

Understanding the roles of housing costs and housing assistance in creating employment disincentives

authored by

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CONTENTS

EXECUTIVE SUMMARY	I
Background	i
Conceptual Framework	i
What Are Housing Related Work Disincentives?	ii
i) Interaction of Tax and Income Support Systems	ii
ii) Concessional Charges – Income Related Rents for Public and Some Community Tenants	iii
iii) Housing Costs and Location	iv
iv) Behavioural Factors	iv
Research Scope and Method	v
1 INTRODUCTION	1
2 CONCEPTUAL FRAMEWORK	3
2.1 Housing, Housing Tenure and Employment Status	3
2.2 Unemployment and Poverty Traps and Work Disincentives	4
2.3 Housing, Housing Assistance and Work Disincentives	5
2.4 Summary	8
3 UNDERSTANDING THE INTERRELATIONSHIPS BETWEEN HOUSING AND WORK DISINCENTIVES	9
3.1 The Interrelationship Between Income Support, Tax and Rent Assistance	9
3.1.1 Withdrawal of Income Support Payments as Income from Paid Employment Increases	9
3.1.2 Effect of the Tax System and Medicare Levy as Unemployed People Receive Income from Paid Work	10
3.1.3 Modelling the Impact of Increments in Income from Paid Work for Unemployed Private Renters in Receipt of RA Compared to Unemployed Non-Private Renters	11
3.2 Income Related Rents	14
3.3 Housing Costs and Location	17
3.4 Behavioural Factors	18
3.4.1 Renters	18
3.4.2 Home Owners	20
3.4.3 Other factors	21
3.5 Summary	21
4 RESEARCH METHODOLOGY	23
4.1 Outline	23
4.2 Research Questions	23
4.3 Research Stages	24
REFERENCES	26
APPENDIX 1	32
Rent Assistance and Tax/Benefits Systems: An International Review	32
New Zealand	32
United States	32
United Kingdom	33
Canada	34
Sweden	34
References	35
APPENDIX 2	37

4.4	Labour Force Status of RA Recipients	37
APPENDIX 3		38
Modelling EMTRs and EATRs for Four Types of Unemployed Households		38
A3.1	EMTRs	38
A3.2	EATRs	44

EXECUTIVE SUMMARY

Background

There is a growing concern and interest in government, and more broadly, in the way that housing assistance and income support systems interact to provide incentives or disincentives for unemployed people to enter paid employment (Industry Commission 1993; Croce 2000). Research outside Australia has highlighted the critical role that housing assistance plays in the decisions that unemployed people make when offered work (Hirsch 1994; Randolph 1994; Giles et al. 1996; Ford, Kempson and England 1996; Wilcox and Sutherland 1997). This research suggests that decisions about moving into paid employment typically involve trade offs between the financial, personal and family benefits expected from participation in paid employment relative to costs in terms of loss of income support payments and impact on personal and family well being. In particular, these studies have pointed to the complex interactions between incomes from paid employment and government benefits, including the combined effect of withdrawal of government benefits and housing assistance, the type and nature of housing costs, and the behaviour of those seeking employment.

There has, however, been little explicit research in Australia on the links between housing costs, different types of housing assistance and work disincentives. While there is a growing literature in social policy and labour market studies looking at work disincentives (e.g. Keating and Lambert 1998; Redmond 1999), none has explicitly taken a housing focus. Nevertheless, housing costs are the single most important financial outlay for most households and have long been recognised as a key element in studies of poverty and household wellbeing. Various types of housing assistance, including public housing, community housing and Commonwealth Rent Assistance (RA), attempt to address the problem of high housing costs faced by low income households, but little is known about their effect on work incentives and disincentives.

One pioneering qualitative study that did examine the role of housing assistance in relation to work disincentives was Burke and Wulff's (1993) study of public housing tenants in Victoria and Queensland. The study found that they faced a real and not just a statistical poverty trap in entering employment but that, despite this fact, some still undertook paid work for a range of reasons, not just related to income. However, the study was limited in terms of non-behavioural assessment of work disincentives, and did not consider the position of private tenants or home owners. Moreover, the nature of the housing assistance has changed markedly since 1992-93 when the research was undertaken.

There has also been growing recognition since the early 1990s of massive changes in labour markets in Australia which have impacted in different ways not only on types of households but also on local and regional areas (e.g. Borland, Gregory and Sheehan 2001). Low cost housing is found increasingly in areas with limited job opportunities so that households who live in, or move to, such areas to obtain cheaper housing may experience more difficulty in finding work. Conversely, those living in, or moving to, areas with better job opportunities are often faced with high housing costs.

This project aimed at filling a substantial gap in our knowledge about the role of housing and housing assistance in contributing to disincentives to taking up paid work or working more hours.

Conceptual Framework

A starting point for the study was Australian data which indicate that there are different patterns of participation in paid employment and of unemployment for households in different housing tenures: outright ownership, purchasing, private renters and public renters. Rates of participation refer to the percentage of a population group who are economically active, including those in paid work and those who are unemployed but who could work if they could find a job. Employment participation rates exclude those considered to be economically inactive, that is, those who are neither not in paid work nor unemployed and seeking work for reasons such as old age, disability or caring responsibilities.

Data on tenure, labour force participation rates and unemployment rates have raised a number of questions about the links between housing tenure and costs and possible work disincentives. Why are participation rates and employment rates amongst public tenants so low? Why is there a higher percentage of unemployed people amongst renters generally than amongst owners? Why do a greater percentage of working age households who are outright owners not participate in paid work than owners with a mortgage? These questions are particularly important since housing assistance in Australia is based primarily on tenure. Are there aspects of the design and administration of housing assistance that contribute to work disincentives?

There are many possible explanations for the differences in labour force participation rates and unemployment rates between groups of people, including mismatches between the skill levels of those not in paid work and the types of jobs available in proximity to where they live. Consideration of all the complex interactions between housing tenure and local labour markets is beyond the scope of this paper. The particular focus of this project is on one key element in understanding differences in rates of labour participation rates and unemployment, namely, the disincentives that people may face which are associated with housing or different types of housing assistance.

In understanding the disincentives that people face when moving into employment we must understand two key concepts: the 'unemployment trap' and the 'poverty trap'. An unemployment trap occurs where the financial benefits available when out of work are greater or not significantly less than those gained when in work. A poverty trap occurs where income gains in work are offset by tax, reductions in means tested income support and other factors to the extent of significantly reducing the net benefits of earning more. There are a number of measures of these traps, with the most common being effective marginal tax rates (EMTRs), which refer to the percentage of each additional dollar of income that goes on tax and withdrawal of various types of income support and other financial benefits. High EMTRs can provide disincentives for people to enter paid work or to increase their income from paid work since they receive little benefit by way of extra income to spend. The income range over which high EMTRs occur may also be important in contributing to disincentives to work or working more hours. A high EMTR over a narrow range of income may not provide a disincentive as strong as a slightly lower EMTR that exists over a wide range of income.

Whilst poverty traps and unemployment traps are critical in understanding the financial aspects of work disincentives, behavioural factors must be considered as well. These include people's perceptions of the benefits of paid work, their assessment of the type of work they can obtain, and judgements about the impact of working on individual and family wellbeing, including non-financial factors. Surprisingly, there is little research evidence on the extent to which EMTRs influence the behaviour of people on income support payments in taking on paid work or earning more once in work, as recognised by the work of the Reference Group on Welfare Reform (2000a: 48).

Until recently, housing has been only a marginal consideration to welfare reform strategies in Australia. Perhaps for this reason, there has been little research on the role of housing generally, and housing assistance more specifically, in contributing to unemployment and poverty traps. The limited work available includes assumptions about housing costs in modelling the financial outcomes for people and households of working different hours and at different wage rates, rather than in terms of them working at all. As a starting point, the project examined possible work disincentives related to housing and housing assistance.

What Are Housing Related Work Disincentives?

For simplicity, we can group possible housing related work disincentives into four categories: i) interaction of tax and income support systems, ii) concessional charges (income related rents in public housing), iii) housing costs and location, and iv) behavioural factors.

i) Interaction of Tax and Income Support Systems

The interaction of tax and income support systems in Australia as measured by EMTRs is complex to calculate. For example, the income tests that are applied to government benefits

can affect EMTRs. Most benefits have a 'free income' area such that people earning less than a prescribed amount from paid work will experience no loss of benefit and the EMTR is not affected. However, if the assessable income from paid work does exceed this area, a reduction in the benefit will result as income increases. The amount of this reduction varies across the range of available payments.

The payment of income tax also contributes to EMTRs. Once a person's taxable income¹ exceeds the tax-free threshold (currently \$6,000 per year), they are liable to pay income tax. If their increased income reduces a payment that is taxable (for example, Newstart Allowance or Youth Allowance), then the outcome for the family's disposable income can be complicated to calculate. This is because the increase in taxable private income is offset or partially offset by the reduction in the taxable transfer income. The operation of tax offsets and the Medicare levy further complicate the picture.

Of particular importance in the context of this study is the effect of RA for private renters on the calculation of EMTRs. RA is an allowance to eligible private renters in receipt of income support payments and family tax benefit payments and is added to primary Centrelink payments for unemployed people such as Newstart or Youth Allowance. It is the last part of a payment to be withdrawn. Modelling undertaken as part of this study shows that the payment and rate of withdrawal of RA has a number of effects: it increases the disposable income (before housing costs) of private renter households compared to non-private renters, it contributes to higher EMTRs over some income bands for private renters compared to non-private renters and, perhaps most importantly, it extends the income range of which high EMTRs apply compared to non-private renters.

ii) Concessional Charges – Income Related Rents for Public and Some Community Tenants

Income related rents in public housing and some community housing are technically a concession on the rent chargeable on a property, usually market rent. Most public housing tenants in Australia (89 per cent) pay rents based on a percentage of household income (FaCS 2002: Table A5) until income rises to a level where market rent is payable for the property. State and territory 'rent rebate' schemes vary, but most public tenants pay between 20 and 25 per cent of household income in rent.

Income related rents (or rent rebates) involve an implicit concession of the difference between the property rent and the rent paid by the household, although the extent of the concession may not be apparent to the tenant. They differ from direct cash payments, such as RA, in the following respects:

- There is an income test for rent rebates in public rental that is separate to the income test for income support payments, thus constituting 'income test stacking' (Ingles 1997);
- Rents are based on household rather than individual or income unit income and also take into account a percentage of any income earned by 'non-dependent' children and that of other resident income earners such as carers and members of extended families;
- There is no 'free area' of income before rents for public tenants increase, which means that public tenants 'lose' 25 cents in additional rent from the first dollar they earn, even though their income is within the free area as far as their Centrelink payment is concerned.
- When income exceeds the free area for Centrelink payments, public tenants lose 25 per cent of each dollar earned, in addition to already high EMTRs resulting from the interaction of the income support and tax systems during the income band in which income support is withdrawn;
- The cut-out point for income related rents depends on the interaction of household income and market rents. This means that a household in a high rent property continues to face rent increases at 25 cents in the dollar as income rises after a household on the same income in a lower rent property has reached the market rent cap.

¹ In the hypothetical component of this paper (Sections 3.3 and 3.4), tax deductions are assumed to be nil. Thus, each family's private income is equal to their taxable income.

The effect of these arrangements is to limit the benefits of public tenants working at all in terms of additional disposable income (an unemployment trap) and to add to already high EMTRs for some types of households (a poverty trap). There is, however, little evidence in Australia on the ways in which the high EMTRs associated with concessional rents affect decision making about taking on paid work by public tenants. The limited evidence available derives from econometric modelling of the effect of concessional rent setting on labour supply. Most of this type of work is from the United States where income related rents are applied more broadly beyond public housing to other types of housing assistance, particularly housing choice vouchers. The findings of these studies are inconclusive, varying between those that argued there was no significant impact of rental housing subsidies (concessional rents) on labour force participation (Keane and Moffitt 1998), to research that claimed there was some impact (Painter 2001), to a study of female-headed households indicating that public housing decreased labour supply by 42 per cent (Shone 1994, quoted in Olsen 2001). Empirical behavioural research to test these findings is non-existent.

A further caveat on the potential significance of income related rents in creating workforce disincentives is that many public housing tenants are not actively seeking work. Increased targeting of public housing, particularly since 1997, has meant that many households are not currently seeking work due to age, disability or parenting responsibilities. Only 11 per cent of Centrelink payment recipients living in public housing in December 2002 were job seekers in receipt of Newstart (see Section 3.2).

iii) Housing Costs and Location

Unlike income support, housing has clear spatial dimensions which may contribute to disincentives to work, in particular, the spatial mismatch between affordable housing and jobs. Put simply, areas where people can access cheaper housing are often also characterised by social and economic disadvantage or exclusion. Households living in these areas face a dilemma: they can stay in their community in affordable housing and either remain unemployed or commute long distances to work in other areas, with commensurate transport costs, or they can move to areas of job growth but pay much higher housing costs which may negate much of the benefits of additional income from work. How does current housing assistance in Australia help households with this dilemma?

One of the proposed advantages of RA is that it avoids some of the inflexibility in location associated with public and community housing. Households can choose housing in an area of their choice and this, in theory, includes renting in locations where job prospects are good. The design of RA, however, focuses primarily on achieving horizontal equity between similar households and does not include a loading for location in the calculation of payments. The impact of this is to limit the effectiveness of the payment in job-rich areas that typically have high housing costs, a problem that has been covered elsewhere (e.g. Berry and Hall 2001; Hulse 2002; Donald, McGlashan and Leisser 2001). A further aspect of the design of the payment is that people who share a home with others in order to afford housing in higher cost areas are penalised by having their payments reduced (by the 'single sharer' rate of RA). Research on the spatial outcomes for RA recipients is very limited.

iv) Behavioural Factors

Whilst it is important to model the financial outcomes for people entering the labour force and working more hours, it is an empirical question whether these anticipated outcomes influence people's decisions and behaviours. Unemployed people or people working a few hours may not be aware of high EMTRs generated by (additional) income from wages or they may not have calculated the impact of working on their disposable income (Millar, Webb and Kemp 1997). Even where they may have done these calculations, they may nevertheless decide to work anyway for other non-financial reasons, such as self-esteem or social benefits. People may accept adverse financial outcomes in the short term in the expectation of wages increasing in the medium term. People may also decide not to work because they consider other priorities to be important, such as providing a stable and caring environment for their children or stabilising their health and personal circumstances.

However, little is known about the behavioural aspects of work incentives and disincentives in general, a field of research described as being 'in its infancy in Australia' (Reference Group

on Welfare Reform 2000a: 48). This applies particularly to behavioural factors associated with housing assistance and costs.

Research Scope and Method

The research seeks to assess the effect of housing costs and different types of housing assistance on the capacity of unemployed people to gain employment and to work more hours or earn higher levels of income. The research findings should assist policy makers and others in understanding how housing costs and different forms of housing assistance impact on work disincentives and what changes are required to improve work incentives.

The specific questions the research will attempt to address include:

- What impact do the costs and conditions associated with housing tenure have on the capacity of unemployed people to move into work?
- Does the design and administration of government housing assistance contribute to a situation where people decide that it is not in their interests to enter the labour force because there is little or no increase in disposable income as a result of moving into work or working more hours?
- Do people calculate the impact on disposable income of working or working more hours, including the effect of changes to housing assistance? What behavioural responses result from this calculation and what other factors are important in making decisions about paid work?
- What examples are there of initiatives to link housing assistance with incentives for people to work or to work more hours?

The research will comprise four main stages:

- A review of the research literature on work disincentives;
- A review of the main policy alternatives to the current tax and income support system, with particular reference to housing assistance;
- A face to face survey of 400 unemployed people in Melbourne and Sydney;
- An analysis and reporting stage.

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1 INTRODUCTION

This research will investigate the extent to which housing cost structures together with the current housing assistance framework in Australia encourage or discourage participation in paid employment. The focus is on people who are currently unemployed and seeking work, such as those in receipt of Newstart and Youth Allowance payments from Centrelink. The research is also relevant to other groups such as sole parents and people with disabilities, traditionally regarded as being out of the labour force due to parenting responsibilities and incapacity to work, but who are increasingly expected to move towards participation in at least some paid work as part of the Commonwealth's *Australians Working Together* strategy (Commonwealth of Australia 2002).

Until recently, policy settings only recognised in the most general terms the linkages between housing costs and housing assistance and potential disincentives to work. One of the guiding principles of the 1999 Commonwealth-State Housing Agreement (CSHA), for example, was that housing assistance should 'be designed to minimise work disincentives' (Commonwealth of Australia 1999: 1(1)(e)(ii)). The Reference Group on Welfare Reform (2000b: 15) reported that: 'It is important that housing is not a barrier to social and economic participation and that housing policies, both public and private, support people's ability to find, access and take-up paid work'. However, the level of understanding of this interrelationship has not been highly developed in Australia and remains underdeveloped in policy terms.

The new 2003 CSHA reiterates that one of its guiding principles is 'to ensure that housing assistance supports access to employment and promotes social and economic participation' (Commonwealth of Australia 2003: 1 (1) 7). However, it goes much further than its predecessor in detailing a number of strategies that states and territories may pursue to reduce the workforce disincentives associated with housing assistance under the Agreement². There will be a financial penalty for those that do not meet performance targets in reducing workforce disincentives (Commonwealth of Australia 2003: Schedule 1).

The issue of whether housing costs and housing assistance contribute to disincentives to working, particularly for tenants in public housing, received some consideration in Australia in the late 1980s and early 1990s (e.g. Gruen 1988; VCOS 1991; DSS 1993; Industry Commission 1993, Burke and Wulff 1993). Since that time, and despite a growing literature on the interaction between social policies and the labour market more generally (e.g. Keating and Lambert 1998; Redmond 1999), relatively little attention has been paid to the role of housing in policy debates about welfare reform. The Reference Group on Welfare Reform (2000b: 15) acknowledged the importance of housing in general terms but suggested only that consideration of people's housing situations and needs should be part of the assessment and streaming process in providing individualised service delivery and that more should be done to encourage community development within public housing estates.

Limited consideration of the role of housing in welfare reform is not restricted to Australia. In Canada, where the provinces and territories have implemented strategies to move people from social assistance and into paid work (Battle 2001), little attention has been given to the role of housing compared to other areas of concern such as child benefits (HRDC 1999). The New Zealand government's welfare reform strategy, 'Pathways to Opportunity', does not specifically consider the role of housing except to acknowledge that job opportunities in areas where rents and housing costs are low are often limited (MSP 2001: 10). Similarly, in the United States, federal housing assistance was 'seldom mentioned' during the mid-1990s debate about reconfiguring social assistance payments (Kingsley 1997).

