

The logo for NATSEM, featuring the word "NATSEM" in a teal, serif font. A small black swoosh is positioned under the letter "A".

National Centre for Social and Economic Modelling  
• University of Canberra •

---

# **Options for Reducing the Adverse Impact of the Proposed Welfare-to- Work Reforms upon People with Disabilities and Sole Parents**

**Ann Harding, Quoc Ngu Vu and Richard Percival**

**Report to the National Foundation for Australian  
Women, 3 November 2005**

---

## **About NATSEM**

The National Centre for Social and Economic Modelling was established on 1 January 1993, and supports its activities through research grants, commissioned research and longer term contracts for model maintenance and development with the federal departments of Family and Community Services, Employment and Workplace Relations, Treasury, and Education, Science and Training.

NATSEM aims to be a key contributor to social and economic policy debate and analysis by developing models of the highest quality, undertaking independent and impartial research, and supplying valued consultancy services.

Policy changes often have to be made without sufficient information about either the current environment or the consequences of change. NATSEM specialises in analysing data and producing models so that decision makers have the best possible quantitative information on which to base their decisions.

NATSEM has an international reputation as a centre of excellence for analysing microdata and constructing microsimulation models. Such data and models commence with the records of real (but unidentifiable) Australians. Analysis typically begins by looking at either the characteristics or the impact of a policy change on an individual household, building up to the bigger picture by looking at many individual cases through the use of large datasets.

It must be emphasised that NATSEM does not have views on policy. All opinions are the authors' own and are not necessarily shared by NATSEM.

Director: Ann Harding

© NATSEM, University of Canberra 2005

National Centre for Social and Economic Modelling  
University of Canberra ACT 2601 Australia  
170 Haydon Drive Bruce ACT 2617

Phone + 61 2 6201 2780 Fax + 61 2 6201 2751

Email [natsem@natsem.canberra.edu.au](mailto:natsem@natsem.canberra.edu.au)

Website [www.natsem.canberra.edu.au](http://www.natsem.canberra.edu.au)

## **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. Our earlier reports have shown that the disposable incomes of affected sole parents will 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 will be as high as \$120. We have also shown 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. This report canvasses some options for reducing the losses in disposable income and reducing the higher effective tax rates created under the new system.

## **Author note**

Ann Harding is Professor of Applied Economics and Social Policy at the University of Canberra and inaugural Director of the University's National Centre for Social and Economic Modelling (NATSEM). Dr Quoc Ngu Vu is a Senior Research Officer at NATSEM and Associate Professor Richard Percival is a Principal Research Fellow at NATSEM.

## **Acknowledgments**

The authors would like to gratefully acknowledge the funding contribution made to this research by the Don Chipp Foundation. We would also like to thank the University of Canberra (through its Collaborative Grants program) and our industry partner, the National Foundation for Australian Women, who together funded our earlier research on the distributional impact of the welfare to work changes. (The earlier reports are available on the NATSEM website.)

## **Contents**

<b>Abstract</b>	<b>iii</b>
<b>Author note</b>	<b>iii</b>
<b>Acknowledgments</b>	<b>iii</b>
<b>1 Introduction</b>	<b>1</b>
<b>2 People with disabilities</b>	<b>3</b>
2.1 The DSP and NSA programs	3
2.2 Disposable incomes and EMTRs	5
<b>3 Sole parents</b>	<b>15</b>
3.1 The PPS and NSA programs	15
3.2 Disposable incomes and EMTRs	16
<b>4 Conclusions</b>	<b>20</b>
<b>References</b>	<b>22</b>

## 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. 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.<sup>1</sup>

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.<sup>2</sup>

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 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

---

<sup>1</sup> 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.

<sup>2</sup> There is now one major exception to this. Family and Community Services Minister Kay Patterson announced on 12 September that parents of children with profound disabilities 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.

'pension' income test.<sup>3</sup> 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, has a much harsher income test, and is associated with much less generous income tax concessions. As a result, many sole parents with school age children and many people with disabilities will receive much lower incomes than under the current rules. Our previous reports suggested that sole parents will be up to around \$100 a week worse off and people with disabilities up to around \$120 a week worse off under the proposed changes relative to the current system (Harding et al, 2005a, 2005b, 2005c, 2005d). In addition, most of those affected will face much higher effective marginal tax rates under the proposed new system than under the current system.

Since the publication of our earlier reports, many parliamentarians and numerous organisations involved in public policy have contacted us requesting information about possible policy options to reduce the adverse impacts of the proposed reforms upon the incomes and effective tax rates of affected sole parents and people with disabilities. This paper canvasses a limited number of possible options for change.

Section 2 of this paper analyses the impact upon people with disabilities of the proposed reforms and some possible amendments to those reforms. Section 3 repeats the analysis for sole parents, while Section 4 concludes.

---

<sup>3</sup> 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.

## **2 People with disabilities**

### **2.1 The DSP and NSA programs**

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, so the following estimates are based on NATSEM's latest projections of these indexes. At the time of writing this paper, the legislation had still not been introduced into Parliament, so 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 1). 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. ('Private income' means income from sources other than government cash transfers, such as earnings.) 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 1. 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 1. 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 1 Summary of the Newstart Allowance and Disability Support Pension Payments for Single Person Aged 21 to 60, 2006-07<sup>a</sup>**

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

<sup>a</sup> 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.

<sup>b</sup> This includes \$2.90 a week of Pharmaceutical Allowance.

<sup>c</sup> This includes the effect of the \$2.90 a week of Pharmaceutical Allowance.

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, 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 is the receipt of the Pensioner Concession Card. As table 1 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 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.

## **2.2 Disposable incomes and EMTRs**

Figure 1 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).<sup>4</sup> *Disposable income* means the income that recipients 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). 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

---

<sup>4</sup> 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.

of \$393 a week. As also shown in Table 2, 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 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 2 shows the EMTRs for single people with disabilities under the current and proposed systems. [An effective marginal tax rate (EMTR) measures how much of an additional dollar of earnings is retained, 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 'disposable' or 'take-home' income increases by only 30 cents when earnings increase by \$1.] It should be noted that 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 shown in Figure 2 can probably be regarded as being somewhat lower than those that will face affected NSA recipients in the real world.

