

Adequacy of Newstart

Submission to the Standing Committee on Community Affairs

‘Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing, and medical care and necessary social services’. The Universal Declaration of Human Rights, Article 25

Submission

David Richardson

Sept 2019

ABOUT THE AUSTRALIA INSTITUTE

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals and commissioned research. We barrack for ideas, not political parties or candidates. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

OUR PHILOSOPHY

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

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

OUR PURPOSE - 'RESEARCH THAT MATTERS'

The Institute publishes research that contributes to a more just, sustainable and peaceful society. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

The Institute is wholly independent and not affiliated with any other organisation. Donations to its Research Fund are tax deductible for the donor. Anyone wishing to donate can do so via the website at <https://www.tai.org.au> or by calling the Institute on 02 6130 0530. Our secure and user-friendly website allows donors to make either one-off or regular monthly donations and we encourage everyone who can to donate in this way as it assists our research in the most significant manner.

Level 1, Endeavour House, 1 Franklin St

Canberra, ACT 2601

Tel: (02) 61300530

Email: mail@tai.org.au

Website: www.tai.org.au

ISSN: 1836-9014

Summary

We think it terribly important that Newstart and poverty measures be explored and discussed in Australia. Just the facts can be so powerful influencing policy makers.

This submission notes that Newstart has not been adjusted since March 1994 other than for the CPI so in real terms Newstart has been unchanged while the rest of the world moved on. The CPI increased just 86 per cent since 1994 while per capita household disposable income, a measure of community standards, increased by 172 per cent. If we compare Newstart with the minimum wage or average weekly earnings we obtain a similar result.

Poverty measures are important when discussing Newstart. The closest thing we have to an official poverty line is the Henderson Poverty Line which dates back to 1973. It is important that the meaning of poverty be readdressed and updated to fit contemporary conditions. Nevertheless, we here rely on the Henderson measure in examining the adequacy of Newstart and use a hypothetical unemployed family of four, two adults and two children.

Compared with the Henderson poverty line that family came from well below the poverty line and almost reached it in 1976 only to see their income eroded again until it began to increase in 1983 and peak in 1992-3. Since then that family's income has been in steady decline until four or five years ago when it was 23 per cent below the poverty line. Since 2014 the economy has been flat and per capita incomes have fallen with the result that the Henderson poverty line has been reduced which has made our hypothetical family look better off at around 20 per cent below the poverty line.

To redress this situation there has been a big debate about increasing the dole with an immediate \$75 per week increase being commonly advocated. We argue in this submission that the actual increase needed is much more than \$75 and more likely in the region of \$200 a week, just to get back to the poverty line. The government has not accepted those calls and suggested that Newstart is only a temporary payment while people are between jobs. However, the government's own figures show the average duration on Newstart is 156 weeks. Meantime there has been a lot of blaming of the victims as job snobs and whose payments have had to be cancelled. We argue that blaming the victims is particularly unfortunate when government policy is to target unemployment rates of 5 per cent—the so-called 'natural rate of unemployment' consistent with the 'full employment level of unemployment'.

To reinforce some of our points we make some international comparisons using OECD data. First, we can ask how an Australian might fare if they lose a job paying 67 per cent of the average wage. For a single person Newstart replaces 39 per cent of their previous wage which puts Australia equal bottom with Greece. Similarly for someone on the minimum wage

Australia's replacement rate is third from bottom. Relative to OECD poverty measures Australia does slightly better and is about mid-way in a comparison with other countries. However, some countries pay rates that exceed the poverty lines as Australia did in the mid-1990s. The UK and northern European countries perform much better than Australia while countries from the former USSR and southern Europe tend to be worse than Australia.

The terms of reference raise many other issues and we attempt to address many of those. An important theme is that cash assistance is often insufficient for people who might also have health, training, and other needs. We also note the fact of unemployment over a period of time has a detrimental impact on people and reduce their chances of ever finding work. We argue that the concept of a natural rate of unemployment has had a particularly cruel impact on the unemployed who are expected to bear the brunt of an anti-inflationary macroeconomic strategy yet are blamed for being 'job snobs' or worse. A higher Newstart allowance can assist people with their health, appearance and mobility which may assist a transition back into work.

People who might otherwise be sympathetic to an increase in Newstart nevertheless suggest that a low Newstart provides the stick to get people back into work. If that thesis is correct then we should find that countries that replace a higher proportion of a workers' previous wage would experience higher unemployment. We were able to examine the data on that and found the opposite. On average those with better replacement rates have *lower* unemployment rates.

An important part of the debate relates to the cost of increasing Newstart. Estimates we have seen are based on an unambitious unemployment rate of 5 per cent. We make the point that any cost attributed to Newstart is an admission of failure to reach full employment which should be the over-riding goal.

Boosting Newstart would make an important contribution to reducing inequality and should be seen as part of an inequality reduction program. Accordingly we outline some of the important benefits of reducing inequality including the positive impacts on other economic outcomes.

This submission deliberately avoids recommending a specific amount by which Newstart might be increased. However, we noted a number of indicators that suggested something of the order of \$200 to just under \$300 a week for our representative family of four. It is urgent that Newstart is much more adequate than now.

Contents

Summary	1
Introduction	5
Adequacy.....	7
A long time to wait for a real increase.....	7
Poverty measurement	9
How do government payments fit in with the henderson poverty line?	10
Recent debates	12
\$75 a week increase in Newstart.....	16
Newstart at 25% average weekly earnings.....	16
International Comparisons	17
Newstart relative to previous wage.....	17
Relative to poverty indicators.....	19
Other considerations	22
Structural unemployment.....	22
The changing nature of work and insecure work	22
Impacts.....	23
Economic cost	24
Hysteresis	24
Benefits of a better deal for the unemployed	26
Relationship between income support payment levels, minimum wages and wage stagnation in Australia and other comparable economies	27
Rate of Newstart and incentives to work	29
The cost and fiscal sustainability of any changes	31
The relative merits of alternative investments in health, education, housing and other programs to improve outcomes	32

Other countries' approaches to setting income support payments, minimum wages and awards.....	32
Why we have minimum wages	33
Any other related matters	33
Inequality, equality and economic performance.....	35
Conclusions	39
List of recommendations	40
References	42
Terms of reference.....	44
Attachment	46

Introduction

The Australia Institute welcomes the opportunity to make a submission to the *Community Affairs References Committee* on the inquiry: *Adequacy of Newstart and related payments and alternative mechanisms to determine the level of income support payments in Australia*. This submission includes a brief on unemployment and Newstart by Raja Junankar as an appendix.

We think it terribly important that Newstart and poverty measures be explored and discussed in Australia. Just the facts can be so powerful influencing policy makers.

The late Tony Atkinson gives the example of Sir Winston Churchill who, in 1901, reported he had been reading an account of poverty in York and is quoted as saying:

I have been reading a book which has fairly made my hair stand on end [which] deals with poverty in the town of York. It is found that the poverty of the people of that city extends to nearly one-fifth of the population....That I call a terrible and shocking thing (Cited in Atkinson 2019).

Apparently this account contributed to Churchill leaving the Conservative Party and joining the Liberal Government in 1906. As a Liberal Minister Churchill introduced labour exchanges and unemployment insurance. Incidentally, Churchill was in a position to read about the numbers of poor people in York in 1901 but Australia does not have an official estimate of the numbers in 2019.

A similar chain of events beginning with US President John Kennedy learning about the extent of poverty ultimately resulted in President Johnson's *War on Poverty* (Atkinson 2019). These estimates show the extent to which modern economies fail to address the hopes and aspirations of many of the residents of those economies. The facts and the shame that goes with them should be a powerful motivator for governments to get things right.

An official poverty line and measures of those in poverty in Australia should be the basis of policy making especially in relation to programs such as Newstart that specifically aim to relieve the hardship experienced by different population groups.

This submission will also address the cost of introducing an adequate unemployment benefit. However, whatever the cost might be Australia as a society can afford to spend big on flat TV screens and submarines but reveals by its inaction that it ranks those things higher than lifting the unemployed above poverty incomes.

Any attempts to increase Newstart inevitably raise concerns about the cost. We might put it differently: the cost of Newstart reflects the failure to achieve full employment. Indeed, at

the moment any cost of Newstart is the cost associated with targeting 5 per cent unemployment as a definition of 'full employment'.

Adequacy

A LONG TIME TO WAIT FOR A REAL INCREASE

The last times Newstart was adjusted in real terms was in 2000 in compensation for the introduction of the GST and in 2013 as compensation following the introduction of the carbon price.¹ Arguably even those should be excluded since they were only ever to serve as compensation measures and were not supposed to be a real increase in living standards for those on Newstart.² Otherwise Newstart has only been adjusted by indexation against the Consumer Price Index. The last truly discretionary increase was in March 1994 (Baldwin 1994). Even then the increase was a modest \$0.85 plus the usual CPI increase bringing the March 1994 increase to \$3 a week. The one-off increase was 'aimed at improving the level of assistance for these people who the Government recognises as being in genuine need' (Baldwin 1994).

Since then (Mar 1994) community standards have increased substantially. The CPI has increased by 86 per cent to now (Mar 2019) while the community standard as measured by per capita household disposable income increased by 172 per cent. Not only that but some of the components of the CPI that fall heavily on the unemployed and other low-income earners have increased even more quickly than the rest of the CPI. For example, while the CPI increased 86 per cent food and non-alcoholic beverages increased by 96 per cent, rents have increased at a rate of 109 per cent, and utilities (electricity, water etc) have increased by a massive 410 (four hundred and ten) per cent.

Rent assistance on Newstart has increased by 101 per cent over this period and are now just \$68.60 a week (\$137.20 a fortnight) for a single. Rent assistance was never adequate and failed to rise with the rent component of the CPI. Of course, not all the CPI components increased by such amounts; overseas holidays increased by less than the CPI at 60 per cent but this item tends not to feature in expenditure by the unemployed.

We are also concerned that the figures for younger unemployed people are even lower. At present a 16-17 year old at home receives just \$124.60 a week and someone 18 plus receives \$149.90 a week. Everything else we say about Newstart rates in this submission applies even more strongly for these people. Similarly, Austudy at \$227.60 per week is an important issue but also raises the question of providing an incentive to go from student to unemployed status.

¹ This payment was ongoing and was indexed to the CPI but indexation ceased in September 2014.

² Typically people on government support spend more than they receive as they run down their assets. That is why the Howard Government was forced to make GST compensation payments on top of ordinary CPI adjustments.

Recommendation Newstart has to keep up with community standards and never again allowed to slip so far against community standards.

In 2014 Richardson and Denniss (2014) published a paper which looked at various aspects of inequality in Australia including the role of Newstart. That included a graph showing how Newstart, the minimum wage and average weekly earnings had moved relative to each other. Figure 1 updates that graph. The minimum wage is self-explanatory, the average weekly earnings series here is the total earnings for all employees and Newstart is the single rate. To facilitate comparisons each series is set at 100 for the year 2000.

