The Distributional Impact of the Proposed Welfare-to-Work Reforms upon Sole Parents and People with Disabilities

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Abstract

In the May 2005 Budget the Federal Government announced a range of proposed welfare to work measures, to take effect from 1 July 2006. Among the numerous measures announced in the Budget were significant changes for sole parents and people with disabilities. Essentially, those sole parents who claim income support after 1 July 2006 with a youngest child aged 6 years or more will be placed on Newstart Allowance, rather than Parenting Payment Single. Similarly, those people with disabilities who apply for income support after 1 July 2006 and who can work between 15 and 29 hours a week at award wages will be placed on Newstart Allowance or Youth Allowance rather than Disability Support Pension.

This report analyses the impact of the proposed changes upon the disposable incomes and effective marginal tax rates of these two groups of people. It shows that the disposable incomes of sole parents can be up to about $100 a week lower under the proposed new system than under the current system and that the losses for people with disabilities could be as high as $120. It also finds that effective marginal tax rates will be sharply increased under the proposed new system over a reasonably wide range of earned income for these two groups of people.

Author note

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1 Introduction

In the May 2005 Budget the Federal Government announced a range of proposed welfare to work measures, to take effect from 1 July 2006. Against the backdrop of projected slower rates of workforce growth in the future due to population ageing (Productivity Commission, 2005), the government is keen to encourage labour force participation. In addition, reducing welfare dependency and increasing employment is seen as likely to improve the lifetime incomes and economic well-being of welfare recipients, as well as boosting economic growth for Australia as a whole. Earlier research by NATSEM and AMP, for example, has shown clearly that many baby boomers have not yet saved sufficient to finance a comfortable retirement – and that this problem is particularly acute for baby boomer women (Kelly and Harding, 2002; Kelly et al, 2002; Kelly, Farbotko and Harding, 2004).

Among the numerous measures announced in the Budget were significant changes in the income support policies for sole parents and people with disabilities. Currently, sole parents with a qualifying child aged less than 16 years who meet various income and asset tests can receive Parenting Payment Single (PPS), which is subject to the pension income test and payment rate rules. Those sole parents who are in receipt of PPS prior to 1 July 2006 will continue to remain on that payment and be subject to the ‘pension’ income test (which is more generous than the ‘allowance’ income test), until their youngest child turns 16. However, new compulsory work obligations will be imposed on this group from the later of 1 July 2007 or when their youngest child turns six. These new obligations will be satisfied by working part-time for a minimum of 15 hours a week or by searching for part-time work and participating in Job Network or other services. 1

The major changes are for those sole parents who apply for income support after 1 July 2006. Those who have a child aged less than six years will still be eligible to receive PPS. However, as soon as their youngest child turns six, they will be transferred to Newstart Allowance (NSA) and be subject to an obligation to seek part-time work of at least 15 hours per week. Those whose youngest child is aged six years or more at the time of application will be placed straight onto Newstart and be obliged to seek part-time work of at least 15 hours a week.

Moving to people with disabilities, under the current system those with physical, intellectual or psychiatric impairment at a sufficient level to make them unable to work for at least 30 hours a week (or undertake training that would equip them for

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1 The Government also announced new spending of $390 million over four years to help increase employment amongst parents of school aged children, including a new Employment Preparation service. 

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work) for at least the next two years are able to receive Disability Support Pension (DSP). DSP is also subject to the pension income test and payment rate rules. Under the proposals, those people with disabilities who are in receipt of DSP prior to 1 July 2006 will generally continue to remain on that payment and be subject to the ‘pension’ income test. Current DSP recipients who give work a go will have a right to return to DSP within two years if they start a job but are unable to sustain it for any reason (Dutton, 2005a). Those people with disabilities who apply for income support after 1 July 2006 who are assessed by the new ‘comprehensive work capacity assessment’ as being able to work 15 to 29 hours per week at award wages in the open labour market will be required to seek 15 hours or more of part-time work a week and will be placed on NSA or Youth Allowance.

While the ‘grandfathering’ provisions mean that sole parents or people with disabilities who are currently on pensions will remain on them, the proposed changes will have a significant impact on those sole parents and people with disabilities who apply for income support after 1 July 2006. NSA provides a lower payment rate than PPS and DSP, and it has a much less generous income test. As a result, in the future many sole parents with school age children and many people with disabilities will receive much lower incomes than under the current rules. In addition, the returns from paid work will be much lower than currently.

Section 2 of this paper analyses the impact upon sole parents of the proposed reforms, including a description of the current and new payment structures and analysis of the changes in the disposable incomes and effective marginal tax rates of affected sole parents. Section 3 repeats the analysis for people with disabilities, while Section 4 concludes.

2 Impact on sole parents

2.1 The PPS and NSA programs

There is inevitably some uncertainty about the exact payment rates for NSA and PPS that will apply in 2006-07, as they depend upon future trends in average weekly earnings and the consumer price index. The following estimates are based on

2 The exception is people applying for DSP between 11 May 2005 and 30 June 2006, who will be assessed for DSP under the existing 30 hours test but be reassessed in periodic reviews against the 15-29 hours test after 1 July 2006. Those able to work 15 to 29 hours per week will be shifted to Newstart and be required to seek work.
NATSEM’s latest projections of these indexes. Using slightly different assumptions about earnings and price changes would slightly change the results. Our modelling is also based on the Government’s current statements about the structure of income support after 1 July 2006 (Andrews, 2005a, 2005b). However, as the legislation has not yet been introduced, it is possible that there may be minor changes to some of the programs and parameters that have fed into our modelling.