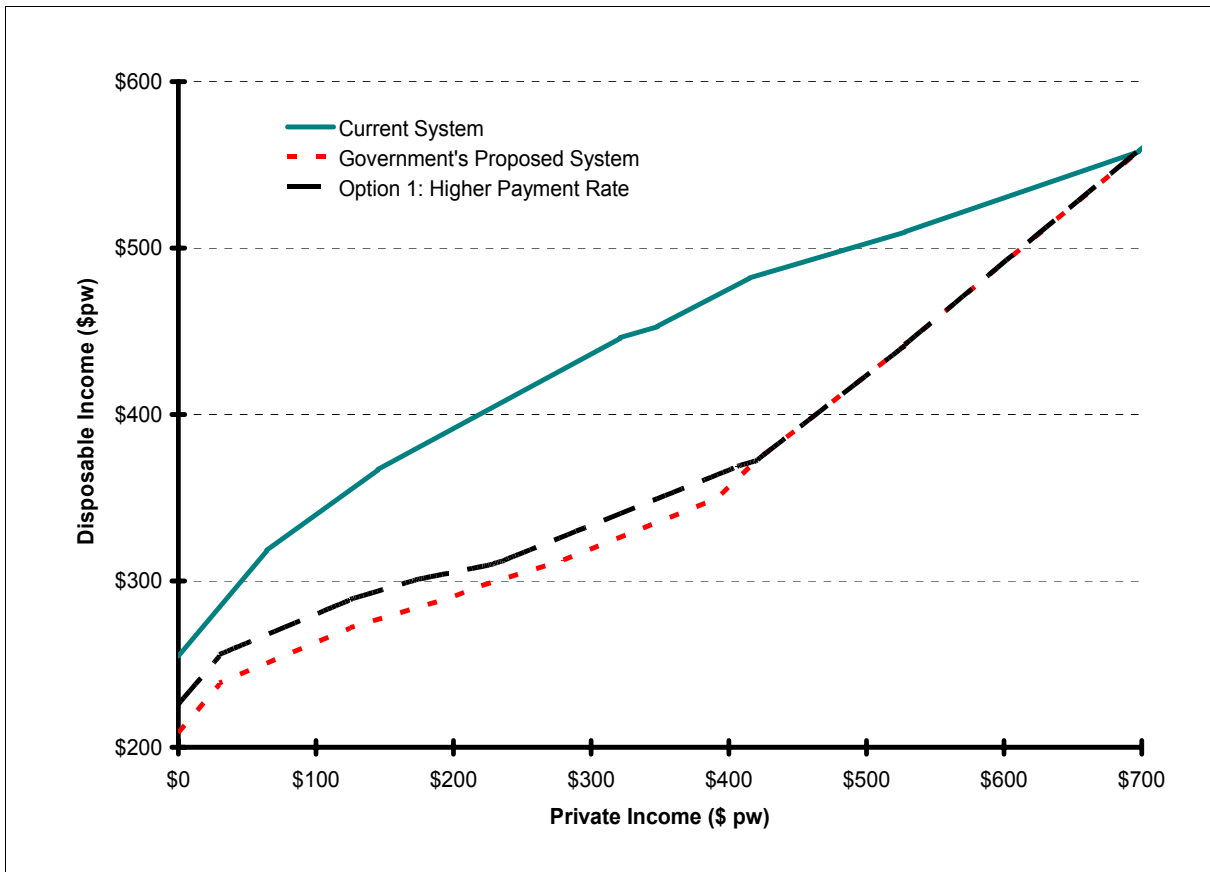
As seen in this Figure, the EMTRs faced at lower levels of private income are generally much higher under the new system than under the existing system. This means that people with disabilities will keep much less of their earnings under the proposed system than under the current system – and this is clearly reflected in the lower disposable incomes referred to above.

What policy options might be available for reducing the impact of the proposed changes upon the disposable incomes and EMTRs of affected people with disabilities? At this stage it appears likely that a substantial number of affected people with disabilities will be placed on Newstart Allowance but not actually be placed in jobs, due to a lack of suitable work opportunities. As shown in Table 2, such single people will receive \$46 a week less than those placed on DSP. This is substantially more than the \$29 a week loss that will be experienced by sole parents with no private income or earnings.

There is evidence that people with disabilities incur higher costs because of those disabilities (Wightman and Foreman, 1991). Similarly, Women with Disabilities Australia has recently collected information and case studies of the likely costs of work that will face some people with disabilities (2005). One possible policy option might thus be the payment of a higher rate of NSA to those people with disabilities who are placed on NSA rather than on DSP. The amount of any such additional payment would need to be determined after up-to-date evidence on the likely costs

associated with disability and labour market activities – and particularly given that Mobility Allowance of \$50 a week will be payable to eligible people with a disability who cannot use public transport. Without suggesting that this is necessarily the most appropriate rate, we have modelled below the impact upon people with disabilities of paying an NSA rate in 2006-07 which is the same as the rate paid for sole parents with dependent children on Newstart. This rate is \$228 a week, which is \$17 a week higher than the projected rate for single people on NSA of \$211 a week in 2006-07.

**Figure 1 Disposable income of single person with disabilities under current and proposed systems and Option 1, 2006-07**



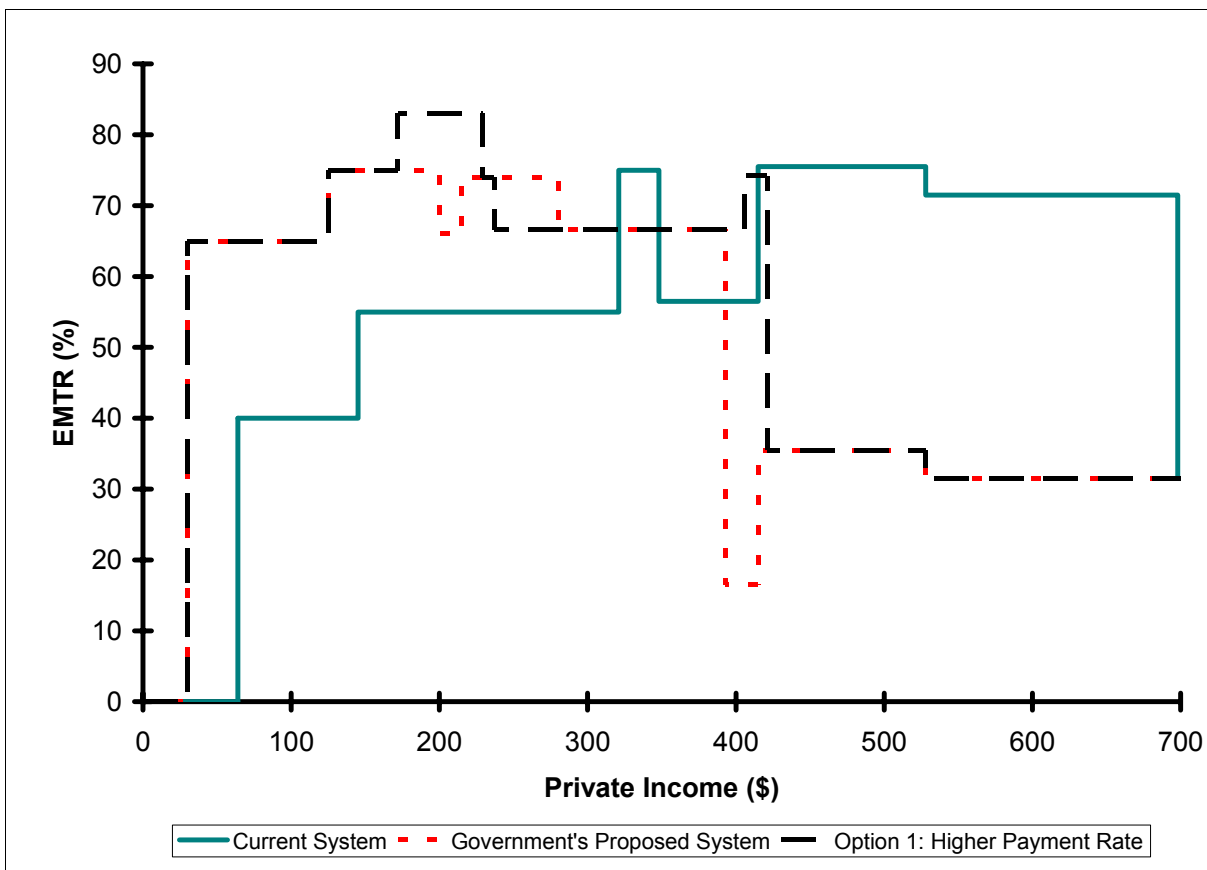
Note: The solid green line represents the current system, under which DSP is received. The red dashed line represents the Government's current proposed system, under which NSA is received. The black long dashed line represents our Option 1, where the payment rate is raised to \$232 a week.