This research project aims to fill a substantial gap in knowledge by examining whether housing costs and housing assistance contribute to work disincentives for unemployed people in Australia. In particular, it will address the following questions:

² Strategies for reducing workforce disincentives outlined in Schedule 1 of the 2003 CSHA include improving the location of social housing relative to employment markets, improving access to services and transport for social housing tenants, public housing estate renewal, enabling transfers within social housing, and reviewing rent setting methods.

- What impact do the costs and conditions associated with housing tenure have on the capacity of unemployed people to move into work?
- Does the design and administration of government housing assistance contribute to a situation where people decide that it is not in their interests to enter the labour force because there is little or no increase in disposable income as a result of moving into work or working more hours?
- Do people calculate the impact on disposable income of working or working more hours, including the effect of changes to housing assistance? What behavioural responses result from this calculation and what other factors are important in making decisions about paid work?
- What examples are there of initiatives to link housing assistance with incentives for people to work or to work more hours?

The following sections briefly review evidence on these issues from Australia and, where relevant, from New Zealand, the United Kingdom, Canada and the United States (this is complemented by a more extensive review of the overseas literature in Appendix 2.) This review will be used to assist in clarifying the key issues to guide the questions to be asked of unemployed people in the empirical part of the project.

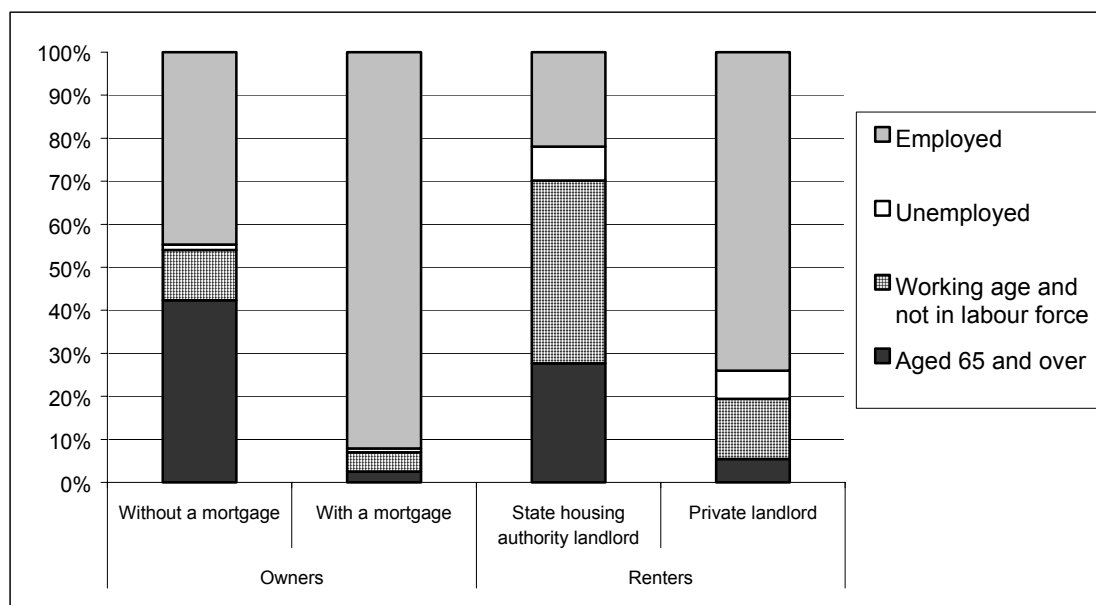
2 CONCEPTUAL FRAMEWORK

2.1 Housing, Housing Tenure and Employment Status

Different housing tenures in Australia are associated with quite different patterns of labour force participation and, for those in the labour force, different patterns of employment/unemployment, as shown in Figure 1. Labour force participation rates are highest amongst home purchasers (93 per cent) and private renters (81 per cent), and distinctly lower amongst outright owners (46 per cent) and public tenants (30 per cent). Some of this difference can be attributed to the higher percentages of retired people amongst outright owners and public housing tenants. Taking into account the number of people aged 65 and over and not expected to work, there are still clear differences in participation rates amongst those of working age (under 65) by tenure. More than four in ten working age public tenants (42.5 per cent) are not in the labour force, compared to 14 per cent in private rental, 12 per cent of outright owners and 4.5 per cent of purchasers with a mortgage.

Figure 1 also indicates that for those who are in the labour force, there are higher rates of unemployment amongst those renting than owning, with 8 per cent of public tenants being unemployed and 7 per cent in private rental, compared to negligible rates amongst home owners generally.

Figure 1: Households by tenure and labour force status, 1999



Source: Calculated from ABS (2000: Table 1)

Note: Those aged 65 and over were assumed not to be in the labour force

Overall, according to the last Australian Housing Survey in 1999 (ABS 2000), half of public tenants were of working age and either not in the labour force or unemployed, compared to 20 per cent of private tenants, 13 per cent of outright owners and 5 per cent of owners with a mortgage, as shown in Figure 1.

These findings about tenure, labour force participation and unemployment rates raise a number of questions about the links between housing tenure and costs and possible work disincentives. Why are participation rates and employment rates amongst public tenants so low? Why is there a higher percentage of unemployed people amongst renters than amongst owners? Why do a greater percentage of working age households who are outright owners not participate in paid work than owners with a mortgage? These questions are particularly important since housing assistance in Australia is based primarily on tenure. Are there aspects of the design and administration of housing assistance that contribute to work disincentives?

The next section of this paper develops a framework for examining some of these linkages between housing and work disincentives.

2.2 Unemployment and Poverty Traps and Work Disincentives

Two key concepts are central to the debate about work incentives: the 'unemployment trap' and the 'poverty trap'. A classic definition of the former refers to 'the existence of social security benefits for the out-of-work that erode any incentive for the unemployed to take a job' (Banrock, Baxter and Davis 1999). By this definition, the incentive of unemployed people to find a job is said to depend on the level of income support payments, the level of income available from paid work and taxation of that income. This has been called the 'Why work?' problem and is commonly measured by the income replacement ratio or rate (RR), which corresponds to the ratio of net income out of work compared to the ratio of net income from paid work (UK Parliament 2000: App. 24). To illustrate this point, a single person on Newstart Allowance with no private income would have a disposable income of \$182 per week. If, however, they had a job paying \$450 per week, their disposable income would be \$379 per week. In this case, the replacement rate would be 48 per cent (i.e. 182/379). The RR captures the general change in the financial return to the individual in taking a job.

The poverty trap, on the other hand, refers to how much of each additional dollar earned translates into disposable income or what happens at the margin as income from paid work increases (Atkinson 1993). This is the 'How much work?' problem and is primarily the result of the combined effect of means tested income support systems and taxation on earned income (OECD 1998). The extent of poverty traps is typically measured by effective marginal tax rates (EMTRs) which show how much of any increase in earned income translates into additional disposable income after taking into account withdrawal of income support payments and the operation of the tax system.

An EMTR can be defined as the proportion of a one-dollar increase in private income that is lost to income tax and withdrawal of government cash payments and government concessions. Hence, it is calculated as:

$$\text{EMTR} = 1 - \frac{\text{Change in family disposable income}}{\text{Change in earnings}}$$

where 'change in earnings' is equal to one dollar.

Disposable income for an *individual* is calculated as the sum of private income (that is, wages and salaries and investment income), plus any government transfer income received, less total income tax paid (which includes the Medicare Levy and is net of any income tax offsets). For a *family*, disposable income is the sum of the individuals' disposable incomes.

An EMTR of 60 per cent means that 60 cents of the one-dollar increase in private income is lost to taxes and reduced government cash payments and the person or family is better off by 40 cents, that is, their disposable income increases by 40 cents.

One criticism of EMTRs is that households are not usually able to control their income in single dollar increments. Effective average tax rates (EATRs) overcome this objection because they provide a picture of the incentives faced by individuals and families for more realistic changes in their income, such as an hourly wage rate. An EATR is calculated as:

$$\text{EATR} = 1 - \frac{\text{Change in family disposable income}}{\text{Change in earnings}}$$

where 'change in earnings' is equal to an amount of more than one dollar (for example, the hourly wage rate).

It is important to note that since the replacement ratio depends on the level of income support payments, a change in the level of Newstart Allowance would change the RR at all levels of income even if the tax rates stayed the same. In the same situation, EMTRs (and EATRs) would be unchanged at some levels of private income.

Whilst the concepts of unemployment traps and poverty traps are widely used in the literature on welfare reform and public policy more generally, they are used in different ways to underpin different explanations of work disincentives. One review of the housing and social

policy literature on poverty traps suggested that usage reflects ‘diverse theoretical and ideological assumptions and biases about such themes as the nature of the individual, the roles and responsibilities of the housing and welfare system, and the wider social and economic structures’ (Burke and Wulff 1993: 4-5). For example, explanations differ in terms of the degree of individual choice that underlies decisions on working when an individual is confronted with acknowledged unemployment or poverty traps. One view is that people are constrained in taking on work by structural factors such as EMTRs or their level of education and training relative to job skills required by employers. Another view is that attitudes and motivation explain different rates of taking up paid work, implying that only focusing on the role of government in creating high EMTRs can reinforce the ‘all-too-human tendency to avoid personal responsibility’ (Abbott 1999).

In conceptualising work disincentives, therefore, there is a basic distinction between those seen as resulting primarily from *structural* factors in which individual decision making about work is shaped by a combination of market forces and government policy settings, and a view that *behavioural* factors such as individuals’ skills, capacities, attitudes and motivation are highly significant as barriers to participating in paid work, as indicated in Figure 2.

Figure 2: Dimensions of work disincentives

	Structural	Behavioural
Core	<i>Tax and income support</i> Interaction of income support and taxation systems	<i>Individual characteristics</i> Individuals’ skills, capacities, attitudes and behaviours
Underlying	<i>Market issues and broader government policies</i> - Loss of concessions and ‘in kind’ benefits - Additional costs in working (childcare, transport etc.) - Educational opportunities, housing costs, transport and labour market issues.	<i>Social values and expectations</i> Underlying expectations about the role, suitability and availability of paid work in the face of parenting and caring responsibilities, disabilities, health status

It is also useful to distinguish between those issues that have been at the *core* of the welfare reform debate and *underlying* issues that have generally received less explicit attention. Welfare reform in Australia has focused on core structural issues such as changes to the income support and taxation systems aimed at improving the financial returns from working (reducing unemployment and poverty traps) but also on eliciting behavioural changes amongst unemployed people through measures such as participation agreements, ‘work for the dole’, job readiness, job search training, literacy and numeracy support, personal support, case management, and breaching for non-compliance with Centrelink requirements (Commonwealth of Australia 2002). A similar combination of measures is evident in New Zealand (MSP 2001) and the United Kingdom (McKay 2002; Harries and Woodfield 2002).

2.3 Housing, Housing Assistance and Work Disincentives

Whilst housing has been often been marginal to a consideration of these core welfare reform strategies, there have been a few attempts to consider whether, and to what extent, different forms of housing assistance contribute to disincentives to work. In its submission to the Industry Commission Inquiry into Public Housing in 1993, the then Department of Social Security drew attention to the differing treatment of public and private renters. It noted that public renters faced higher EMTRs and suggested restructuring public housing arrangements to more closely reflect the actions of the Commonwealth Rent Assistance (RA) scheme. In its report, the Industry Commission (1993: 57) argued that public housing tenants in similar circumstances should receive the same level of subsidy rather than pay the same level of rent. The Commission also suggested a non-linear withdrawal rate as a compromise between disincentives and cost (DSS 1993: 83-4).

Since then, however, the only housing component included in most modelling of the financial outcomes for people and households of working different hours and at different wage rates

(Reference Group on Welfare Reform 2000a: 37) has been RA for private renters, since this is an integral part of the national income support system whilst the effect of withdrawal of concessions such as public housing rents is not uniform across the country. Ingles (1997) found that RA increased the range of income over which a typical family experienced high EMTRs. By comparison, income related rents in public housing (rent rebates or concessions) caused the EMTRs to 'stack', i.e. the rebate system compounded the effective 'taxation' rate for those taking a job. This resulted in EMTRs that were generally 10 to 20 percentage points higher than for those renting privately and receiving RA. The flipside of this discrepancy was that public housing residents had greater disposable income at low levels of private income.

Ingles (2000), discussing arrangements after the introduction of A New Tax System (ANTS) in July 2000, subsequently argued that income related rents/rental rebates and RA schemes should be merged, or at least brought closer together, to improve horizontal equity. He also proposed withdrawing RA only after all maximum family tax payments have been exhausted as a means of reducing high EMTRs for those families eligible for both payments³. As a less generous alternative, Ingles proposed that the family tax benefit payment and RA means tests should be allowed to stack, provided the tapers on both were lowered so that they resulted in EMTRs not exceeding 60 per cent.

The difference in financial incentives to work for public housing tenants and private renters also emerged as an issue in the welfare reform process. In its consultations, the Reference Group on Welfare Reform (2000b: 25-6) noted 'strong support for lowering the impact of increased income on public housing rents'. Since then, some State Housing Authorities, such as Western Australia and New South Wales, have introduced initiatives to disregard additional income earned by tenants from paid work for a limited period when assessing rents. The 2003 CSHA takes this one step further by requiring the states and territories to introduce rent policies that reduce the workforce disincentives associated with the current link between earned income and rent (Commonwealth of Australia 2003: Schedule 1).

There has been limited consideration of housing in terms of improving individuals' capacity and motivation to work. There are some implicit links here that have as yet not been fully explored. For example, Commonwealth, state and territory homelessness strategies address a most basic barrier to finding and keeping work, lack of a secure home. The Supported Accommodation Assistance Program and other initiatives that link housing assistance and support services to enable people to stabilise their lives may also contribute to them being in a sufficiently stable situation to look for work. state and territory social housing programs targeted at people who have support needs in addition to low incomes provide lower and predictable rents, relative security of tenure and access to support services. These may contribute to circumstances in which people with support needs due to health, disability and other issues are more able to seek and maintain work.

A further range of underlying issues underpins the 'core' welfare debate. For example, modelling of the combined effect of income support (including RA) and tax does not usually consider withdrawal or loss of concessions to people moving into work from income support although these add to EMTRs (Ingles 1997; Turton 2001). Empirical research suggests that people considering moving into work are deeply concerned about the loss of entitlement to government concessions, particularly the Commonwealth health care card (Cowling 1998: 34), and that public housing tenants are concerned about the withdrawal of rent concessions (rent rebates) (Burke and Wulff 1993). Loss of public rental concessions will exacerbate unemployment and poverty traps for particular households, but also makes calculation of the financial impact of working more complex and may add to uncertainty.

There is increasing recognition that analysis of the financial returns from working relative to receipt of income support and an individual's capacity and behaviour in becoming job-ready and searching for work do not in themselves fully explain decisions to work or take on more work. There has, however, been little research on the underlying structural issues that impact

³ In practice, RA and Family Tax Benefit A payments are proportionally reduced under one income test so that the total benefit payable is equal to the amount that would be paid if RA was only reduced when the Family Tax Benefit A payments reached the base rate. Whilst the mix of payments would be different under this proposal, since neither component is taxable, there would be no change to rate of withdrawal of payment and hence no effective change to the EMTR (communication from the Department of Family and Community Services).

on these decisions. These could include loss of concessions, as discussed above, but also the additional costs of working, such as childcare, and broader issues such as the availability of jobs in proximity to home and transport and access to education and training.

One United States commentator describes this tier of underlying issues as important:

not just for its substantive content but also for its symbolic value. It reflects the acknowledgement that moving recipients from welfare to work requires more than job skills and work readiness. It involves, in addition, solving the logistic problems of everyday life and satisfying very basic needs so that getting and keeping a job is possible (Newman 1999: 1).

In the United States and Canada, there has been a focus on assistance with childcare, health care and transportation to reduce some of the underlying structural barriers to working. Canadian experience is that these so-called 'collateral supports' are essential in promoting employment (HRDC: ch. 6). In the United States, acknowledgement of the contribution of these three areas to welfare reform has translated into funding services that now account for 57 per cent of federal and state expenditure on the main welfare program, Temporary Assistance for Needy Families (TANF), compared to 43 per cent on cash assistance (Coven 2002).

Consideration of underlying structural issues begins to throw the spotlight on location in the welfare reform debate. In the United States particularly, the focus on transportation is a response to a locational issue whereby social assistance recipients are concentrated in inner city areas but job growth has occurred in suburban areas often not served by public transport (Newman 1999). The New Zealand welfare reform also strategy recognises this point:

How we assist people to make the transition to work and to make work pay also needs to reflect the realities of where people are living. In Auckland it could mean help with transport, housing or childcare (MSP 2001: 10).

Whilst there has been little attention to date of the role of housing in welfare reform in Australia, a focus on housing, which has an inherent spatial dimension, enables a clearer articulation of the importance of location to an understanding of work disincentives. Do current forms of housing assistance, for example, enable people to afford housing in areas where there are good work opportunities? Does the housing assistance framework support those who wish to move to be nearer to work? Do the costs of the journey to work or the ease of that journey, especially if other tasks need to be performed in the process, such as dropping children at childcare or school, deter people from taking on paid work? The locational aspect of housing in relation to the location of available job opportunities plays a critical role in how individuals and families resolve these issues.

Finally, there are a set of underlying behavioural issues that reflect social values about the importance of paid work relative to other priorities, rather than individual capacities and attitudes. These may be widely held beliefs about the role and suitability of paid work relative to other life concerns, such as family and caring responsibilities, maintaining good health or trade-offs between work and other activities, particularly as people get older. There is some research, particularly in respect of women with children, which suggests that the difficulty of balancing work commitments with family responsibilities is a major barrier to moving into paid work (e.g. Cowling 1998; Burke and Hulse 2002; MSD 2002). This has implications in terms of flexible working hours and conditions but also emphasises the importance of location, including housing. Does the form of housing assistance mean a lack of opportunities to work at home? Does housing assistance result in housing being poorly located in terms of jobs, childcare and schools, thereby tipping the balance in favour of not working? Does it provide the security and predictability that may be required in order to sustain other life commitments, including working? Does strong attachment to local community, sometimes expressed in attachment to a particular dwelling or local area, tie people to places in which job opportunities may be very limited?

Figure 3 summarises the discussion above, indicating some elements of housing and housing assistance that may impact on work disincentives.