Sole parents with one child and no private income receiving PPS are expected to receive about $257 a week on average in PPS in 2006-07 (‘Private income’ means income from sources other than government cash transfers, such as earnings.) (Table 1). A crucial factor is the amount of private income that they can receive before their income support payment is reduced. In 2006-07, a sole parent with one child on PPS will be able to earn $76 a week without any reduction in the income support they receive. For every dollar of income they earn above this threshold, their payment from government is reduced by 40 cents. This is also the payment rate and income test that will face those sole parents who apply for PPS after 1 July 2006 and have a youngest child aged less than six years.

The proposed payment rate and income test for new sole parents whose youngest child is aged six years and over is also summarised in Table 1. They will be placed on NSA, which is expected to average $228 a week in 2006-07. This is $29 a week less than the PPS payment rate. In addition, they will be able to earn only $31 a week before their income support payment begins to be reduced. That is, their ‘free area’ will decline sharply relative to the current rules, by about $45 a week. The first $94 of private income above that $31 a week ‘free area’ will reduce their NSA by 50 cents for every dollar of private income above the free area. Once they reach the second income test threshold of $125 a week, this withdrawal rate will increase further, with their allowance rate being reduced by 60 cents for every additional dollar of earnings. In other words, once their private incomes reach $125 a week, they will keep a maximum of 40 cents out of each additional dollar of private income, until they reach the ‘cut out point’ where they receive no further allowance from government.

The NSA income test is thus much more restrictive than the PPS income test, and this is reflected in the very different ‘cut out points’ shown in Table 1. Sole parents with one child on PPS will be able to earn up to around $718 per week before their entitlement to income support is extinguished. Sole parents with one child on NSA will only be able to earn up to about $426 a week before their entitlement to income support is extinguished.

This means that income support will cease at a much lower level of earnings for those subject to the new NSA test than for those on the existing PPS. For those with more than one child the difference will be even greater, as the ‘free area’ for PPS is
increased by a further $12.30 per child per week for each child after the first, whereas the ‘free area’ under NSA does not vary with the number of children.

Table 1  Summary of the Newstart Allowance and Parenting Payment Single Payments for Sole Parents with One Child, 2006-07a

<table>
<thead>
<tr>
<th></th>
<th>Parenting Payment Single (PPS)</th>
<th>Newstart Allowance (NSA)</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment rate for those with one child</td>
<td>$257</td>
<td>$228 b</td>
<td>-$29</td>
</tr>
<tr>
<td>Amount of income that can be earned before payment is reduced</td>
<td>$76</td>
<td>$31</td>
<td>-$45</td>
</tr>
<tr>
<td>Withdrawal rate for each $ of private income above this threshold</td>
<td>40%</td>
<td>50%</td>
<td>+ 10%</td>
</tr>
<tr>
<td>Second income test threshold</td>
<td>na</td>
<td>$125</td>
<td></td>
</tr>
<tr>
<td>Withdrawal rate for each $ of private income above this threshold</td>
<td>40%</td>
<td>60%</td>
<td>+20%</td>
</tr>
<tr>
<td>Income support cuts out when private income reaches this point (cut-out point)</td>
<td>$718 c</td>
<td>$426 c</td>
<td>$292</td>
</tr>
</tbody>
</table>

a These are the estimated averaged payment rates and thresholds that will apply in 2006-07. The actual payment rates vary at various points throughout the financial year, in line with indexation arrangements. All figures rounded to nearest whole dollar.

b This includes $2.90 a week of Pharmaceutical Allowance, which the government has said will also now be paid to Newstart Allowees who are sole parents.

c This includes the effect of the $2.90 a week of Pharmaceutical Allowance.

Source: Specially created version of STINMOD/05A

Sole parents receiving NSA will clearly receive lower payments and face a harsher income test than those on PPS: however there are also other, less obvious, factors that will adversely affect them relative to PPS recipients. One is that pensioners (who include PPS recipients) qualify for the Pensioner Tax Offset. The aim of the tax offset is to ensure that no tax is payable by a pensioner whose assessable income consists of the pension and around $144 a week of non-pension income. In 2006-07, some tax reduction will be received by PPS recipients whose taxable income is less than about $35,000. In contrast, the Beneficiary Tax Offset (which ensures no tax is payable by maximum rate allowance recipients with up to $31 a week of private income — and begins to be withdrawn when private income is above $31 a week) means some tax reduction will be received by sole parent NSA recipients whose taxable income is less than about $27,500. Thus, the reduction in income tax liabilities allowed is much greater for pensioners than for allowance recipients.

A second issue is the receipt of the Pensioner Concession Card. PPS recipients are automatically entitled to a Pensioner Concession Card, which many organisations
use as a ‘passport’ to a range of concessional prices for such services as property charges and taxes, energy, water, transport, education, health, car registration, housing and recreation services and so on. While such services are often provided by State and local governments, many private sector businesses also use the possession of a Pensioner Concession Card as the trigger for lower prices for such diverse services as movie tickets and shoe repairs. Similarly, doctors may often bulk bill those with Pensioner Concession Cards, so that they do not have to pay any additional co-payment.

The Government has stated that those sole parents who are shifted to NSA under the proposed new arrangements will retain the right to a Pensioner Concession Card. However, as Table 1 makes clear, eligibility for NSA for sole parents will cease at a much lower level of private income than eligibility for PPS. As a result, there is a wide range of private income of almost $300 a week over which those sole parents who would formerly have qualified for the Pensioner Concession Card will apparently not qualify under the new rules.