Note also 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 in all of the Figures and in Table 2. 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. PA excluded from all calculations (see footnote to Table 2)

The impact of this possible reform on disposable income and EMTRs is shown in Figures 1 and 2 and in Table 1. This option has almost no impact upon EMTRs relative to the Government's current proposals, with slightly higher EMTRs occurring between \$173 and \$229 a week of private income when the recipient reaches the Medicare levy phase in range and is also still experiencing the higher EMTRs caused by the withdrawal of the Allowance Tax Offset. However, the option does slightly reduce the declines in disposable income that people with disabilities will encounter under the new system. The difference between the Government's current proposal and this option is clearly shown in Figure 1 – and the impact of further raising the NSA maximum payment rate for those with disabilities can also be readily deduced, as it would simply shift the 'Higher payment rate' line upwards, thus further reducing the losses relative to the current system.

**Figure 2 EMTRs faced by single person with disabilities under current and proposed systems and Option 1, 2006-07**



Note: The solid green line represents the current system, under which DSP is received. The red dashed line represents the Government's current proposed system, under which NSA is received. The black long dashed line represents our Option 1, where the payment rate is raised to \$228 a week.

Source: Specially created version of STINMOD/05A. PA excluded from all calculations (see footnote to Table 2)

Option 1 makes little difference to the higher losses in disposable income experienced by those with weekly earnings of around \$50 and above, as these losses are primarily due to the tougher Newstart Allowance income test relative to the pension income test. While across-the-board reductions in the NSA taper rates would reduce these losses, such a measure seems unlikely to be acceptable, as it would have extensive implications for other Newstart recipients, such as the unemployed. We also do not consider it likely that the Government would contemplate varying the taper rates in the Newstart Allowance income test only for those with disabilities and sole parents.

Another possible option to reduce the losses to people with disabilities placed on NSA would be to extend to them the Pensioner Tax Offset. Currently, NSA recipients are eligible for the Allowance Tax Offset<sup>5</sup>, which provides an estimated 2006-07 maximum income tax reduction of about \$14 a week and starts to be tapered away as soon as private income reaches \$31 a week. In contrast, the Pensioner Tax Offset provides an estimated maximum income tax reduction of about \$38 a week in 2006-07 and does not start to be tapered away until private income reaches \$339 a week (at a taxable income level of about \$372 a week). In addition, a further special concession given to those receiving the Pensioner Tax Offset is that the point at which liability for the Medicare levy begins shading in at 20 cents in the dollar is increased – from \$16,740 of taxable income in 2006-07 for single people to \$20,266 a week for single taxable pensioners. This is very important for reducing the EMTRs of those with disabilities on NSA, as the Medicare levy shade-in under the existing Newstart system is a key reason for high EMTRs between \$215 and \$280 a week of private income.

The Government has already set a precedent for slightly different concessions being given to those sole parents and people with disabilities placed on NSA rather than pension, by extending to these groups the Pensioner Concession Card, Pharmaceutical Allowance and Telephone Allowance. Thus, our second modelled option is the extension of this concessional treatment to include the Pensioner Tax Offset.

This second option would ensure that almost no affected NSA recipients would face EMTRs of more than 60 per cent below private incomes of up to \$390 a week, thus eliminating the extremely high EMTRs of between 65 and 75 per cent that will apply across quite broad private income ranges under the Government's current proposals. This second option would ensure that people with disabilities kept more of each dollar of earnings. As comparison of Figures 1 and 3 shows, the impact of Option 2 on disposable incomes is very different to Option 1, as it provides greater benefit to

---

<sup>5</sup> This is called the Beneficiary Tax Offset on the ATO website. We have put Allowance here to reflect the change in the payment name from 'Benefits' to 'Allowances'.

those NSA recipients with higher levels of private income, whereas Option 1 provided a similar dollar benefit that did not vary with the level of private income.

As also shown in Figure 3, the current parameters of the Pensioner Tax Offset are sufficiently generous that there is a 'sudden death' withdrawal of this Offset when the person goes off NSA at around \$395 a week of private income. (This is because we have assumed in our modelling that a person has to be receiving NSA in order to receive this special tax concession.) This results in a \$30 to \$40 decline in their disposable income when private income moves up by a dollar and that dollar extinguishes any remaining eligibility to NSA (i.e. at around \$395 a week of private income). Such 'sudden death' effects are generally not favoured in the Australian income support system, although they do exist (e.g. in the 'sudden death' assets test for NSA receipt).

