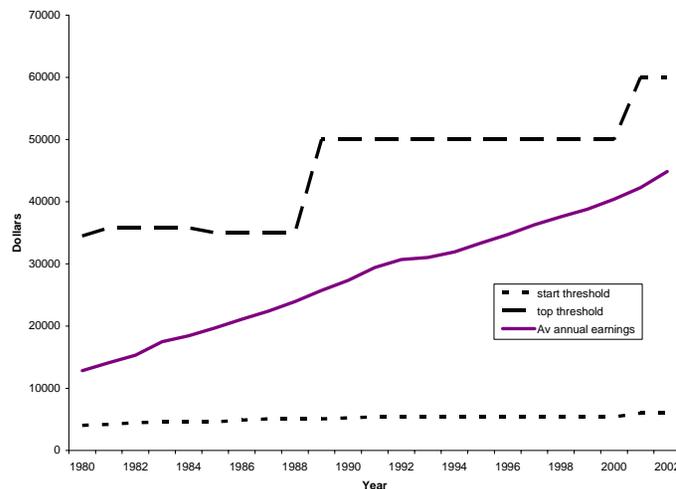
## Top rate:

- In 1980 the top rate of tax (then 60%) started at \$35,000 – 3 times average income.
- Today, top rate (47%) starts at one and one-third times average income.

## Tax-free threshold:

- In 1980, you paid no tax on first \$4,041 (one-third of average earnings).
- Wages up 350% since 1980 but tax-free threshold only increased 50%, to less than one-seventh average earnings.

Average earnings and tax thresholds 1980-2002



Source: Bendzulla Actuarial Pty Ltd website ([www.bendzulla.com.au](http://www.bendzulla.com.au))

# Tax strategy: Raise tax-free thresholds above welfare floor (and keep them there)

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*Principle:* Earn your subsistence before you are taxed

Reduce (eliminate?) tax/benefit churning:

Nobody on welfare pays tax

No taxpayer gets welfare

Children get own tax-free threshold

No other earnings top-ups

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*Avoid tax credits* (another welfare payment with disincentive effects):

Gradual taper traps middle/high earners (UK 83% of families)

Steep taper creates high work disincentives in middle range

*Tax credits also:*

Penalise second earners

Encourage fraud

Expensive & politically irreversible

## A politically attractive strategy!

### 4. At what level of annual earnings do you believe people should start to pay income tax?

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid On every dollar they earn, right from the first dollar	217	3.8	3.8	3.8
On earnings above \$6,000 per year (as now)	764	13.4	13.4	17.1
Not until they earn above the basic welfare benefits level	2445	42.7	42.7	59.9
Not until they earn above the minimum award wage	2014	35.2	35.2	95.1
People should not have to pay income tax at any level	230	4.0	4.0	99.1
Don't know/no opinion	51	.9	.9	100.0
Total	5721	100.0	100.0	

## (2) LABOUR MARKET REFORM

**To get more people into work we need more jobs**

Job subsidies/public sector job creation do not work:

