Incentives and capabilities:

Strengths and weaknesses in Australian welfare to work policy

Peter Davidson,
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What should welfare to work policy do?

- Assist jobless people to improve their living standards and choices in life through paid employment.

- But not all income support recipients need, or will benefit from, welfare to work strategies.
Reliance on social security has fallen as fulltime jobs have grown.

Workforce age social security recipients and growth in full time jobs: 1990-2002
As unemployment falls, those still left out are more disadvantaged

**Newstart & Youth Allowance (other) recipients**

- Long term (> 1 year)
- Very long term (> 2 years)
- Short term
An increasing % of recipients have disabilities or caring responsibilities

![Graph showing Workforce age payments]
Incentives and capabilities

**Capabilities** are people’s ability or freedom to exercise choices (Sen)
- e.g. skills and qualifications, demand for their labour

**Incentives** are those factors that influence people’s choices
- e.g. financial work incentives, alternative roles such as parenting
Incentives

**Financial**: benefits, wages, and work expenses

**Activation**: Activity tests & penalties

**Disabilities & caring roles**
Capabilities (& barriers)

- **Work capacities and barriers:**
  - skills, work experience, wages

- **Income:**
  - income support

- **Social capacities & barriers:**
  - disabilities & adverse social environments
Two welfare to work strategies compared

Anglophone countries (includes US, UK, Australia):
- Greater emphasis on individual agency
- Lower minimum wages to ease workforce entry – except Australia
- Lower benefits, in-work payments & ‘activation’ policies to maintain work incentives (despite low wages)

‘High employment’ Europeans (includes Scandinavians, Netherlands, Austria):
- Greater emphasis on State responsibility
- Higher wages and benefits
- ‘Activation’ policies to maintain incentives (despite high benefits)
- More investment in human capital to improve competitiveness
OECD analysis of two welfare to work strategies

Average benefit replacement rates, tax wedges, investment in LMPs per unemployed person as a % of GDP per capita, poverty line = 50% of median income.
1. Financial work incentives
OECD summary measure of benefits compared to wages

Benefits as a % of wages
(OECD summary measure - 2004)

Source: OECD 2006, Employment Outlook
- average of 4 family types, 3 wage levels, over 5 years of unemployment
- includes all major income support payments and income taxes.
Estimated costs and outcomes of policies to boost financial incentives

Melbourne Institute research:

- Earned income tax credit of up to $47pw for low wage-earning families:
  - boosts participation of 62,000 jobless families, but costs >$5,000 million p.a. ($80,000 each)

- Ease Newstart Allowance taper rate from 70% to 60%:
  - ‘effects are small’
  - (cost = $250 million p.a. when implemented in 2006-07)

2. Activation and compliance
Typical activity requirements

- Attend Centrelink & Job Network regularly
- Approach up to 10 employers per fortnight (6 for sole parents & people with disabilities)
- Accept jobs at all wage & skill levels (part time for sole parents, people with disabilities)
- Job search training after 3 months
- Mutual obligation after 6 months
- Intensive job search in Customised Assistance after 12 months
- Payments suspended if in breach
- Loss of 8 weeks benefits for 3 breaches or leaving a job voluntarily
Australian system is relatively tough

Benefit sanctions as a % of claims (1998)

Source: Grubb 2000, Eligibility criteria for unemployment benefits, OECD.
Effects of activation and compliance

1. Can speed progress to employment if activity requirements were ‘weak’:
   ○ UK - 6 month ‘Restart’ interviews increased employment prospects by 6% after 12 months
2. But impact is less if system is already ‘tight’:
   ○ 9 month review interviews in Oz had no effect
3. Less effective for more disadvantaged people:
   ○ e.g. job seeker diary in Oz
4. Biggest gains are when activation is combined with intensive employment assistance:
   ○ UK - New Deal for Young People
5. Penalties need not be large to have effect:
   ○ Study of penalties in Rotterdam, Netherlands
3. People with disabilities and caring roles

The income support system is based on, and reinforces, their ‘distance from employment’:

1. *Pensions* are paid to those with greatest distance from employment
   - higher rates, limited employment assistance

2. *Allowances* are paid to ‘unemployed’ people
   - $30 to $165pw less for people with disabilities & sole parents, more employment assistance
Fairer and simpler income support system

1. Payment rates based on need (pension rate plus supplements, including for costs of disability)

2. Disabilities and caring roles still recognised through separate payments

3. Activity requirements take better account of disabilities and caring roles
4. Work capacities and barriers
Bias in jobs growth to high skilled and service jobs: Index of job growth 1995 = 100

Source: Hart (Labour Market Strategies Group, DEWR), Job Prospects, Skill Shortages and Job Outlook, CEET Conference 2005
Many income support recipients have Year 10 education or less

- 62% of people with disabilities
- 72% of jobless Parenting Payment recipients
- 64% of those on Newstart Allowance for 2 years or more.

Source: ACOSS 2005, Participation or punishment.
Australian investment in employment assistance is relatively low

Effects of employment assistance programs

Typical increase in employment prospects:
- 0% to 7% for job search support & counselling
- 0% to 8% for medium to long term training
- 3% to 14% for wage subsidies

Best results where job search support is integrated with other forms of assistance.

Job Network model

**Strengths:**
- Focus on outcomes
- Job seeker account to invest in most disadvantaged

**Weaknesses:**
- Limited resources and incentives to invest
- Over-emphasis on short term outcomes
- Over-emphasis on welfare compliance
- Trend towards micro-management of contracts
5. Social barriers to work

Disabilities
○ Trend to higher-productivity jobs disadvantages many people with disabilities

Mental health conditions
○ Poorer job prospects than people with physical disabilities

Adverse social environments
○ Families or communities disengaged from labour market
○ Violence
Incidence of ‘social barriers’

- 45% of PPS, 30% of DSP recipients, and 35% of long term NSA recipients have mental health conditions.
- 48% of PPS recipients experienced personal violence at some stage in their lives.
- 12% of PPS recipients, 6% of NSA recipients and 7% of DSP recipients considered suicide in the past 12 months.
- These conditions are often linked to labour market conditions – e.g. prolonged unemployment.

6. The importance of income support

- An adequate income is essential for effective job search
- Well designed income support systems connect people to the formal labour market
- People lacking income support are more likely to drift out of it
- When Governments provide income support they are more strongly motivated to invest in welfare to work programs
The weakest link?

Work incentives are \textit{relatively} strong and compliance systems are strict:
- Higher wages & lower benefits than most OECD nations
- Rigorous activity requirements & severe penalties

But investment in capacity building is lacking:
- A growing % of recipients is disadvantaged
- Investment in employment and training is inadequate
- Need for comprehensive support to overcome social barriers
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