

## Document 7

**From:**  
**Sent:** Thursday, 12 July 2012 3:45 PM  
**To:** IncomeSupportTaskforce@deewr.gov.au  
**Cc:** @deewr.gov.au); @deewr.gov.au;  
**Subject:** FW: Treasury Modelling [SEC=UNCLASSIFIED]  
**Attachments:** Kalb 2000 C Labour supply and welfare participation in Australian two adult households-accounting for involuntary unemployment and the cost of part ime work WP BP-35.pdf

**Importance:** High

**Security Classification:** UNCLASSIFIED

Please find below a note from the Treasury modelling team looking into the potential participation impacts of changes to the rate of Newstart.

Regards,

-----

Hi

Further to our conversation from last week, regarding the issues in using our behavioural model STINMOD\_B for modelling the participation impacts of changes to unemployment allowances, we have investigated further and concluded that **the model is not suitable** to analyse the changes requested. There are two important reasons for this:

- (1) The model assumes that unemployment is a choice. It is based on the assumption that people's observed hours in the base (estimation) data reflect their preferred utility-maximising hours. While this may be a reasonable assumption for much of the population, it is obviously a mis-representation of the situation of the unemployed.
- (2) The model assesses entitlement purely on the basis of broad characteristics and income-testing. It does not take into account the assets test (including liquid assets), work or job search requirements, any social stigma that may be attached to receiving welfare benefits, or any future gains that working now could produce in the future in regards to promotions, wage rises etc.

For these reasons, the model will grossly over-estimate the additional receipt of unemployment allowances in the event of them being made more generous.

Some research into the second of the above two reasons has been undertaken by Kalb (2000) in ‘Labour supply and welfare participation in Australian two adult households – accounting for involuntary unemployment and the cost of part time work’ (see attached). Kalb notes that ‘Welfare payments are not just ‘free’ income for which no work has to be done, but they have a negative side effect attached to them when received by a household.’ The costs involved include running down liquid assets and meeting the job search requirements prescribed by Centrelink. As Kalb notes, ‘applying for welfare is not as attractive as some people seem to think.’ This is particularly relevant for changes to the NewStart Allowance, which is activity tested.

A higher unemployment benefit would reduce the relative financial returns from working (**assuming the benefit is accessible** if the person drops out of the labour force), but caution needs to be taken in assessing its impacts on labour supply because of the considerations noted above. An increase of \$50 a week is fairly substantial so we do believe it will have a negative participation effect, but cannot quantify it. Secondary earner parents who often have lower returns from working due to child care costs could be more reactive to the increase. The increase to PPP, **which is not activity tested if families have a child aged under 6**, may make paid work less attractive for secondary earners with young children who have either low wages, or are currently working part time. This would only be the case though for couples where the primary earner’s wage is at a level that does not income test out their partner’s allowance.

A rise to the rate of Youth Allowance may also make full time study more attractive to young people.

In our investigations of the proposals we went back in time and applied both ALCI(o) indexation and MTAW benchmarking to working age income support payments to see what impact a change in indexation over a few years would have. The table below presents a comparison of the current payment rates with the alternative indexation rates; having been applied to the payment from the 20<sup>th</sup> September 2008.

	Current payment rates	Current rate had ALCI(o) indexation applied since 20th September 2008	Current rate had MTAW benchmarking applied since 20th September 2008
Coupled	\$442.00	\$455.20	\$474.50
Singles (No dependents)	\$489.70	\$504.50	\$525.90
Singles (Aged 60 and Over, Continually in receipt of NSA for 9 months or more)	\$529.80	\$545.80	\$568.80
Single Parents	\$529.80	\$545.80	\$568.80

As an aside, we note that an equal \$50 increase to allowances for both singles and each member of a couple would distort the current relativity between them. We also noted that an increase of \$50 a week each for a couple with children could mean that the couple is receiving some allowance at a level of income above the first FTBA income threshold, thus resulting in a sudden decrease to their FTBA payment if they were to lose their last dollar of allowance.

Happy to discuss further.

Regards