Figure 1: relative movements in average weekly earnings, the minimum wage and Newstart.³

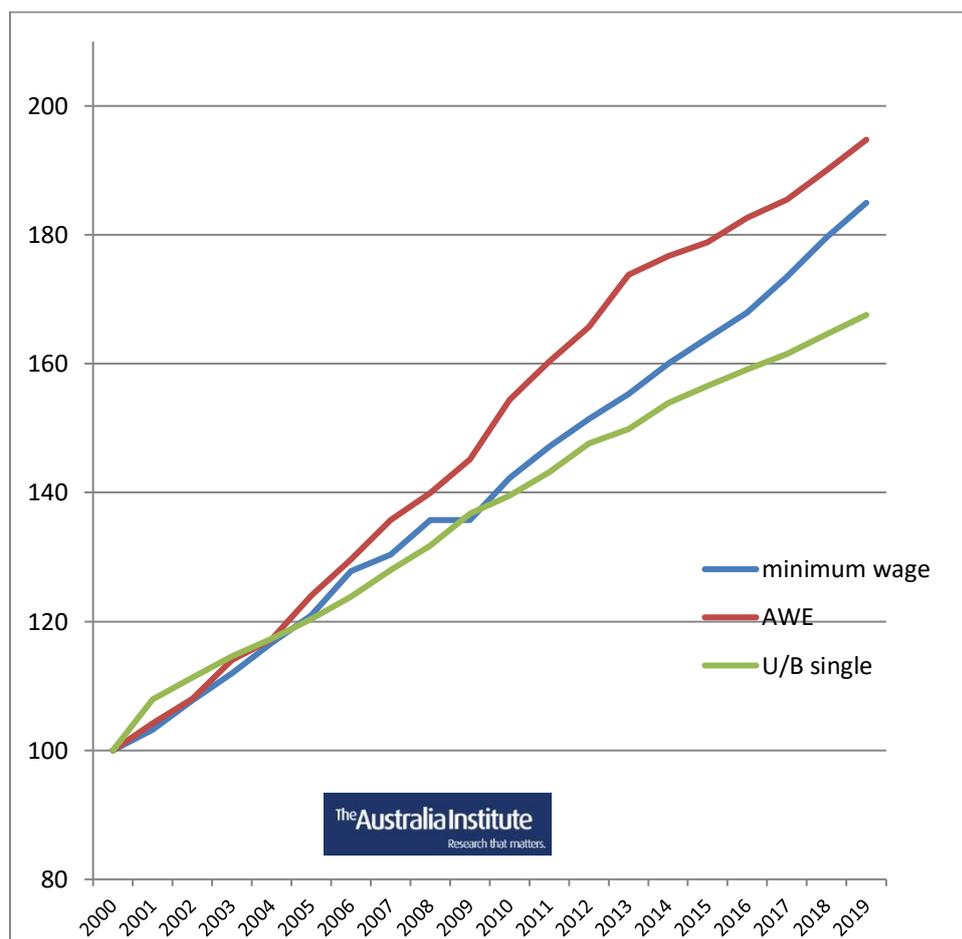


Figure 1 clearly shows that over the period since 2000 Newstart has fallen relative to both average earnings and the minimum wage. In line with the movements in the relative series in Figure 1, Raja Junankar (2019) has reported that Newstart has fallen from 19.6 per cent of average weekly ordinary-time earnings in September 2008 to 17.0 per cent in June 2019.

³ Sources: Author's calculations based on ABS Cat no 6302.0, Social Security Guide, 12 August, FairWork Commission (2019) The Australian minimum wage from 1906, 12 July.

POVERTY MEASUREMENT

Unlike many other countries the Australian government does not produce an official poverty line. In August 1972 the McMahon Government commissioned Professor Ronald Henderson to report on poverty and the Whitlam Government later expanded the terms of reference 'to focus on the extent of poverty in Australia together with the groups most at risk of experiencing poverty, the income needs of those living in poverty, and issues relating to housing and welfare services'.⁴ An enduring legacy of the report was the Henderson Poverty Line which is the closest thing we have to an official poverty line in Australia. In many countries the official poverty line is also the criteria for government assistance programs. Hence the eligibility for many state and federal programs in the US depends on a family's circumstances relative to the poverty line (Atkinson 2019).

The Henderson Poverty Line was calculated for a family of four in 1973 and updated since then by increasing the figure in line with national accounts data and specifically the per capita household disposable income. The first published figure applied to September 1973. Just the fact that the conceptual basis of the estimate dates back to 1973 suggests it is certainly time for reviewing the figure. But even then the Henderson figure was based on research in New York that looked at the required components of consumption before people could be described as out of poverty. As mentioned above there is now the problem that the relative prices of components of the CPI have changed dramatically which makes all the more reason for figuring out what a modern measure of poverty might mean.

The Henderson Poverty Line for a single allowee is \$529.57 per week and is equal to 62.5 per cent of the national accounts figure of household disposable income per head (HDI/head). However, that figure includes the additional costs of being in the workforce. Without that the Henderson poverty line falls to \$429.40 per week or 50.7 per cent of HDI/head.⁵

Equivalence scales

An important feature of any poverty measure is the equivalence scales that are used to adjust figures for a single adult to other family types. In other cases it may be other family types used as the standard and other ratios are used to derive figures for other family types. In any even equivalence scales need to be reweighted as part of a new review into poverty and the adequacy of Newstart.

⁴ <https://digitised-collections.unimelb.edu.au/handle/11343/126875>

⁵ The difference is reflected in the different poverty lines for pensioners who are assumed to be out of the workforce and allowees assumed to be in the workforce.

Recommendation A new inquiry should address what it means to be poor in Australia and what constitutes an up-to-date poverty line.

While the development of appropriate measures are important so too are commitments to meet the targets to ensure that Australians do not suffer poverty.

Recommendation An official poverty line be adopted and maintained on a quarterly basis.

Recommendation Governments should commit to meeting targets on poverty and making themselves accountable on that measure.

In the meantime the Henderson poverty line is perhaps the best we have and is relied upon heavily in the rest of this paper. However, it has to be borne in mind that other definitions suggest the poverty line should be drawn higher than the Henderson Poverty Line. For example, the OECD definitions used in the comparative discussion below are slightly higher than Henderson.

HOW DO GOVERNMENT PAYMENTS FIT IN WITH THE HENDERSON POVERTY LINE?

At March 2019 an unemployed single person on Newstart and receiving rent assistance received \$347.40 per week while the poverty line was \$529.57 for that person. That is a gap of \$182.17 per week. Evidently those who advocate an increase of \$75 a week mean well but that would still leave recipients more than \$100 per week below the poverty line. Similar considerations apply for a family of four; two adults and two children. The figures for these two examples are given in Table 1.

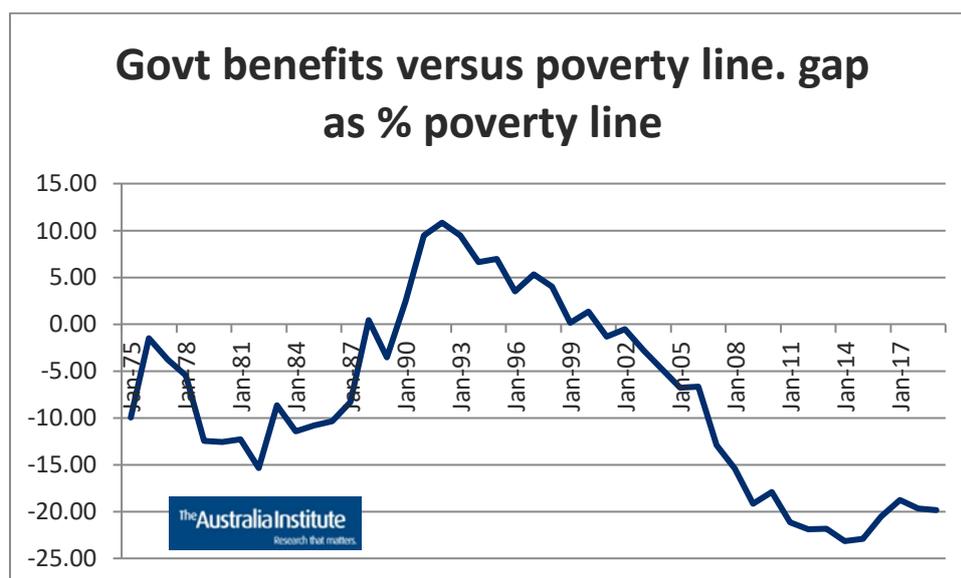
Table 1: Poverty lines, actual payments and gaps for two household types – Mar 2019

 The Australia Institute Research that matters.	Poverty line	Max payment	Gap
Single	529.57	347.4	182.17
Family of four	994.68	797.14	197.54

Source: Melbourne Institute Applied Economic and Social Research (2019) *Poverty Lines: Australia, March Quarter 2019*.

These are point of time estimates and it is important to realise that the gaps have not always been so large. Figure 2 examines how Newstart has fared over time against the poverty line. Where the graph line touches zero, payments for this family are the exact amount needed to be at the poverty line. Where the graph line is below it, the family is living below the poverty line. The axis shows the percentage by which the family is above or below the poverty line.

Figure 2: Newstart payments v Henderson poverty line



Source: Calculations by The Australia Institute based on Melbourne Institute of Applied Economic and Social Research, Poverty Lines: Australia (various issues)

Figure 2 clearly shows that, when considered against the poverty line Australian unemployed families have been on something of a roller coaster. In the campaign leading up to the 1987 election the then Prime Minister Bob Hawke made the famous promise that “by 1990 no Australian child will live in poverty”. That promise has been ridiculed ever since by cynics, but few people have looked at the facts. Around that time there were enormous changes introduced under the then Minister for Social Security, Brian Howe. Increases in income support and family payments significantly increased incomes and the impact is best illustrated by taking the example of an unemployed family of four, two adults and two children, and examining how their income moved relative to the Henderson poverty line. This is represented in Figure 2, which begins in 1975 when the Henderson report was first released. At the time, payments for that family were almost 10 per cent below the poverty line but increased substantially under Whitlam.

After Hawke made ‘that promise’, our representative family had indeed moved above the poverty line. By the early 1990s their income had peaked at just a bit more than 10 per cent above the poverty line. The movement relative to the poverty line has been downward ever since. By the early 2000s this family was back on the poverty line. By June 2012 the family was 20 per cent below it – much worse off than when Hawke made his original promise. Indeed, to get back to the early 1990s against the Henderson poverty line might require an increase of 37.5 per cent or \$299/week for our representative family of four.

Of course poverty is relative and the Henderson poverty line was deliberately designed so that it would keep up relative to the rest of society. Even though payments have been indexed ever since the early 1990s, such a long period of time has elapsed that the payments continue to fall further behind community standards – we take this up below.

The up-tick in the graph from around June 2015 is an artefact of the slow down in per capita household disposable income. Newstart continues to be indexed but per capita household disposable income failed to keep up with inflation. If the latter had increased by just 2 per cent per annum since June 2015 then the poverty gap would now be 25 per cent below the poverty line. There have been references to ‘per cap recession’ in media commentary⁶ which has been associated with the sluggish economy and the shift in incomes towards non-labour incomes. That perhaps is an important limitation of any poverty measure based on a ratio to a national accounts figure. In the short to medium run improvements may reflect downturns in the economy rather than genuine improvements in the living standards of those on Newstart. It is like trying to measure distances with a ruler that has shrunk. Nevertheless, any measure that can keep up with community living standards is likely to have this limitation. Australia’s experience and the dramatic features of the graph in Figure 2 illustrates just how far a government payment can rise and fall against community standards.