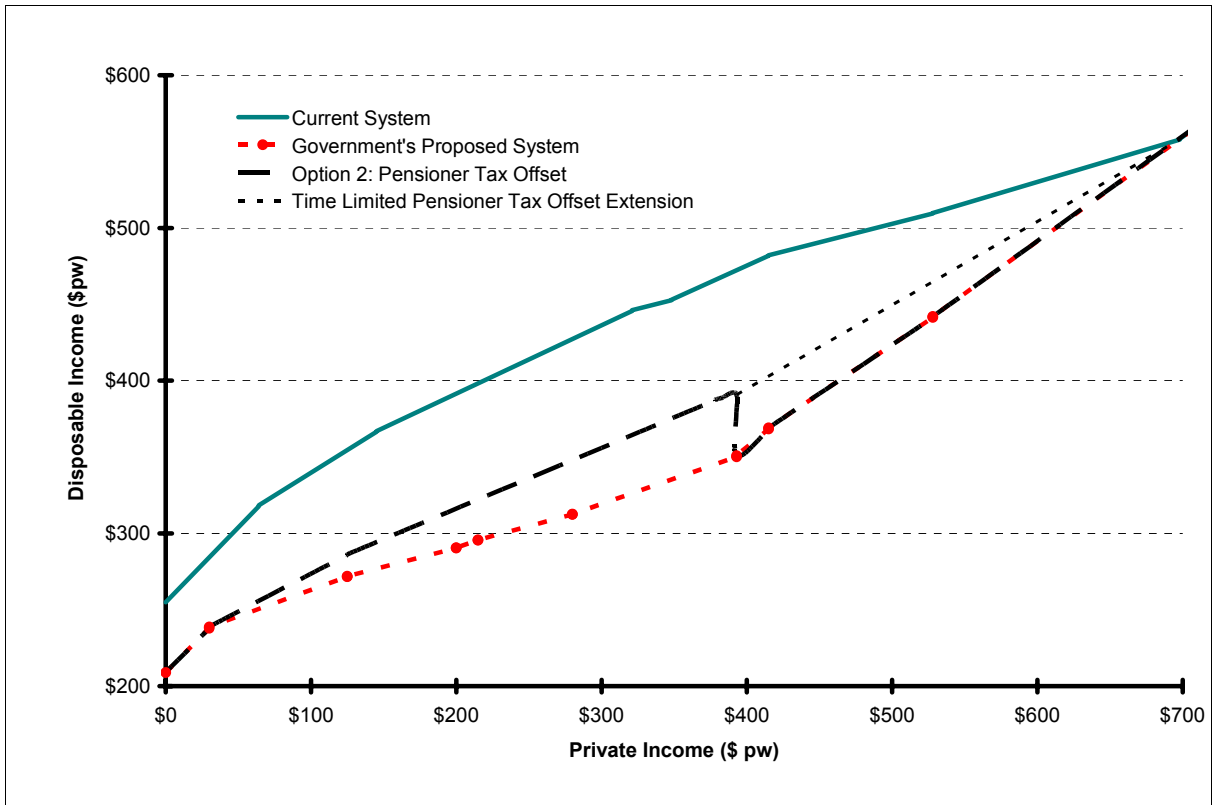
A number of options exist for avoiding this 'sudden death' effect. One would be to increase the withdrawal rate for these 'special' recipients of the Pensioner Tax Offset, with the Tax Offset currently being reduced at 12.5 cents for every dollar of income above a threshold. However, it is difficult to make a tax concession that is as generous as the Pensioner Tax Offset reduce to zero by the point where NSA cuts out and still have much impact on reducing effective marginal tax rates (which was the main point of this second policy option).

A second possibility would be to extend the tax concession to those whose taxable incomes have become sufficiently high to take them off NSA for some period of time after they cease receipt of NSA. (For example, perhaps the Pensioner Tax Offset could be received by those sole parents and people with disabilities, who cease receipt of NSA due to higher earnings, in the financial year that they cease receipt and in the financial year following the cessation of receipt.) We have shown the approximate impact of extending the Pensioner Tax Offset for some period of time after exiting receipt of NSA in Figures 3 and 5, through the thin dashed black line.<sup>6</sup>

---

<sup>6</sup> We also tested the impact of extending a tax concession to people with disabilities that had exactly the same characteristics as the current Senior Australian Tax Offset. This tax offset is slightly more generous than the Pensioner Tax Offset. Its receipt was not tied to receipt of NSA, so it was modelled as being available to all persons with disabilities who would have been placed on DSP under the current system but were not receiving DSP under the new system. The results are available from NATSEM, but they are not dissimilar to the Pensioner Tax Offset with the 'time extension' shown in Figures 3 and 5.

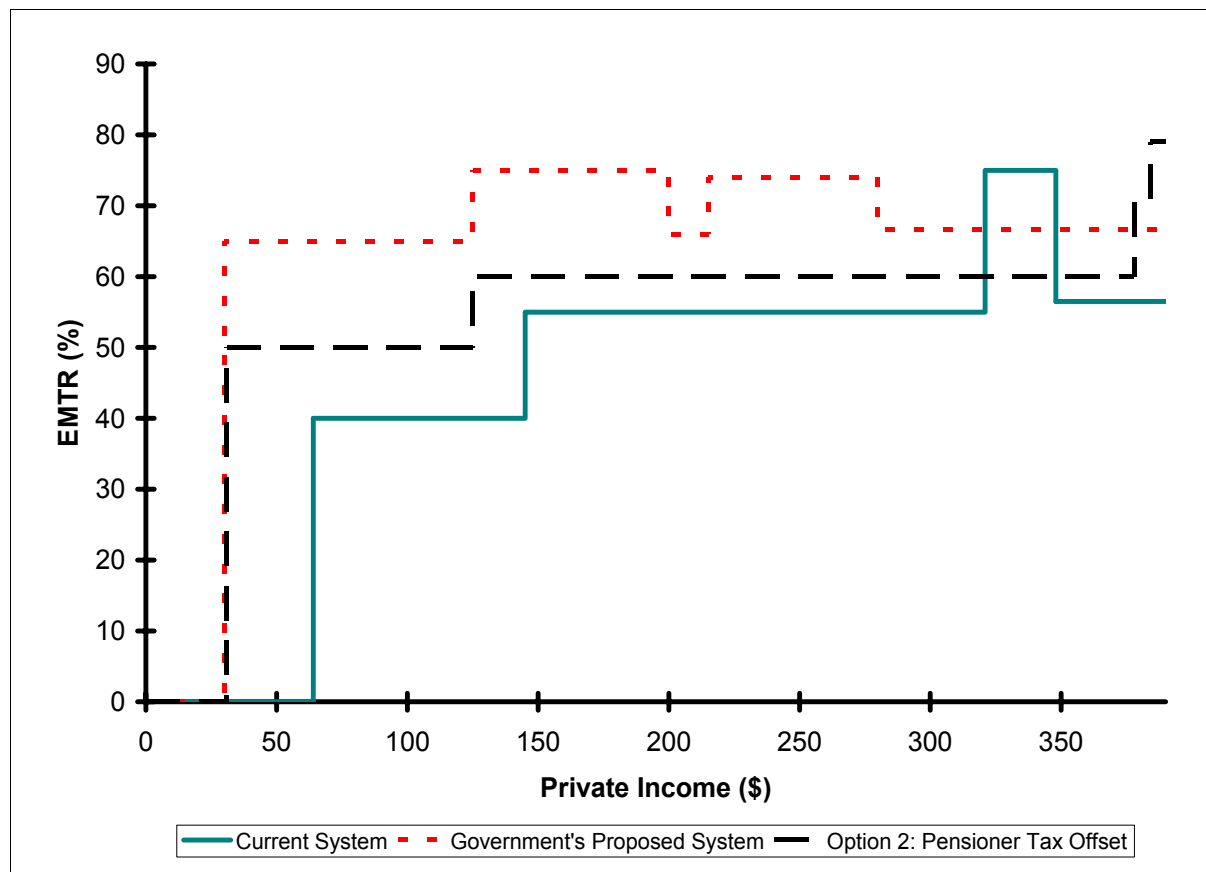
**Figure 3 Disposable income of single person with disabilities under current and proposed systems and Option 2, 2006-07**