Most such sole parents will still receive a Health Care Card, via their receipt of maximum rate Family Tax Benefit Part A, but some concessions are provided by State and local governments and other organisations only to those with Pensioner Concession Cards and not to those with Health Care Cards. In Victoria, for example, Pensioner Concession Card holders (but not Health Care Card holders) qualify for an additional municipal rates concession of up to $160 a year and an additional transport accident charge concession of up to about $170 a year. Thus, the loss of these three items alone could reduce the effective income of some sole parents by some $6 a week. However, the value to sole parents of the Health Care Card or the Pensioner Concession Card have not been included in the following analysis of their disposable incomes.

As well, under the existing NSA arrangements sole parents would no longer be eligible for the Pensioner Education Supplement. This supplement is currently worth $31.20 a week.

2.2 Disposable incomes

Figure 1 traces the impact upon the disposable incomes of sole parents who would qualify for PPS under the current rules but will qualify for NSA under the proposed new rules. Thus, the graph shows the impact upon those sole parents whose youngest child is aged six to 15 years and who commence receipt of income support after 1 July 2006. For simplicity, the figure abstracts from the precise point in the year at which sole parents become eligible for the payments and simply shows the estimated averages for the entire 2006-07 year.
Disposable income means the income that sole parents have left in their pockets to spend each week, after the receipt of any income support and/or private income, the payment of income tax and Medicare levy (net of the various tax allowances such as the pensioner tax offset and the low income tax rebate). The figure does not take any account of any possible child care costs or rebates or the possible impact of rising private income levels on such factors as consequent increases in public housing rents. The value of the Pensioner Concession Card is also not included.

As clearly shown in Figure 1, the disposable incomes of sole parents with one child aged six years and over are much lower under the proposed new system than under the current system over a very broad range of private income. The losses sustained by sole parents amount to almost $100 a week when earnings are between about $200 and $450. As shown in Table 2, for example, the proposed new reforms reduce the ‘take-home’ incomes of sole parents with one child and earnings of $200 a week from $531 under the current system to $439 under the proposed new system – a cut of $92 a week. This effectively represents a 17 per cent cut in the living standards of these sole parents and their children. It should perhaps be mentioned again that cuts of this magnitude will be experienced almost overnight by sole parents when their youngest child turns six.  

\[3\]

\[3\] It should be noted here that under the existing system sole parents are transferred from Parenting Payment Single to Newstart Allowance when their youngest child reaches the age of 16 years. Thus, ‘overnight’ cuts in income are also a feature of the current system – but 10 years later than is proposed for the new scheme.
At low levels of private income, there is about a $30 a week difference between the proposed new and existing systems, due to the difference between the maximum rates of pension and allowance. At the other end of the spectrum, above around $700 a week, there is no difference in the incomes of sole parents under the proposed new and current systems because, beyond this point, they are not receiving any income support. Between these points, disposable incomes of sole parents are lower under the new system than under the current system, primarily because of the stricter income test applying to NSA but also because of the less favourable tax concessions for allowees compared with pensioners.4

4 Sole parents with two and three children have higher disposable incomes than those with only one child, due to the receipt of additional Family Tax Benefit Part A payments. Moreover, at most income ranges, the losses that those with two and three children will experience under the new system are slightly higher than for those for one child due to the additional ‘free area’ per child of $12.30 per week allowed under the Parenting Payment Single income test. More detailed analysis can be found in Harding et al (2005a).
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Table 2 Impact of proposed new system on disposable incomes and EMTRs of sole parents with various levels of earnings, 2006-07

<table>
<thead>
<tr>
<th>Private Income</th>
<th>Disposable Income</th>
<th>Effective Marginal Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current System</td>
<td>New System</td>
</tr>
<tr>
<td></td>
<td>$ pw</td>
<td>$ pw</td>
</tr>
<tr>
<td>One child aged 6 years and over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0</td>
<td>385</td>
<td>356</td>
</tr>
<tr>
<td>$50</td>
<td>435</td>
<td>394</td>
</tr>
<tr>
<td>$100</td>
<td>476</td>
<td>411</td>
</tr>
<tr>
<td>$150</td>
<td>506</td>
<td>426</td>
</tr>
<tr>
<td>$200</td>
<td>531</td>
<td>439</td>
</tr>
<tr>
<td>$300</td>
<td>565</td>
<td>470</td>
</tr>
<tr>
<td>$400</td>
<td>597</td>
<td>504</td>
</tr>
<tr>
<td>$500</td>
<td>632</td>
<td>562</td>
</tr>
<tr>
<td>$600</td>
<td>656</td>
<td>629</td>
</tr>
<tr>
<td>Two children aged 6 years and over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$0</td>
<td>468</td>
<td>439</td>
</tr>
<tr>
<td>$50</td>
<td>518</td>
<td>477</td>
</tr>
<tr>
<td>$100</td>
<td>563</td>
<td>494</td>
</tr>
<tr>
<td>$150</td>
<td>593</td>
<td>509</td>
</tr>
<tr>
<td>$200</td>
<td>617</td>
<td>522</td>
</tr>
<tr>
<td>$300</td>
<td>651</td>
<td>553</td>
</tr>
<tr>
<td>$400</td>
<td>683</td>
<td>587</td>
</tr>
<tr>
<td>$500</td>
<td>717</td>
<td>645</td>
</tr>
<tr>
<td>$600</td>
<td>750</td>
<td>714</td>
</tr>
</tbody>
</table>

Note: Averaged 2006-07 payment levels have been used. All dollar figures rounded to nearest dollar. All EMTRs rounded to nearest one per cent. Note that we have been unable to simulate the receipt by sole parent Newstart Allowees of Pharmaceutical Allowance within the time frame allowed for this project. Pharmaceutical Allowance (PA) has a particularly complicated income test and is also non-taxable. To make a fair comparison between the current and proposed systems, we have excluded Pharmaceutical Allowance from the calculations in both the current and proposed new world. However, this exclusion makes little difference, as the payment is only worth $2.90 a week and is received by sole parents in both the current and proposed new systems if they are in receipt of income support. Thus, the difference between the two systems is in most cases not affected by this exclusion. It should be noted that Pharmaceutical Allowance is also excluded in Figures 1.