Atkinson (2019) makes the point that poverty lines need to be frequently updated to keep up with community attitudes. Atkinson describes the differences between measures based on ‘absolute’ measures of poverty and relative measures. Absolute measures tend to be based around physiological minimum standards for survival. While absolute measures that do not change over time may be appropriate for third world economies it is important to note his observation that above a certain level of income countries invariably talk about poverty in a relative sense.

However, there are cases such as in the US where it is the government that defines the poverty line used for certain income support payments and, as a cost savings measure, definitions are decades old. This creates a difference between official measures for policy purposes and the ‘supplemental poverty measure’ which is updated to give up-to-date measures of poverty that are not used for official purposes.

Recommendation The Committee should note that Newstart for a family of four had almost reached parity with the Henderson line in the mid-1970s, exceeded it in the early 1990s but has been declining ever since and is now well below the poverty line. Government should again set targets to exceed appropriate poverty measures.

RECENT DEBATES

The recent debates and commentary have been dominated by the proposal to increase Newstart by \$75 per week. Almost nobody seems to be opposed to attaining at least that except for some government front benchers. Even the Prime Minister has not denied that it is a good idea but suggests he has other priorities which he made clear in Parliament when he said:

⁶ For example Letts (2019)

Our government has set priorities on investing in health, in schools, in education, in mental health, in combating the terrible curse of suicide in our country and in supporting our veterans. We have made those choices about «priorities» rather than increasing the size of the welfare budget. (Morrison 2019)

This followed a question that went to the adequacy of Newstart and whether the Prime Minister could live on \$40 a day.

The government's labour market policy is in a logical bind because its macroeconomic policy is inconsistent with its microeconomic policy insofar as it applies to the labour market. On the one hand it targets the NAIRU which ensures that unemployment will not go much below 5 per cent.⁷ On the other hand it consistently spruiks its labour market policies as designed to get the unemployed back to work. This is implied by its slogan 'the best form of welfare is a job'.

In Parliament following a question on the adequacy of Newstart, the Prime Minister, Scott Morrison said:

the most important support that is provided by this government is to ensure that people can get off welfare and into work...The best form of welfare is a job. ... Our government will not rest until we get all of them into jobs, because that's the pledge we made at the last election: 1¼ million new jobs over the next five years (Morrison 2019).

This definitely sounds like he wants to assure us that all of the unemployed will get a job and that he really means to get a job for all the unemployed. And that becomes his excuse for ignoring the plight of people trying to live on the inadequate Newstart Allowance. If the Government is going to get you a job soon then why do you need a higher allowance? Indeed, on that issue he also accused the Opposition of 'unfunded empathy' (Morrison 2019).

The idea that Newstart is a temporary payment for people between jobs may well reflect its history given it was introduced at a time when unemployment was always less than 2 per cent. The Treasurer reflected this when he said that the dole was only ever intended to be a temporary payment while people find another job and, indeed, two-thirds of people going on to it move off within 12 months (Gittins 2019).

Raja Junankar (2019) reports official figures that show the duration of people on Newstart was 156 weeks at December 2018. But notice that the recorded duration of people on Newstart does not tell us how long it takes to get off Newstart. Suppose you did a survey and found the average age in Australia was 38. That does not tell you how long people are likely to live - you must roughly double it. The same is true when we go from average duration figures to likely length of time on Newstart. So those duration estimates give you roughly half

⁷ This is documented in Richardson (2019).

the time people can be expected to spend unemployed which implies the average spell on Newstart is likely to be around 312 weeks.

Recommendation Newstart has to be recognised a form of long term support for many people.

As an aside we might well agree that a job beats welfare and note that there are many people putting a strong case for a “guaranteed Job program” (GJP) including Democrat presidential candidates. There are of course numerous precedents in Australia and elsewhere of programs that go some way towards the GJPs. Australian examples include Landcare and the Regional Employment Development Scheme. While discussion of the GJP takes us too far afield for the present inquiry this Committee may nevertheless wish to consider recommending an inquiry into these ideas.

The other tactic is to blame the victim. The Minister for Employment poured fuel on the fire when she released data which was reported as would be expected: it was reported under the headline ‘Welfare crackdown: Majority of job-seekers lose pay over missed meetings’ (AAP 31 July 2019). The article went on to say: ‘New figures released by Employment Minister Michaelia Cash show nearly four in five of the 744,884 Jobactive participants had payments suspended at least once in the 12 months to the end of June’. TV program ‘Sunrise’ was forced to apologise after it took the bait and referred to ‘dole bludgers’ (The New Daily-31 Jul 2019).

In 1999 when Tony Abbott was employment minister in the Howard Government he referred to the unemployed (or a good many of them) as ‘job snobs’ (Castles 2014). Later on he was elaborating when he said:

people in regional areas would rather be unemployed than work in jobs such as fruit picking and cleaning. This idea that you can be unemployed on benefits in a town where you can't get fruit pickers...it's just wrong (Peatling 2016).

Abbott might have added that the unemployed have other options such as busking or windshield washing. Later, when Abbott became Prime Minister, his first budget proposed some particularly cruel measures for the unemployed (Australian Government 2014 BP no 2). For example, one of the Abbott Government’s measures was to deny the unemployed the dole for months in order to discourage unemployment. Fortunately the worst features of the 2014 horror budget never made it through the Senate.

While on the point of blaming the victims it should be noted that we often hear attacks on welfare that are really code for attacks on the unemployed. It is suggested that welfare cheats are costing taxpayers a fortune. In fact a quick examination of the budget papers shows that outlays on Newstart are around 0.2 per cent of the budget and it is only ever suggested that a small fraction of that be recovered by specific measures the government may announce from time to time.

The second way the language is unhelpful is the free pass it delivers to governments. By sheeting home responsibility to the undeserving, Morrison (and others before him) fail to properly interrogate what might actually be going on....If being stuck in a poverty trap is the fault of the individual, then governments, wonderfully, fortuitously, are off the hook. There is no need to investigate whether we are making a choice in this country, either consciously or unconsciously, to fail a group of fellow citizens, and in doing that, failing an important ideal of ourselves (Murphy 2019).

The effect of targeting a 5 per cent full employment rate of unemployment means the government is thereby using macroeconomic management to keep the Australian economy below its potential. The unemployed are clearly the main victims. By targeting a fixed unemployment rate the government is essentially trying to keep their numbers constant as a proportion of the workforce. This means that as people are assisted into work they necessarily displace other people at least in aggregate. That is important given that the government does undertake programs designed to assist some workers. At best such programs merely rotate a subgroup of the workforce in and out of unemployment. Given that official unemployment is much less than the real number as outlined above, we can assume that a 5 per cent target involves many more people are suffering a life of actual unemployment with temporary bouts of employment.⁸

Despite Morrison trying to suggest he can find jobs for all the unemployed, no matter what carrots and sticks they use the NAIRU target dooms large numbers to unemployment. The various labour market programs at best churn people in and out of precarious employment without accommodating macroeconomic policies.

Nothing here should be taken as suggesting that labour market programs themselves are a waste. In a buyers' market the prospects of all unemployed would improve through targeted training and other programs and it is also important that governments develop people's skills so their experience in the labour market will be better irrespective of the state of the labour market.

Recommendation Australia should cease blaming the unemployed who are victims of a macroeconomic policy that has long ago forsaken genuine full employment.

Recommendation Australia should again embrace a genuine full employment policy.

⁸ See Howe (Independent Inquiry into Insecure Work 2012) on insecure work.

\$75 A WEEK INCREASE IN NEWSTART

The Parliamentary Budget Office estimated the cost of increasing Newstart and similar allowances by \$75 a week.⁹ Their figure is \$3.6 billion in the first two years rising to \$4.2 billion in the year 2022-23 for a total of \$15.0 billion over the forward estimates.

NEWSTART AT 25% AVERAGE WEEKLY EARNINGS

The Whitlam government in February 1973 increased the standard rate of unemployment and sickness benefits by discrete amounts above indexation and set about to bring them to parity with the age pension. Whitlam had promised before the 1972 election that the age pension itself would be lifted to 25 per cent of average weekly male earnings in a number of discrete increments until the target was reached (this par relies heavily on Kewley 1980). So effectively the unemployment benefit was also tied to male average weekly earnings. The same unemployment benefit rate applied for all age groups at first. The Whitlam Government never quite reached 25 per cent falling short by 0.5 percentage points and lost office before the target was reached. Nevertheless 25 per cent remained the target set for the pension by various governments since then and was eventually legislated in 1996 under the Howard Government. However, as mentioned earlier, while pensions were fixed against average weekly earnings Newstart has been limited to CPI indexation. That has opened up the gap with with the pension over time. If parity with the pension could be restored today then that would represent an increase in the single Newstart of almost \$180 per week.

⁹ Other allowances included Youth Allowance (other – living away from home only), ABSTUDY (non-tertiary), Sickness Allowance, Special Benefit, Widow Allowance, Crisis Payment, and Jobseeker Payment.