Note: The solid green line represents the current system, under which DSP is received. The red dashed line represents the Government's current proposed system, under which NSA is received. The black long dashed line represents our Option 2, where recipients are given the Pensioner Tax Offset. The thin dashed black line proxies the impact of extending the Pensioner Tax Offset to former NSA recipients in the financial year they come off NSA.

Source: Specially created version of STINMOD/05A. PA excluded from all calculations (see footnote to Table 2)

**Figure 4 EMTRs faced by single person with disabilities under current and proposed systems and Option 2, 2006-07**



Note: The solid green line represents the current system, under which DSP is received. The red dashed line represents the Government's current proposed system, under which NSA is received. The black long dashed line represents our Option 2, where recipients are given the Pensioner Tax Offset. The graph is truncated at \$390 of private income because, as we have tied eligibility for the Pensioner Tax Offset to receipt of NSA, there is a sudden fall in disposable income at around \$395 of private income, and this produces an EMTR 'spike' of over 3000 per cent that cannot be captured in this chart.

Source: Specially created version of STINMOD/05A. PA excluded from all calculations.

Our third option consisted of both Options 1 and 2 – that is, an increase in the basic payment rate for those on Newstart with disabilities to \$228 a week *and* the extension of the Pensioner Tax Offset to them. The impact of this Option 3 is shown in Figures 5 and 6. Putting the two options together both reduces the negative impact of the Government's proposed reforms upon disposable income *and* reduces the EMTRs facing those with disabilities placed on Newstart. Once again, there is a 'sudden death' drop in income where such recipients cease receipt of NSA (and thus the Pensioner Tax Offset) – and, once again, we have proxied the impact of allowing those who have gone off NSA to keep the Pensioner Tax Offset for a year or two after exit and this is shown in the thin dashed black line in Figure 6.

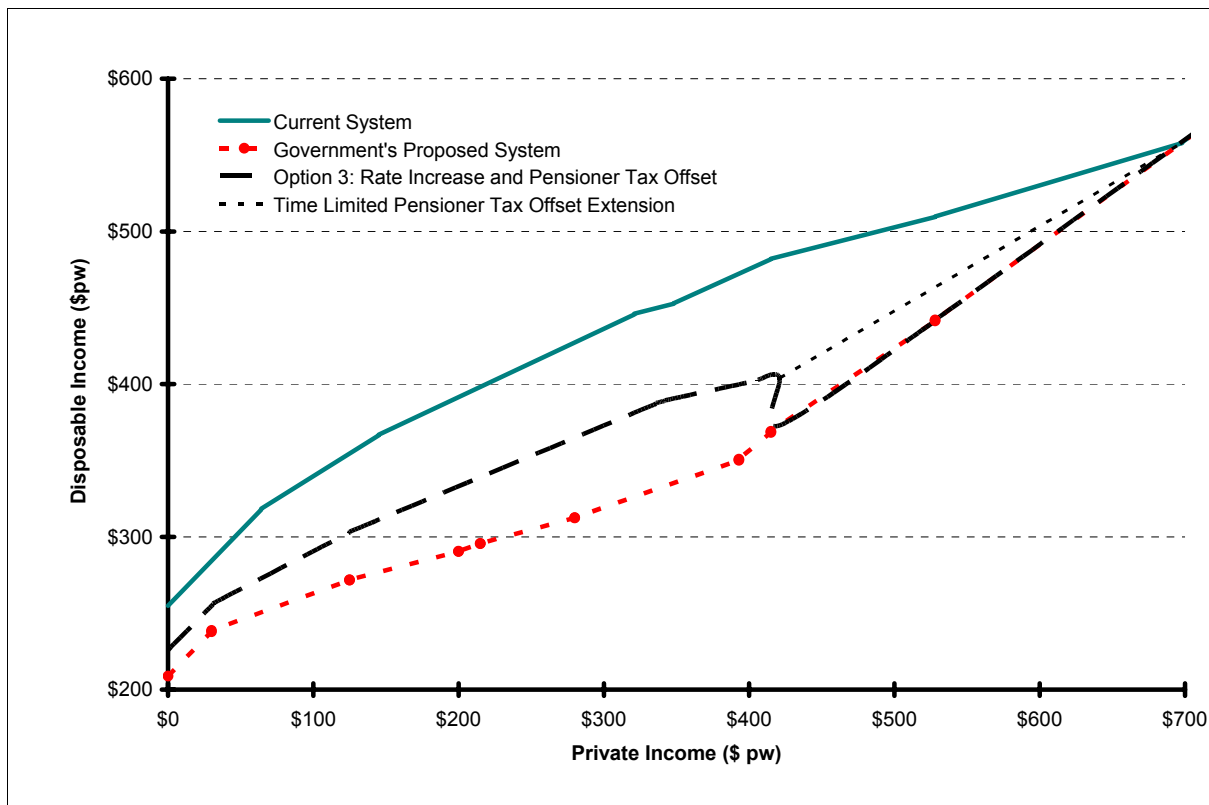


**Table 2: Impact of Various Policy Options on Disposable Incomes and Effective Marginal Tax Rates of Single Person with Disabilities Aged 21-60 Years, 2006-07**

Private Income	Disposable Income						Effective Marginal Tax Rates														
	Current System		Government's Proposed New System		Option 1: Higher rate		Option 2: Pensioner tax offset		Option 3: Combined higher rate & tax offset		Current System		Government's Proposed New System		Option 1: Higher rate		Option 2: Pensioner tax offset		Option 3: Combined higher rate & tax offset		
	A	B	C	D	E	F	G	H	I	J	F	G	H	I	J	F	G	H	I	J	
\$0	\$ pw	208	225	208	225	208	225	208	225	208	225	208	225	208	225	0	0	0	0	0	0
\$50	\$ pw	245	262	248	265	248	265	248	265	248	265	248	265	248	265	0	65	65	50	50	50
\$100	\$ pw	263	280	273	290	273	290	273	290	273	290	273	290	273	290	40	65	65	50	50	50
\$150	\$ pw	278	295	296	313	296	313	296	313	296	313	296	313	296	313	55	75	75	60	60	60
\$200	\$ pw	290	305	316	333	316	333	316	333	316	333	316	333	316	333	55	73	83	60	60	60
\$300	\$ pw	319	333	356	373	356	373	356	373	356	373	356	373	356	373	55	67	67	60	60	60