For simplicity, in this Table and in Figures 1, it is assumed that the sole parents are not receiving any child support. As such child support is received in both the existing and proposed new systems, and affects only Family Tax Benefit Part A entitlement rather than income support payments, this makes no difference to the results.

* The $pw changes in disposable incomes may not exactly equal the difference between the two figures due to rounding.

Source: Specially created version of STINMOD/05A

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2.3 EMTRs

When announcing the Welfare to Work Budget changes, Minister Kevin Andrews noted that ‘these changes are designed to assist, support and encourage parents to return to work when their children are old enough to go to school’ (Andrews 2005a). One of the factors affecting the workforce incentives of sole parents is the effective marginal tax rate that they face. An effective marginal tax rate (EMTR) measures how much of an additional dollar of earnings sole parents actually keep, after taking account of the various income tests associated with social security and family payments, the payment of income tax and the receipt of various tax allowances and rebates. An EMTR of 70 per cent means that the ‘disposable’ or ‘take-home’ income of a sole parent will increase by only 30 cents when earnings increase by $1.

The EMTR graph shown in Figure 2 takes no account of the possible increased costs associated with rising earnings, such as increased transport or child care costs. It also takes no account of possible ‘knock on’ effects to programs or services not administered by the Federal Government, such as rent payments for public housing tenants or State and local government concessions. As a result, the EMTRs can probably be regarded as being somewhat lower than those that will face sole parents in the real world. As explained above, this is because we have at this stage probably over-estimated how much of each additional dollar of earnings many sole parents will actually retain to improve the welfare of themselves and their children, primarily by taking no account of any increased costs associated with working.

For sole parents with one child aged six years and over, the EMTRs faced at lower levels of private income (that is, earnings) are generally higher under the new system than under the existing system. Sole parents with weekly private incomes between around $31 and $76 a week face an EMTR of 65 per cent under the new system, compared with a zero EMTR under the current system. That is, for each additional dollar of earnings in this range, sole parents will keep only 35 cents under the new system, compared with 100 cents under the existing system.

Sole parents with one child with private incomes between $76 a week and $125 a week will also face substantially higher EMTRs under the proposed new system – 65 per cent under the new system compared with only 40 per cent under the current system. That is, each additional dollar of earnings in this range net sole parents 25 cents less under the new system than under the existing system.
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Figure 2 EMTRs facing sole parents with one child aged 6 years or over under current and proposed systems, 2006-07

Why do sole parents face a 65 per cent EMTR when their private income ranges between $31 and $125 a week under the proposed new system (compared with either a 0 or 40 per cent EMTR under the current system)? This effect is due to ‘income test stacking’, with sole parents facing a 50 per cent EMTR due to the allowance income test plus a 15 per cent EMTR due to a combination of the effective withdrawal of the ‘allowance tax offset’ and the payment of income tax. The ‘pensioner tax offset’, in contrast, is withdrawn at the lesser rate of 12.5 per cent and only from a private income level which is almost five times higher than that for the beneficiary tax offset ($31 of private income per week for allowees versus $144 of private income per week for sole parent pensioners). Thus, one of the less obvious implications for sole parents of the proposed changes is that they will be subject to the harsher allowance tax offset under the new system rather than the more generous pensioner tax offset which applies under the current system.

Private incomes between $125 a week and $171 a week are again subject to much higher EMTRs under the proposed new system – 75 per cent under the new system compared with only 40 per cent under the existing system. Thus, the current system
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allows sole parents to keep an extra 35 cents out of every additional dollar of income that they earn in this range, relative to the proposed new system.

Put another way, over this income range the rewards to sole parents for working are almost twice as high under the existing system as under the proposed new system. The particularly high EMTRs under the new system are due to the allowance withdrawal rate rising from 50 to 60 per cent, with this being stacked on top of the effective withdrawal of the allowance tax offset and the payment of income tax.

Under the NSA regime, sole parents with a weekly income of just above $420 cease receiving any allowance and their EMTRs fall to those facing standard taxpayers. Their EMTRs of 34 per cent consist of the 30 per cent payable through the standard income tax schedules plus the 4 per cent withdrawal of the Low Income Tax Offset (LITO). Once the LITO withdrawal finishes, their EMTRs remain at 30 per cent until they start paying the Medicare levy, at $594 of private income. Where private incomes range from about $230 to just over $400, those sole parents under the existing system face higher EMTRs than those under the proposed system, as sole parents under the existing system face one or more of the 40 per cent pension income test withdrawal, the 30 per cent tax rate, and the withdrawal of the LITO and the pensioner tax offset.

What do the higher EMTRs facing sole parents with one child under the proposed new regime mean in practical terms? Those sole parents receiving NSA with private incomes ranging between $31 a week and $420 a week face EMTRs of 65 per cent or more. This is substantially higher than the top marginal income tax rate of 48.5 per cent (including Medicare levy) paid by the most affluent taxpayers in 2006-07 – that is, those whose taxable incomes exceed $125,000 a year. As shown below, the impact of these high EMTRs is to ensure that the financial benefits from work are very low for sole parents receiving NSA.