Figure 3: Elements of housing and housing assistance that may impact on work disincentives

	Structural	Behavioural
Core	<i>Tax and income support</i> • Payments for housing as part of the income support system (RA)	<i>Individual characteristics</i> • Assistance to homeless people focusing on individual capacities and behaviours • Emergency housing assistance to people in crisis situations • Needs based allocation of social housing to people with the highest support needs
Underlying	<i>Market issues and broader government policies</i> • Concessional charges such as income related rents in public housing • Affordability of housing in areas with jobs opportunities and transport (all tenures) • Assistance with housing costs in areas with better work opportunities (e.g. RA) • Disadvantaged communities with high unemployment rates (e.g. community renewal)	<i>Social values and expectations</i> • Security of housing • Predictability in housing costs to facilitate budgeting • Suitability of housing in view of parenting and caring responsibilities, health status, disability and age. • Ability to work at home or near to home to manage balance between work and other commitments • Strong attachment to housing and/or community

2.4 Summary

This section has explored the nature of work disincentives, in particular, the concepts of poverty and employment traps. It also introduced measures that are commonly used to indicate the size of these traps, such as RRs, EMTRs and EATR. A conceptual model was then developed which distinguishes between the structural and behavioural elements of work disincentives and between those that have been at the core of welfare reform and other underlying aspects of work disincentives. This model was the basis of a brief review of the literature on the role of housing and different forms of housing assistance in contributing to work disincentives (a more detailed discussion of the international literature on housing subsidies and their interaction with the tax and benefit system is presented in Appendix 1). The review found that this literature is limited as housing has in general been marginal to the welfare reform debate in Australia and similar countries. A number of questions about the possible ways in which housing and housing assistance contribute to work disincentives were then identified for further discussion in Section 3.

3 UNDERSTANDING THE INTERRELATIONSHIPS BETWEEN HOUSING AND WORK DISINCENTIVES

This section examines the interrelationships between housing costs, housing assistance and work disincentives in more detail. It outlines available evidence on the ways in which housing costs and different types of housing assistance may contribute to work disincentives in Australia and similar countries. In addition, the section identifies some examples of initiatives to change the delivery of housing assistance to provide better incentives for people to work or to work more hours. This more detailed understanding of the links between housing and work disincentives will help frame the questions to be asked of unemployed people in the empirical part of the research.

3.1 The Interrelationship Between Income Support, Tax and Rent Assistance

One of the key issues in looking at work disincentives more generally is the interaction of the income support and tax systems. This section examines the interactions of these two systems and then looks at the role of RA, specific payments to eligible income support recipients who rent privately which are embedded within the income support system.

Working out what happens as people move from income support payments and into paid work is complex. The analysis here is centred on what happens as unemployed people in receipt of Newstart Allowance or Youth Allowance move into work. Newstart Allowance is paid to people aged 21 to Age Pension age (currently 65 for men and 62 for women) who are unemployed, subject to income, assets and activity tests. Youth Allowance is paid to unemployed people aged 16 to 20, again subject to income, assets and activity tests.⁴ The analysis was carried out in late 2002 and is based on income support payments and tax rates applicable at that time.

3.1.1 *Withdrawal of Income Support Payments as Income from Paid Employment Increases*

People on Newstart and Youth Allowance are able to earn a small amount of private income⁵ before their payments are affected, the so-called 'income test free area'. In late 2002, they could earn a maximum of \$31 a week and still receive the full rate. Beyond this level, any additional income from paid work resulted in a reduction in the primary payment (such as Newstart and Youth Allowance) due to the application of income tests.

Firstly, recipients are tested on their *personal* income. In the case of Newstart and Youth Allowance there is a two step personal income test. Each dollar earned above the income test free area (more than \$31 a week) and up to \$71 a week results in a reduction in payment of 50 cents. Above this second income threshold (i.e. more than \$71 per week), each additional dollar of income from work results in a reduction in payment of 70 cents in the dollar. The rate at which each additional dollar of earned income results in a corresponding decrease in income support payment is referred to as the 'taper'; the higher the taper above the income test free area, the higher the EMTR.

Newstart and Youth Allowance recipients with partners may also have a *partner* income test applied. For every dollar that their partner's income exceeds a certain limit (which is equal to the cut-out point under the personal income test), their payment is reduced by 70 cents. The partner income test applies in all cases unless the partner receives a pension such as the Age Pension. Thus, if both members of a couple are on Newstart payments, the earned income of one person may affect not only that person's payment but also their partner's entitlement to Newstart⁶.

⁴ Youth Allowance is also available to full-time students aged 16 to 24; however, they are not considered in this analysis.

⁵ Private income refers to wages and salaries and investment income. For the purposes of this analysis, it is assumed that it includes only earned income from wages and salaries.

⁶ Communication from the Department of Family and Community Services.

Youth Allowance recipients who are considered to be 'dependent' may also be subject to a *parental* income test, whereby every dollar of the parents' income above a certain threshold reduces the entitlement by 25 cents.

Unemployed people may be eligible for RA to assist with the cost of private rental accommodation. RA pays 75 per cent of rent above a minimum threshold up to a specified maximum. The minimum rent threshold and maximum rate of RA vary by type and size of household. For example, a single person living alone can receive RA for rent of more than \$81.60 per fortnight, with the maximum payment of \$92.00 payable when rent is \$204.27 per fortnight (Centrelink 2002).

The amount of RA is added to the recipient's maximum Newstart or Youth Allowance entitlement and income tested under the income test(s) for that payment. If, however, the person has dependent children aged under 16 years, their maximum RA entitlement is added to their Family Tax Benefit Part A and income tested under the Family Tax Benefit Part A income test. Essentially, therefore, RA does not have its own income test but simply increases the amount of maximum entitlement to another payment (either Newstart Allowance, Youth Allowance or Family Tax Benefit Part A). In this sense, RA does not cause EMTRs to 'stack' and there is no 'double taper' as is the case, for example, with payment of Housing Benefit in the United Kingdom (Kemp, Wilcox and Rhodes 2002).

3.1.2 Effect of the Tax System and Medicare Levy as Unemployed People Receive Income from Paid Work

Income tax is calculated on the basis of individual income. Individuals whose taxable income⁷ is less than the tax-free threshold, currently \$6,000 per year, do not have to pay income tax. Above this threshold a person is liable to pay income tax at the initial rate of 17 cents in the dollar, with higher rates applying to higher income bands.

After income tax liability has been calculated, many taxpayers are entitled to tax offsets (previously known as rebates). These are subtracted from income tax liability but cannot be used to generate a tax refund, nor can they be used to reduce Medicare liability. There are many different tax offsets, but the main ones for unemployed people are the allowance tax offset and the low income tax offset.

An *allowance tax offset* may be payable to recipients of taxable allowances (such as Newstart and Youth Allowance). Its purpose is to protect those with little or no private income from paying income tax on their taxable government cash payment. Thus, the amount of the allowance tax offset is equivalent to the income tax payable on the taxable allowance. Once the amount of the taxable allowance falls below the tax-free threshold (\$6,000), no allowance tax offset is payable.

The *low income tax offset* is another offset that can reduce an unemployed person's income tax liability. It is provided to low income taxpayers (currently defined as those with taxable income of less than \$20,700 per year) subject to an income test. If the person's taxable income is less than \$20,700 a year, they receive the full entitlement of \$150. The offset is reduced by four cents for every dollar of taxable income above this threshold.

The effect of these tax offsets can be complicated to calculate. A further complication is where income from paid work exceeds the Medicare Levy threshold, at which stage people become liable to pay the Medicare Levy. To avoid a sudden large increase in tax liability, the Medicare Levy initially applies at a shade-in rate of 20 per cent of income above the threshold until it reaches 1.5 per cent of total taxable income, when the normal rate of 1.5 per cent applies. Over the range of income in which the shade-in rate applies, however, the EMTRs for families are significantly higher than for incomes above the range.

⁷ In the hypothetical component of this paper (Sections 3.3 and 3.4), tax deductions are assumed to be nil. Thus, each family's private income is equal to their taxable income in the case of all hypothetical families in this study.

3.1.3 Modelling the Impact of Increments in Income from Paid Work for Unemployed Private Renters in Receipt of RA Compared to Unemployed Non-Private Renters

Most RA recipients are of labour force age (as shown in Appendix 2), and in most cases payment of RA is additional to an income support payment or part payment. Only 9 per cent do not receive any income support payment and receive RA attached to their family payments. It is apparent then that most RA recipients will be affected by the high EMTRs indicated in the analysis above.

High EMTRs, generally considered to be those that greatly exceed the top marginal income tax rate of 47 cents in the dollar, indicate potential work disincentive problems. However, it is not only high EMTRs that are of concern, but also the range over which they occur. A high EMTR over a narrow range of income may not provide a disincentive as strong as a slightly lower EMTR that exists over a wide range of income.

In order to illustrate the interactions of earnings from paid work, the income support system and the tax system for private renters in receipt of RA, it is helpful to consider some hypothetical examples of families as they start to earn income from paid work. The National Centre for Social and Economic Modelling (NATSEM) at the University of Canberra calculated the EMTRs for hypothetical family types generated by the EMTR model in STINMOD, NATSEM's general-purpose static microsimulation model. STINMOD/01B simulates incomes by applying the rules of federal government income tax and cash transfer payments to a database of Australian families (see Lambert 1994 for more information). Included in STINMOD are the major federal income support payments, family payments and RA, as well as payments from the Department of Veterans' Affairs. Personal income tax, tax offsets and the Medicare Levy are also modelled⁸.

Four household types were chosen for this analysis:

- A single unemployed person aged over 21 years;
- A single unemployed person aged 19 years;
- A couple, both unemployed and aged over 21 years, with no children;
- A couple, both unemployed and aged over 21 years, with two children aged 4 and 6.

Each of these types has two variations: one where they are private renters, and one where they are not. The EMTRs were then compared. For those who pay rent, the amount that they pay is assumed to be \$150 per week for all household types, which ensures that they receive the maximum possible entitlement to RA.

The STINMOD model was also used to generate EATRs for the same hypothetical families. As discussed in Section 2.2, EATRs are most often measured over ranges of income that correspond to hourly wage rates or to an arbitrary round number, for example, \$50 (see Beer 1998 for an example). As they look at changes over broader ranges of income, EATRs tend to exhibit less variability than EMTRs.

The EATR analysis assumed that an adult gets a job that pays the federal minimum wage of \$431.40 a week (AIRC 2002). The awards to which the minimum wage applies have a 38 hour week as standard, which gives an hourly wage rate of \$11.35. Full-time employees worked an average of 39.8 hours in 2000 (ABS 2001)⁹, so the EATR examples are calculated for up to 40 hours of work.

The detailed results and commentary for each household type are set out in Appendix 3. The results show that unemployed people and their households face very steep EMTRs as they receive some income from paid work and then move up the income scale and/or work longer hours. In some cases, EMTRs spike at more than 100 per cent over specific income bands,

⁸ Some programs and payments that could affect EMTRs are not included in STINMOD. These include Childcare Benefit, Higher Education Contribution Scheme and rent paid to public housing authorities. The modelling also assumes that assets do not affect entitlement to government payments.

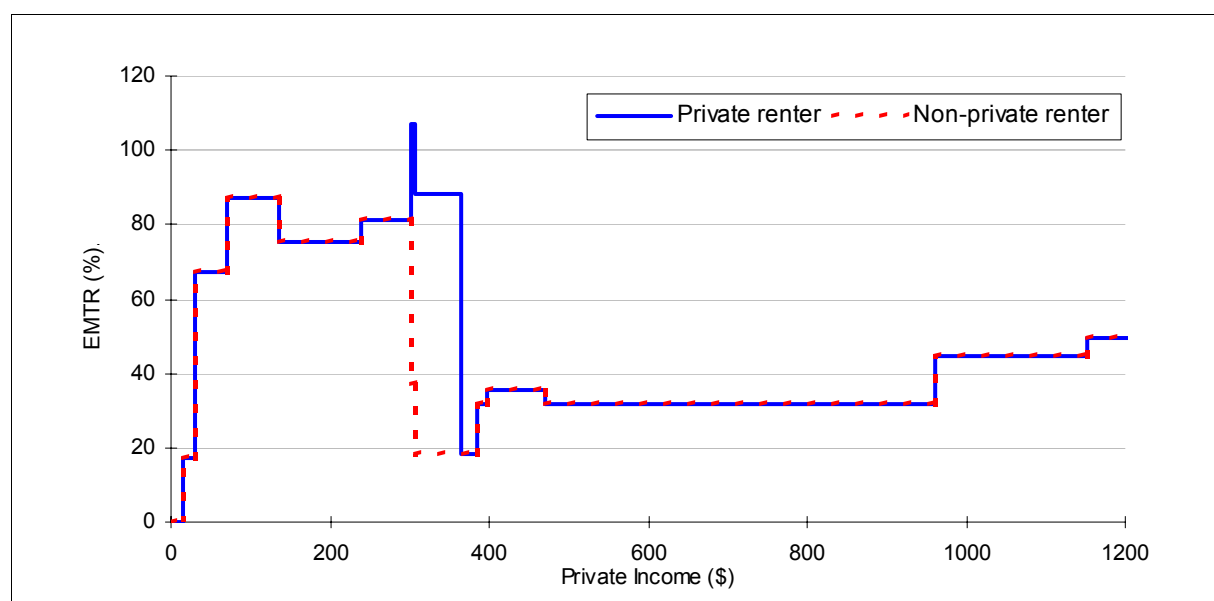
⁹ Including all employed persons in scope for the Labour Force Survey (mostly the self-employed) leads to a higher figure for average full-time hours – 42.0 in August 2002 (ABS 2002: 27).

meaning that for each extra dollar earned, more than a dollar is lost in income support payments and tax liability. The effect of RA is to increase disposable income (before housing costs) for private renters relative to non-private renters, to increase already high EMTRs over specific income bands relative to non-private renters, and to extend the range of income over which high EMTRs apply. These findings apply whether RA is attached to an income support payment such as Newstart or Youth Allowance or is paid with Family Tax Benefit Part A for families with children. Here we illustrate these points by selecting two examples of hypothetical families: a single unemployed person aged over 21 years and in receipt of Newstart; and an unemployed couple, both aged over 21, with two children aged four and six.

Example 1: Single unemployed person aged over 21 years in receipt of Newstart

A single unemployed person aged over 21 years on Newstart faces high EMTRs once their income from work exceeds the income test free area of \$30 a week. Between \$30 and \$302 of earned income per week for a non-private renter and \$30 and \$367 for a private renter in receipt of RA, the EMTRs are between 60 and 85 per cent. This confirms that, as previous studies have shown, the effect of RA is to extend the income band over which these very high EMTRs apply. This happens because the Newstart Allowance takes longer to be income tested away, since RA is paid as part of Newstart Allowance. As RA is being withdrawn, the EMTR spikes to more than 100 per cent, largely due to the combined effect of the withdrawal of RA and the Medicare Levy shade-in. At \$314, the Medicare Levy shade-in ends and the EMTR drops to 88.5 per cent until private income reaches \$367 per week. At this stage, EMTRs drop to just over 30 per cent. These changes in EMTRs are illustrated in Figure 4.

Figure 4: EMTRs faced by a single unemployed person aged over 21 years over different levels of private income



Source: Calculated by the National Centre for Social and Economic Modelling (see Appendix 3)

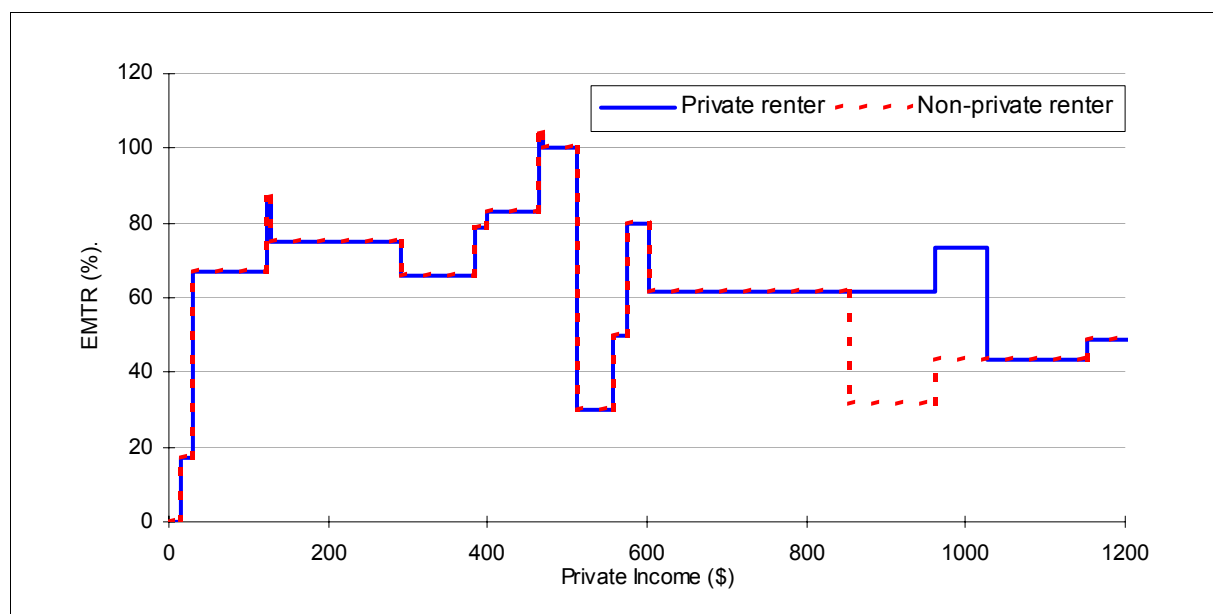
The analysis also showed that high EMTRs over this income range mean only a gradual increase in disposable income (before paying for housing). For instance, as income from work increased from \$30 and \$302 per week for a non-private renter (i.e. an increase of \$272 per week), disposable income increases by just \$60 – from \$210 to \$270. The outcome for the private renter is similar. As private income increases from \$30 to \$367, disposable income increases by only \$66 from \$256 to \$322 per week. Once the Newstart Allowance has been fully withdrawn and EMTRs fall back to lower levels, disposable income increases more rapidly.

This person also faces high EATRs of over 60 per cent until they are working 26 hours per week at the federal minimum wage if they are a non-renter or 32 hours per week if they are a renter in receipt of RA. This means that for every additional hour of work between 0 and 32 hours per week for a private renter, less than 40 per cent of their hourly wage will end up as increased disposable income and 60 per cent or more will be lost to increased income tax and/or reduced government cash benefits.