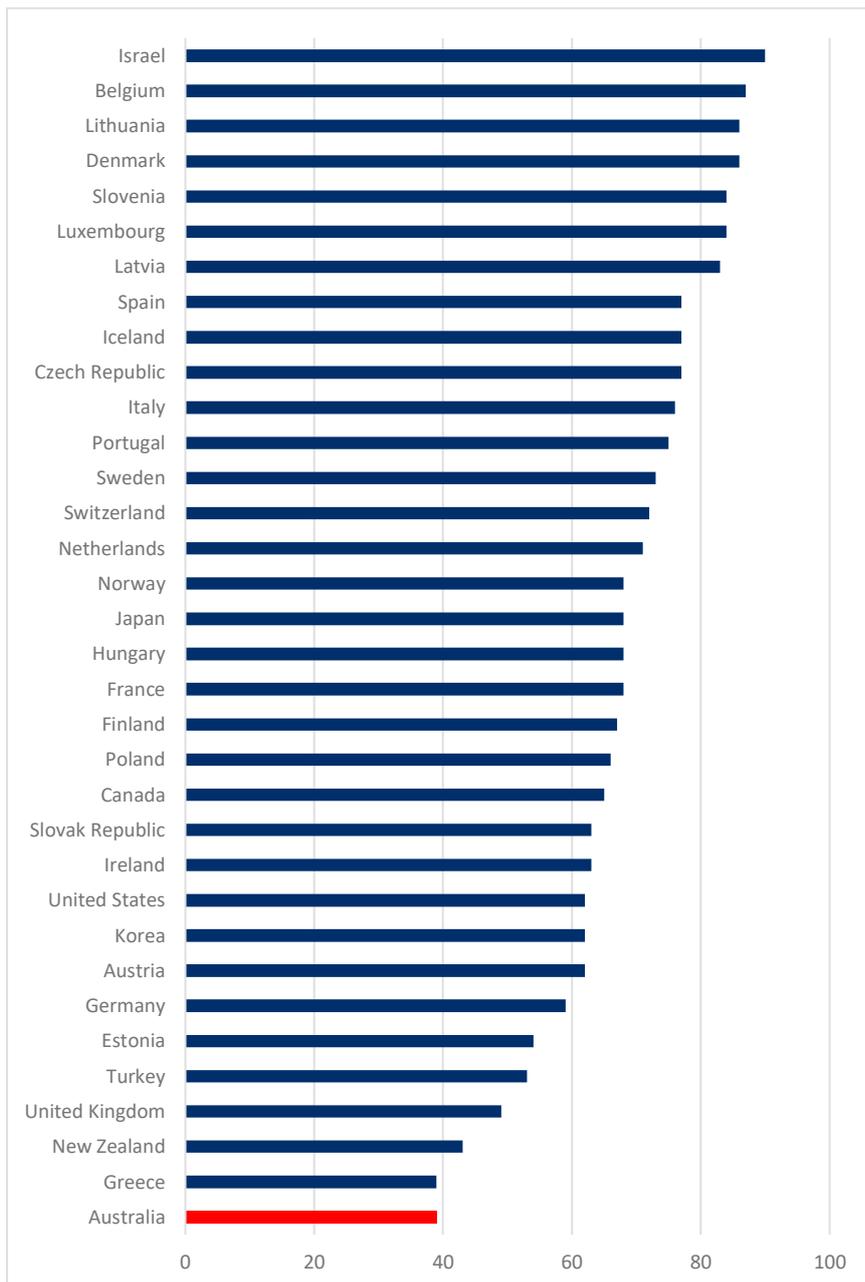
International Comparisons

It is useful to see Australia's experience in the context of the international arrangements and there are lessons we can learn.

Newstart relative to previous wage

Figure 2 looks at how much Newstart makes up for income lost as a result of unemployment. This is the OECD measure of the 'Proportion of previous in-work household income maintained after [two months] of unemployment'. The particular figures here refer to a single male earning 67 per cent of the average wage which in Australia at the moment would be \$1,094.60 per week.

Figure 3: Income replacement rates when unemployed. Person previously on 67 per cent of average weekly earnings, 2017.



Source: OECD <http://www.oecd.org/social/benefits-and-wages/data/>

Australia and Greece offer the worst deal to the unemployed at a 39 per cent replacement rate. By contrast seven countries, Israel, Belgium, Lithuania, Denmark, Slovenia, Luxembourg and Latvia offer the unemployed an 80 per cent or higher replacement rate. Most other OECD countries offer replacement benefits in the range 60 to 80 per cent of previous incomes.

Recommendation That the Committee note that in terms of replacing wages in a previous job Australia performs very poorly and is equal bottom with Greece.

Relative to poverty indicators

It is also worth comparing the adequacy of Newstart for different family types across countries. We again use the OECD database from which we can obtain incomes of different unemployed family types in different countries. These are presented as a percentage of median income for each country. We have converted those figures to give the percentage of the poverty line which here is defined as just 50 per cent of median income. The results are shown in Figure 4 for a single unemployed person.

Figure 4: Single person: Unemployment benefits as % of poverty line 2018¹⁰

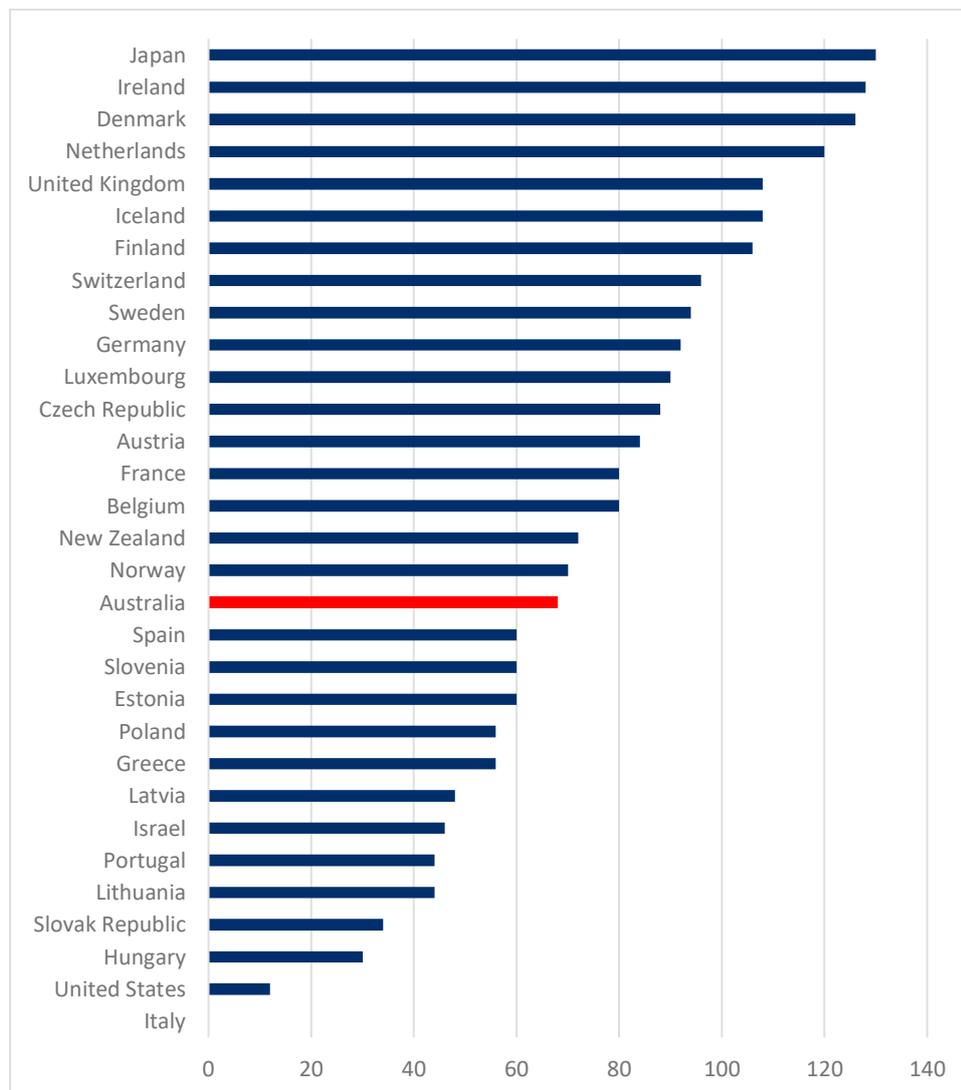


Figure 4 shows that Australia is well down the list when it comes to supporting unemployed single workers. It can be appreciated here that Australia's score here is very low compared with the countries we like to compare ourselves with. Many of those countries provide support at levels that greatly exceed their own poverty levels when defined as 50 per cent of median income. Indeed, four countries, Japan, Ireland, Denmark and the Netherlands, pay

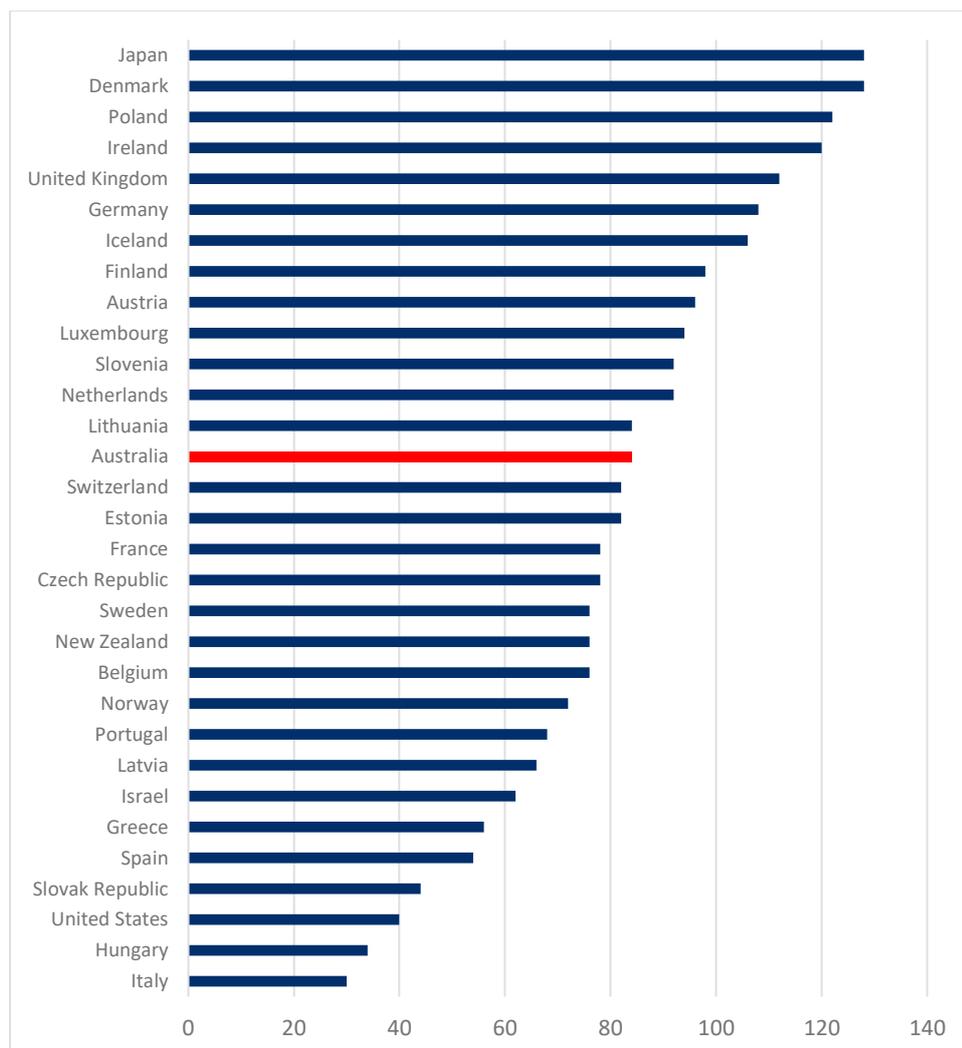
¹⁰ Source: TAI calculations based on OECD <http://www.oecd.org/social/benefits-and-wages/data/>

benefits of 120 per cent of the poverty line or better. At the other end Italy apparently gives no benefits to single unemployed workers and the US is extremely miserly.

Of course a higher figure for the assumed poverty line would reduce the values in Figure 3 and all countries would fall in proportion. The relative position of the various countries would remain unchanged.

Figure 5 presents data using the example of a family of four. The data were collected in the same way as for singles except that the share of median income is adjusted for families of more than one person.¹¹ The data in Figure 4 rely on OECD adjustments.

Figure 5: Family of four: Unemployment benefits as % of poverty line 2018¹²



¹¹ Specifically the poverty threshold is multiplied by the square of the family size, the usual OECD procedure.