Our earlier analysis has shown clearly that those sole parents who are receiving PPS and do not currently have jobs are a particularly disadvantaged section of the labour market (Harding et al, 2005b, p. 205). A striking 80 per cent have no post-school qualifications – and the wages that they can expect to command will thus be relatively low.

The recently announced minimum wage is $484 for a 38 hour week, or $12.74 an hour. Suppose we examine the likely impact of the proposed new system on a sole parent with one child on NSA who manages to find a 15 hour a week job that thus satisfies the proposed new work obligations and for which the pay is $191 a week ($12.75 an hour multiplied by 15 hours). Under the current system, this sole parent will keep $142 of this $191, thus substantially increasing the amount of income they have to support themselves and their child after moving from no paid work to the 15 hours of paid work. Under the proposed new system, this sole parent will

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experience only an $80 a week increase in their take-home income. In effect, the Federal government will be the major beneficiary of this sole parent being required to undertake 15 hours of paid work a week. Thus, while the sole parent will keep $80 a week of their $191 a week of earnings, the government will take the other $111, via reduced NSA and increased income tax payments.

If we follow an example recently used by the government and compare a sole parent on PPS with no private income with a sole parent on Newstart Allowance earning $191 a week, the difference in disposable income is only $51 a week. (This is the difference between the $436 shown in the black column below and the $385 shown in the green column below). This $51 gain represents an effective return of $3.40 for each of the 15 hours of work. 5

And making the assumption that the sole parent on NSA will actually experience this $51 gain assumes that the costs of work are zero and that there are no ‘knock on’ effects to other income-tested programs. Public housing tenants generally pay 25 per cent of their gross income in rent. In the example given above, the gross income of the sole parent increases by $75 as they move from PPS with no private income to Newstart with $191 a week of earnings. (This equals the $51 gain mentioned earlier plus the $24 paid in income tax by the sole parent on Newstart, because public housing rent is assessed against gross rather than ‘after-tax’ income.) As a result, if this sole parent was in public housing, their rent would increase by $19 a week – further eroding the $51 gain to only $32. As shown in figure 4 below, just under one-third of all those sole parents currently on PPS who do not have jobs are in public housing. On this basis, we can expect that a substantial proportion of sole parents affected by the welfare to work policy will be public housing tenants, and thus face effective tax rates of more than 80 per cent over wide earnings bands. Returning again to our example, if the costs of work for such a sole parent through transport, clothing etc exceed $31 a week, then the sole parent is no better off on Newstart working 15 hours a week than they are on Parenting Payment Single and not working at all. This underlines how low the gains from paid work can be under the relatively harsh Newstart Allowance income test.

5 The Minister calculated a $58 gain, rather than the $51 shown here, because he used 2005 income support payment rates (Andrews, 2005c). By 2006-07 the gap between the basic rate of Newstart and PPS will have increased by another $7, due to their different indexation arrangements. (The Minister’s figures also included Rent Assistance, but this is paid in both the ‘before’ and ‘after’ calculations, and thus does not affect the ‘bottom line’ of $51 a week gain.)
Figure 3 Disposable income of sole parent under current and proposed system at zero and $191 a week of earnings, 2006-07

Note: Sole parent with one child aged six years and over.

Figure 4 Housing tenure of PPS recipients who do not have a job

Data source: ABS 2002-03 Survey of Income and Housing Costs confidentialised unit record file
3 Impact on people with disabilities

3.1 The DSP and NSA programs

As with the payment rates for PPS, the exact payment rates for NSA and DSP that will apply in 2006-07 depend upon future trends in average weekly earnings and the consumer price index. Once again, the following estimates are based on NATSEM’s latest projections of these indexes, and our modelling is also based on the Government’s current statements about the structure of income support after 1 July 2006 (Dutton, 2005a, 2005b).

Single DSP recipients aged over 20 years age are expected to receive about $257 a week on average in DSP in 2006-07 (Table 3). Using the same definition of private income as in section 2, a single DSP recipient will be able to earn $64 of private income a week in 2006-07 without any reduction in the income support they receive. For every dollar of income they earn above this threshold, their payment from government is reduced by 40 cents.

The proposed payment rate and income test for Australians with disabilities that are assessed as being able to work 15 to 29 hours a week are also summarised in Table 3. They will be placed on NSA, which is expected to average $211 a week in 2006-07. This is $46 a week less than the DSP payment rate. In addition, they will be able to earn only $31 a week before their income support payment begins to be reduced. That is, their ‘free area’ will decline sharply relative to the current rules, by about $33 a week. The first $94 of private income above that $31 a week ‘free area’ will reduce their NSA by 50 cents for every dollar of private income above the free area. Once they reach the second income test threshold of $125 a week, this withdrawal rate will increase further, with their allowance rate being reduced by 60 cents for every additional dollar of earnings, until they reach the ‘cut out point’ where they receive no further allowance from government.

The NSA income test is thus much more restrictive than the DSP income test, and this is reflected in the very different ‘cut out points’ shown in Table 3. Single DSP recipients will be able to earn up to around $706 per week before their entitlement to part-rate income support is extinguished. People with disabilities on NSA will only be able to earn up to about $398 a week before their entitlement to income support is extinguished, meaning that income support will cease at a much lower level of earnings for those subject to the new NSA test than for those on the existing DSP.
Table 3  **Summary of the Newstart Allowance and Disability Support Pension Payments for Single Person Aged 21 to 60, 2006-07**

