

# **Increasing the Newstart Allowance**

## **A necessary part of equitable fiscal stimulus**

**Research Paper No. 60**

**February 2009**

David Ingles and Richard Denniss

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### **Introduction and overview**

Australia is experiencing a negative terms of trade shock with the price of exports falling relative to the price of imports. This shock is estimated to be minus 13 per cent in 2009–10 (Treasury 2009), which means that real incomes will either need to fall or, at best, rise less quickly than they otherwise might. The more evenly the shock is spread across the economy, the less painful will be the adjustment; in particular, we should not be designing policies aimed solely at assisting those who already have good jobs and secure incomes.

Instead, we should be doing more to help the unemployed who are discriminated against compared to pensioners, thus creating an escalating problem of financial hardship. This is especially important in the light of the expected addition of 300,000 people to the dole queues over the next 16 months. The unemployed are the missing people in the fiscal stimulus equation.

Treasury estimates imply that GDP per head will fall by 0.5 per cent in 2008–09 and by a further 0.75 per cent in 2009–2010. But with inflation down to an estimated two per cent per annum and hourly wages rising an estimated 3.75 per cent this year and 3.25 per cent next year, ‘those in work will be better off than ever’ (Colebatch 2009). This is especially so after taking into account the benefits contained in the latest package. By contrast, those who lose their jobs not only missed out in the December 2008 package, which assisted pensioners and carers, but will gain very little from the current fiscal stimulus package.

The new \$950 a year tax bonus for working Australians will accrue to those who paid tax in the 2007–08 financial year. Some of the newly unemployed will benefit from this but their net transfer benefits will remain well below those of pensioners. The long-term unemployed, in particular, are rarely liable for tax and these are the most disadvantaged section of the unemployed population. Some unemployed will gain

from additional payments in respect of school-age children<sup>1</sup> but, as a general observation, the unemployed are the forgotten people in the two fiscal stimulus packages.

In an earlier paper, The Australia Institute pressed for a higher pension to stimulate the economy (Denniss and Fear 2008). Arguments advanced for raising the age pension included the fact that age pensioners have a low propensity to import and to save and are geographically distributed across the country. The 2008 stimulus package did in fact include this approach, which also extended to disability pensioners.

The arguments for a higher Newstart Allowance (NSA) or unemployment benefit are precisely similar and have the added virtue of helping to address an increasing problem of horizontal equity, the notion that those in a similar financial position should be treated equally. The different indexation regimes applying to pensions (indexed to wages) and allowances (indexed to prices) increasingly create distortions in the welfare safety net. The single rate of the NSA is now \$11,682 per annum compared with the pension rate of \$14,615, and the couple rate is \$21,070 compared with \$24,414. In addition, the means tests on the NSA are much tighter.

To bring the NSA to pension parity requires an increase of \$56 a week for singles and \$64 a week for couples. The more severe the recession ultimately realised, the greater the increase in extra funds for the NSA that will flow automatically to the most economically depressed parts of the country. They act, in other words, as a very effective automatic stabilizer.

Currently, government spending on allowances is around \$5 billion per annum covering some 450,000 recipients.<sup>2</sup> By July 2010, this will increase by two-thirds according to Treasury projections. An average 22 per cent increase in allowances to bring them to parity with pension rates, together with some easing of asset test conditions, could therefore create an eventual fiscal stimulus of over \$2 billion. This is a comparatively modest amount that would be a sensible component in the 2009 Budget. If such spending is deemed unaffordable, proposed income tax cuts should be deferred to pay for it.

The paper begins by asking who benefits from the income tax cuts foreshadowed for July 2009 and July 2010. The answer is that it is predominantly the well-off, with modest cuts going to those on incomes higher than \$34,000 per annum and greater cuts going to those on incomes over \$80,000 per annum. Why such cuts should be a priority during a recession is not clear. The only cuts that should be a priority are those flowing from increases in the low-income tax offset (LITO), which raise the effective income tax threshold to \$15,000 in July 2009 and \$16,000 in July 2010.

Part 2 describes the different indexation regimes applying to the NSA and the age pension, which have resulted in a steady widening in the rate differential over the past

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<sup>1</sup> Some unemployed will also benefit from the \$950 temporary supplement to the Education Entry Payment, which is extended to those who have been receiving eligible benefit payments for one month or longer.