¹² Source: TAI calculations based on OECD <http://www.oecd.org/social/benefits-and-wages/data/>

Figure 5 shows that the family of four in Australia receives 84 per cent of the assumed poverty line in this exercise. In this respect Australia is about half way down the list of OECD countries but well behind the leaders, Japan, Denmark, Poland and Ireland, where an unemployed family of four receives 120 per cent of the poverty line or more. Figure 4 also reminds us of Figure 1. In 1992 the family of four reached 110 per cent of the Henderson poverty line where the UK and the other four countries now sit. Now that family is 16 per cent below the poverty line implied in Figure 5 and 20 per cent below the Henderson Poverty Line shown in Figure 2.

Recommendation That the Committee note that Australia performs relatively poorly in terms of maintaining the unemployed when compared with poverty lines.

Other considerations

In this section we discuss some of the issues not yet discussed but which are suggested by the terms of reference.

STRUCTURAL UNEMPLOYMENT

The terms of reference ask for consideration of 'structural causes of long-term unemployment and long term reliance on Newstart'.

The concept of structural unemployment has a long history and seem obvious when we think of single employer towns and regions which suffer with the fortunes of the single employer. Places such as Elizabeth, South Australia, come to mind with the hastened demise of the motor vehicle industry. Generally, there has been a movement from the bush to the cities with consequences for those remaining in the bush. On top of that are the declines of particular industries.

Noticing an unemployed person in a particular region or industry may tell us very little about the next job that person may find. If the economy were strong enough then employers are likely to hire people previously thought unemployable and people may see a point in moving to areas with large vacancy numbers. So the concept of structural unemployment does not always take us very far.

Having said that there are clear areas where people may be better assisted and for example the NDIS includes policies to assist the disadvantaged with workforce issues. This takes us back to the earlier discussion on in-kind assistance.

Recommendation That the Committee note that other remedies are likely to be required to address regional and other issues that fall under categories associated with 'structural unemployment'.

THE CHANGING NATURE OF WORK AND INSECURE WORK

Historically income support for the unemployed was based on a presumption of a male breadwinner spending short spells between full-time 'good' jobs. When the post war unemployment benefit was designed unemployment was generally well under 2 per cent of the workforce and jobs were relatively easy to find.

Since the 1970s we have experienced a dramatic change to an economy in which unemployment is rarely below 5 per cent and the constellation of insecure movements in and out of unemployment (formal or otherwise) and in and out of 'poor' work. 'Poor' work is classified by the ABS as work in which people do not accumulate entitlements to leave, sick leave, super and the like. Payment is often in cash and workers may not be covered by workers' compensation arrangements, superannuation, causal loadings and the like.

If Newstart remains inadequate, or people are pushed too hard into unsuitable work, then we should expect to see more 'poor' work. Newstart could well be regarded as backstop which provides at least some sort of alternative and so does not force people to work for worse (and illegal) conditions than the incomes available on Newstart.

The other issue that arises from part-time and insecure work is the difficulty of designing a Newstart income test that caters for people making a transition from unemployment to part-time work. The work test taper is too harsh in that above a certain point it withdraws too much income for the additional private dollar of income.

While all of these points are relevant it should also be remembered that of the total number of employees, 31 per cent are part-time workers and 28 per cent of those would rather work more hours (ABS 6202.0). That suggests 78 per cent of employees either have or want full time work. Full time work appears to remain the norm in Australia.

Recommendation Newstart payments and administrative arrangements should reflect very grim outlooks for people who claim Newstart.

Recommendation While part-time and insecure work are important features of the labour market the numbers suggest the main emphasis should be on full time work.

IMPACTS

Terms of reference part f asks for submissions on the "impact of the current approach to setting income support payments on older unemployed workers, families, single parents, people with disability, jobseekers, students, First Nations peoples, people from culturally and linguistically diverse backgrounds, people living in regional and remote areas, and any others affected by the process". Part g asks us to examine "the impact of geography, age and other characteristics on the number of people receiving payments, long term unemployment and poverty".

The impact parts remind us that the Newstart has to address people in different circumstances. However, we do not think that income support should discriminate on grounds other than family size and composition. Issues arising from age, cultural backgrounds, disabilities and others have traditionally been addressed by provision of in-kind

of assistance. All of the groups mentioned have special needs which should be addressed. The risks is that the unemployment experience is perpetuated from generation to generation.

We have no particular expertise to be able to specify exactly how those needs might be addressed. However, we do recognise that the in-kind assistance available at the moment is evidently less than that required to get anywhere near some sort of equalisation of the life changes of *all* Australians.

Recommendation The Committee's terms of reference rightfully raise non-financial issues and that many people have needs that go beyond cash assistance.

ECONOMIC COST

Part I asks about the economic cost of long-term unemployment, underemployment, poverty, inequality and inadequate income support payments. Like many other participants in this inquiry we have heard accounts of problems that the unemployed experience the longer they are unemployed. Contributing to those problems are the low incomes and so the failure to meet ordinary standards of appearance, hygiene, sociability and mobility. Poverty becomes entrenched. Other submissions will no doubt address that better than this submission might. However, this submission can share some of the insights economists have developed based on the concept of hysteresis.

Hysteresis

'Hysteresis' itself refers to as a process whereby the very nature of an equilibrium is changed when the system departs from that equilibrium. There will be a new equilibrium as a result of the change. At the moment the natural rate of unemployment is taken to be around 5 per cent (Richardson 2019). Clearly that natural rate (if the concept is accepted) must have drifted up substantially since the 1950s and 60s when the actual rates averaged 1.2 per cent and remained fairly stable for decades. The movement in the natural rate has been ascribed to hysteresis effects beginning with an American economist, Edmund Phelps (1972). With the hysteresis effect a temporary increase in unemployment may have permanent effects. Hence, if unemployment increases to a higher level for a fair length of time then it is less likely that we will return to the initial lower levels of unemployment. To explain this effect economists have pointed to such things as the atrophy of skills, the work ethic, work habits, motivation, confidence and the like that affects people the longer they are out of the workforce. An especially important aspect of this is the effect on young people. Young people tend to experience higher unemployment for many reasons. However, a cohort of young people who arrive in the labour market when it is recessed may be permanently affected by the difficulties they face in such a labour market.

Strong evidence is reported for hysteresis effects in Australia. The hysteresis effects can be thought of as increasing or reducing the structural level of unemployment in Australia. The *International Monetary Fund* (IMF) recently studied the analogous situation in the US and found that the long term unemployment in the US reduces the probability that the individual will find a job so that the experience of long term unemployment tends to increase the level of structural unemployment.¹³ The IMF recommended that forceful measures should be introduced that reduce long-term unemployment and address the risks associated with long spells of unemployment, namely skills erosion and a weaker attachment to the labour force. It should be pointed out that by ‘forceful’ the IMF did not mean using force on the unemployed but ‘policies to increase demand for the long-term unemployed in the short run’—active labour market programs that would get people back into work.

It seems that if we started the post war era with unemployment at less than one per cent but now have a higher natural rate we should be able to get back to the lower rates by reversing those increases in structural unemployment through labour market and education/training programs on the one hand and better income maintenance on the other. Higher aggregate demand would also assist and is likely to be the critical factor. That seems a particularly perverse incentive in the system that needs to be corrected.

Whether or not we accept the natural rate of unemployment the mechanisms attributed to hysteresis may still be at work and would have important consequences. As Dobrescu et al suggest ‘high persistent unemployment might have surprisingly deep consequences, because its leads to an increase in the NAIRU, whereas low unemployment has a beneficial effect, in that it leads to a reduction in the NAIRU’ (Dobrescu et al 2011). This effectively refutes the Friedman idea, or the common interpretation of Friedman, that nothing can be done to influence the natural rate of unemployment. Holding the rate below the natural rate lowers the natural rate itself and so refutes Friedman’s argument against policy activism.

Hysteresis effects raise the question of whether we should persist with the concept of a NAIRU that shifts with the state of the economy. Hysteresis has been tacked on to the NAIRU to try and keep the latter concept alive. However, it could be regarded as pointing to a failure of the NAIRU and one that throws serious doubt about any policy based on a supposedly optimal and invariant rate of unemployment.

These issues are taken up in Richardson (2019) which makes the point that labour market and other initiatives to assist the unemployed are doomed to fail so long as the government itself targets a so-called natural rate of unemployment which is estimated at 5 per cent. Note that the policy splits between the government and Reserve Bank of Australia about the use of fiscal policy essentially reflect different views of how high is the natural rate of

¹³ Structural unemployment refers to unemployment by certain categories of workers whose skills may be unwanted, whose location puts them at a disadvantage, or who otherwise remain unemployed due to so called structural factors and whose plight is unlikely to be addressed by macroeconomic settings.

unemployment. We reject the concept entirely and believe that the government endorse a genuine full employment where 'full' means 'full'.

Recommendation The Committee note the message of hysteresis; that unemployment begets unemployment. Governments should not be content with 5 per cent unemployment and the target should be zero unemployment.

BENEFITS OF A BETTER DEAL FOR THE UNEMPLOYED

Part J asks the Committee to address “the economic benefits – including job creation, locally and nationally – of increasing and improving income support payments and supports, and decreasing poverty and inequality”.

The first and most obvious thing we need to say is that an increased Newstart allowance would immediately benefit those on Newstart and their dependents. This may seem an obvious point however, it needs to be stressed that any idea of the benefits or costs of a policy can only be thought of as somehow measuring the impact on the economic welfare of the population as a whole, including the perhaps 5 per cent who might benefit directly.

The section above on hysteresis gave the theoretical arguments showing how the experience of unemployment can be self-perpetuating and suggested low income support is an important part of that. It is difficult to put an exact figure on some of the benefits but we note that 5 per cent unemployment involves an economic waste of the order of \$95 billion.¹⁴

Those who believe 5 per cent unemployment is optimal no doubt consider that there are other costs, such the cost of higher inflation and a more assertive workforce, that offset the benefits of lower unemployment. But we find it hard to imagine there is any goal more important than reducing unemployment and so it is hard to imagine there are equivalent costs of holding the economy below the estimated natural rate. If those costs have in fact been over estimated, then the cruelty of the present target has been unnecessary. We go into more detail in Richardson (2019) but for the moment note that for two months in 2008 (February and August) unemployment went down to 4.0 per cent (seasonally adjusted). There appeared to be no obvious additional costs associated with unemployment below the 5 per cent target on that occasion.

It goes without saying that no one from the government, politicians or officials seem to be on the record outlining the costs or benefits associated with the economy being under the natural rate and in particular the 5 per cent target.

¹⁴ That assumes a hypothetical zero unemployment would be associated with a 5 per cent increase in GDP. That figure would be higher if we took into account the waste associated with under- and hidden-unemployment.

There is another aspect of the 5 per cent policy that is difficult to fathom. On the one hand the government knows its own policy is for a permanent 5 per cent unemployment. However, on the other hand it blames the unemployed themselves for their plight and designs policies using sticks and, to a lesser extent, carrots to encourage and coerce people out of unemployment and into work.

Recommendation The unemployed should not be blamed when Australia deliberately keeps unemployment at 5 per cent.