Example 2: Couple, both unemployed and aged over 21 years, with two children aged four and six

EMTRs for an unemployed couple with two children who are both unemployed are also very high and exceed 60 per cent over a very wide range of income private income, as illustrated in Figure 5. With the exception of earnings between \$511 and \$574 a week, the EMTRs for this family exceed 60 per cent from \$30 to \$853 per week for a non-privately renting family and \$1,027 per week for a privately renting family in receipt of RA.

Figure 5: EMTRs faced by a couple, both unemployed and aged over 21 years, with two children, over different levels of private income



Source: Calculated by the National Centre for Social and Economic Modelling (see Appendix 3)

The longer range of private income for the privately renting family is due to RA being attached to Family Tax Benefit Part A rather than their Newstart payment. The income test for Family Tax Benefit Part A is far more generous than the income test for unemployment benefits (Newstart Allowance or Youth Allowance) and thus, RA is fully withdrawn at a much higher level of private income for families with children. Once their RA has been fully withdrawn, at \$1,030 private income, the two families face the same EMTRs (which are less than 60 per cent). Between \$31 and \$512, the high EMTRs are due to the withdrawal of the reference person's and then the spouse's Newstart Allowance, the spouse reaching her maximum Family Tax Benefit Part B entitlement, income tax and the loss of tax offsets for allowances and low income. Between \$574 and \$602, the high EMTRs are attributable to the withdrawal of Family Tax Benefit Part A, income tax and the Medicare Levy.

As with the previous example, high EMTRs mean that the disposable income of this family increases slowly. Because RA is withdrawn under the Family Tax Benefit Part A income test, which has a relatively high threshold, the disposable incomes of the private renters (before housing costs) are higher than for non-private renters until private income exceeds \$1,030 a week, although the difference is quite modest. In the case of this family type, RA provides additional disposable income well beyond average weekly earnings of \$906.80¹⁰ (ABS 2002).

Modelling of EATRs for this family was based on the assumption that one of the couple works whilst the spouse remains without a job. EATRs for this family type exceed 60 per cent for every additional hour of work by the reference person between 0 and 40 hours per week. This is because even when one partner is working full-time and earning the federal minimum wage, their income is not sufficient to fully remove their spouse's Newstart Allowance entitlement. Thus, every additional hour of work between 0 and 40 hours per week means that either their own Newstart Allowance is being withdrawn or, once they have lost their allowance entitlement, their spouse's Newstart Allowance is being withdrawn under the

¹⁰ Figure quoted is trend full-time adult total earnings at May 2002.

partner income test (which has a taper of 70 per cent). In combination with paying income tax, withdrawal of tax offsets and/or paying Medicare, this constitutes high EATRs over the whole range of hours worked for this couple.

Families in this scenario face almost always face the same EATRs regardless of whether they rent privately or not. Whether or not the couple rents privately does not impact on their EATRs when the reference person earns \$11.35 per hour. This is due to the fact that even when the reference person works 40 hours per week, their income does not fully remove their spouse's Newstart Allowance entitlement. Thus, at 40 hours work per week (by the reference person), the privately renting couple are still eligible for maximum RA.

These examples show that unemployed people and their households face high rates of effective taxation, whether measured by EMTRs or EATRs as they move into work, and either move up the income scale or work longer hours which translates into very gradual increases in disposable income. The effect of RA is to increase disposable income of non-private renters (prior to paying for housing) compared to non-private renters but this in turn extends the income band over which very high effective tax rates occur.

3.2 Income Related Rents

Income related rents have been a cornerstone of the public housing system from the first CSHA in 1945, although take-up rates were low until the mid-1970s as most tenants were able to afford property rents based on historic costs. The system of income related rents was intended to ensure that rents are affordable without recourse to direct rent allowances in the sector (Burke, Ralston and Hulse 2003). Tenants pay rents based on a percentage of household income until income rises to a level where market rent is payable for the property, at which point the market rent is paid regardless of how high income rises. Currently, some 89 per cent of tenants pay an income related rent (FaCS 2002: Table A5). State and territory rent rebate schemes vary, but most public tenants pay between 20 and 25 per cent of household income in rent¹¹. In this section, a flat rate 25 per cent of income ratio is used for illustrative purposes¹².

Income related rents (or rent rebates) are effectively a concession on the rent chargeable for the property (property rent), which most public landlords in Australia currently set at market rent levels. The cost of the concession may not be apparent to the tenant. Income related rents do not reflect the quality or location of housing nor the housing services the tenant receives. They differ from direct cash income supplements such as RA in the following respects:

- There is an income test for rent rebates in public rental that is separate to the income test for income support payments, thus constituting 'income test stacking' (Ingles 1997);
- Rents are based on household rather than individual or 'income unit' income and also take into account a percentage of any income earned by non-dependent children and that of other resident income earners such as carers and members of extended families;
- Unlike the income support system there is no 'free income test area' before additional rent is charged (i.e. the concession starts to be withdrawn). Rents increase from the first dollar earned at the rate of 25 cents in the dollar, effectively an EMTR of 25 per cent for any income the tenant earns under the 'free income test area' for the relevant income support payment. Above this threshold, public rent setting results in up to an additional 25 per cent on top of the already high EMTRs for non-private renters discussed in the previous section;

¹¹ Of the 89 per cent of public tenants paying a concessional public housing rent in 1999-2000, just under a quarter (23 per cent) paid 20 per cent or less of assessable income in rent, almost three-quarters (73 per cent) paid more than 20 per cent but not more than 25 per cent of assessable income in rent, and 4 per cent paid more than 25 per cent of income in rent (FaCS 2002: Table C2).

¹² States and territories vary in how they apply percentage of income. This can be a flat percentage across all income ranges, a sliding scale from some minimum or a stepped scale. Housing New Zealand Corporation (HNZC) uses 25 per cent for income up to the level of the relevant income support payment and 50 per cent above that level (information supplied by HNZC).

- The cut-out point for income related rents depends on the interaction of household income and market rents. This means that a household in a high rent property continues to face rent increases at 25 cents in the dollar as income rises after a household on the same income in a lower rent property has reached the market rent cap.

These elements of the design of public rent setting make it extremely difficult to model RRs, EMTRs and EATRs for public tenants. NATSEM's STINMOD model, for example, does not currently include provision for concessional rents paid by public tenants. Whilst precise quantification is difficult, it is apparent that the effect of income related rents is to limit the financial benefits of working for public tenants (in terms of additional disposable income) and add to already high EMTRs and EATRs for some types of households once they move into work. These effects are exacerbated by rent setting practices that take into account some of the income of older children under 21 but who make no or negligible contribution to rent, contributing to even higher EMTRs for the parent(s) (Burke and Wulff 1993). For households living in properties with high market rents, determined primarily by location rather than the size and quality of housing, this system contributes to higher EMTRs over a longer income range for public tenants. High rent areas where this disincentive applies are paradoxically also the areas likely to have the most job opportunities.

The states and territories have undertaken internal reviews of the poverty traps associated with this system of concessional rents and there have been some more general reviews (e.g. Gruen 1988; DSS 1993; Industry Commission 1993; Burke and Wulff 1993; Ingles 1997). This research confirms that income related rents contribute to unemployment and poverty traps for public housing tenants.

As we saw in Figure 1, public tenants have low rates of labour force participation and relatively high rates of unemployment for those in the labour force. The key question is whether the design of income related rents contributes directly to these outcomes. Most work on the labour supply effects of providing this type of concessional assistance comes from the United States where, although there are differences in design, public and some private tenants also pay income related rents subject to a rent cap. Federal subsidies pay the shortfall between the income related rent and the rent cap ('fair market rent') directly to the landlord.

This work is limited (Painter 2001) and primarily uses econometric modelling techniques. Such studies find that the marginal housing tax rate (30 cents in the dollar)¹³ is additional to EMTRs that are already high for some types of households and across some income bands (Olsen 2001). They also suggest that there is an 'income effect' in that those paying income related rents can survive on social assistance payments and unreported income from friends, family, charity and informal jobs without having to engage in the formal labour market (Fischer 2000: 154). Attempts to quantify the income effects of income related rents vary and are complicated by the inclusion of other forms of assistance, particularly social assistance payments, food stamps and Medicaid¹⁴. The findings of these studies are inconclusive, varying between no significant impact of rental housing subsidies (concessional rents) on labour force participation (Keane and Moffitt 1998), some impact (Painter 2001) to a study of female-headed households indicating that public housing decreased labour supply by 42 per cent (Shone 1994, quoted in Olsen 2001). Empirical behavioural research to test these findings is non-existent.

One of the difficulties in this work has been the assumption that it is the design of income related rents that lead to labour market outcomes. A missing element has been consideration of the impact of increased targeting of social housing on employment participation rates, although one United Kingdom modelling study does acknowledge this point (Bingley and Walker 2001: 1-2). Similarly, a United States study which found that residents in public housing worked fewer hours than either those without any housing assistance at all or private

¹³ Under federal housing assistance programs for renters in the United States, households generally pay 30 per cent of income in rent and utilities.

¹⁴ For example, under federal rules, eligible households can deduct from their assessable income for food stamps an amount equal to any housing costs in excess of 50 per cent of their net income. The effect of this measure is to give low income households with high housing costs more food stamps, releasing cash income for payment of housing costs (Rosenbaum, Tenny and Elkin 2002).

renters with housing vouchers considered that this might be due mainly to the particular profile of public housing tenants who faced significant difficulties in the labour market, such as the attitudes of employers towards those who had been in long-term receipt of social assistance or who were from minority groups (Ong 1998: 790).

This position is supported by the increasingly marginalised position of public tenants. Since 1997, public housing agencies in Australia have allocated housing based on need such that by 1999-2000 nearly 45 per cent of households entering public housing had 'special needs' typically including indigenous status, youth, newly arrived migrants, frail aged, those with addictions and people with pressing health problems or a disability (FaCS 2002: 17). Securing and holding down paid work is likely to be more difficult for this group than for many others due to both the operation of the labour market and pressing personal needs such as dealing with addictions or family breakdown. Indeed, many public tenants are not currently in the position of actively seeking work. In December 2002, of those in receipt of Centrelink payments who lived in public housing, only 11 per cent were job seekers in receipt of Newstart, compared to 57 per cent who were dependent on an Age or Disability Support Pension and 21 per cent in receipt of Parenting Payment Single¹⁵.

Finally, there are examples of measures, mainly from the United States, to minimise the work disincentives associated with income related rents. These include compliance measures, for example, a United States federal requirement that households who have their social assistance payments reduced or removed because they do not comply with 'self-sufficiency' requirements are not eligible for a reduced rent because their income has gone down (HUD 2000b). For the most part, however, measures to offset the work disincentive effects of income related rents comprise mutual obligation arrangements, most notably:

- A mandatory 'earned income disregard' for tenants paying income related rents under federal rental assistance programs was enacted in 1998 by the federal Quality Housing and Work Responsibility Act. This legislation specifies that eligible tenants who complete an approved job training program and then move into paid work can have the additional income disregarded for a period of up to 18 months rather than face increased rent of 30 cents for each dollar of earned income (National Center on Poverty Law 2002).
- Intensive case management through participation in voluntary Family Self-Sufficiency Program contracts in which the household head agrees to find and retain employment and keep off social assistance payments. In return, household members are able to access services such as childcare, transportation, education, job training and employment counselling¹⁶. The public housing agency agrees to credit any increased rent that is attributable to increased earnings to an 'escrow account' with funds available to households during the period of the contract (usually five years) for approved activities such as education and otherwise at the end of the contract period if no member of the family is in receipt of social assistance (HUD 2000a).
- Individual Development Accounts set up by public housing agencies in lieu of the mandatory 'earned income disregard', in which the increase in rent that would have been charged due to increased income is deposited in a savings account. The funds are then matched by a variety of public and private organisations¹⁷. The household must receive training in personal finances and the savings must be used for investments in assets such as home ownership, postsecondary education or capital for a business (Rist 2001).

There is increasing recognition at a policy level that income related rents as applied in Australia and elsewhere represent, in theory at least, a potential disincentive to public tenants moving into work or working more hours. This project will explore this issue further, not only from the perspective of policy makers, but in particular identify how important the design and administration of income related rents are to public tenants in making decisions about paid work.

¹⁵ Communication from the Department of Family and Community Services (unpublished data).

¹⁶ HUD does not fund these services directly, but provides some funding on a competitive basis to public housing authorities for the employment of Family Self-Sufficiency coordinators to develop and operate these programs.

¹⁷ These include non-government organisations such as banks, charitable foundations and employers.

3.3 Housing Costs and Location

Whilst measurement of the effects of working relative to receipt of income support (through RRs, EMTRs and EATRs) is critical to an understanding of work disincentives, reviews of welfare reform in both the United States and Canada have emphasised that so-called 'collateral supports' such as assistance with childcare or transport are also essential in assisting people to move into paid work (Newman 1999; HRDC 1999). Housing has played a relatively minor role in consideration of collateral supports for welfare reform, with a Canadian government review acknowledging that 'research is sparse on the impact of collateral supports (job costs and housing) on re-employment' (HRDC 1999: 6.5). This section examines briefly the spatial dimensions of housing and possible links with work disincentives, in particular, the spatial mismatch between affordable housing and jobs.

The New Zealand welfare reform strategy highlights the spatial mismatch between the locations of housing and jobs, stating that 'job opportunities in areas where rents and housing costs are low, are often limited' (MSP 2001: 11). Similarly, in the United States, many commentators have pointed out that job growth has not been in central cities or rural areas where housing costs are low but in suburban areas of major cities with high housing costs (Sard and Waller 2002: 4). In the United Kingdom, the work of the Social Exclusion Unit (2001b) has highlighted the problems of areas of social and economic disadvantage characterised by cheaper housing, often public housing, but with high rates of unemployment and offering few job opportunities. Households living in such areas face a dilemma: they can stay in their community in affordable housing and either remain unemployed or commute long distances to work in other areas, with commensurate transport costs, or they can move to areas of job growth but pay much higher housing costs which may negate much of the benefits of additional income from work.

How does current housing assistance in Australia help households with this dilemma? The location of some public housing stock may contribute to difficulties which public tenants face in entering employment. Whilst much public housing was originally built in proximity to industries that generated employment, the longevity of the housing asset combined with substantial changes in the labour market mean that much of it is now in areas with high rates of unemployment (see Peel 1995 and Bryson and Winter 1999 for a detailed examination of such areas). The situation is similar in New Zealand where the concentration of tenants in public rental stock built in the post-war decades and now poorly located in terms of employment and service is seen as a major challenge (HNZC 2001). The wholesale abandonment of social housing in some cities in northern England also reflects the longstanding decline of employment in these areas (Social Exclusion Unit 2001a).

On the other hand, one of the proposed advantages of RA for private tenants is that it avoids some of the inflexibility in location associated with public housing. Households can choose housing in an area of their choice and this, in theory, includes renting in locations where job prospects are good. The design of RA, however, focuses primarily on achieving horizontal equity between similar households and does not include a loading for location in the calculation of payments. The impact of this is to limit the effectiveness of the payment in job-rich areas that typically have high housing costs, a problem that has been covered elsewhere (e.g. Berry and Hall 2001; Hulse 2002; Donald, McGlashan and Leisser 2001). A further aspect of the design of the payment is that people who share with others to afford housing in higher cost areas are penalised by having their payments reduced (the single sharer rate of RA). Research on the spatial outcomes for RA recipients is very limited. One study of metropolitan Melbourne found that unemployed RA recipients tended to rent in certain inner suburbs whilst other recipients, notably households with children, rent in certain older industrial suburbs and outer suburban areas where lower rental housing was concentrated. Whilst this reflects in part the different housing requirements of these groups, the overall conclusion was that increased policy reliance on RA may 'reinforce the geography of urban disadvantage' (Wulff and Evans 1999: 108).

Understanding the links between housing, jobs and location is a developing area of research in Australia (e.g. O'Connor and Healy 2001; Bradbury and Chalmers 2002), as is exploration of the role of housing assistance in strategies for community renewal and community building in areas where there are concentrations of unemployed people (e.g. Hugman and Sotiri 2001;

Beer and Maude 2001). The states and territories are already engaged in projects of different types in an attempt to address the problems of some of these economically and socially disadvantaged areas (Randolph and Judd 2000). Such area based approaches are likely to require 'whole of government' approaches if they are to stimulate job growth and improve the skills of job seekers in addition to physical and other improvements. The neighbourhood renewal strategy in the United Kingdom provides an example of the many interrelated facets of such an area based approach (Social Exclusion Unit 2001a, 2001b).

In the United States, where a literature on the links between housing assistance and welfare reform has been developed over the last few years (e.g. Kingsley 1997; Bell and Gleason 1999; CBPP. 2000), a different view of the role of housing assistance is often taken. Analysts have pointed to a 'neighbourhood effect' whereby low rent housing is in areas with high rates of poverty, criminal activity, unemployment and teenage pregnancy (Ellen and Turner 1997; Newman 1999). Rather than relying on community renewal and other area based approaches, housing policy settings have promoted residential mobility, encouraging people to move to areas with higher employment prospects and better social conditions. Housing choice vouchers which are the main form of housing assistance to low income households in the United States have been increasingly portrayed as an essential means of achieving this (e.g. Newman and Schnare 1997; Turner 1998; Bell and Gleason 1999; Zedlewski 2002; Sard and Strom 2002). One review of this literature surmised that:

A growing body of research suggests that providing housing assistance to low income families and enabling families to move closer to employment opportunities may help welfare recipients get and keep jobs (Sard and Waller 2002: 9).

The role of housing assistance in enabling unemployed people to afford housing in areas with better job prospects may merit attention in Australia, as a complementary strategy to area based approaches. This could include examination of aspects of the management of public housing, such as practices limiting transfers within the sector that may restrict work options available to public tenants. Similarly, exploration of the potential role of RA in enabling households to move to, or remain in, areas with good job prospects could involve consideration of the inclusion of location, and associated higher housing costs, in the payment formula, such as higher level payments for households in areas of higher housing costs and higher employment, as already occurs in New Zealand (Hulse 2002). A further component that could be examined is the availability and use of private rental assistance under the CSHA. Whilst state and territory schemes vary, assistance is given to private renters with ongoing subsidies, bonds and relocation expenses at a cost of some \$66.8 million in 1999-2000 (FaCS 2002: 102). Very little is known about the use and effectiveness of these schemes, but there is potential to consider a specific role for them in assisting households to improve their employment prospects.