<sup>2</sup> We do not include Youth Allowance here, although this is also a form of unemployment payment.

decade. On average, the NSA rate is now a fifth lower than the pension rate and even less if pension bonuses are taken into account.

Part 3 describes differences in income tests, which are much tighter for the NSA than for the pension. The combined effect of these differences in rates and income tests is that disposable incomes for pensioners are much higher than those for allowees at all levels of private income up to about \$40,000 per annum. This is creating serious structural problems in the welfare safety net as sole parents are losing income when their youngest child turns eight and disabled individuals assessed as having a modest capacity to work (and thus placed on the NSA) are much worse off than those who are more disabled and therefore able to claim the disability pension.

Part 4 examines the possibility of reforming the NSA asset test, which is particularly harsh. If a recipient's assets exceed the threshold, there is a 'sudden-death' loss of the allowance. This is in contrast to the pension asset test which phases in gradually. Moreover, there is an additional waiting period of up to 13 weeks for allowees who hold liquid assets above risibly low levels (Part 5). Both these facets of the NSA asset test should be reformed.

These Australian practices stand in sharp contrast to the overseas convention of providing unemployment benefits as a form of insurance readily available in the event of job loss. That is, if individuals lose their jobs, they are eligible for benefits and their assets are not a barrier, a situation that prevails unless they are unemployed for so long that they fall back on to means-tested social assistance.

In conclusion, the paper argues that the 2009 Budget should have as one of its foremost aims the easing of financial hardship experienced by the unemployed, both those currently on the books and those likely to join them as the economy weakens.

## Who benefits from income tax cuts?

Prospective income tax cuts, the result of the pre-election commitment of the Rudd Government to match the income tax cuts proposed by the Howard Government, are described in Table 1 below.

**Table 1: Current and projected personal tax rate scale for resident individuals**

From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable income	Rate %	Taxable income	Rate %	Taxable income	Rate %
\$		\$		\$	
0–6,000	0	0–6,000	0	0–6,000	0
6,001–34,000	15	6,001–35,000	15	6,001–37,000	15
34,001–80,000	30	35,001–80,000	30	37,001–80,000	30
80,001–180,000	40	80,001–180,000	38	80,001–180,000	37
180,001	45	180,001	45	180,001	45

Source: Treasury 2000a, Table 2.2.

Apart from a small adjustment to the 30 per cent income tax threshold, which confers \$150 per annum on all those earning above \$35,000 per annum, most of the benefit from the July 2009 tax cuts (costing \$2.5 billion) goes to those earning over \$80,000.

The July 2010 cuts, which will cost about \$4 billion, are slightly more progressive (\$300 per annum will go to those earning above \$37,000) but again, the greatest benefits go to high-income earners on more than \$80,000. It is possible in the current conditions that a good part of these tax cuts will be saved, not spent.

Several commentators have suggested that the tax cuts should have been brought forward as part of fiscal stimulus. This paper argues that, far from bringing the tax cuts forward, consideration should be given to deferring them until the economic crisis is past. They should be a lower priority than increases in unemployment benefits and other job-creating spending. The aim should be an equitable spread of the burden of economic slowdown.

However, there is one component of the foreshadowed tax cuts that should go ahead. This is the increase in the LITO, which is currently \$1200, will rise to \$1350 in July 2009 and to \$1500 in July 2010. The LITO acts to raise the tax threshold from \$14,000 currently to \$15,000 in July 2009 and \$16,000 in July 2010. Increases in the threshold help low-income earners and are therefore likely to be quickly spent. They also ameliorate some of the high effective marginal tax rates (EMTRs) arising from interaction between income tax and the social security means tests.<sup>3</sup>

### **Effect of different indexation—the NSA and the pension**

The NSA was allowed to wither away during the long boom of the last 15 years. It has been frozen in real terms (that is, indexed to prices) while the pension has been indexed to wages and thus increased with rising real wages. Less generous indexation of the NSA may have had some justification during an era of virtually full employment but this is no longer the situation with unemployment forecast to worsen dramatically. Spending more on the unemployed not only makes sense from a counter-cyclical fiscal policy perspective, it also helps to ameliorate the burden of the economic crisis on those most affected by it.