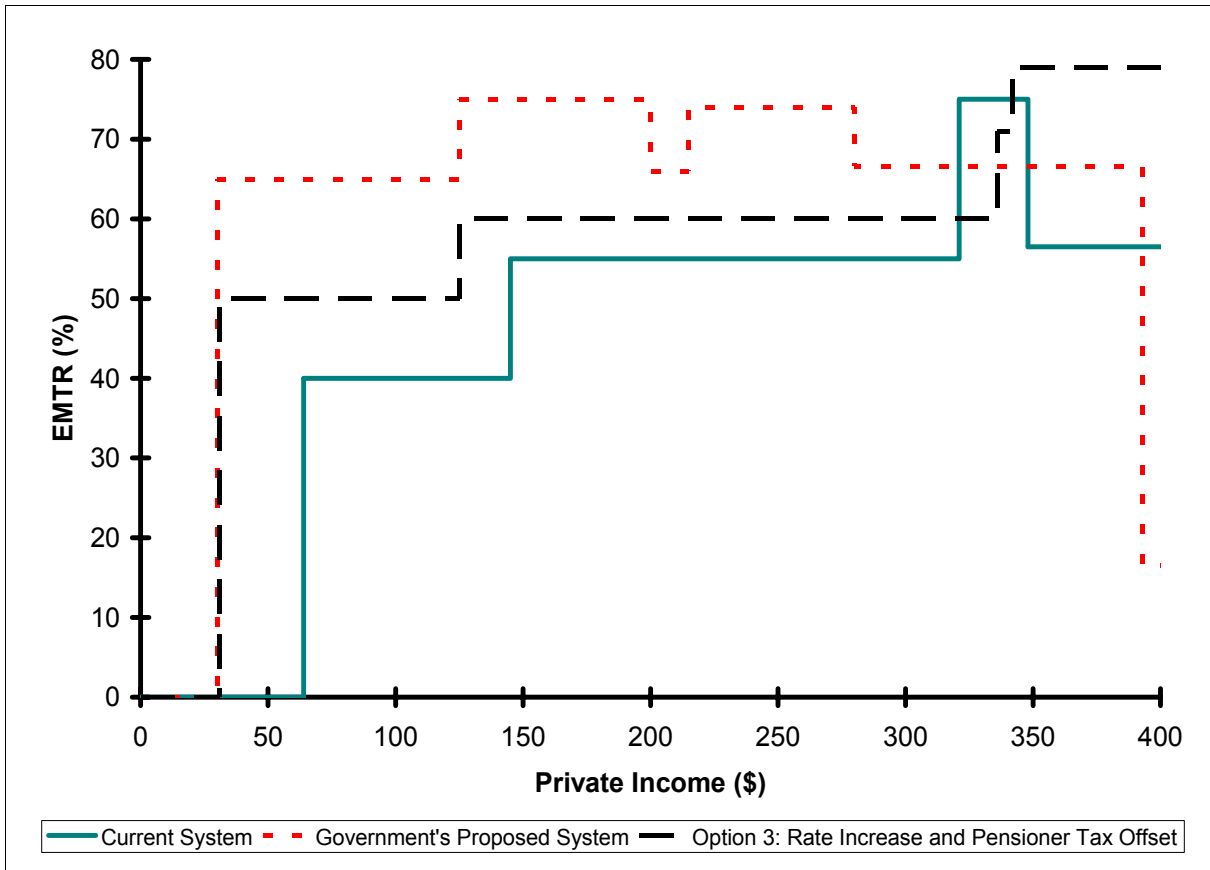
As shown in Table 2, Option 3 substantially reduces the losses from the welfare to work reforms for people with disabilities. For example, for those who are placed on Newstart but who are either exempted from participation requirements or are unable to find suitable jobs, the losses in disposable income at zero private income are reduced from \$46 a week under the reforms as currently proposed by the government to \$29 a week (comparison of columns A, B and E). For those with private incomes of \$200 a week – a reasonably likely pay packet for someone with disabilities working 15 hours a week – the losses are reduced from \$101 a week under the Government’s current proposals to \$58 a week under Option 3. These increases in disposable incomes relative to the government’s current reform package reflect the lower marginal tax rates applying under Option 3. For example, a person with \$200 a week private income faces an EMTR of 55 per cent under the existing DSP system, 73 per cent under the Government’s current proposed system, and 60 per cent under Option 3 (comparison of columns F, G and J).

**Figure 5 Disposable income of single person with disabilities under current and proposed systems and Option 3, 2006-07**



Note: The solid green line represents the current system, under which DSP is received. The red dashed line represents the Government’s current proposed system, under which NSA is received. The black long dashed line represents our Option 3, where recipients are given both an increase in the maximum rate to \$228 and the Pensioner Tax Offset. The thin dashed black line proxies the impact of extending the Pensioner Tax Offset to former NSA recipients in the financial year they come off NSA. Source: Specially created version of STINMOD/05A. PA excluded from all calculations

**Figure 6 EMTRs faced by single person with disabilities under current and proposed systems and Option 3, 2006-07**



### 3 Sole parents

#### 3.1 The PPS and NSA programs

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 (Table 2). 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 2. 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 2. 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.

### **3.2 Disposable incomes and EMTRs**

Figure 7 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. 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.

**Table 2 Summary of the Newstart Allowance and Parenting Payment Single Payments for Sole Parents with One Child, 2006-07<sup>a</sup>**

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

<sup>a</sup> 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.

<sup>b</sup> 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.

<sup>c</sup> This includes the effect of the \$2.90 a week of Pharmaceutical Allowance.