<table>
<thead>
<tr>
<th></th>
<th>Disability Support Pension DSP</th>
<th>Newstart Allowance NSA</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Payment rate</strong></td>
<td>$257  b</td>
<td>$211  b</td>
<td>-$46</td>
</tr>
<tr>
<td><strong>Amount of income that can be earned before payment is reduced</strong></td>
<td>$64</td>
<td>$31</td>
<td>-$33</td>
</tr>
<tr>
<td><strong>Withdrawal rate for each $ of private income above this threshold</strong></td>
<td>40%</td>
<td>50%</td>
<td>+ 10%</td>
</tr>
<tr>
<td><strong>Second income test threshold</strong></td>
<td>Na</td>
<td>$125</td>
<td></td>
</tr>
<tr>
<td><strong>Withdrawal rate for each $ of private income above this threshold</strong></td>
<td>40%</td>
<td>60%</td>
<td>+20%</td>
</tr>
<tr>
<td><strong>Income support cuts out when private income reaches this point (cut-out point)</strong></td>
<td>$706  c</td>
<td>$398  c</td>
<td>-$308</td>
</tr>
</tbody>
</table>

*a* These are the estimated averaged payment rates and thresholds that will apply in 2006-07. The actual payment rates vary at various points throughout the financial year, in line with indexation arrangements. All figures rounded to nearest whole dollar. Both NSA/YA with disabilities and DSP recipients will receive the Pensioner Concession Card, Pharmaceutical Allowance (PA) and Telephone Allowance. NSA/YA recipients with disabilities who are unable to use public transport to undertake job search and take up employment will be able to receive Mobility Allowance of $50 a week. DSP recipients who cannot use public transport and are undertaking sufficient paid or voluntary work or vocational training or job search activities also receive $50 a week in Mobility Allowance. Mobility Allowance is not income or asset tested.

*b* This includes $2.90 a week of PA.

*c* This includes the effect of the $2.90 a week of PA.

**Source:** Specially created version of STINMOD/05A

Being put on NSA, people with disabilities will clearly receive lower payments and face a harsher income test than those on DSP. In addition, like the case of PPS, there are also other, less obvious, factors that will adversely affect them relative to DSP recipients. One is that DSP is not subject to income tax. In contrast, both NSA and Youth Allowance are taxable payments. This means that those with earned or other private incomes in addition to their income support are adversely affected by being placed on Newstart rather than DSP. A second issue, outlined earlier in section 2, is the receipt of the Pensioner Concession Card. As table 3 makes clear, eligibility for NSA for people with disabilities will cease at a much lower level of private income than eligibility for DSP - $706 vs $398. As a result, there is a wide range of private income of more than $300 a week over which those Australians with disabilities who would formerly have qualified for the Pensioner Concession Card will apparently not qualify under the new rules. In addition, it appears that those people with disabilities with private incomes above $398 a week will not receive a Health Care Card - and thus will lose their right to concessional pharmaceuticals. Those people receiving Mobility Allowance will still receive a Health Care Card, but as seen
earlier, some concessions are provided by State and local governments and other organisations only to those with Pensioner Concession Cards and not to those with Health Care Cards. This further extends the loss of those people with disabilities under the new proposal.

It also appears that the proposed changes will be particularly harsh for those people with disabilities who are engaged in full-time study as part of their preparation for future workforce participation. They will be ineligible for Newstart while undertaking full-time study and will thus be placed on Austudy. While people with disabilities on DSP receive the Pensioner Education Supplement, currently worth $31.20 a week, it appears that this will not be payable to people with disabilities placed on Austudy. Thus, it appears that a person with disabilities in full-time study and no private income who is placed on Austudy under the proposed new rules will face a very substantial cut in income (relative to the payment they would have received under the current system).

A final issue is that NSA is much more strictly asset-tested than DSP. In 2006-07, a single homeowner with assets of more than $157,000 loses their entitlement to any NSA. In contrast, a pensioner with assets above this level loses $3 per fortnight of DSP for every $1000 by which assets exceed this level. A 50 year old person with disabilities who owns their own flat and who has inherited a $200,000 house from their parents will thus not be entitled to NSA, but would be entitled to DSP and the Pensioner Concession Card under the current system.

3.2 Disposable incomes

Figure 5 traces the impact upon the disposable incomes of those with disabilities who would qualify for DSP under the current rules but qualify only for NSA under the proposed new rules i.e. those people with disabilities who are assessed as being able to work 15 to 29 hours per week and who commence receipt of income support after 1 July 2006.6 As clearly shown, the disposable incomes of single people with disabilities are very much lower under the proposed new system than under the current system over a broad range of private income. The losses sustained by Australians with disabilities amount to more than $100 a week when earnings are between about $196 and $448. The peak loss of $122 a week is experienced by disabled people with private incomes of $393 a week. As also shown in Table 4, for example, the proposed new reforms reduce the ‘take-home’ incomes of Australians with disabilities and private incomes of $200 a week from $391 under the current system.

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6 Note that if suitable work is not available in the area where the person lives, it appears that they will still be put on NSA rather than DSP. Thus, the test is in their potential ability to work such hours, not whether such work is actually available.
The Distributional Impact of the Proposed Welfare-to-Work Reforms upon Sole Parents and People with Disabilities

system to $290 under the proposed new system – a cut of $101 a week. This effectively represents a 26 per cent cut in the living standards of these people with disabilities.