The single rate of the NSA at \$449.30 per fortnight (\$11,682 per annum) compares with the pension rate of \$562.10 per fortnight (\$14,615 per annum), a difference of \$112.80. The couple rate at \$810.40 per fortnight (\$21,070 per annum) compares with the pension of \$939.00 per fortnight (\$24,414 per annum), a difference of \$128.60. The NSA rate is 80 per cent of the single and 86 per cent of the couple pension rate; to achieve parity therefore requires increases of 25 per cent in the single rate and 16 per cent in the couple rate. Increases in the NSA would necessarily flow through to Sickness Allowance (SA), but this is a relatively small population and the cost negligible.

Under current arrangements, a single pensioner receives 60 per cent of the couple rate and there are pressures to increase this. Estimates of equivalent living standards put the required single rate at between 60 and 70 per cent of the couple rate. By contrast, a single Newstart allowee receives only 55 per cent of a couple's entitlement.<sup>4</sup>

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<sup>3</sup> EMTRs are, however, increased slightly over the range in which the LITO is withdrawn, starting at \$30,000 per annum.

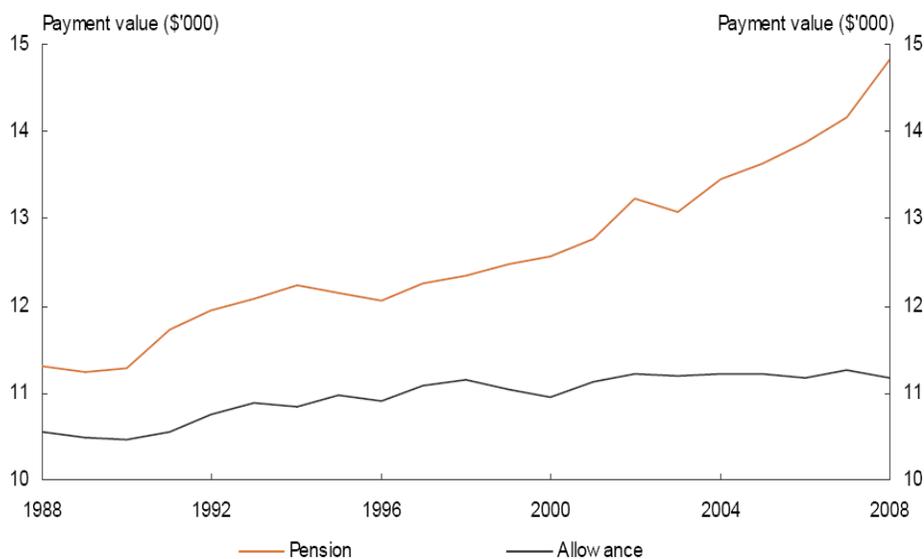
<sup>4</sup> A point also made by ACOSS (2008b, p.8). If a single allowee has a child or is aged over 60 and has been in receipt of an allowance for over nine months, they receive 60 per cent of the couple rate.

These disparities between the NSA and the pension are understated because of supplements paid to pensioners, including the utilities allowance and telephone and pharmaceutical allowances, which increase the gap for singles to \$79 per week (ACOSS 2008a, p.20). The ACOSS paper provides a comparison of living standards between NSA recipients, age pensioners and others, confirming research findings that the NSA and other payments like Austudy and Youth Allowance are inadequate.

This difference is even greater when account is taken of one-off pension bonuses paid in some recent years and pensioner concessions. A pension bonus of \$1400 (single) and \$2100 (married) was paid in December 2008 in addition to bonuses of \$500 per pensioner in the 2008–09 and 2007–08 Budgets (FaHCSIA 2008). Taking these into account exacerbates the rate differences shown in Figure 1.

The gap between the two rates has been widening since 1997 when pension rates were benchmarked to 25 per cent of *male total average weekly earnings* (MTAWE) while NSA rates were indexed to prices. Wages have grown strongly in recent years and the gap has widened as a consequence (Figure 1).