Source: Specially created version of STINMOD/05A

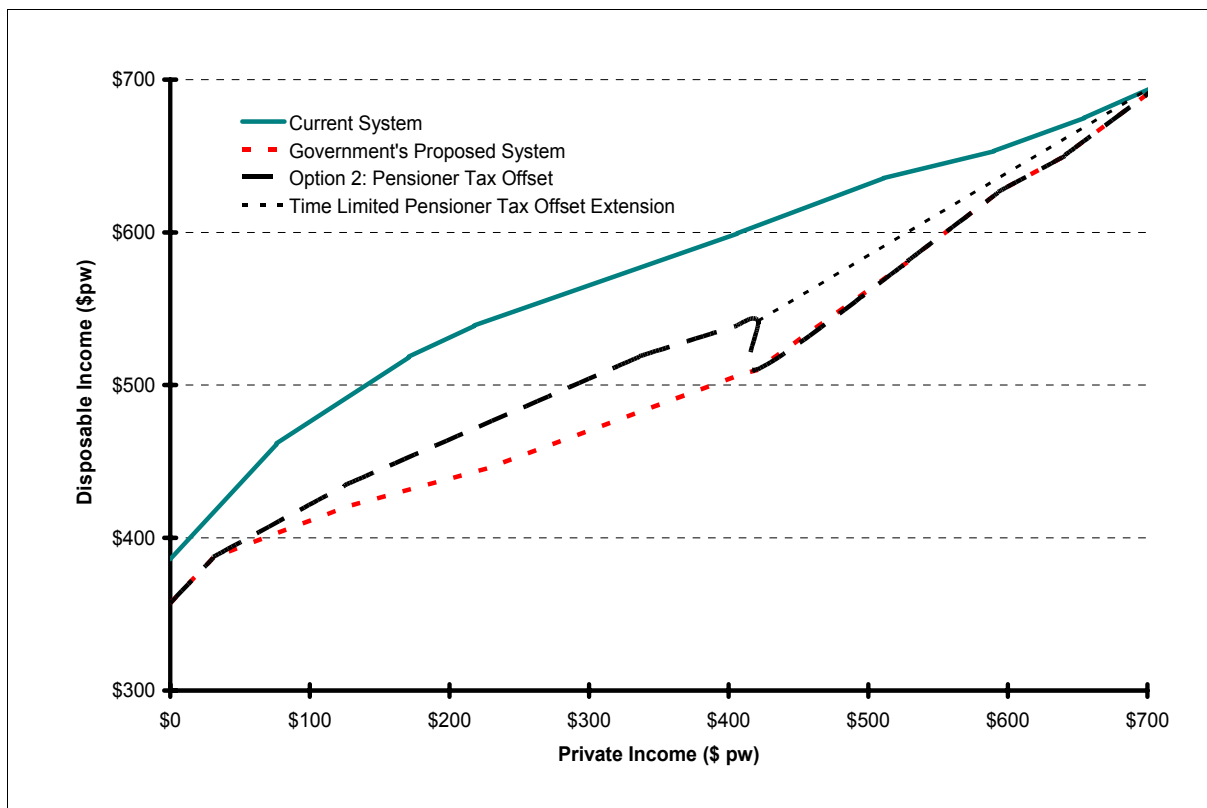
As clearly shown in Figure 7, the disposable incomes of sole parents with one child aged six years and over are much lower under the proposed new system than under the current system over a very broad range of private income. The losses sustained by sole parents amount to almost \$100 a week when earnings are between about \$200 and \$450.<sup>7</sup> As shown in Table 3, 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

<sup>7</sup> 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).

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.<sup>8</sup>

Figure 7 and Table 3 show the impact of the same Option 2 modelled for people with disabilities – namely the extension of the Pensioner Tax Offset to those sole parents on NSA. Again, the thin dashed black line shows the impact of extending the Tax Offset for a time limited period to those with levels of private income that take them off receipt of Newstart.

**Figure 7 Disposable income of sole parents with one child aged 6 years or over under current and proposed systems, 2006-07**



Source: Specially created version of STINMOD/05A. PA excluded from all calculations

<sup>8</sup> 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.

**Table 2 Impact of proposed new system on disposable incomes and EMTRs of sole parents with various levels of earnings, 2006-07**

Private Income	Disposable Income			Effective Marginal Tax Rates		
	Current System	Government's Proposed New System	Option 2: Pensioner tax offset	Current System	Government's Proposed New System	Option 2: Pensioner tax offset
	\$ pw	\$ pw	\$ pw	%	%	%
\$0	385	356	356	0	0	0
\$50	435	394	397	0	65	50
\$100	476	411	422	40	65	50
\$150	506	426	444	40	75	60
\$200	531	439	464	57	75	60
\$300	565	470	504	68	66	60
\$400	597	504	537	68	66	71
\$500	632	562	562	66	34	34
\$600	656	629	629	66	50	50

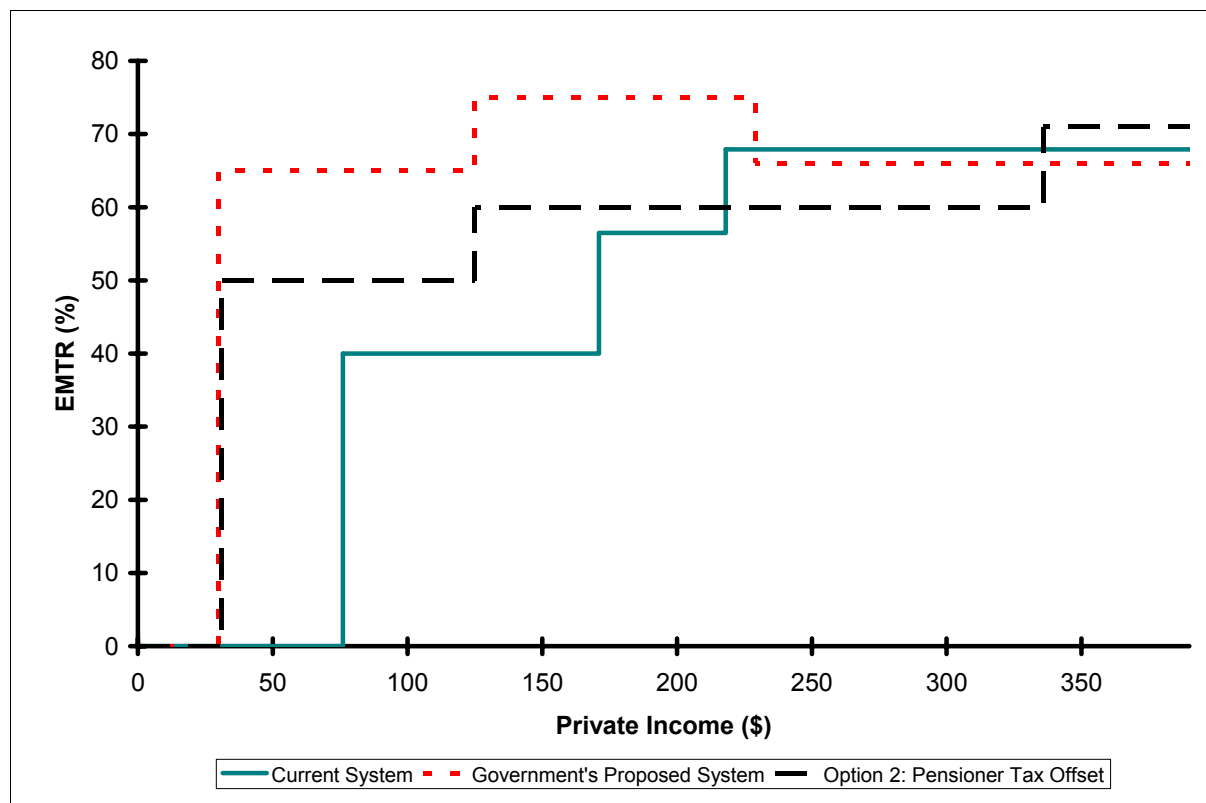
*Note:* Averaged 2006-07 payment levels have been used. All dollar figures rounded to nearest dollar. All EMTRs rounded to nearest one per cent. Note that we have been unable to simulate the receipt by sole parent Newstart Allowees of Pharmaceutical Allowance within the time frame allowed for this project. 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.