Figure 5 Disposable income of single person with disabilities under current and proposed systems, 2006-07

At low levels of private income, there is a $46 a week difference between the proposed new and existing systems, due to the difference between the maximum rates of pension and allowance for single people. At the other end of the spectrum, above around $700 a week, there is no difference in the incomes of people with disabilities under the proposed new and current systems because, beyond this point, they are not receiving any income support. Between these points, the disposable incomes of people with disabilities are lower under the new system than under the current system, primarily because of the stricter income test and lower payment rates applying to NSA.
The Distributional Impact of the Proposed Welfare-to-Work Reforms upon Sole Parents and People with Disabilities

Table 4 Impact of proposed new system on disposable incomes and EMTRs of single disabled people with various levels of private income, 2006-07

<table>
<thead>
<tr>
<th>Private Income</th>
<th>Disposable Income</th>
<th>Effective Marginal Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current System</td>
<td>New System</td>
</tr>
<tr>
<td></td>
<td>$ pw</td>
<td>$ pw</td>
</tr>
<tr>
<td>$0</td>
<td>254</td>
<td>208</td>
</tr>
<tr>
<td>$50</td>
<td>304</td>
<td>245</td>
</tr>
<tr>
<td>$100</td>
<td>339</td>
<td>263</td>
</tr>
<tr>
<td>$150</td>
<td>369</td>
<td>278</td>
</tr>
<tr>
<td>$200</td>
<td>391</td>
<td>290</td>
</tr>
<tr>
<td>$300</td>
<td>436</td>
<td>319</td>
</tr>
<tr>
<td>$400</td>
<td>475</td>
<td>356</td>
</tr>
<tr>
<td>$500</td>
<td>503</td>
<td>423</td>
</tr>
<tr>
<td>$600</td>
<td>530</td>
<td>491</td>
</tr>
</tbody>
</table>

Note: Averaged 2006-07 payment levels have been used. All dollar figures rounded to nearest dollar. All EMTRs rounded to nearest one per cent. Note that we have been unable to simulate the receipt by single disabled Newstart Allowees of PA within the time frame allowed for this project. To make a fair comparison between the current and proposed systems, we have excluded PA from the calculations in both the current and proposed new world. However, this exclusion makes little difference, as the payment is only worth $2.90 a week and is received by disabled people in both the current and proposed new systems if they are in receipt of income support. Thus, the difference between the two systems is in most cases not affected by this exclusion.

Source: Specially created version of STINMOD/05A

3.3 EMTRs

With the same assumptions as in section 2, Figure 4 shows the EMTR for single people with disabilities under the current and proposed systems. As seen in this Figure, the EMTRs faced at lower levels of private income are generally higher under the new system than under the existing system. People with disabilities with weekly private incomes between around $31 and $64 a week face an EMTR of 65 per cent under the new system, compared with a zero EMTR under the current system. That is, for each additional dollar of earnings in this range, people with disabilities will keep only 35 cents under the new system, compared with 100 cents under the existing system.
Australians with disabilities with private incomes between $64 a week and $125 a week will also face substantially higher EMTRs under the proposed new system – 65 per cent under the new system compared with only 40 per cent under the current system. That is, each additional dollar of earnings in this range nets 25 cents less under the new system than under the existing system.

**Figure 6 EMTRs faced by single person with disabilities under current and proposed systems, 2006-07**

This effect is due to ‘income test stacking’, with recipients facing a 50 per cent EMTR due to the allowance income test plus a 15 per cent EMTR due to a combination of the effective withdrawal of the ‘allowance tax offset’ and the payment of income tax. This tax treatment contrasts with the much more favourable tax treatment given to those on DSP, with DSP being non-taxable. Thus, one of the less obvious implications for people with disabilities of the proposed changes is that they will be subject to the harsher allowance tax offset under the new system rather than the more generous DSP tax provisions which apply under the current system.

Private incomes between $125 a week and $200 a week are again subject to much higher EMTRs under the proposed new system – 75 per cent under the new system compared with only 40 or 55 per cent under the existing system. The Medicare levy shade-in range ends at $280 a week of private income, at which point the EMTRs faced by people with disabilities under NSA fall to 66.6 per cent, where they remain until eligibility for NSA ceases at around $393 a week.
The EMTRs of 65 per cent or more over the private income range between $31 and about $393 a week makes the financial benefits from work very low for those people with disabilities receiving NSA. Returning to our earlier example of a person working 15 hours a week for the minimum wage, we find that the disposable income of a person with disabilities on Newstart and earning $191 a week is only $36 a week higher than that of someone on DSP with no earnings or private income ($288 minus $254 - figure 7). This is an effective return of $2.40 for each of the 15 hours of paid work.

Figure 7 Disposable income of person with disabilities under current and proposed system at zero and $191 a week of earnings, 2006-07

Source: Harding et al (2003c)

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7 Using the same example, Minister Kevin Andrews argued that a person with disabilities working 15 hours a week for $191 would be $92 a week better off than a person on DSP with no paid work (Andrews, 2005d). To reach this conclusion, the Minister assigned the person on Newstart a Mobility Allowance of $50 a week. It is debatable whether this is the most appropriate approach, given that only some people with disabilities on NSA (namely, those ‘who cannot use public transport without substantial assistance’) will be eligible for this payment. Similarly, while Mobility Allowance was not given to the person on DSP in this example, some of those on the existing DSP payment who are not in paid work but who are undertaking voluntary work or vocational training are eligible for Mobility Allowance. After subtracting $50 Mobility Allowance from the ‘gain’ of $92, we are left with $42 a week. The remaining difference between this $42 and our $36 estimate is due to the Minister’s income support rates being for 2005-06, while ours are for 2006-07.
And, as argued earlier, this $34 a week gain assumes that the costs of work are zero and that there are no knock-on effects to other programs, such as public housing rent increases. According to the 2002-03 ABS Income Survey, 19 per cent of DSP recipients who do not currently have a job are in public housing. Thus, returning to our $34 a week gain scenario, in perhaps one-fifth of cases we might expect these people to face a rental increase of $15 a week from their public housing authority\(^8\), further reducing the net gain figure to only $19 a week. And we still have not included any costs associated with working. Clearly, the costs of work would not have to be very high to result in people with disabilities on Newstart being no better off financially from undertaking paid work than those currently on DSP with no paid work. These calculations also, of course, assume that the value of leisure time is zero, as the relevant income support recipients have exchanged zero hours of work for 15 hours of work plus additional likely travel time.