**Figure 1: Real rates of the single pension and allowances, 1988 to 2008**



(a) Rates for all years are expressed in 2008 dollar values.  
 Source: FaHCSIA estimates.  
 Source: Treasury 2008b, Chart 4.3, p. 92.

## Differences in income tests

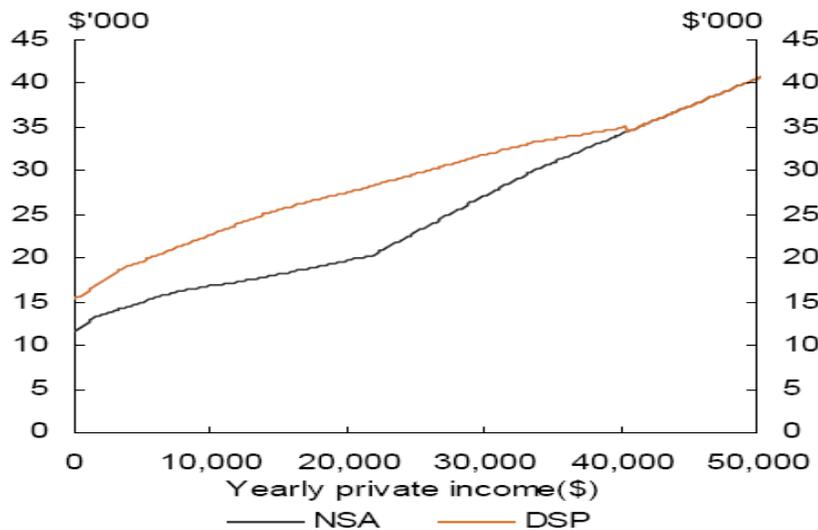
The differences in indexation between the NSA and pensions are exacerbated by the differences in the applicable means-test regimes. An NSA recipient can earn up to \$62 per fortnight (before tax) before payment is affected. Income between \$62 and \$250 reduces the fortnightly payment by 50 cents in the dollar while income above \$250 reduces the payment by 60 cents in the dollar. Partner income, which exceeds the cut-out point, also reduces the payment by 60 cents in the dollar.

The income test for the pension is more generous with a free area of \$138 per fortnight or \$240 per fortnight for a couple. The pension taper at 40 per cent is lower

than the NSA taper of 50 per cent and 60 per cent. Together with the discrepancies in rates, this has created a situation where there is a very strong incentive for Centrelink clients to try and get themselves on to the more generous pension conditions (Figure 2), a situation which concerned the Treasury in its tax consultation paper (2008b, Chapter 4).

For example, an individual with even a moderate disability will naturally seek a Disability Support Pension (DSP) rather than NSA. Not only are the conditions more favourable, but there is limited work testing. By contrast, if an NSA recipient has a disability but is deemed able to work more than 15 hours a week, they may be reliant on Newstart for many years. With a third of NSA clients being long-term unemployed, it is not possible to justify the low NSA rate on the basis that it is only a short-term payment.

**Figure 2: The NSA and DSP compared: disposable incomes by yearly private income**



Source: Treasury 2008b, Chart 4.11, p. 108.

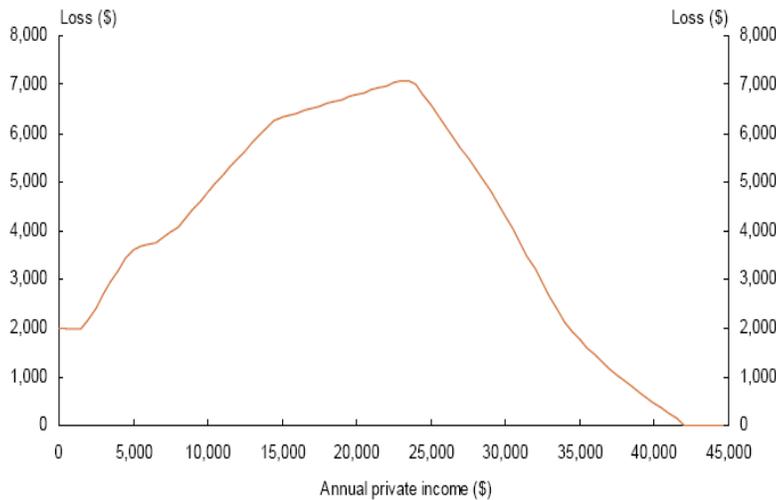
Figure 2 shows the disposable income for given levels of private income accruing to those receiving DSP compared to those receiving the NSA. The maximum difference in disposable income is about \$7000 per annum at a private income of \$20,000 per annum. These anomalies will continue to widen with time given the differences in the indexation regimes.