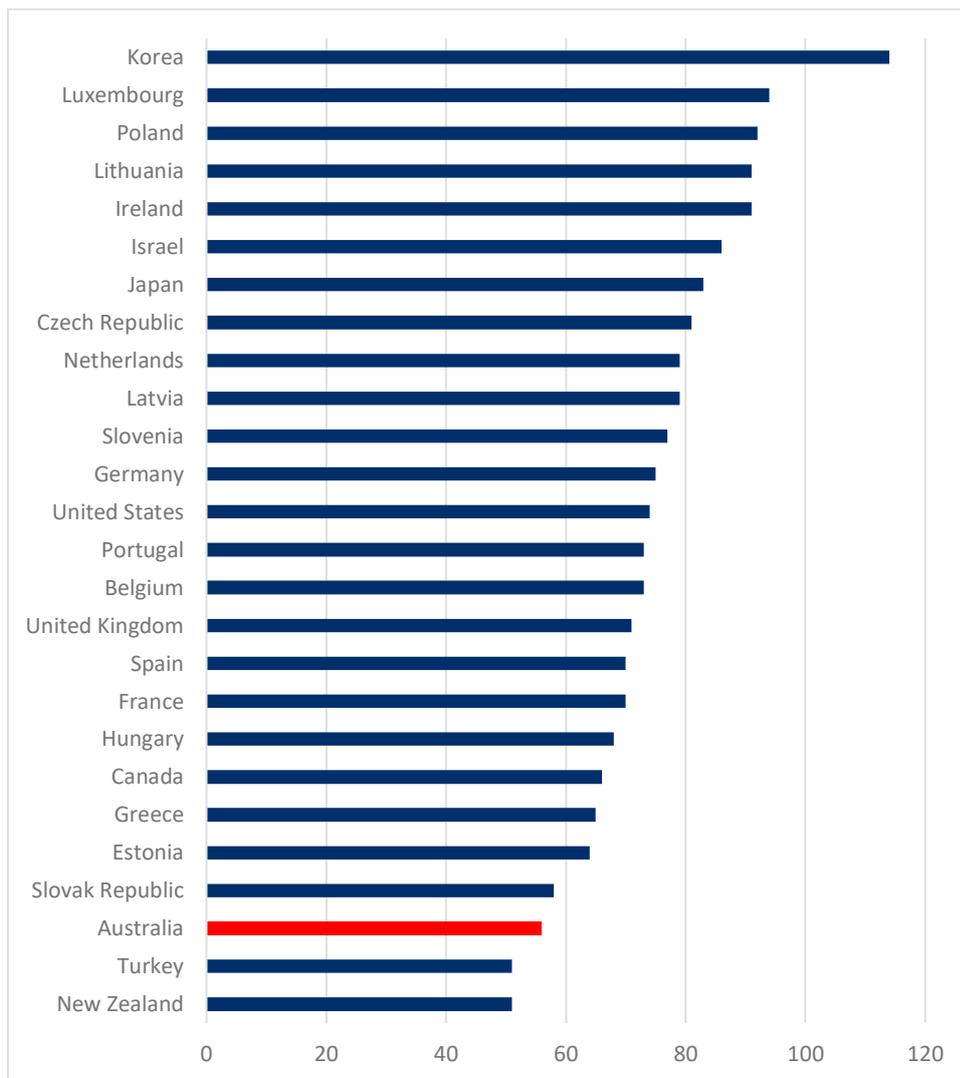
At this point it is worth noting that the IMF has long made the point that inequality is actually at odds with high economic growth. Put differently, more equality is consistent with higher economic growth and improved living standards for all.

RELATIONSHIP BETWEEN INCOME SUPPORT PAYMENT LEVELS, MINIMUM WAGES AND WAGE STAGNATION IN AUSTRALIA AND OTHER COMPARABLE ECONOMIES

Our section on international comparisons above showed that, of the OECD countries included in the analysis, Australia and Greece rated lowest in terms of the proportion of previous earnings made good by unemployment benefits. The figures referred to a hypothetical worker on 67 per cent of average earnings who becomes unemployed. Australia and Greece provide 39 per cent replacement of the lost incomes. 27 countries replace 60 per cent or more of the previous earnings and seven countries replace 80 per cent or more of previous earnings.

We can also examine how Australia's Newstart and minimum wage compare with other OECD countries. Figure 5 gives that comparison for 2017.

Figure 6: Unemployment benefits as % minimum wages, 2017



The international comparisons in Figure 6 confirm the impressions in Figure 2, namely that Australia’s Newstart gives a very poor replacement of the income that might be lost as a result of unemployment. However, at least compared with Figure 2 Australia moves up to third worst rather than equal worst. From Figure 6 we see that on the minimum wage comparison Australia is no longer on the bottom but at third bottom out of 26 countries Australia does not perform much better.

Obviously, many people would suggest that the dole needs to be kept low so that there is an incentive to move off benefits and into whatever work is around. The implication is that unemployment is a voluntary state of affairs and you need only provide an incentive and people will move off the dole. That approach assumes that it is only the relative prices that are important and that such things as the activity test are not relevant.

Recommendation The Committee note Australia’s relatively poor performance with Newstart as a share of the minimum wage in Australia.

RATE OF NEWSTART AND INCENTIVES TO WORK

In an earlier submission to a Senate inquiry a joint submission from a number of departments¹⁵ said: ‘an increase in the base rate of Newstart Allowance has the distinct disadvantage of reducing employment incentives, especially for those who can only obtain low paying employment’. hence ‘The rates of Newstart Allowance and other allowance payments are set such that they ensure that receipt of these payments do not become an attractive and viable alternative to paid work’ (Australian Government 2012). While we can readily understand what they are trying to say it has to be noted that the incentive proposition is nowhere backed up with any evidence.

A critical element in the Australian system is the work test which is often portrayed as very harsh. Yet the sort of analysis by the government departments just described seems to assume that it is only the relative price of the wage and Newstart allowance that matters. It is almost as if all the compliance efforts are for naught.

Let us suppose for a moment that the government departments were correct. Suppose a lower Newstart would encourage those ‘job snobs’ to take jobs with poor and unsafe conditions. Is that necessarily a good thing? If people are forced to take the first job that comes along they may end up in ill-suited jobs for both themselves and their employers. However, if Newstart is a better buffer between jobs then it may enable the job seeker to wait until the best and most suitable offer comes along which would lead to the best long term outcome for all concerned, and indeed for the rest of the country.

Recommendation Government should try to encourage the unemployed find a job that best fits rather than waste everyone’s time on job matches that do not fit either party.

We also think that when unemployment benefits are low and eligibility hard to achieve then we risk excluding people from the labour market altogether. In addition to those formally classified as unemployed there are a large number who would like to increase their hours and there are a large number of people who say they want to work but fail the ABS definition. These people are classified as not in the labour force (NILF). In another forthcoming paper we examine the monthly flows in Australia going from employment to unemployment or NILF and back again as well as the other combinations. What we find is that the flows from employment to NILF are much larger than the flows from employment to unemployment.

¹⁵ The Department of Education, Employment and Workplace Relations, the Department of Families, Housing, Community Services and Indigenous Affairs, the Department of Human Services and the Department of Industry, Innovation, Science, Research and Tertiary Education

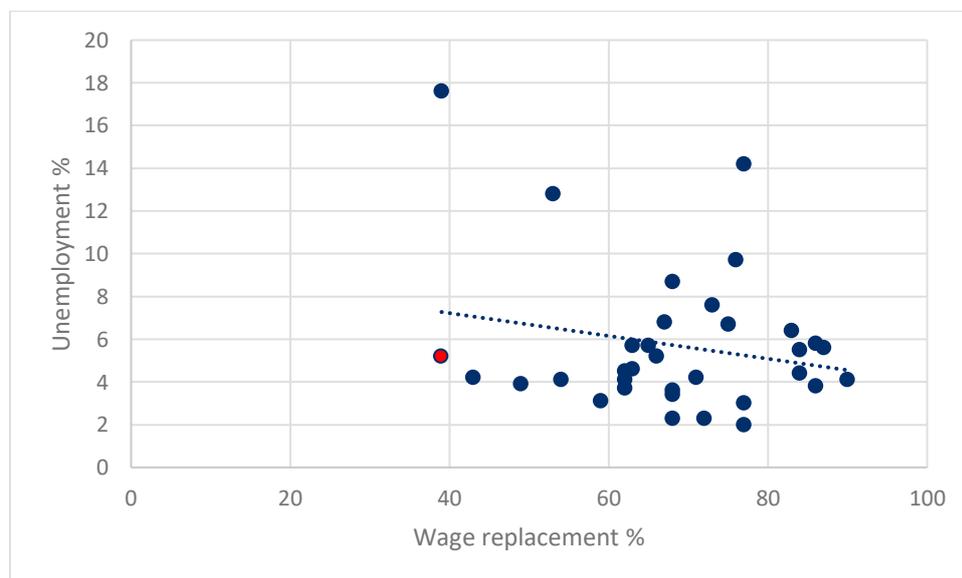
We think there is a benefit in a reasonable rate of Newstart so that people want to get it and will go through the hoops one goes through to get it. Being on Newstart should keep people attached to the workforce rather than dropping out altogether.

Recommendation That the Committee note that higher Newstart may lead to more attachment to the labour market.

The counter argument addressed elsewhere in this submission is that a higher Newstart allowance will cause people to drop out of the workforce. A low Newstart is therefore seen as necessary as the stick to get people back into the workforce. We can do a test on that by examining experience in other countries.

If we examine OECD countries around the world and plot their data we can see if there is any apparent relationship between their unemployment and the value of their unemployment benefit relative to their wages. Figure 6 plots the data using the above OECD figures for the benefit as a percentage of previous wages in the case of a wage at 67 per cent of average earnings. That compares with unemployment as measured by the latest (late August was used) *Economist* magazine or, where the country is not given, the latest OECD (2019) figures are used. Australia is the red dot in Figure 6 below.

Figure 7: Unemployment and relative value of unemployment benefits across countries.



Source: OECD (2019a and b), and Economist (2019).

Figure 6 clearly shows there is no support for the proposition that countries with higher unemployment benefits (relative to wages) might experience higher unemployment. Indeed, the trendline shown in Figure 6 suggests that if anything, higher benefits are associated with lower unemployment.

Recommendation That the Committee note that international comparisons show that higher Newstart payments are unlikely to be associated with higher unemployment and the converse is also true.

THE COST AND FISCAL SUSTAINABILITY OF ANY CHANGES

We mentioned above that the government has said increasing Newstart is not high on its priorities. We fail to see how anyone can argue for that position. All members of Parliament claim that the national interest is their priority and surely the national interest is the welfare of the 25 million or so Australian residents. The fact that 711,000 people and their dependents are in poverty must surely signal that welfare could be improved significantly by taking a large number of Australians out of poverty.

Increases in Newstart by \$75 per week have been costed by the government and other players. A report by Deloitte Access Economics shows that would cost \$3.3 billion in a year (Henriques-Gomes 2018).¹⁶ We earlier mentioned the Parliamentary Budget Office estimated the cost of increasing Newstart and similar allowances by \$75 a week. Their figure is \$3.6 billion in the first two years rising to \$4.2 billion in the year 2022-23 for a total of \$15.0 billion over the forward estimates. Those figures compare with total budgeted outlays on the unemployed and sick equal to \$10.8 billion in 2019-20 rising to \$11.8 billion in 2022-23 for a total \$44.8 billion over the forward estimates.