3.4 Behavioural Factors

3.4.1 Renters

While it is important to understand the financial outcomes of working, it is an empirical question whether and to what extent these outcomes actually influence people's decisions and behaviours in deciding to enter the labour force or to work additional hours. People may not be aware of high EMTRs generated by (additional) income from wages or they may not have calculated the impact of working on their disposable income (Millar, Webb and Kemp 1997). They may have done these calculations but decide to work anyway for other non-financial reasons, such as self-esteem or pride. For example, one small-scale qualitative study in the United Kingdom found that a quarter of people were working for less money than they could have received in benefits, about a half had done the calculations and acted accordingly, whilst the remaining quarter had not calculated the financial implications of working at all (Ford, Kempson and England 1996). People may accept adverse financial outcomes in the short term in the expectation of wages increasing in the medium term. People may also decide not to work because they consider other priorities to be important, such as providing a stable and caring environment for their children or stabilising their health and personal circumstances.

There is increasing recognition of the complex reasons that underlie individual decisions about work, with one leading Canadian commentator asserting that:

These decisions [regarding paid work] cannot simply be taken as given according to the usual simplistic assumptions of traditional economic theory. Issues such as social expectations, opportunities, transportation, childcare, workplace policies and many other factors fit into the equation. It is not clear, nor does economic theory suggest, that the effective marginal tax rate is the most important of these variables (Battle 2001: 48).

Unfortunately, little is known about the behavioural aspects of work incentives and disincentives in general, a field of research described as being 'in its infancy in Australia' (Reference Group on Welfare Reform 2000a: 48). This applies particularly to behavioural factors associated with housing costs and location.

One study of poverty traps in public housing in Australia almost a decade ago did include research on attitudes to housing, housing assistance and working¹⁸. It found that financial and non-financial reasons were cited equally as the main reason for not working, with 'need to care for children' and 'concern about losing pension of benefits' being given most often¹⁹. Only 13 per cent of tenants stated specifically that the main reason for not working was concern about paying more rent (Burke and Wulff 1993: Table 4.3). Tenants were generally aware of the impact of extra income on rents and in some cases decided to work anyway for other reasons such as self-esteem, friendship, companionship and to avoid boredom (Burke and Wulff 1993: 64).

The study found that tenants were particularly concerned about the administration of rent rebates, which required them to notify the housing authorities each time they had a change in income. They were concerned that paid work was often intermittent or casual, resulting in fluctuating income and frequent changes in rent. They also expressed a view that getting a low paid job may not be worth the time and effort involved in providing documentation and having income verified and rent recalculated at frequent intervals, in addition to going through the same process for income support payments (Burke and Wulff 1993: 61-3). This suggests the possibility that the administration of concessional rents may affect decisions about working as much as, or more than, EMTRs.

Finally, the research found that there was particular opposition to inclusion of some of the income of 'independent' children aged under 21 in the assessment of rent, leading in some cases to family conflict (Burke and Wulff 1993: 74). Other systems deal with children's income differently. For example, New Zealand public tenants are allowed two 'free boarders' without affecting their rent, typically non-dependent children²⁰.

Other research highlights another possible work disincentive associated with social housing that may also apply to some private rental housing. A recent report for the Joseph Rowntree Foundation in the United Kingdom examined the practices of social landlords in encouraging or discouraging working from home (Dwelly 2002). In the light of a general trend towards working at home, and the targeting of social housing in Australia to households with support needs, this aspect of housing management may provide a further disincentive to work. The lack of a spare bedroom to be used as an office or work space, due to stringent allocation policies designed to remove 'under-occupation', may hinder public tenants compared to home owners and private tenants in obtaining earned income from home working or self-employment. Tenancy agreements that proscribe using accommodation for work may also limit opportunities, for example, for those with health issues or disabilities or sole parents with young children.

It is a matter for further research whether low income households value highly the security of tenure of public housing and predictability of rent payments, compared to renting privately, in terms of stability for themselves and their children. Industrial restructuring in Australia has

¹⁸ The methodology comprised focus groups of public tenants and a small-scale follow-up survey.

¹⁹ It should be noted that most of the tenants in the survey were either female sole parents or married women with children.

²⁰ Information supplied by Housing New Zealand Corporation.

relegated displaced workers to 'precarious employment in the form of intermittent, casual and part-time work, and their histories of employment display disjointed and chaotic patterns' (Weller and Webber 2001: 160). Taking up paid work in this environment, particularly if it leads to frequent changes in rent levels as well as changes in income, may create budgeting difficulties in terms of the amount of disposable income available for food and other necessities each week. It is possible that some public tenants opt for predictability in budgeting, even though on very low incomes.

The links between the higher mobility associated with private renting and participation in paid employment are also unclear. One of the major differences found in a recent study comparing sole parent public housing tenants with those in receipt of RA was that the latter had moved much more frequently (Burke and Hulse 2002). Do the frequency of these moves enhance job prospects or limit them? Further research is required on this point.

3.4.2 *Home Owners*

A number of Australian states have residual mortgage relief and interest rate assistance schemes for home purchasers (FaCS 2002: Table F1), but no research has been carried out on any links between this type of assistance and possible work disincentives. Income support recipients who are purchasing homes are not eligible for RA, unlike people on similar incomes in private rental arrangements. Consultations with stakeholders for the National Housing Policy Project strongly suggested conversion of RA into a more general housing assistance payment that could also be made available to low income people with home mortgage commitments (Donald, McGlashan and Leisser 2001: 13), a policy change that has also been supported based on other research (e.g. Burke and Hulse 2002). It is important, in this context, to consider evidence of any behavioural responses to this type of assistance.

Whilst assistance with mortgage interest and other home purchase costs is possible within Canadian and United States social assistance programs, few recipients are home purchasers, and there is no research on behavioural responses. Most of the relevant research on this point comes from the United Kingdom where social assistance recipients (on Income Support and Job Seeker Allowance) can get assistance with mortgage interest payments after a waiting period of nine months during which time they are expected to rely on private insurance (Kemp and Price 2002; Burrows and Wilcox 2000). Under current policy settings, low wage earners who are purchasing are unable to get assistance with mortgage interest payments, unlike low wage earners who are renting and can continue to access Housing Benefit (Ford and Wilcox 1998; Pivot 2001). Thus assistance with mortgage interest costs only when on social assistance payments does contribute to a theoretical unemployment trap, although the extent of this will vary according to factors such as mortgage interest rates, wage levels and the design of mortgage assistance (Webb and Wilcox 1991).

Does the availability of assistance with mortgage payments when in receipt of social assistance affect decision making about entering paid work? A report in the mid-1990s suggested not, finding that about 600,000 households with mortgages in the United Kingdom were working even though their incomes were below Income Support and Job Seeker Allowance levels (cited in Ford and England 2000: 32). Specific behavioural evidence on the work disincentive effects of assistance with mortgage interest costs for the unemployed is limited and inconclusive. Small-scale qualitative research confirmed that that home purchasers with mortgages in some circumstances return to work in low paid jobs even though they are worse off financially as a result (Ford, Kempson and England 1996; Oldman and Kemp 1996). Other studies, however, have found that some home purchasers in receipt of mortgage interest assistance decide not to return to paid work fearing that employment income will be either irregular or so low as to incur mortgage arrears, whilst others decide not to work for other reasons, including skilled workers choosing not to take jobs at unskilled rates as a point of principle (Ford and England 2000).

The New Zealand Accommodation Supplement in theory avoids the unemployment trap associated with the United Kingdom system since, following changes introduced in 1993²¹,

²¹ Before 1993, only home purchasers on income support had been eligible for assistance (the Accommodation Benefit) if their commitments exceeded 30 per cent of income support payments.

eligible home purchasers can access government assistance with their mortgage costs, whether they are on income support or in receipt of low wages²², in the same way as private renters. About 17 per cent of recipients are home purchasers with private mortgages (Hulse 2002), but there is no behavioural evidence on whether the theoretical removal of an unemployment trap translates into households' decision making about work.

3.4.3 Other factors

One interesting question that will form part of the research design is whether women consider different factors and trade-offs in making decisions about work compared to men. Most United States research on the impact of rental housing assistance (concessional rents) on labour market supply, for example, takes no account of the fact that most households in receipt of this type of assistance are female-headed households (see Hulse 2002).

Some of the most detailed work on the behavioural aspects of work disincentives focuses on female sole parents with children. For example, one Australian study suggests that, whilst most sole parents fully expect to work when their children are older, those with young and school age children give first priority to caring for children, even if this means existing on low levels of income support. This finding applied equally to sole parents in public housing and sole parents renting privately in receipt of RA (Burke and Hulse 2002). Similar findings are reported from Canada, with sole parents wishing to work and move off social assistance but finding that they cannot do this. Reasons for not moving into work are that many of the jobs available are part-time and precarious, and practices such as shift work and rosters make organising childcare difficult. The financial returns from working are also minimal once childcare and transport costs are taken into consideration (CCSD 2001).

Similarly, an evaluation of welfare reform for sole parents in New Zealand confirmed that they would move into work if jobs were suitable, that is, those with hours and conditions that enable them to meet their parenting responsibilities, sufficient income to cover the additional costs associated with employment, particularly childcare, and medium- to long-term certainty of income (MSD 2002: 10). Sole parents in the study were fully aware that additional earned income would mean withdrawal of income support payments such that part-time work was unlikely to improve their financial circumstances, when taking into account the other costs of working (MSD 2002: 45).

The interviews with unemployed people in the empirical part of the research will explore some of the trade-offs and issues considered by people in making decisions about work, including differences between men and women and between those with children and those without.

3.5 Summary

The role of housing and different types of housing assistance has been given little attention in debates about removing disincentives to work in Australia. This mirrors the situation in similar countries such as Canada, New Zealand and the United States.

Modelling for this project found that unemployed people moving into paid work and working more hours face very high effective tax rates (EMTRs and EATRs) once the combined effect of withdrawal of income support payments, tax and other adjustments such as the Medicare Levy are taken into account. Although the exact rates vary by type of household, typically less than 40 cents of each dollar earned is available as additional disposable income over quite broad income ranges. The only form of housing assistance included in this modelling is RA for private renters. The modelling concludes that whilst RA does not result in income test 'stacking' it does increase already high effective tax rates over specific income bands for private renters compared to non-private renters and it extends the income range over which these very high effective tax rates apply for private renters compared to non-private renters.

The model used does not include public renters but an analysis of public rent setting suggests that these have even higher effective tax rates. Beginning with the first dollar they earn, public tenants lose one dollar in every four, indicating an unemployment trap. The range of income over which additional rent adds to already high effective tax rates depends on the property

²² In the case of low wage earners, the Accommodation Benefit is payable to households whose purchase payments exceed 30 per cent of the relevant rate of Invalids Benefit.

rent, those in higher rent properties facing increased rents over a broader income range until the property rent level is reached. There is increasing recognition of the work disincentives inherent in income related rents both in Australia and overseas. As a result, some initiatives have been developed to reduce disincentives, particularly in the United States, and in some Australian states.

There has been relatively little attention to some of the underlying issues around housing, housing assistance and work disincentives, such as the location of job opportunities relative to affordable housing. Similarly, a review of the literature both in Australia and overseas shows that very little is known about the behavioural aspects of work disincentives associated with housing.

The empirical part of the research will provide some much needed original data on the factors which unemployed people consider important in deciding whether, and how much, to work. In particular, it will explore the way in which housing and housing assistance contributes to incentives or disincentives to move into paid work.

4 RESEARCH METHODOLOGY

4.1 Outline

The proposed research seeks to assess the effect of housing costs and different types of housing assistance on the capacity and willingness of unemployed people to gain employment. It will attempt to assess the contribution of different forms of housing assistance to the creation of unemployment traps (where unemployed households find their net disposable income when in work is less than or not significantly more than when out of work) and poverty traps (where withdrawal of assistance of income support payments and the impact of tax and other deductions overlap to significantly reduce the net gain from earning more from paid work). As we have seen, these traps may be compounded by the location of housing relative to jobs and by people's assessment of the overall benefits of working when taking into account both financial and non-financial factors, such as commitment to care for children.

The empirical part of the research will seek to explore these issues through a survey of unemployed people in Sydney and Melbourne. This is designed to explore both the financial/economic and the behavioural aspects of the issues being studied.

4.2 Research Questions

The specific focus of the research is unemployed people who rent their accommodation, rather than those who own their own homes or are buying since, as indicated in Section 2.1, a higher percentage of renters are of working age but not in the labour force, or in the labour force and unemployed, than for owners and purchasers. The research will examine whether, and how, renters' housing circumstances affect their capacity to move into work and, in particular, how different elements of housing assistance (e.g. RA payments, rent rebates in public housing, security of tenure, location of housing) affect the transition to work.

The research will consider the following specific questions, derived from the four major research questions noted in the Introduction:

- How do the different costs and conditions associated with public and private rental impact on the capacity of unemployed people to move into work?
- Do the design and administration of housing assistance programs for renters have inbuilt disincentives for unemployed people to move into work, and if so, what alternatives are there?
- How, and to what extent, do different types of housing assistance increase or reduce the financial returns to people of working?
- Do people looking for jobs make detailed calculations about the financial returns from working, and if they do, how do these calculations affect their decision making behaviour?
- How important are housing costs and forms of rent setting to the decision making of unemployed renters searching for work?
- What factors other than financial returns are important for unemployed renters in deciding to work or to work more hours?
- Is the location of housing relative to jobs a factor that affects the capacity of unemployed people to find jobs?
- Are there any differences between the attitudes of unemployed renters in terms of the impact of housing assistance and related factors if they have been unemployed for a short or a longer period?
- Are there differences in the behaviours and attitudes of unemployed renters considering moving into work by age, gender or stage in life cycle?
- What difficulties do unemployed people face in the initial transition from unemployment to paid work?

- What examples are there of initiatives to link housing assistance with incentives for people to work or to work more hours?

4.3 Research Stages

The research will have four stages, as follows.

Stage 1: Literature review of the links between housing and work disincentives

The project involves an ongoing review of the literature on the relationship between housing costs, housing assistance and work disincentives from both Australia and overseas. This review will assist in identifying current problems and refinement of issues for the empirical part of the research. It will also inform the development of the research method, in particular, the survey questionnaire, analysis and policy options assessment.

Stage 2: Policy review of the Australian housing assistance system for renters

A review of the current Australian housing assistance system will be included in the project both to lay the groundwork for the analysis of policy scenario testing in the latter half of the project and also to assist in the analysis of the survey results. It is proposed to conduct a limited number of interview discussions with housing providers and policy makers in the two states which are the focus of the empirical survey work (Victoria and New South Wales) to assess the perception of providers on the issue of housing costs, housing assistance and work disincentives. Some material on relative housing costs and housing markets in the two states will also be collected to provide context material.

Stage 3: Survey of unemployed renters

The survey will take the form of face to face interviews with a sample of 400 unemployed job seekers who are public, community or private renters or who live in other types of rental arrangements²³. Home owners and purchasers and those who live at home with parents or parents in law will be screened out of the survey.

Respondents will be recruited and interviewed in Job Network offices²⁴ managed by Mission Australia in Sydney and the Salvation Army in Melbourne, who have agreed to participate in the project. A sample of 20 Job Network offices will be selected, 10 each in Sydney and Melbourne. Offices will be selected based on analysis of areas with high rates of unemployment and high rates of rental across inner, middle and outer suburbs in the two cities. The target is for 400 interviews across the 20 offices (i.e. an average of 20 per office). This is considered feasible given the timescales and budget for the project (assuming response rates of around 50 per cent among those approached for an interview). A sample size of 400 is considered the minimum required to obtain a satisfactory level of confidence in the results.

The fieldwork will be undertaken by Surveys Australia, the fieldwork subsidiary of AC Nielsen. Prospective interviewees will be informed of the purpose of the survey, that their answers will be confidential and that participation in the research will in no way affect the services they receive from their Job Network office or from Centrelink. As an incentive to participate, those who complete the interviews will go into a draw to win supermarket vouchers.

Interviewers will be people trained in interviewing by Surveys Australia. They will also be given specific training in the questionnaire to be administered in this survey. Respondents will be screened to ensure broadly that half are short-term unemployed (under six months) and half longer-term unemployed (over six months) and that the survey includes both public and private renters. Interviews will take place in the Job Network offices in a quiet location and will last around 30 to 45 minutes.

²³ There will be no quota on the percentage of different types of renters in the survey although it is hoped to recruit those living in a variety of rental arrangements. Newstart recipients live in a variety of arrangements according to Centrelink records: 7 per cent in public housing, 36 per cent in receipt of RA and renting privately, 18 per cent owners or purchasers, and 36 per cent living rent free or not having verified their rent (communication from the Department of Family and Community Services).

²⁴ The federal government's employment services are delivered by the Job Network, which is a national network of private and community organisations contracted by government to find jobs for unemployed people, particularly the long-term unemployed.

A questionnaire has been developed for the interviews, which will be piloted by Surveys Australia in one Sydney office before interviews commence. It comprises mainly structured questions and will cover:

- The rental arrangements and housing situation of respondents;
- Type of housing assistance (if any);
- Expectations about rent payable after getting a job;
- Attitudes to housing assistance and employment;
- Previous employment and current job search;
 - Perceptions of the financial returns from working;
 - Perceptions of the extra costs associated with moving into work or working more hours;
 - Perceptions of financial and non-financial trade-offs when in work compared to being unemployed.

Stage 4: Analysis and Reporting

The data collected in the policy review and survey of unemployed people will be analysed in depth in terms of the detailed research questions outlined above. Analysis of this data will form the major part of the final report.

Timetable

The proposed timetable for the project is:

Fieldwork set-up	17 February – 14 March 2003
Questionnaire design	17 February – 14 March
Pilot	17 – 28 March
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APPENDIX 1

Rent Assistance and Tax/Benefits Systems: An International Review

In contrast to the paucity of Australian research on housing subsidies and their interaction with the tax and benefit systems, other countries have given this issue more attention. This Appendix presents a summary review of the literature from several countries, focusing on the impact of housing subsidies on the financial incentives to work.

New Zealand

The New Zealand system of housing subsidies is quite similar to the Australian system. New Zealand has a public housing subsidy, as well as assistance for private renters and people paying mortgages. One important difference is that the New Zealand Accommodation Supplement (AS), paid to private renters and homebuyers, has a two-step income test. As in Australia, there is no overlap between the income test for unemployment benefits and AS (RA in Australia), and consequently there is no stacking of the tapers for these two payments.