Similar disparities exist for sole parents transiting from Parenting Payment Single to the NSA. The Welfare to Work changes of July 2006 require sole parents to look for part-time work of 15 hours a week when their youngest child turns six. When the youngest child turns eight, sole parents may be moved on to the NSA and could

experience a drop of over \$200 per fortnight in their benefit income. The new rules allow prior recipients of Parenting Payment to continue on this payment.<sup>5</sup>

Figure 3 (an alternative way of depicting information similar to that in Figure 2) shows the loss of disposable income, depending on the amount of private income received, on moving from Parenting Payment Single to NSA rates. These losses are so great (up to \$7000 per annum) that they are beginning to strain the whole system and undermine the potential for simplifying changes such as a single workforce age payment. They also create severe inequities between those subject to the new rules and those whose Parenting Payment entitlements were ‘grandfathered’ under the 2006 changes.

**Figure 3: Loss of disposable income on switching from Parenting Payment Single to NSA, by annual private income, 2008–09**



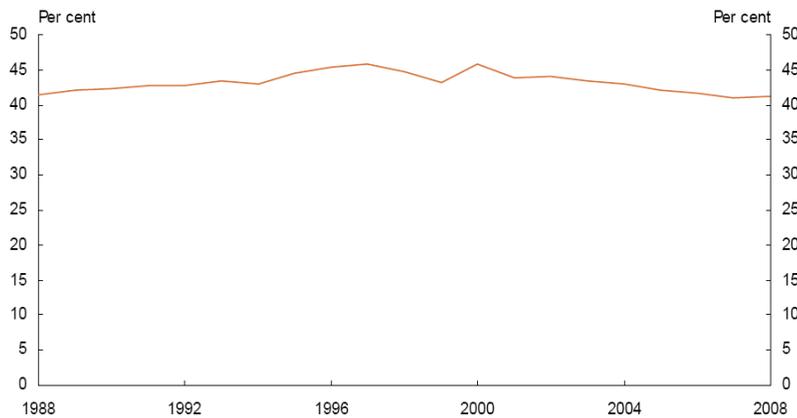
Source: DEEWR estimates.

Source: Treasury 2008b, Chart 4.4, p. 93.

Maximum NSA rates may be constrained by their relationship to the minimum wage, which has been falling as a percentage of the average wage. The result is that the allowance rate, while falling as a percentage of the average wage, has tended to be a fairly steady percentage of the federal minimum wage (FMW) since 2000 and now stands at about 42 per cent, the same proportion as in 1988. An allowee undertaking substantial part-time work can earn 80 per cent of the FMW and still receive some income support (Treasury 2008b, p. 99).

<sup>5</sup> If a sole parent on Parenting Payment with a child aged eight or over ceases to need the payment for over 12 weeks (due to income, re-partnering or loss of custody of the child), they lose it and fall under the NSA regime instead.

**Figure 4: Allowances as a percentage of the minimum wage, 1988 to 2008**



Source: DEEWR estimates.

Source Treasury 2008b, Chart 4.6, p. 99.

How much the NSA can or should be raised relative to the minimum wage is a matter for judgement. For example, the recommended 25 per cent increase in the single NSA would take it to 52 per cent of the minimum wage, with entitlement phasing out at around 100 per cent of the minimum wage. There is no reason to suggest that this should be regarded as excessive.

### Reforming the allowance asset test

The second set of issues concerns the NSA asset test. Unlike the pension test, which phases out at higher asset levels, this is a ‘sudden-death’ test that extinguishes eligibility when assets exceed the cut-outs shown below.