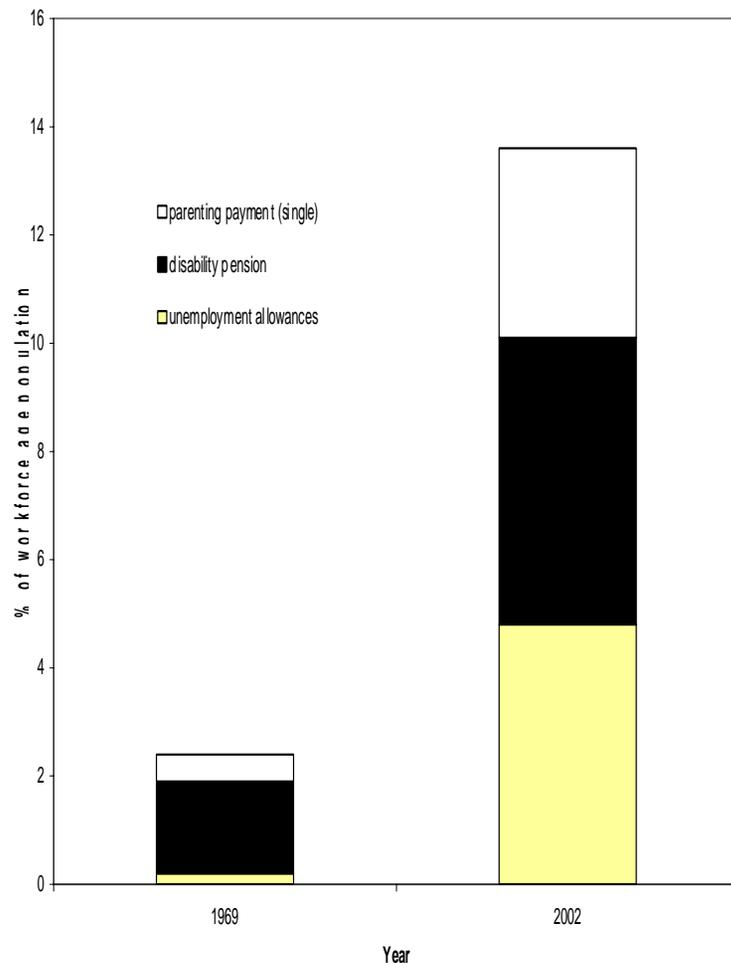
- Substantial deadweight effects & displacement effects
- “Negligible impact on long-term job prospects” (John Freebairn)
- “been of little success in helping unemployed people get permanent jobs” (OECD)
- “variable but usually small effects” (Productivity Commission)

## **Need more flexibility to encourage employers to take on more workers (esp. lower skilled)**

- *Award System*: Regional variation, easier exemption, opt-outs under common law with voluntary mediation
- *Minimum wage*: 2<sup>nd</sup> highest after France. Safeguard take-home pay with higher tax thresholds
- *Job-destroying regulations*: e.g. Reform Unfair Dismissal Laws for small employers (70,000 extra jobs)