St John and Rankin (1998) give examples of hypothetical families facing high EMTRs. In their example, AS is withdrawn at a rate of 25 per cent over the first \$80 of private income. Once earnings exceed \$80, AS stops being withdrawn and the unemployment benefit taper of 70 per cent commences. When unemployment benefit has been exhausted, AS starts to be withdrawn, again at the taper rate of 25 per cent. This avoids the stacking of tapers that would lead to EMTRs of at least 95 per cent. However, it extends the range over which high EMTRs apply.

Liebschutz (1999) estimated EMTRs for the New Zealand population and found that only 3 per cent of families experienced EMTRs of more than 65 per cent. These were more common in families with children. Almost 5 per cent of couple with children families faced EMTRs of 65 to 80 per cent, while 2 per cent of both sole parent and couple with children families had EMTRs of more than 80 per cent. High EMTRs were most common among welfare recipients, including those receiving AS.

United States

Housing assistance in the United States operates at the state and local level. This has resulted in a wide variety of schemes, which makes it difficult to give a general description. The emphasis on social policy research in the United States also means that there is more literature to cover. We have concentrated on only the most relevant literature.

Bell and Gleason (1999) reported that income related rents for people living in subsidised housing contributed to work disincentives but that the implementation of the Quality Housing and Work Responsibility Act 1998 (QHWRA) could reduce this effect. Under QHWRA, public housing authorities are required to give tenants the option of income related or flat rents. By choosing a flat rent (fixed for a year), tenants can reduce their EMTRs by 30 per cent.

Miller and Riccio (2002) reported that changes to the public housing system during the 1990s dramatically increased the returns to work for public housing residents. The difference in net annual income after rent of not working and working in a low-wage job increased from around \$2,700 in 1990 to almost \$8,000 in 2000 (in 2000 prices). This improvement in returns to work was the result of a number of policy changes, including the option of flat rents, lower rent ceilings and a 100 per cent disregard of any income increase from employment for 12 months. In the sites participating in the Jobs-Plus pilot, a range of extra incentives were used to increase the financial returns to work for public housing residents. These included rents set to a lower proportion of disposable income (10 or 20 per cent), further reductions in rent ceilings, rent credits for working and subsidised transport. Miller and Riccio concluded that there are many ways to increase work incentives for public housing residents, although each has some trade-offs.

Zedlewski (2002) reported the results of a national survey of households with cash incomes below the poverty line. She noted that people coming off social assistance but retaining their housing assistance had higher rates of employment and paid nearly 10 per cent less of their

income on rent than those without housing assistance, even though those with housing assistance earned less and were more disadvantaged.

Ong (1998) found that recipients of housing vouchers in metropolitan California worked more hours than unassisted private renters and public housing residents. While a subsidy would normally be expected to reduce the labour supply of recipients, Ong suggested that the observed increase in hours worked resulted from the increased ability of voucher recipients to choose housing that improved their job prospects, for example, by living in a better neighbourhood or reducing transport costs.

Painter (2001) criticised Ong for failing to take waiting lists into account in determining the impact of housing vouchers on work incentives. Painter's methodology uses augmented data from the Survey of Income and Program Participation to estimate the effect of a package of welfare payments and subsidies with and without housing assistance²⁵ on the labour force participation of female-headed households. His results suggest that eliminating rationing of housing assistance, that is, making it a universal entitlement to all who are eligible²⁶, would reduce labour force participation by 6.4 per cent. This result has only limited relevance to Australia, where state housing is rationed but RA is not (except by the income and assets tests). Painter estimated that removing housing assistance and the package of welfare payments and subsidies would increase labour force participation by 13.4 percentage points. In contrast, the estimated impact of removing the welfare package from a model that excluded housing was an 11 percentage point increase in the labour force participation rate. This implies that removing housing assistance and the welfare package would increase labour force participation by 21 per cent more than the just removing the welfare package.

United Kingdom

Housing Benefit (HB), the United Kingdom equivalent of Australia's RA, assisted 4.5 million households at a cost of £11.2 billion in 1998-99 (Bingley and Walker 2001: C86). HB applies to private and some public renters. It pays the total cost of rent, subject to some restrictions based on average market rents in the area. HB is reduced for earnings above a threshold, for other income (including social security payments) and for non-dependents living in the household. These reductions can be offset based on the needs of the household, for example, the number of children. The level of needs is usually set so that social security recipients' rent is fully paid.

Giles, Johnson and McCrae (1997) argued that no single measure captures the effect of taxes and benefits (including housing subsidies) on the financial incentives to work. They used rates RRs, EMTRs and EATRs (which they refer to as average tax rates) in their analysis. They found that low levels of actual and potential private earnings, high rents and the structure of the HB system substantially reduced the incentives to work for renters. Giles, Johnson and McCrae modelled the effect on financial returns to employment of several potential changes to the system: lowering rents in the social housing sector, lowering the taper rate and increasing the threshold at which earnings affect HB. They found that lowering rents would lead to small but widespread reductions in EMTRs, compared with larger but more narrowly distributed reductions in EMTRs for the other measures.

Bingley and Walker (2001) extended this analysis by modelling the responsiveness of female labour supply to changes in net income from HB. They found that labour force participation was quite sensitive to changes in the level of HB. Changing the level of HB had a similar effect to changing earned income, which Bingley and Walker interpreted as a low level of stigma associated with claiming HB. This last result has less relevance to the Australian situation because RA cuts out at lower levels of income. Nevertheless, as Australia has double the proportion of households in private rental (Wulff, Yates and Burke 2001; Bingley and Walker 2001), a considerably smaller response could still have significant effects.

²⁵ The welfare package included Medicaid, food stamps and Aid to Families with Dependent Children (see Painter 2001: 20-1 for more detail).

²⁶ The United States federal government allocates funding to local housing authorities based on the number of low income households in the area, but this is insufficient to provide housing assistance to all eligible families. Priority is given to the displaced and homeless, as well as families paying more than 50 per cent of net income in rent or living in substandard accommodation (Painter 2001: 21).

In a research paper on the effects of the 1998 budget on work incentives, Vidler and Cracknell (1998) noted that changes to taxes, tax credits and benefits had reduced the number of people in the United Kingdom facing high EMTRs. However, recipients of HB were virtually unaffected by these reforms with most continuing to face very high EMTRs, due largely to the 65 per cent taper rate.

Hills (2001) highlighted ten of the problems with HB. His list included the high taper rate and its effect on the incentive to work. He acknowledged that lowering the taper rate would draw more people into a poverty trap, albeit a shallower one, but suggested that this would be preferable to the existing arrangements.

Kemp, Wilcox and Rhodes (2002) proposed converting HB into a Housing Tax Credit (HTC) that would be integrated with other tax credits. HTC would be withdrawn first. They argued that this would eliminate EMTRs higher than 80 per cent. However, many households with EMTRs of between 60 and 70 per cent under the present arrangements would face EMTRs of between 70 and 80 per cent under their proposal.

Canada

Public housing and housing subsidies in Canada are a provincial responsibility, so there is considerable variation in the design and operation of subsidised housing (HRDC 2002). According to a review of welfare systems by Human Resources Development Canada, the most successful of these schemes, such as Quebec's Shelter Allowance Program, cover a high proportion of rent above an affordability threshold (up to a maximum). This is similar to RA in Australia, in that they cover a large proportion of rent between minimum and maximum thresholds. To be eligible for 'shelter allowance' in most cases people must be in work. This provides a strong incentive to work, as people receive more assistance when they are working in low-wage jobs than when they are unemployed.

Not all housing assistance in Canada works this way. In Nova Scotia, recipients receive the difference between their private income and the income required to meet their 'basic needs' (Nova Scotia 2002). This includes 100 per cent of rental costs up to a maximum based on the number of people in the household. This type of scheme creates large (but uniform) disincentives to work as each additional dollar of wage income is matched by the withdrawal of 70 cents of assistance, until private income reaches the 'basic needs' level of income.

The housing assistance system in Ontario was criticised by Steele (1998: 223) because the recipients faced high EMTRs. Furthermore, 'incentives for shopping around are essentially non-existent for...housing allowance recipients whose rent is well below the maximum rent'.

Finally, Fallis (1993) gives a very general discussion of the implications of the choice of housing subsidies on housing consumption, income redistribution and labour supply. From the limited number of empirical studies that calculate the sensitivity of labour supply to housing subsidies, he concludes that public housing and rent related schemes (like the Australian RA) probably reduce labour supply more than an income related housing subsidy. An important caveat on this result is that the EMTR should not be too high, although Fallis does not specify what this level might be.

Sweden

Sweden, with its generous welfare system, also suffers from the problem of high EMTRs. Gunnarsson (1999: 6) demonstrates the problem with a short example:

KP lives in the 'out-back' of the north of Sweden. It is a small community where unemployment and taxes are high. He is a single parent with two children and, not surprisingly, unemployed since a long time. In the middle of August 1997 he finally finds a job. His gross income rises from SEK 11,500 (unemployment benefit) to SEK 14,125 a month, a total of SEK 9,187²⁷ for 1997. Because of the comparatively small income increase, his housing allowance is reduced from SEK 1,000 to SEK 592 a month, for every month of the year even during those months when KP is out of work. Other negative effects due to the increase in income also

²⁷ It is not clear from the article how Gunnarsson arrived at the figure of SEK 9,187 for the increase in gross income for the year.

occur. The repayment of the study loan increases and so does the personal social charge. Moreover the basic personal deduction for assessment of income tax is reduced. The reduction of the housing allowance and the increase of the repayment of the study loan will be in full effect in 1999. In the end KP finds out that, because of the EMTR, he only has 7 per cent of the increase of gross income left. On top of this, KP will have to bear employment related expenses that are not deductible. The obvious conclusion is that KP is trapped in his effort to raise the total disposal income of the family.

The calculation of housing allowance in Sweden is based on a combination of rental cost, private income and the number of dependent children. As the example above demonstrates, although the response to changes in income is slow, it can have large impacts on work incentives.

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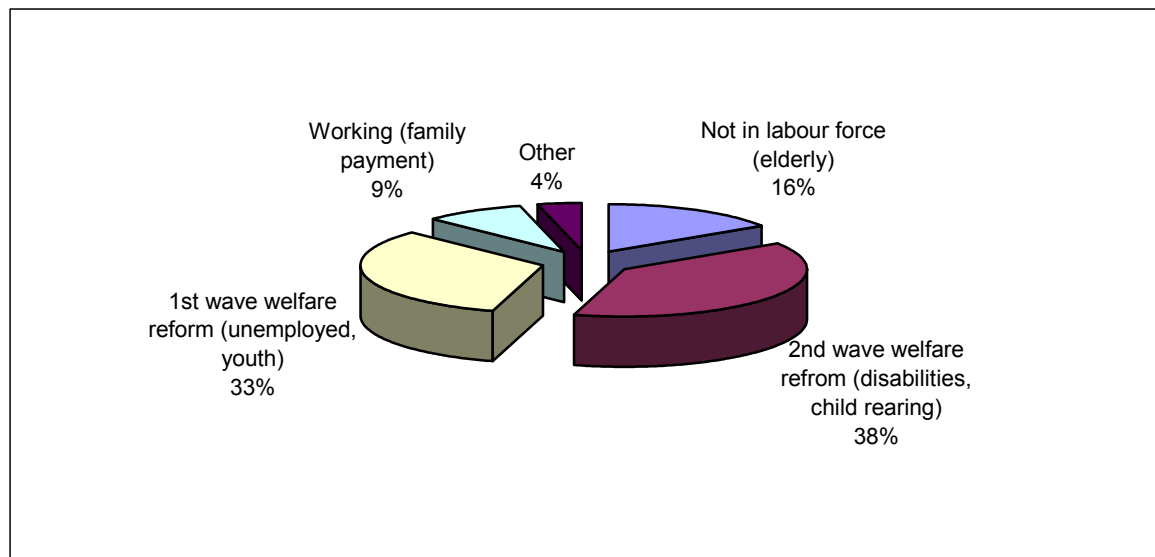
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APPENDIX 2

Labour Force Status of RA Recipients

The labour force status of RA recipients is shown in Figure A2. Whilst most (84 per cent) are of working age, just under one in ten recipients are working and do not receive any income support payments other than Family Tax Benefit Part A for their children. About a third of RA recipients receive income support payments that are conditional on compliance with activity agreements to engage in job search, training or education introduced during the first wave of welfare reforms in Australia centring on young people and the unemployed. About one in four RA recipients receive income support payments because of their disabilities or child rearing responsibilities that have traditionally been considered legitimate reasons for remaining outside the labour force. These are, however, being affected by the second wave of welfare reforms that focuses on improving work participation rates, particularly for people with disabilities and sole parents. In addition, there will be a third wave of welfare reform in July 2003 when access to the Mature Age Allowance and Partner Allowance (part of 'other' in Figure A2) will be closed off and those aged over 50 but under retirement age will receive the Newstart Allowance for unemployed people and will be required to look for work as part of a participation agreement.

Figure A2: Labour force status of RA recipients, June 2001



Source: Calculated from FaCS 2001: Table 22

APPENDIX 3

Modelling EMTRs and EATRs for Four Types of Unemployed Households

A3.1 EMTRs

To understand the interactions between earnings and the tax and social security systems (including housing subsidies) and their impact on incentives to work, it is helpful to consider some hypothetical examples. The examples discussed below highlight the effect on EMTRs of the RA supplement paid with Department of Family and Community Services allowances or family assistance. The comparison is between people renting privately and people not renting privately (perhaps because they own their home). The examples do not include people living in public rental housing, as public housing subsidies are not currently included in the model used to generate the EMTRs.

Four household types are used:

- A single unemployed person aged over 21 years;
- A single unemployed person aged 19 years;
- A couple, both unemployed and aged over 21 years, with no children;
- A couple, both unemployed and aged over 21 years, with two children aged 4 and 6.

Each of these types has two variations: one where they are private renters, and one where they are not. The EMTRs are then compared. For those who pay rent, the amount that they pay is assumed to be \$150 per week for all household types, which ensures that they receive the maximum possible entitlement to RA.

It is worth noting that these hypothetical examples do not cover the full range of family types, so it is quite possible that the EMTRs faced by other families differ markedly from those discussed here. These examples also tell us nothing about the distribution of EMTRs in the population.

The EMTRs for the hypothetical examples are generated by the Effective Tax Rates model in STINMOD, NATSEM's general-purpose static microsimulation model. STINMOD/01B simulates incomes by applying the rules of federal government income tax and cash transfer payments to a database of Australian families (see Lambert 1994 for more information). Included in STINMOD are the major FaCS pensions and allowances, family payments and RA, as well as payments from the Department of Veterans' Affairs. Personal income tax, tax offsets and the Medicare Levy are also modelled.

It is also important to note that some programs and payments that could affect EMTRs are not included in STINMOD. These include Childcare Benefit, Higher Education Contribution Scheme (HECS) repayments, and rent paid to public housing authorities. The modelling also assumes that a person's or family's entitlement to government payments is not affected by assets. This means that when people are eligible for assets tested payments, their assets are below the level set for that payment and only their income will influence the amount of their payment (Bremner et al. 2002).

A3.1.1 Single unemployed person aged over 21 years

Figure A3.1 compares the EMTRs for a single person aged over 21 years who is not renting privately with the EMTRs for a single person aged over 21 years who is renting privately (and thus is eligible for RA). Being unemployed and aged over 21 years means that, subject to the income test, they are entitled to Newstart Allowance. In the case of the private renter, total maximum Newstart Allowance entitlement will include RA and thus will be more than the total maximum Newstart Allowance entitlement of the non-renter.

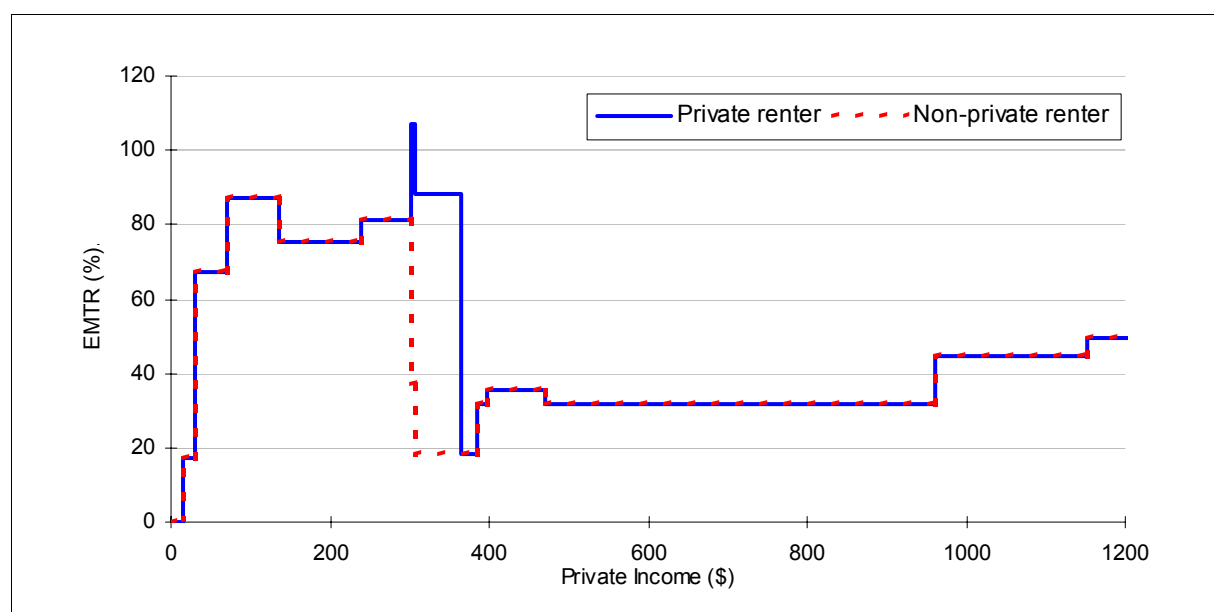
As Figure A3.1 shows, at relatively low levels of private income, a single unemployed person aged over 21 years faces relatively high EMTRs. Between \$30 and \$302 per week for a non-renter and \$30 and \$367 for a private renter, the EMTRs are consistently more than 60 per

cent. Such high EMTRs over this range are due to various combinations of the income test operating on their Newstart Allowance, payment of income tax, withdrawal of the allowance tax offset and the Medicare Levy (initially paid at the shade-in rate of 20 per cent).