\* 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

Figure 8 traces the EMTRs of sole parents under the current, the Government's current proposed new system and Option 2. EMTRs are lower under Option 2 than under the proposed system – although they are still higher than those existing currently under PPS at higher levels of private income.

**Figure 8 EMTRs facing sole parents with one child aged 6 years or over under current and proposed systems and Option 2, 2006-07**



Source: Specially created version of STINMOD/05A. PA excluded from all calculations .

## 4 Conclusions

Since publication of our earlier reports highlighting the substantial cuts in disposable income and the higher effective marginal tax rates resulting from the Government's proposed welfare to work reforms, many have contacted us asking about whether there are feasible options to ameliorate these adverse impacts. For people with disabilities placed on Newstart Allowance, we have modelled three illustrative possible options in this paper:

- a higher maximum payment rate of NSA for those with disabilities of \$228 a week (due to the higher costs faced by such people) (Option 1);
- extension of the Pensioner Tax Offset and the associated liberalisation in Medicare levy shade-in arrangements (Option 2); and
- the combined impact of the above two options (Option 3).



Option 3 would reduce the high effective marginal tax rates faced by people with disabilities placed on NSA and would also reduce their losses relative to the current DSP system. There would still, however, be major losses in income for those placed on NSA rather than on the existing DSP.

We have also modelled the impact of Option 2 for sole parents with one child aged six years and over. Other possible options for sole parents that we have not modelled here include:

- an increase in the NSA 'free area' for each child after the first; or
- an increase in the NSA payment rate for sole parents.

The Government has recently announced a series of circumstances that might qualify parents for temporary exemption from the 15 hours per week minimum participation requirement. Primary carer parents who are foster carers, distance educators, home schoolers, parents with large families or who care for a child with an illness or disability may be eligible to seek temporary exemption (Andrews, 2005c). In addition, parents who have been subjected to domestic violence will continue to be temporarily exempted from participation requirements. It is also clearer that primary carer parents will not be expected to take-up work if that work is to occur outside school hours, if no suitable child care is available, or if the cost of care would result in a very low or negative financial gain from working. However, it is important to note that all such parents *will still be placed on Newstart Allowance*, rather than PPS or DSP. Thus, if they have no private income, they will still be at least \$29 a week worse off in 2006-07 relative to remaining on pension – even for long periods of 'temporary exemption'. Another possible option would be to allow affected parents to return to PPS, perhaps with re-assessment on an annual basis, if their 'temporary exemption' appeared to involve a set of circumstances that were unlikely to change for many months.

A final issue is that the relative losses experienced by sole parents and people with disabilities placed on NSA rather than pension will increase over time. The maximum payment rate for Newstart is indexed by the CPI, whereas the pension rate is indexed by the higher of AWE or the CPI. As a result, by 2008-9, for example, the maximum payment rate for Newstart Allowance will be about \$42 a week lower than that for Parenting Payment Single (rather than the \$29 a week apparent for 2006-07.) In addition, while the pension 'free-area' is indexed to the CPI, the allowance free-area is not indexed, so that the relative losses for those with private incomes will grow further through time. Indexation of the two allowance threshold parameters would resolve this latter issue.

## References

- Andrews, Kevin, 2005a, 'Welfare to Work - Increasing participation of parents', Budget 2005-06, Office of the Hon Kevin Andrews MP, Parliament House, Canberra.
- Andrews, Kevin, 2005b, 'Welfare to Work - Improved returns from work for people receiving allowance', Budget 2005-06, Office of the Hon Kevin Andrews MP, Parliament House, Canberra.
- Andrews, Kevin, 2005c, 'Exemptions announced for parents with special family circumstances', Media Release, 21 September,, KA260A/05, Office of the Hon Kevin Andrews MP, Parliament House, Canberra.
- Dutton, Peter, 2005a, 'Increasing participation of people with a disability', Budget 2005-06, Office of the Hon Peter Dutton MP, Parliament House, Canberra.
- Dutton, Peter, 2005b, 'Increase in the mobility allowance to \$100 per fortnight', Budget 2005-06, Office of the Hon Peter Dutton MP, Parliament House, Canberra.
- Harding, A, Vu, Q N, Percival, R and Beer, G, 2005a, 'The Distributional Impact of the Proposed Welfare-to-Work Reforms Upon Sole Parents', report to the National Foundation for Australian Women, 25 August (available from NATSEM website at [www.natsem.canberra.edu.au](http://www.natsem.canberra.edu.au)).
- Harding, A, Vu, Q N, Percival, R and Beer, G, 2005b, 'Welfare-to-work reforms: impact on sole parents', *Agenda*, Vol 12, No 3, pp 195-210.
- Harding, A, Vu, Q N, and Percival, R, 2005c, 'The Distributional Impact of the Proposed Welfare-to-Work Reforms Upon Australians with Disabilities', report to the National Foundation for Australian Women, 13 September (available from NATSEM website at [www.natsem.canberra.edu.au](http://www.natsem.canberra.edu.au)).
- Harding, A., Vu, Q N and Percival, R, 2005d, "The Distributional Impact of the Proposed Welfare-to-Work Reforms upon Sole Parents and People with Disabilities" Paper presented at the 34<sup>th</sup> Conference of Economists, University of Melbourne 28 September 2005, (available from NATSEM website at [www.natsem.canberra.edu.au](http://www.natsem.canberra.edu.au)).
- Wightman, Peter and Foreman, M, 1991, A Survey of the Costs of Disability for People with Disabilities in Labour Force Related Activity', Policy Research Paper No 59, Department of Social Security, October (available from [www.facs.gov.au](http://www.facs.gov.au))
- Women With Disabilities Australia (WWDA), 2005, The Impact of Welfare to Work On People with Disability: Costs associated with undertaking employment, unpublished mimeo