**Table 2: The NSA and pension asset test cut-outs**

	NSA allowees (\$)	Age and DSP pensioners (\$)
Homeowners	171,750	550,500
	243,500	873,500
Non-homeowners	296,250	675,000
	368,000	998,000

The pensioner asset test has the same thresholds as the cut-outs for allowees but exceeding these thresholds does not suddenly extinguish eligibility; instead the pension phases out at the rate of \$1.50 per fortnight (\$39 per annum) for every \$1000 of assets above the limit. This amounts to a 3.9 per cent wealth tax above the thresholds or an imputed income of 9.75 per cent from assets (given the 40 per cent pension taper).

The sudden-death NSA cut-out is arbitrary and unfair, especially to people just above the limits who may end up significantly worse-off than those with several thousand dollars fewer in assets. As a general principle, sudden-death cut-outs should be avoided wherever possible precisely because of this effect, particularly given the

difficulties in measuring asset values accurately. The NSA means test should therefore phase in gradually rather than arbitrarily cutting out people with assets that are not excessive by current community standards (mean household net worth is \$563,000 according to the latest ABS data (ABS 2007)).

One option is to reduce the allowance by, say, \$3 per fortnight<sup>6</sup> for every \$1000 by which assets exceed the thresholds. It is difficult to cost this option but if it added 10 per cent to the cost of the NSA, the cost would be \$500 million per annum.

It is important to note that asset tests in overseas unemployment insurance benefit schemes are unusual. Rather, benefits are related to income in employment and are often time-limited. Asset tests only cut in when insurance benefits lapse and people fall back on social assistance.<sup>7</sup> Responses to recessions often include lengthening the period over which insurance benefits are paid.

### **Liquid assets waiting period**

One of the most penal features of the NSA asset test is the liquid assets waiting period. Liquid assets are defined as cash, bank deposits (including term deposits), shares and debentures and so on. An allowee can be required to serve a waiting period of between one and 13 weeks if their liquid assets exceed \$2500 (\$5000 for a couple).<sup>8</sup> These are very small amounts and the whole point of this test appears to be highly punitive.

The test is in addition to the *income maintenance period*, which affects payment for that period of time relating to accrued leave paid out as a lump sum. While the liquid asset waiting period is partly aimed at those who have received a termination payment from their last job, the philosophy behind it is in complete contrast to the insurance philosophy of most OECD countries whereby unemployment payments are payable simply because of the contingency of job loss.

In 1997 the Coalition Government halved the allowable assets of \$5,000 (for singles) and \$10,000 (for couples) as part of their general policy of punishing the unemployed. At the very minimum, this should be undone. A fairer policy, however, would be to abolish the liquid assets waiting period altogether. We estimate that this would cost some \$50 million per annum.

### **Conclusion**

The two fiscal stimulus packages, while probably preventing many more people from becoming unemployed, have largely overlooked those who actually are unemployed. But it is not too late. The 2009 budget should have, as one of its aims, an easing of conditions for the unemployed who are subject to sub-poverty-line payment rates and a stigmatising and onerous asset and income-test regime.

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<sup>6</sup> This was the rate under the pension asset test prior to the 2007 changes.

<sup>7</sup> Such social assistance can be more tightly means-tested than NSA.

<sup>8</sup> For each \$1000 over the limit, a person faces a one-week waiting period up to the maximum of 13 weeks; thus with \$15,500 a single person can wait three months to receive any NSA. In 2003–04, 38,460 NSA recipients were affected by the provision, with an average waiting period of 8.4 weeks (National Welfare Rights Network 2005).

Monies directed to the unemployed will be quickly spent and will thus be more stimulatory than tax cuts for the middle class and well-off. They should thus be a higher priority for a government that calls itself social-democratic. In addition, the burden of adjustment to the economic crisis will be spread more fairly across the whole of the population, with the measures directly benefiting those most adversely affected.

The total estimated cost of the changes suggested in this paper is set out in Table 3. The cost would rise with increases in unemployment, from \$1.6 billion currently to about \$2.8 billion, but that is a desirable feature of an automatic stabiliser. Overall, the cost would be a modest part of the total fiscal stimulus so far, amounting to some \$52 billion.

**Table 3: Total cost of proposed NSA changes 2008–09 (\$m)**

<b>Increase rates to pension parity</b>	<b>Tapered asset test</b>	<b>Abolish liquid asset waiting period</b>	<b>Total</b>
\$1100	\$500	\$50	\$1650

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