The high EMTRs prevail over a wider range of private income for the private renter because Newstart Allowance takes longer to be income tested away, because RA is paid as part of Newstart Allowance. For the private renter, as RA is being withdrawn, the EMTR spikes to more than 100 per cent, largely due to the combined effect of the withdrawal of RA and the Medicare Levy shade-in. At \$314, the Medicare Levy shade-in ends and the EMTR drops to 88.5 per cent until private income reaches \$367 per week.

In both cases, once the Newstart Allowance (including any RA) has been fully withdrawn, the EMTRs fall to much lower levels. This is because after Newstart Allowance has been income tested away, the only factors impacting on the individual's EMTRs are from the income tax system. The payment of income tax, the withdrawal of the low income tax offset and the payment of the Medicare Levy are the only three factors that influence the EMTRs beyond \$302 private income per week (for the non-renter) and \$367 per week (for the private renter).

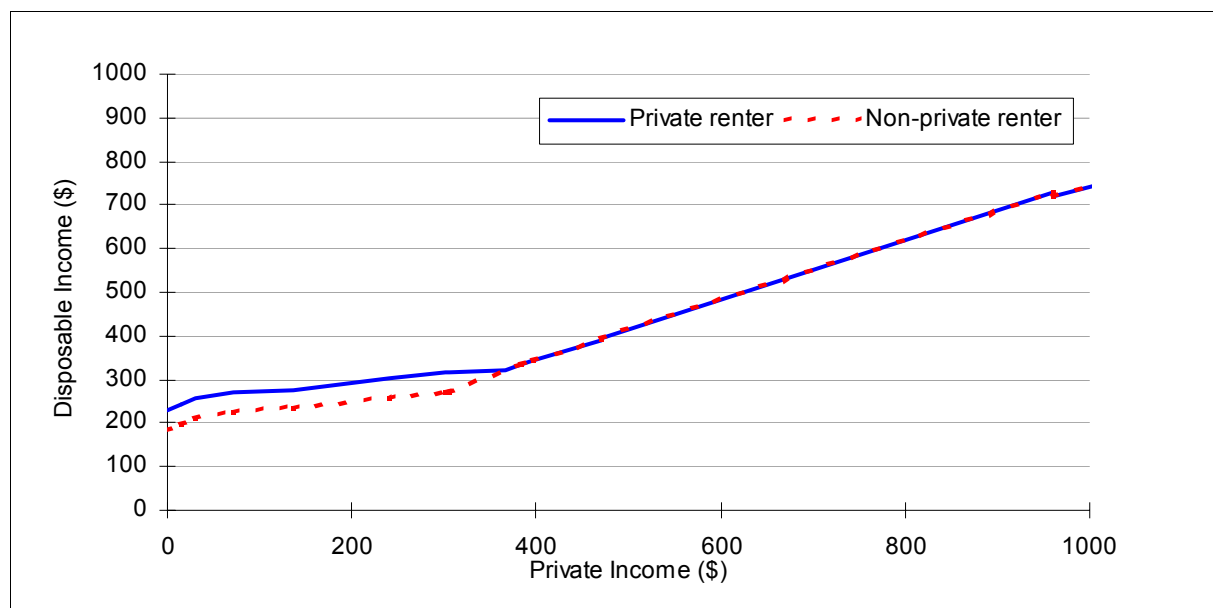
Figure A3.1: EMTRs faced by a single unemployed person aged over 21 years



The effect of RA on disposable income can be seen in Figure A3.2. Note that this shows disposable income before expenses, so the amount of rent paid by the private renter is not deducted from disposable income. The effect of the high EMTRs at the low levels of income shown in Figure 1 translate into only gradual increases in disposable income over the range of private income in which the high EMTRs prevail. For instance, as private income increases from \$30 and \$302 per week for a non-private renter, Figure A3.2 shows that disposable income increases by \$60 – from \$210 to \$270. That is, for a \$272 increase in private income, they receive just \$60 in increased disposable income. The outcome for the private renter is similar. As private income increases from \$30 to \$367, disposable income increases by \$66 – from \$256 to \$322. Once the Newstart Allowance has been fully withdrawn and the EMTRs fall back to lower levels, disposable income increases more rapidly.

RA increases the disposable income of the renter by around \$45 a week until private income reaches a little over \$300 a week. It then phases out so that disposable incomes become equal at \$367 per week of private income. It should be noted that in terms of *after-housing* disposable income, a person paying \$150 per week in rent is significantly worse off at all levels of private income, compared with someone with no housing costs. RA merely narrows this gap at low levels of income.

Figure A3.2: Disposable income for a single unemployed person aged over 21 years



A3.1.2 Single unemployed person aged 19 years

EMTRs for a single unemployed person aged 19 years are shown in Figure 3. Being aged 19 and living away from home, they are eligible for Youth Allowance (subject to the income test). Once again, the EMTRs are shown for a person who is privately renting and a person who is not a private renter.

As in the case of the older unemployed person, the EMTRs faced by a single unemployed person aged 19 are relatively high at low levels of private income. For the non-private renter, EMTRs of more than 60 per cent prevail between \$30 and \$253 per week of private income. For the private renter, high EMTRs prevail between \$30 and \$317. The high EMTRs over the wider range of private income for the private renter are due to the fact that their Youth Allowance entitlement includes RA. Therefore, Youth Allowance is fully withdrawn at a higher level of private income. Over the range of private income in which the high EMTRs prevail for both private and non-private renters, the EMTRs are due to the withdrawal of Youth Allowance, income tax and withdrawal of the allowance tax offset.

It is also interesting to note from Figure A3.3 that the private renter experiences EMTRs of more than 100 per cent for private income between \$283 and \$306. This means that over this range of private income, an increase of one dollar leaves them with *less* disposable income than before the increase in their private income. This is a result of the interaction of the Youth Allowance taper, income tax and the Medicare Levy shade-in.

Figure A3.3: EMTRs faced by a single unemployed person aged 19 years

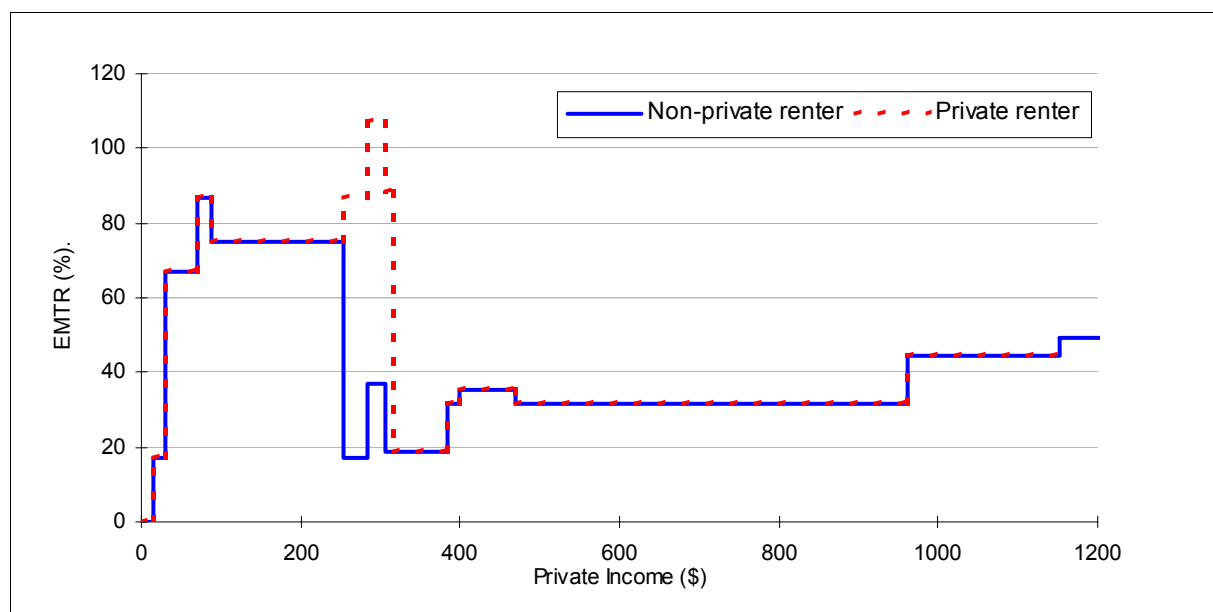
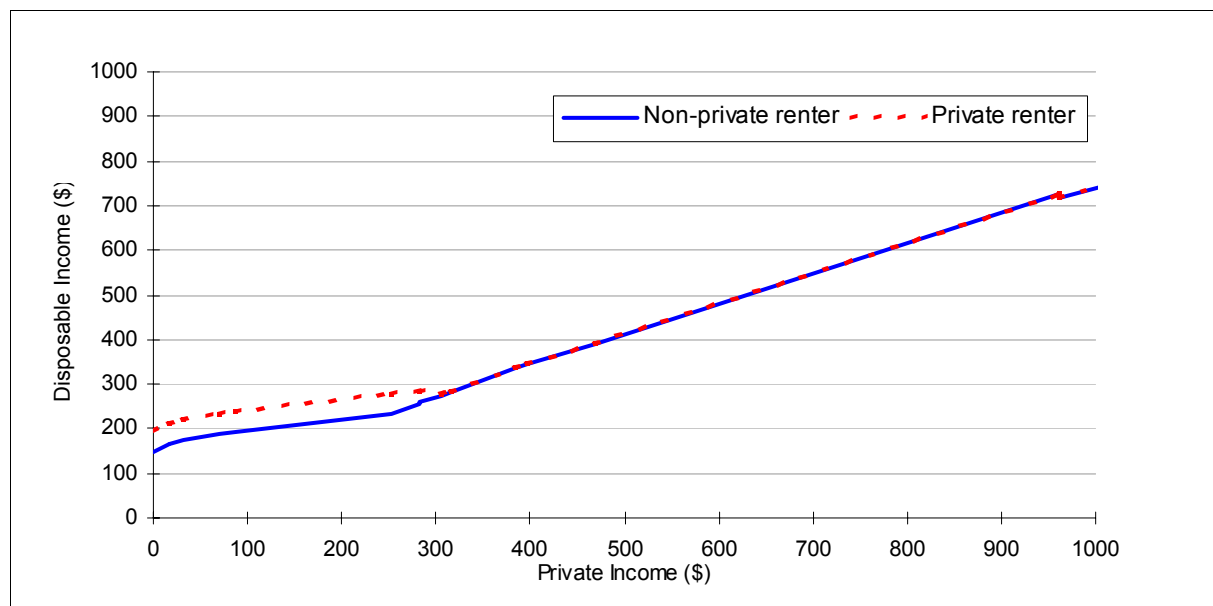


Figure A3.4 shows the disposable incomes for the private renter and the non-private renter. The high EMTRs over the low levels of private income result in the gradual increases in disposable income for both the private and non-private renter. For an increase of \$287 in weekly private income, from \$30 to \$317, the disposable income of the private renter increases by just \$60 (from \$222 to \$282 per week). Further to this, at \$306 per week, the private renter's disposable income is almost \$2 a week *lower* than it is at \$283 of private income a week. This is because, as shown in Figure A3.3, EMTRs of more than 100 per cent exist over the range \$283 to \$306 of weekly private income.

Figure A3.4: Disposable income for a single unemployed person aged 19 years



Once the Youth Allowance has been fully withdrawn (at \$254 of private income for the non-private renter and \$318 for the private renter), the EMTRs faced by each person fall to much lower levels and the disposable income increases more rapidly. For the private renter, RA provides additional disposable income until their private income reaches \$317 per week.

A3.1.3 Couple, both unemployed and aged over 21 years, with no children

Figure A3.5 shows the EMTRs for an unemployed couple with no children. For simplicity, we have assumed that 100 per cent of the private income goes to the reference person and the spouse's private income stays at zero. Given that they are unemployed and aged over 21

years, both are eligible for Newstart Allowance, subject to the income test. For the private renters, their Newstart Allowance includes RA.

For an unemployed couple with no children, high EMTRs prevail over a wide range of private income. Indeed, between private income of \$30 and \$511 (for non-private renters) or \$572 (for private renters), EMTRs faced by this couple exceed 60 per cent. This is a much wider range of private income than for single people (shown in Figures A3.1 and 3). The wider range can be attributed to larger number of factors influencing the EMTRs. For couples, the EMTRs of more than 60 per cent can be attributed to the withdrawal of the reference person's Newstart Allowance, followed by the withdrawal of the spouse's Newstart Allowance (through the partner income test), income tax, the withdrawal of the allowance tax offset, Medicare and the phasing-in of the Dependent Spouse tax offset.

Figure A3.5 also shows that the privately renting couple experiences EMTRs of 100 per cent or more at two points. At \$384 of private income, the EMTR of 100 per cent is due to the withdrawal of the spouse's Newstart Allowance (under the partner income test), and the reference person paying income tax (at the 30 per cent marginal tax rate). This EMTR increases to 104 per cent at \$398 of private income, when the withdrawal of the low income tax offset gets added to the mix. At \$564 to \$572 of private income, the EMTR of 101.5 per cent for the private renters is due to the withdrawal of the spouse's RA entitlement (which is part of her Newstart Allowance), the reference person paying income tax at the 30 per cent marginal tax rate, the reference person reaching the maximum Dependent Spouse Rebate entitlement, and the payment of Medicare (at the 1.5 per cent rate). The non-renting couple faces the highest EMTR (107 per cent) over the interval \$504 to \$511 of private income when the last of the spouse's Newstart Allowance is being withdrawn, the reference person is paying income tax at the 30 per cent marginal tax rate, the reference person has reached the maximum Dependent Spouse Tax Offset entitlement and the Medicare Levy shade-in rate applies.

Figure A3.5: EMTRs faced by a couple, both unemployed and aged over 21 years, with no children

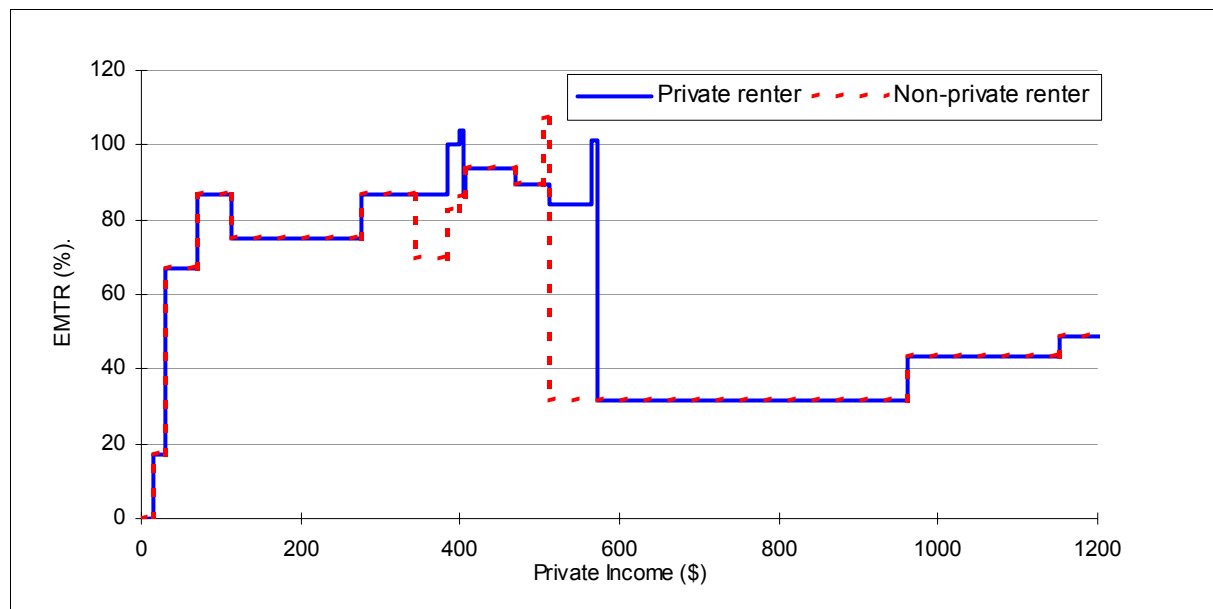


Figure A3.6: Disposable income for a couple, both unemployed and aged over 21 years, with no children

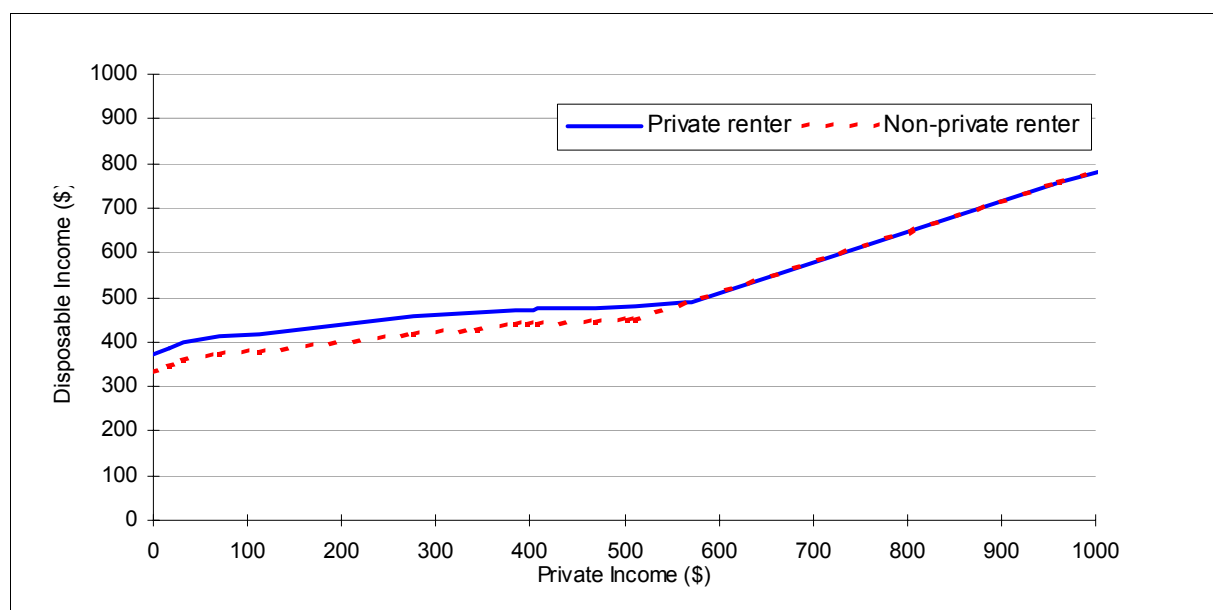


Figure A3.6 illustrates how the high EMTRs translate into small increases in disposable income. For an increase of \$542 in private income from \$30 to \$572, the disposable income for the privately renting couple increases by only \$90 (from \$400 to \$490 per week). Figure 6 also shows that the difference in disposable income between the privately renting and non-privately renting couples remains at \$43 until private income reaches \$511. This difference is due to the RA entitlement for the privately renting couple. At \$511 of private income, RA begins to taper off so that both couples have the same disposable income at \$572 of private income.