# (3) WELFARE REFORM

## (starting with Working Age Income Support)

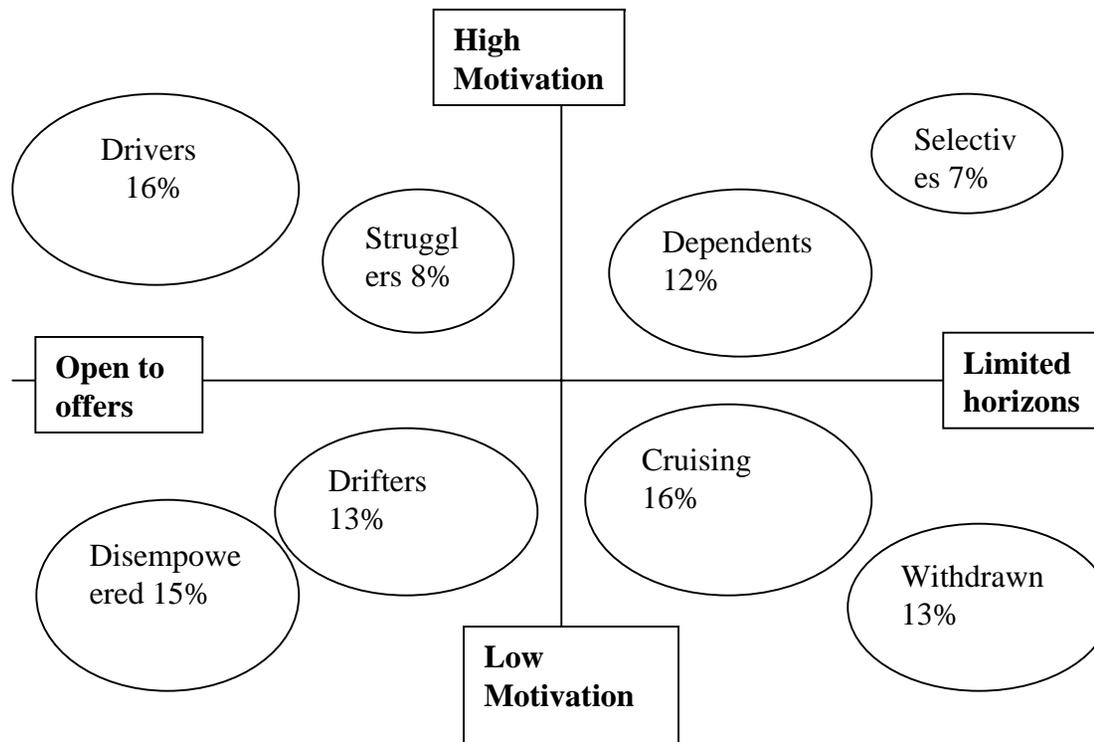


- 1969: <5% adults below retirement age drawing welfare payments.  
Today: >20%
- 1965: 22 income tax payers for every 1 person reliant on welfare payments.  
Today: 5
- 1 in 6 working-age adults now depend on welfare for 90%+ of their income
- Working-age welfare dependency is concentrated in 3 groups:

the unemployed  
people on disability support  
parents on Parenting Payment (Single).

# Reforming Unemployment Benefits

“Disadvantaged people without jobs find no end to reasons why working is impossible for them... They avoid personal responsibility and blame circumstances beyond their control...a mentality is at work that refuses to believe that opportunity exists, even when it does” (Lawrence Mead)



Source: Colmar Brunton Social Research, *Job Seeker Attitudinal Segmentation: An Australian Model* (report for the Dept of Employment & Workplace Relations, 2002)

## Solution: Time Limits followed by WfD

Half registering as unemployed find a job in 8 weeks, but more than half have been claiming benefits for more than a year > disillusion & unemployability

“Compulsory participation in programs can generate a *compliance (or motivation or deterrence) effect...* some job seekers increase their job search activity and find employment, or those inappropriately claiming income support stop doing so”  
(Productivity Commission)

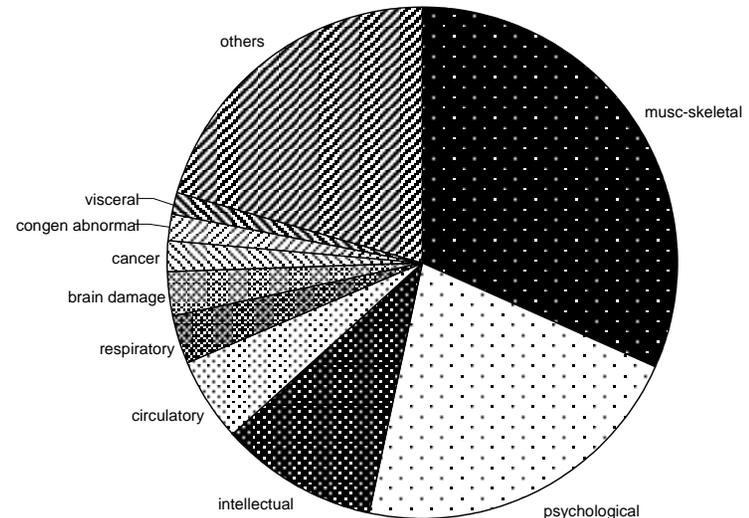
**3 It has been suggested that unemployment benefits should be limited to a period of six months, after which people would be expected to participate full-time in a 'Work for the Dole' scheme until they find a job. Do you think this is:**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	A very good idea	170	36.4	36.5	36.5
	A good idea	156	33.4	33.5	70.0
	No strong feeling either way	39	8.4	8.4	78.3
	A bad idea	67	14.3	14.4	92.7
	A very bad idea	34	7.3	7.3	100.0
	Total	466	99.8	100.0	
Missing	System	1	.2		
Total		467	100.0		

# Reforming Disability Pension entitlement

- Proportion of working-age population on DSP increased from 2% to 5% since 1980. Half of all disability pensioners are recruited from long-term unemployment.
- Strong incentives for unemployed to get reclassified as ‘disabled’: not subject to mutual obligation activities and receive a higher payment.
- A majority suffer from bad backs (‘musculo-skeletal’) or depression.
- Attempts to tighten eligibility rules are stalled in the Senate (yet 63% public support reform).