4 Conclusions

The Government’s proposed welfare to work reforms will not directly affect the distributional income or effective marginal tax rates (EMTRs) of those sole parents or people with disabilities who are already in receipt of Parenting Payment Single (PPS) or Disability Support Pension (DSP) on 1 July 2006 and who remain on that payment. These sole parents will, nevertheless, face new work obligations if their youngest child is aged six years or more, but they will not be placed on NSA until their youngest child reaches the age of 16 years.

However, sole parents who begin receiving income support after 1 July 2006 will be placed on PPS if their youngest child is aged less than six years — but on NSA if (or as soon as) their youngest child reaches the age of six years.\(^9\) And those persons with disabilities who begin receiving income support after 1 July 2006 will be placed on NSA if they are assessed as being able to work at least 15 hours a week at award wages.

\(^8\) As noted in the case of sole parents, this is because public housing authorities set rents at 25 per cent of gross income (not after-tax income). While the disposable income of this person has increased by only $34 a week, their gross income has increased by $58 a week. One-quarter of this $58 is about $15 a week.

\(^9\) There is now one exception to this. Family and Community Services Minister Kay Patterson announced on 12 September that parents of profoundly disabled children would become newly eligible for Carer Payment. This is a ‘pension’, which means it has a higher payment rate and more liberal income test than Newstart Allowance. This is effectively the only group that the government has so far exempted from the move to Newstart from pension.
The NSA maximum payment rate is about $29 a week lower than that of PPS, resulting in an immediate loss of this amount of income for those transferred from PPS to NSA when their youngest child turns six. Similarly, the NSA maximum payment rate for a single disabled adult in 2006-07 is $46 a week lower than that of DSP, resulting in an immediate loss of this amount of income for those placed on NSA rather than DSP. Furthermore, the gap between the two pension rates and Newstart Allowance will increase further in future years, as PPS and DSP are indexed to movement in average weekly earnings, while NSA is indexed to the Consumer Price Index, which is generally lower. As a result, by 2008-9, for example, the maximum payment rate for NSA will be about $42 a week lower than that for PPS and $68 lower than that for DSP.

The NSA income test is also much less generous than the PPS or DSP income test, and the tax treatment of allowees is much less generous that the income tax treatment of pensioners. Taken together, these mean that the losses in take-home income can be as high as $96.50 a week for sole parents with one child and around $230 per week of private earnings who are transferred to NSA. The loss increases with the number of dependent children. For example, for sole parents with five children, the maximum losses could reach $107 a week for those with private incomes ranging from about $215 to $290 a week. For disabled people who are placed on NSA rather than DSP, the loss in take-home income can be as high as $122 a week for single people who earn around $390 per week of private income.

The other consequence of the more restrictive NSA income test and harsher income tax treatment is to create much higher effective marginal tax rates for sole parents and disabled people than they face under the current PPS or DSP income test. Sole parents and people with disabilities placed on Newstart Allowance will face EMTRs of 65 per cent or more over a broad band of private income ranging from $31 to about $400 a week under the proposed new system. For those who are in public housing, the maximum EMTRs faced can exceed 80 cents in the dollar. The overall effect of all these income test and tax changes is thus to reduce the attractiveness of paid work to sole parents and disabled people – and thus to reduce the amount of income that they have available to support themselves and their children after they undertake paid work.

The need to increase the number of workers as our population ages and the long-term improvements in economic well-being that occur with ongoing workforce participation are some of the factors that lie behind the Federal Government’s proposed changes. Many will not object to the goal of increasing the labour force participation of sole parents or disabled people. However, in trying to encourage sole parents and disabled people to participate in the labour force, other aspects also need to be taken into account in the proposed policies.
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One issue is the short or long term impact on children living in sole parent families. Our analysis suggests that sole parents placed on Newstart Allowance will receive much lower incomes than under the current system. The package of exemptions announced by Minister Andrews on 21 September for a range of sole parents (including those with large families or children with disabilities or those who live in areas where there is no suitable child care) means that these groups will be exempt from the job-hunting requirements — but they will still be placed on Newstart. Their take-home incomes will thus be $29 a week less than the pension rate in 2006-07, with this gap increasing over time — placing many of them perilously close to or below commonly used poverty lines.

While it is to be hoped that in the longer term many children will be living in sole parent families whose incomes are higher as a result of the expected increases in paid work, in the shorter term many children will be living in sole parent families whose incomes are much lower than under the current income support rules. These concerns could be overcome by allowing sole parents to remain on the existing PPS, rather than transferring them to NSA when their youngest child turns six. Thus, the government’s key goal of encouraging sole parents to work could still be achieved via some form of paid work obligation, but sole parents could remain on an income support payment regime that ensured that they and their children were financially much better off after undertaking paid work.

A second issue is the difference in capability and family circumstances of potential job seekers. Some would argue that all potential job seekers should be treated in the same way and placed on NSA. However, this assumes that, for example, a single 34 year old able bodied person with no dependent children has the same capacity to undertake paid work as a 34 year old person with a substantial disability or with two young dependent children. This appears a strong assumption, given the long-term caring responsibilities associated with being a sole parent, and the long-term difficulties encountered by those with substantial disabilities.
References


The Distributional Impact of the Proposed Welfare-to-Work Reforms upon Sole Parents and People with Disabilities