Overall, with a \$75 a week increase outlays on unemployment and sickness benefits would increase to around \$60 billion over the forward estimates and substantially more if we were to meet poverty measures. These figures sound like a lot but they compare with a total budget outlays of \$501 billion in 2019-20 and \$2,113 billion over the forward estimates.

We assume the PBO estimate was based on projected unemployment rates of 5 per cent which is consistent with the Government's projections based on the 2019-20 budget papers. That means a ballpark figure for the savings due to a reduction of unemployment to 4 per cent is approximately \$2.2 billion in 2019-20 and \$8.8 billion over the forward estimates. If unemployment could be eliminated altogether then clearly the cost of Newstart would be virtually zero.

We would therefore submit that any outlay on Newstart should be seen as the *cost of failing to achieve full employment*. It may never be possible to reduce outlays to zero but anything above zero means there is unemployment and we should be trying harder to eliminate it. We think absolute full employment should be rehabilitated as an objective of economic policy

as outlined in the Reserve Bank Act and the 1944 White Paper and the policy target associated with the NAIRU should be renounced.

The role of automatic stabilisers should be mentioned here. Downturns in the economy are associated with induced reductions in tax receipts on the one hand but also increased expenditures on the other. Those two effects tend to increase budget deficits and/or reduce budget surpluses. Those that are appropriate in an economic downturn are referred to as the automatic stabilisers. A higher level of Newstart will improve the role of the automatic stabiliser by increasing cash injections into the economy during economic downturns.

Recommendation Any costs associated with Newstart should be seen as the price of failing to reach full employment.

THE RELATIVE MERITS OF ALTERNATIVE INVESTMENTS IN HEALTH, EDUCATION, HOUSING AND OTHER PROGRAMS TO IMPROVE OUTCOMES

This heading reflects the terms of reference. There are many other programs that affect the wellbeing of the unemployed and other groups in society. The ones mentioned, health, education and housing, readily spring to mind. However, the way it is expressed suggests there are trade-offs in that you cannot have both a higher Newstart and better health, education and other services. However, the budget is not that tight that we cannot afford higher Newstart payments. Indeed, some of these payments assist with keeping the costs of each other down. A less healthy population would mean lower productivity, more people on sickness benefits etc. It is also worth noting that the cost of increasing Newstart is well within the average error in budget estimates.

It might be observed that while the terms of reference envisage a trade off with other spending programs, taxes and tax expenditures are not included in the mix.

Recommendation There are a host of worthwhile objectives in the budget but these should not be considered as substitutes or trade-offs for an adequate Newstart. An adequate Newstart is or should be a core objective of policy.

OTHER COUNTRIES' APPROACHES TO SETTING INCOME SUPPORT PAYMENTS, MINIMUM WAGES AND AWARDS

This is an area we have not spent much time on but we gave some important figures earlier. They showed that Australian support levels were much lower than previous earnings in employment. For example we showed that Newstart represented under 60 per cent of the minimum wage and, on that basis, was 26th out of 29 countries.

We have some comment on the minimum wage based on some work we are doing for a different purpose.

Why we have minimum wages

The role of minimum wages is to prevent people undermining the social norms.

An opinion writer who actually believed Australia does not need a minimum wage inadvertently reminded us exactly why we do need it. She said:

The minimum wage is a fantasy. because workers regularly accept less than mandated minimum wage or conditions to hold some jobs. And they count themselves lucky to do so...We'd all like to have higher wages and better conditions. But our actions reveal what we are willing to accept (McGuinness 2019).

The whole point of minimum wage legislation is to stop exactly the type of thing the author describes. Without such legislation vulnerable and insecure workers are subject to exploitation by employers and desperate workers are liable to undercut standards. Without minimum wages we would soon have a race to the bottom whenever employers have the upper-hand. The OECD (1998) has pointed out that countries have introduced minimum wage legislation in order to pay a 'fair' compensation in exchange for the work effort and, as well, to raise the standard of living of low paid workers and their dependents. The OECD found that minimum wages do in fact compress the distribution of wages as might be expected. That is another way of saying that the minimum wage produces a more equal distribution of income. In addition, the degree of compression—the extent of the movement towards more inequality—depended on how high the minimum was set relative to other wages and measures such as the median wage. There have been suggestions that the minimum wage should be kept low relative to other measures of wages (the median and mean). However, that is an argument for more inequality among wage earners. This is important and should be kept in mind in the rest of this paper. The other main achievement of the minimum wages has been to narrow earnings differentials across demographic groups. Apparently the effects have been stronger in the case of gender and age differences (OECD 1998). The result of more equality among wage earners translates into more equality in the dispersion of household incomes.¹⁷

ANY OTHER RELATED MATTERS

So far in this submission we have assumed that obtaining Newstart is not an issue, so long as the claimant is eligible. However, anecdotal evidence suggests this is far from the case. People

¹⁷ Of course minimum wages have no impact on households without wage earners. Other mechanisms are important for addressing poverty among those households.

from an English-speaking background without the complications of mental health or other issues have problems.

Recommendation The government needs to simplify its procedures to ensure it is easy as possible for eligible claimants to get Newstart.

Rather than putting the onus on the unemployed to get it right we think that the staff at Centrelink should be incentivised to ensure that anyone entitled to Newstart gets it as soon as possible. If needs be case managers acting for the unemployed should be allocated to assist those who are finding it difficult to navigate the bureaucracy.

Recommendation Claimants should be allocated an assistant whose role is to act on behalf of the claimant to clear any hurdles.

The other main thing that has been implicit in this submission is that increasing the adequacy of Newstart improves the distribution of income in Australia. The next section discusses some of the IMF's work on the relationship between in/equality and economic performance.

Inequality, equality and economic performance

An adequate Newstart has to be part of any program of increasing equality in Australia and so it is worth thinking about Newstart in that wider context. It used to be thought that there was a tradeoff between equality and economic performance you could have more of one or the other but not both at the same time. However, that old view no longer holds. The work of the IMF 'shows that high inequality imposes a direct economic cost, in addition to the costs highlighted by other (non-IMF) authors such as capture of the political process by elites, and a decline in social cohesion'.¹⁸

in an article by some of the IMF's senior economists (Ostry et al (2016) the IMF has made a very strong statement on inequality and blamed a lot of the increases in inequality on the fiscal austerity measures introduced in advanced countries. For example it referred explicitly to 'fiscal consolidation, sometimes called "austerity," which is shorthand for policies to reduce fiscal deficits and debt levels' and said:

The costs in terms of increased inequality are prominent. Such costs epitomize the trade-off between the growth and equity effects of some aspects of the neoliberal agenda.

Not only is inequality a result of austerity budgets but inequality itself reduces the prospects of the economy as a whole. The IMF points out:

Increased inequality in turn hurts the level and sustainability of growth. Even if growth is the sole or main purpose of the neoliberal agenda, advocates of that agenda still need to pay attention to the distributional effects (Ostry et al 2016).

They elaborate and it is worth quoting in full:

The evidence of the economic damage from inequality suggests that policymakers should be more open to redistribution than they are. Of course, apart from redistribution, policies could be designed to mitigate some of the impacts in advance—for instance, through increased spending on education and training, which expands equality of opportunity (so-called predistribution policies). And fiscal consolidation strategies—when they are needed—could be designed to minimize the adverse impact on low-income groups. But in some cases, the untoward distributional consequences will have to be remedied after they occur by using taxes and government spending to

¹⁸ <https://blogs.imf.org/2017/02/22/the-imfs-work-on-inequality-bridging-research-and-reality/>

redistribute income. Fortunately, the fear that such policies will themselves necessarily hurt growth is unfounded.

Predistribution policies are important and for example the Gonski reforms ¹⁹ were a deliberate strategy designed to break the cycle of poverty and low incomes when poor children from deprived backgrounds are not given the opportunity to catch up to their peers. We take up some of these themes below.

The neoliberal agenda produces what the IMF refers to an ‘adverse loop’ when it says:

...since both openness and austerity are associated with increasing income inequality, this distributional effect sets up an adverse feedback loop. The increase in inequality engendered by financial openness and austerity might itself undercut growth, the very thing that the neoliberal agenda is intent on boosting.

In a speech the IMF Managing Director, Christine Lagarde, quantified the impacts when she said:

Our research shows that, if you lift the income share of the poor and middle class by 1 percentage point, then GDP growth increases by as much as 0.38 percentage points in a country over five years. By contrast, if you lift the income share of the rich by 1 percentage point, then GDP growth decreases by 0.08 percentage points. One possible explanation is that the rich spend a lower fraction of their incomes, which could reduce aggregate demand and undermine growth (Lagarde 2015).

A recent research paper said in regard to the emphasis on economic growth ‘It would still be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable’ (Ostry et al 2014). Yet that seems to be what is happening at the moment.

The relationship between inequality and economic performance was also raised by the Economic Report of the President observed that

Several authors have argued that increases in inequality have likely adversely affected the economy. For example, the rise in income inequality may have reduced aggregate demand, because the highest income earners typically spend a lower share of their income—at least over intermediate horizons—than do other income groups. The following calculation illustrates the potential magnitude of this effect. As shown in recent research by Piketty and Saez (2003, 2010), the share of all income going to the top 1 percent has risen sharply over the past three decades, rising by 13.5 percentage points, from 10 percent to 23.5 percent, between 1979 and 2007. This is the equivalent

¹⁹ Named after David Gonski the chair of the panel that produced Review of funding for schooling (2011) *Review of Funding for Schooling—Final Report*, December which produced a plan for making sure all school children had sufficient resources required to receive a good level of education.

of about \$1.2 trillion of annual income in 2007 (Economic report of the President 2012).

In his book *Fault Lines*, Raghuram Rajan (Rajan 2010) argues that slow income growth for the middle class led, in part, to the rising levels of debt and the overleveraging that played a central role in the 2007–08 financial crisis. Work by the IMF has reinforced the link between inequality and household debt. Greater income inequality can lead to excessive borrowing by low- and middle-income households, and that debt can trigger a crisis of the sort to both the Great Depression and the Great Recession. The authors say they:

explore the nexus between increases in the income share of high-income households, higher debt leverage among poor and middle-income households, and vulnerability to financial crises. We provide evidence which suggests that this nexus was prominent prior to both the Great Depression and the Great Recession (Kumhof et al 2013).

Increasing inequality associated with corporate power explains some recent phenomenon that would be otherwise inexplicable, namely the surveys that show business is happy while consumer confidence has slumped. As the Financial Review reported:

Slumping confidence among heavily indebted, increasingly taxed and low-wage-growth inflicted households is contrasting dramatically with a buoyant business sector enjoying the best operating conditions in a decade.... While corporate Australia's debt levels are relatively modest and profits have surged, Westpac's survey shows families are becoming ever-more concerned about their finances compared to a year ago (Greber 2017).

Saul Eslake said:

Business is happy not least because profits are strong, with the profit share of national income close to a record...By contrast, the wages share is close to an all-time low. And whereas, for example, rising unemployment is primarily of concern to people who have lost, or fear losing, their job - which is never a majority of employees - the stagnation of wages affects virtually all employees (Greber 2017).