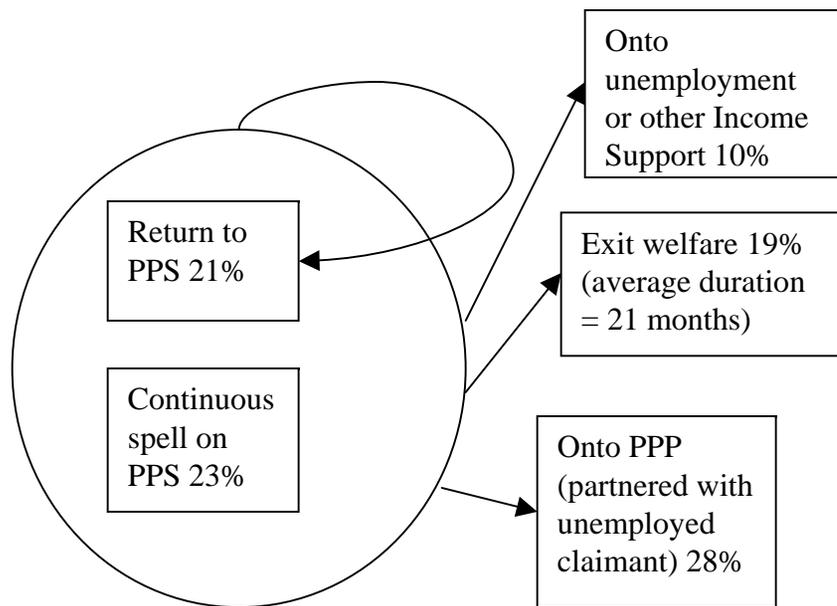
Main disability recorded for Disability Support Pension recipients aged 16-65



Source: Australian Bureau of Statistics, *Australian Social Trends 2002: Income and Expenditure, Income Support, Trends in Disability Support* (Commonwealth of Australia, 2002)

# Reforming Parent Payment

What happened over the next 66 months to sole mothers on Parenting Payment in January 1995



Source: Bob Gregory, Keynote Address to Australian Institute of Family Studies Conference, Melbourne, 2003

- 10% of lone parents do not claim PP(S), but 1/3rd have no income other than PP(S), and another 20% rely on PP(S) as their principal source of income.
- Proportion of working-age women receiving PP(S) has risen from 1% to 6% since 1969.
- Average duration of each PP(S) claim is 2 years, but Gregory estimates PP(S) claimants spend an average of 12 years on welfare, switching between benefits.
- 3/4 return to welfare within 6 months of leaving PPS (43% within one month).

## Solution: Employment once youngest child starts school

Most countries require single parents to move into PT (or even FT) work by the time the youngest child starts school.

Employment improves wellbeing of claimants and their children (especially into adolescence).

### 3. When do you think it is reasonable to expect a sole parent to go out to work part-time?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	By the time the youngest child reaches its first birthday	346	6.0	6.0	6.0
	Once the youngest child is old enough to attend pre-school	1906	33.3	33.3	39.4
	Once the youngest child starts primary school	2563	44.8	44.8	84.2
	Once the youngest child goes to high school	488	8.5	8.5	92.7
	Once the youngest child turns 16	354	6.2	6.2	98.9
	Don't know/no opinion	64	1.1	1.1	100.0
	Total	5721	100.0	100.0	

## Summary of Policy Recommendations

- No increase in value of benefits; no tax credits
- Tax-free thresholds raised above welfare floor
- Children get own threshold allowances/credits; no other in-work benefits
- Reform award system, freeze minimum wage, stop deterring job-creation with over-regulation
- Six month time limit on unemployment benefits (then WfD)
- Tighten DSP eligibility – return to 1980 levels
- Part-time employment requirement for any parents with school-age children seeking to claim welfare
- (Future) Reform superannuation; transition to individual accounts for retirement, sickness, unemployment