So business is more confident but will not invest and consumers are less confident so will not spend.

Recent research suggests there may be an 'inequality multiplier' at work in the economy. We have an event that causes a slump with the result a worsening in the income distribution which then worsens the slump even further.

When a labor [sic] demand shortfall hurts poor individuals the most, it exacerbates the adverse demand effects of inequality, and the inequality multiplier is high (Auclert et al 2016).

The important factor behind the inequality multiplier is that the high and lower income earners have different propensities to spend out of their income. The *Economic Report to the President* cites studies showing that the top one percent of households save about half of their income, while the population at large has a saving rate of about 10 percent of their total income (economic report of the President 2012). If the same were true in Australia it implies that every 1 per cent of national income transferred from the top one per cent to the rest of the population would increase national income by 0.4 per cent as a result of increased consumption in the first instance.²⁰

Recommendation That the Committee note that, as part of an overall policy of increasing equality, an increase in Newstart will have a positive impact on the economic performance of Australia.

²⁰ The ultimate impact depends on the size of the multiplier in Australia and that in turn depends on where Australia is in the business cycle.

Conclusions

Any attempt to examine the adequacy of Newstart takes us in a number of directions and that can have the effect of making our submission look like it wanders all over the place. But some things stand out. Australians on Newstart have performed very poorly relative to poverty measures. They also perform poorly compared with their counterparts in other OECD countries.

It is hard to find anyone who actually supports the status quo and at most we get vague suggestions that the stick of low income is needed to prod people back into the workforce even as we deny them the means to maintain appearances, hygiene, health and mobility. Moreover there is the tendency to blame the victims. Blaming the victims may even be understandable if we had genuine full employment but seems illogical when we have a government policy of targeting 5 per cent unemployment—the so called ‘natural rate of unemployment’. 711,000 people and their dependents are the victims of this policy and are presently doomed to live a pale imitation of the lives the majority of Australians enjoy.

The Treasurer has said that Newstart is short term assistance for those between jobs. He may genuinely believe that but the administrative data from Social Security does not support that view. The other fob is to suggest the ‘best form of welfare is a job’.

The fact of widespread poverty was enough to stir Sir Winston Churchill and JF Kennedy. We hope it also stirs the Australian Government and that this Committee provides that impetus. This submission has deliberately avoided recommending a specific amount by which Newstart might be increased. However, we noted a number of indicators that suggested something of the order of \$200 a week might be appropriate. To get back to the peak in the early 1990s requires just under \$300 a week for our representative family of four. It is urgent that Newstart is made much more adequate than now.

List of recommendations

1. **Recommendation** Newstart has to keep up with community standards and never again allowed to slip so far against community standards.
2. **Recommendation** A new inquiry should address what it means to be poor in Australia and what constitutes an up-to-date poverty line.
3. **Recommendation** An official poverty line be adopted and maintained on a quarterly basis.
4. **Recommendation** Governments should commit to meeting targets on poverty and making themselves accountable on that measure.
5. **Recommendation** The Committee should note that Newstart for a family of four had almost reached parity with the Henderson line in the mid-1970s, exceeded it in the early 1990s but has been declining ever since and is now well below the poverty line. Government should again set targets to exceed appropriate poverty measures.
6. **Recommendation** A new inquiry should address what it means to be poor in Australia and what constitutes an up-to-date poverty line.
7. **Recommendation** An official poverty line be adopted and maintained on a quarterly basis.
8. **Recommendation** Governments should commit to meeting targets on poverty and making themselves accountable on that measure.
9. **Recommendation** The Committee should note that Newstart for a family of four had almost reached parity with the Henderson line in the mid-1970s, exceeded it in the early 1990s but has been declining ever since and is now well below the poverty line. Government should again set targets to exceed appropriate poverty measures.
10. **Recommendation** Newstart has to be recognised a form of long-term support for many people.
11. **Recommendation** Australia should cease blaming the unemployed who are victims of a macroeconomic policy that has long ago forsaken genuine full employment.
12. **Recommendation** Australia should again embrace a genuine full employment policy.
13. **Recommendation** That the Committee note that in terms of replacing wages in a previous job Australia performs very poorly and is equal bottom with Greece.
14. **Recommendation** That the Committee note that Australia performs relatively poorly in terms of maintaining the unemployed when compared with poverty lines.
15. **Recommendation** That the Committee note that other remedies are likely to be required to address regional and other issues that fall under categories associated with 'structural unemployment'.
16. **Recommendation** Newstart payments and administrative arrangements should reflect very grim outlooks for people who claim Newstart.

17. **Recommendation** While part-time and insecure work are important features of the labour market the numbers suggest the main emphasis should be on full time work.
18. **Recommendation** The Committee note the message of hysteresis; that unemployment begets unemployment. Governments should not be content with 5 per cent unemployment and the target should be zero unemployment.
19. **Recommendation** The unemployed should not be blamed when Australia deliberately keeps unemployment at 5 per cent.
20. **Recommendation** The Committee note Australia's relatively poor performance with Newstart as a share of the minimum wage in Australia.
21. **Recommendation** Government should try to encourage the unemployed find a job that best fits rather than waste everyone's time on job matches that do not fit either party.
22. **Recommendation** That the Committee note that higher Newstart may lead to more attachment to the labour market.
23. **Recommendation** That the Committee note that international comparisons show that higher Newstart payments are unlikely to be associated with higher unemployment and the converse is also true.
24. **Recommendation** Any costs associated with Newstart should be seen as the price of failing to reach full employment.
25. **Recommendation** There are a host of worthwhile objectives in the budget but these should not be considered as substitutes or trade-offs for an adequate Newstart. An adequate Newstart is or should be a core objective of policy.
26. **Recommendation** The government needs to simplify its procedures to ensure it is easy as possible for eligible claimants to get Newstart.
27. **Recommendation** Claimants should be allocated an assistant whose role is to act on behalf of the claimant to clear any hurdles.
28. **Recommendation** That the Committee note that, as part of an overall policy of increasing equality, an increase in Newstart will have a positive impact on the economic performance of Australia.

References

- Atkinson AB (2019) *Measuring Poverty Around the World*, Princeton Univ Press.
- Auclert A and Rognlie M (2016) 'Inequality and aggregate demand', at <http://web.stanford.edu/~aaauclert/inequad.pdf>
- ABS Cat no 6302.0
- Australian Government (no date) *Submission to the Senate Inquiry on the adequacy of the allowance payment system for job seekers and others*.
- Baldwin P (1994) 'Measures to assist unemployed people', *Minister for Social Security Media Release, MPS 13/94*, 18 March.
- Dobrescu M, Paicu C and Iacob S (2011) 'The natural rate of unemployment and its implications for economic policy', *Theoretical and Applied Economics*, Vol XVIII(2), pp181-94.
- Economic Report of the President transmitted to the Congress*, February 2012 at <https://www.gpo.gov/fdsys/pkg/ERP-2012/pdf/ERP-2012.pdf>
- Economist (2019) 'Economic data, commodities and markets', *The Economist*, 22 August.
- FairWork Commission (2019) The Australian minimum wage from 1906, 12 July.
- Greber J (2017) 'Households versus business - the widening sentiment gap', *The Australian Financial Review*, 9 August.
- Gittins R (2019) 'There's a strange logic to Josh Frydenberg's stand on Newstart', *Sydney Morning Herald*, 24 July.
- Henriques-Gomes L (2018) 'Push to raise Newstart allowance by \$75 a week', *The Guardian (Australia)*, 17 Sept.
- IMF (2012) 'United States; Selected issues', *IMF Country Report No 12/214*, August
- Kumhof M Ranciere R and Winant P (2013) 'Inequality, Leverage and Crises: The Case of Endogenous Default', *IMF Working Paper WP/13/249*, November.
- Lagarde C (2015) 'Lifting the small boats', Address at Grandes Conférences Catholiques',
- Letts S (2019) 'Australia's economy just entered recession on a per capita basis', *ABC News*, 7 March.

McGuinness PP (2019) 'Why minimum wages are a fantasy', *Australian Financial Review*, 20 March <https://www.afr.com/news/economy/employment/why-minimum-wages-are-a-fantasy-20190319-h1cjdv>

Morrison S (2019) 'Answer to question on notice', *House of Representatives Hansard*, 29 July.

Murphy K (2019) 'The meaning of Morrison's mantra about getting a fair go is clear. It's conditional', *The Guardian (Australia)*, 17 April.

OECD (1998) 'Making the most of the minimum: Statutory minimum wages, employment and poverty', *OECD Employment Outlook*.

OECD <http://www.oecd.org/social/benefits-and-wages/data/>

OECD (2019) 'OECD unemployment rate falls to 5.2% in April 2019', *OECD Media Release*, 13 June.

Ostry JD, Loungani P and Furceri D (2016) 'Neoliberalism: Oversold?' *International Monetary Fund, Finance and Development*, June Vol 53(2)

Ostry JD, Berg A and Tsangarides CG (2014) 'Redistribution, inequality, and growth', *IMF Staff Discussion Note*, SDN/14/02, p. 27 at <http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>

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

Richardson D (2019) *Government Vs the Reserve Bank and the NAIRU*, forthcoming.

Social Security Guide, 12 August <https://guides.dss.gov.au/guide-social-security-law/5/2/1/20>

Terms of reference

The adequacy of Newstart and related payments and alternative mechanisms to determine the level of income support payments in Australia, with specific reference to:

- a. consideration of what constitutes an acceptable standard of living in Australia, including the cost of safe and secure housing;
- b. the labour market, unemployment and under-employment in Australia, including the structural causes of long term unemployment and long term reliance on Newstart;
- c. the changing nature of work and insecure work in Australia;
- d. the appropriateness of current arrangements for supporting those experiencing insecure employment, inconsistent employment and precarious hours in the workforce;
- e. the current approach to setting income support payments in Australia;
- f. the impact of the current approach to setting income support payments on older unemployed workers, families, single parents, people with disability, jobseekers, students, First Nations peoples, people from culturally and linguistically diverse backgrounds, people living in regional and remote areas, and any others affected by the process;
- g. the impact of geography, age and other characteristics on the number of people receiving payments, long term unemployment and poverty;
- h. the adequacy of income support payments in Australia and whether they allow people to maintain an acceptable standard of living in line with community expectations and fulfil job search activities (where relevant) and secure employment and training;
- i. the economic cost of long-term unemployment, underemployment, poverty, inequality and inadequate income support payments;
- j. the economic benefits – including job creation, locally and nationally – of increasing and improving income support payments and supports, and decreasing poverty and inequality;
- k. the relationship between income support payment levels, minimum wages and wage stagnation in Australia and other comparable economies;

- l. the interactions with other payments and services, including the loss of any increased payments through higher rents and costs;
- m. the cost and fiscal sustainability of any changes;
- n. the relative merits of alternative investments in health, education, housing and other programs to improve outcomes;
- o. other countries' approaches to setting income support payments, minimum wages and awards;
- p. other bodies that set payments, minimum wages and awards in Australia;
- q. the role of independent and expert decision-making in setting payments; and
- r. any other related matters.

Attachment

Please click on title to open [Unemployment and the Newstart Allowance by Dr. Raja Junankar](#)