A3.1.4 Couple, both unemployed and aged over 21 years, with two children

The EMTRs for a couple with two children aged 4 and 6 years are quite different to those for couples and individuals without children. This is because families with children are eligible for family assistance (Family Tax Benefit Part A and Family Tax Benefit Part B). For a family that is renting privately, instead of their RA being paid with their unemployment benefit, RA is paid with Family Tax Benefit Part A. The income test for Family Tax Benefit Part A is far more generous than the income test for unemployment benefits (Newstart Allowance or Youth Allowance) and thus, RA is fully withdrawn at a much higher level of private income for families with children.

Figure A3.7 shows that the EMTRs for an unemployed couple with two children exceed 60 per cent over a very wide range of private income. With the exception of private earnings between \$511 and \$574 a week, the EMTRs for this family exceed 60 per cent from \$30 to \$853 per week for a non-privately renting family and \$1,027 per week for a privately renting family. The longer range of private income for the privately renting family is due to the withdrawal of RA as part of their Family Tax Benefit Part A. Once their RA has been fully withdrawn, at \$1,030 private income, the two families face the same EMTRs (which are less than 60 per cent). Between \$30 and \$512, the high EMTRs are due to the withdrawal of the reference person's and then the spouse's Newstart Allowance, the spouse reaching her maximum Family Tax Benefit Part B entitlement, income tax and the loss of tax offsets for allowances and low income. Between \$574 and \$602, the high EMTRs are attributable to the withdrawal of Family Tax Benefit Part A, income tax and the Medicare Levy.

The disposable incomes of a couple family with two children are shown in Figure A3.8. Because RA is withdrawn under the FTB(A) income test, which has a relatively high threshold, the disposable incomes of the private renters and non-private renters do not meet until private income reaches \$1,030 a week. In the case of this family type, RA provides additional disposable income well beyond average weekly earnings of \$906.80²⁸ (ABS 2002).

²⁸ Figure quoted is trend full-time adult total earnings at May 2002.

Figure A3.7: EMTRs faced by a couple, both unemployed and aged over 21 years, with two children

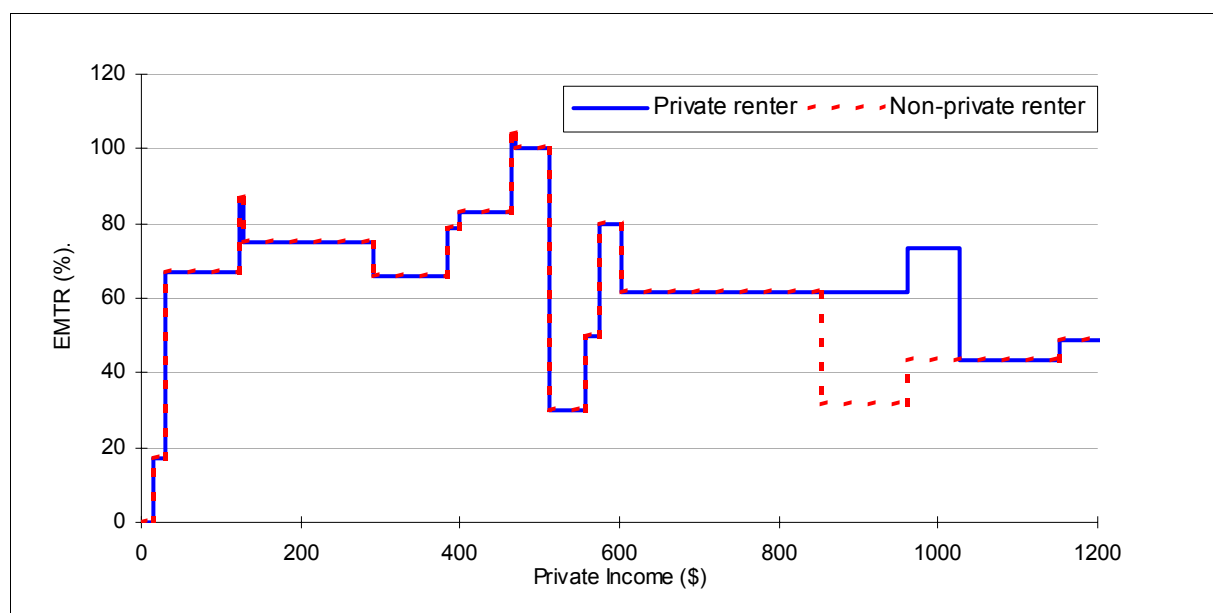
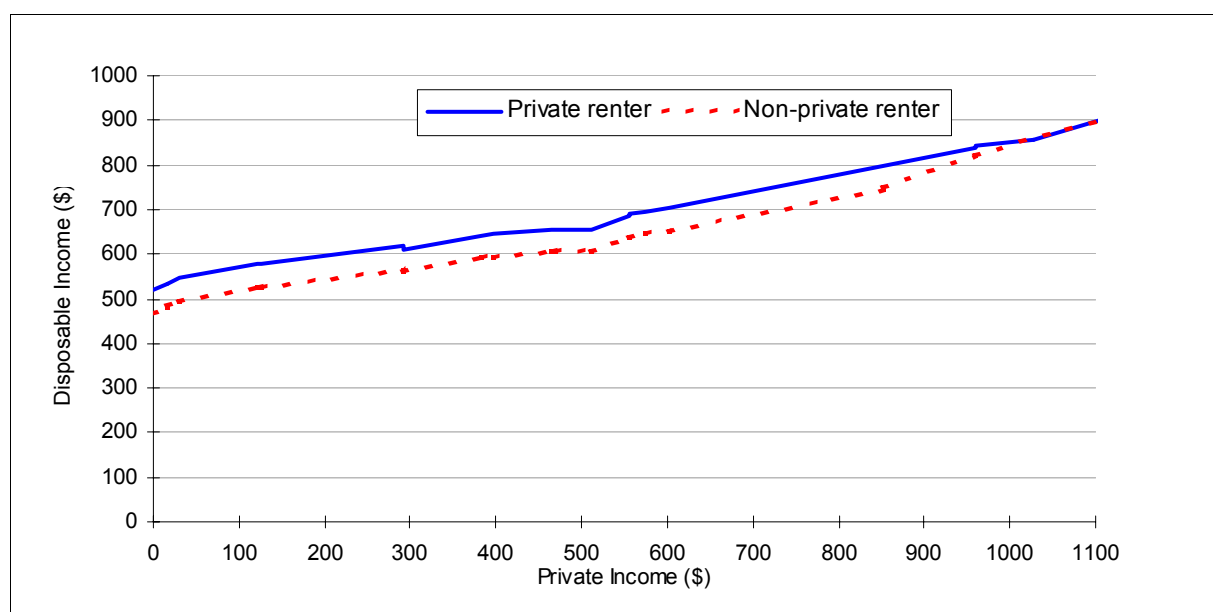


Figure A3.8: Disposable income for a couple, both unemployed and aged over 21 years, with two children



A3.2 EATRs

EMTRs are useful in highlighting how the tax and transfer systems interact and the sometimes large disincentive to work that can result from this interaction. However, they are not always realistic, in the sense that very few families are able to control changes in their private income to the nearest dollar. As discussed in Section 2.2, EATRs are calculated in the same manner as EMTRs except that private income increases in increments of more than a dollar. They are most often measured over ranges of income that correspond to hourly wage rates or to an arbitrary round number, for example, \$50 (see Beer 1998 for an example). Because they look at changes over broader ranges of income, EATRs tend to exhibit less variability than EMTRs.

The examples in the following section assume that an adult gets a job that pays the federal minimum wage of \$431.40 a week (AIRC 2002). The awards to which the minimum wage applies have a 38 hour week as standard, which gives an hourly wage rate of \$11.35. A lower rate is assumed for non-adults (that is, the 19 year old single unemployed person). Full-time

employees worked an average of 39.8 hours in 2000 (ABS 2001)²⁹, so the EATR examples are calculated for up to 40 hours of work. For simplicity we assume that the person works the two hours of overtime at the ordinary time wage rate, although using an overtime rate for the last two hours worked would not dramatically affect the results.

The EATRs are calculated using the Effective Tax Rates model in STINMOD/01B (see the introductory section of Appendix 3.1 for a brief explanation of the model). They are calculated for the same four main hypothetical family types as used in Appendix 3.1, that is:

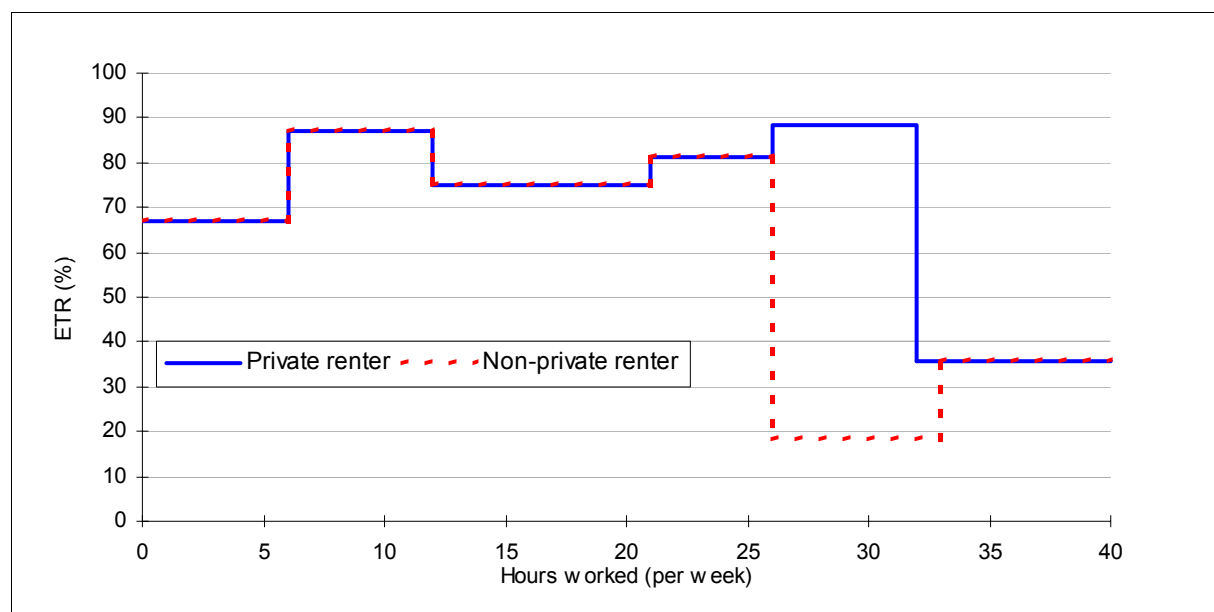
- A single unemployed person aged over 21 years;
- A single unemployed person aged 19 years;
- A couple, both unemployed and aged over 21 years, with no children;
- A couple, both unemployed and aged over 21 years, with two children aged 4 and 6.

A3.2.1 Single unemployed person aged over 21 years

Assuming that the single unemployed person gets a job that pays the federal minimum wage of \$11.35 per hour, Figure A3.9 shows the EATRs calculated by taking an hour's pay as the increment, up to a private income of \$454 per week when they work 40 hours per week.

Because of the larger increment of \$11.35 (as opposed to \$1), the EATRs in Figure A3.9 exhibit less variability than the EMTRs in Figure A3.1. Most noticeably, there are no EATRs greater than 100 per cent. Nevertheless, a single unemployed person faces high EATRs until they are working 26 hours per week as a non-renter or 32 hours per week as a renter. This means that for every additional hour of work between 0 and 32 hours per week for a private renter (the figure is 26 hours per week for a non-private renter), less than 40 per cent of their hourly wage will end up as increased disposable income, with 60 per cent or more being lost to increased income tax and/or reduced government cash benefits.

Figure A3.9: EATRs faced by a single unemployed person aged over 21 years



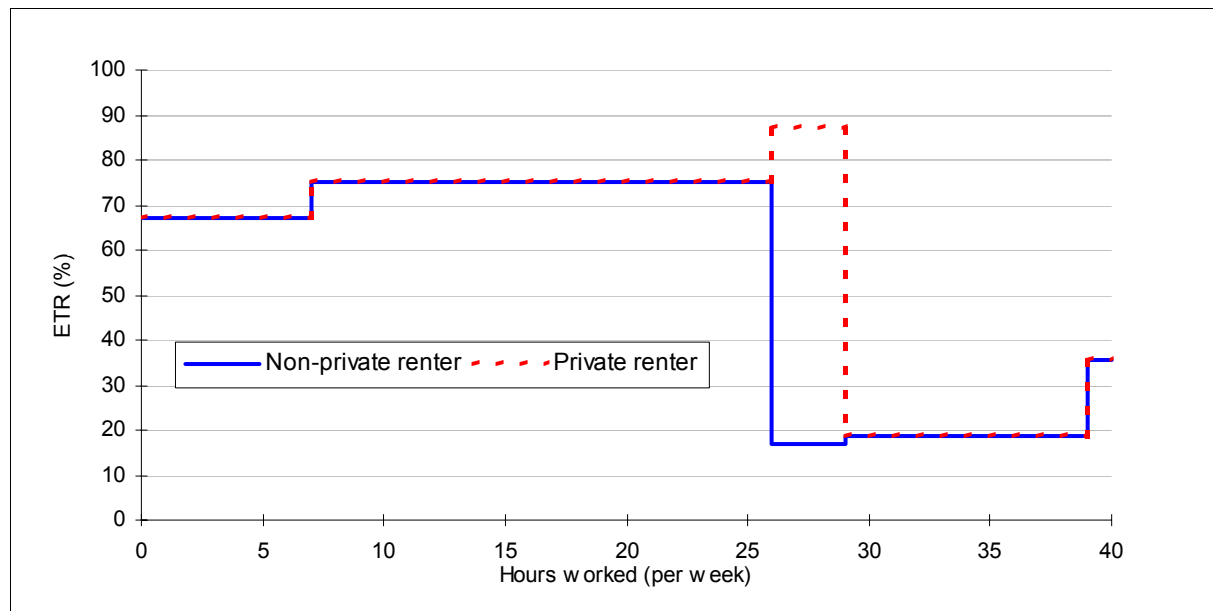
A2.2.2 Single unemployed person aged 19 years

Because a 19 year old does not qualify for the adult federal minimum wage, we assume that he earns less than the adult wage rate. The exact percentage of the adult wage paid to 19 year olds varies between awards. This analysis assumes that our 19 year old earns 85 per cent of the adult wage, giving an hourly wage of \$9.65.

²⁹ Including all employed persons in scope for the Labour Force Survey (mostly the self-employed) leads to a higher figure for average full-time hours – 42.0 in August 2002 (ABS, 2001, 2002).

Figure A3.10 shows EATRs for 0 to 40 hours per week (which is equivalent to private income of \$0 to \$386 per week). The EATRs show much less variability than the EMTRs in Figure 3, with no EATRs greater than 100 per cent. However, he still faces high EATRs over a long period of private income. Between 0 and 26 hours work per week for a non-private renter or 0 and 29 hours work for a private renter, the EATRs are no lower than 67 per cent. This means that by working an extra hour in this range, disposable income increases by no more than 33 per cent of the \$9.65 hourly wage.

Figure A3.10: EATRs faced by a single unemployed person aged 19 years



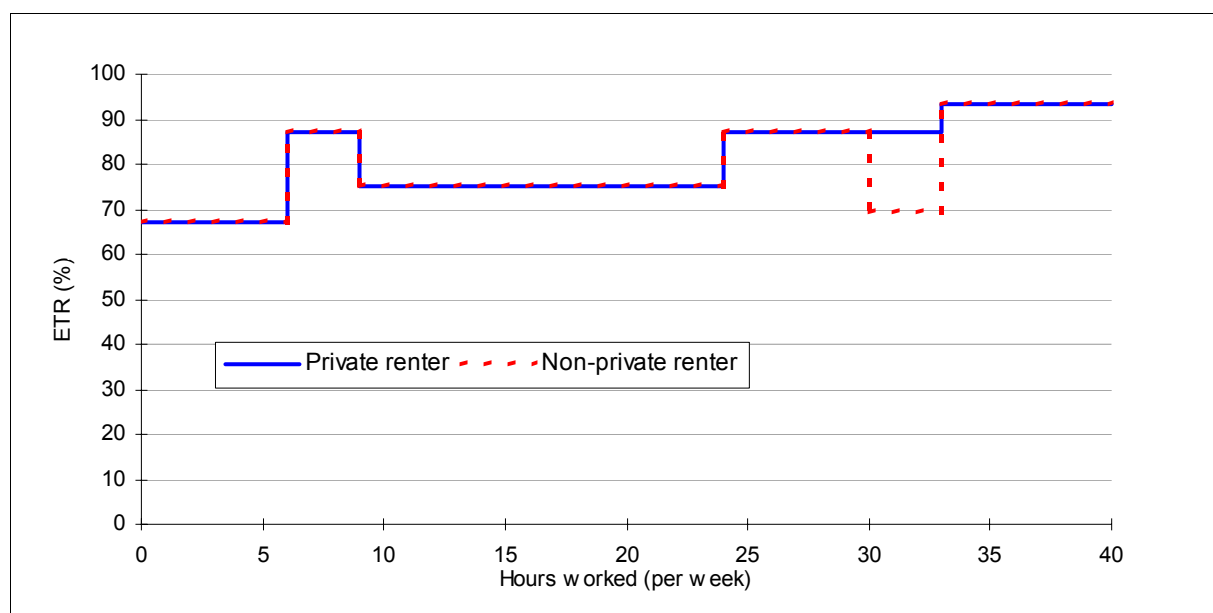
A3.2.3 Couple, both unemployed and aged over 21 years, with no children

For the unemployed couple with no children, the EATRs are shown in Figure A3.11. Note that the EATRs calculated here assume that the reference person has the opportunity to work an extra hour (from 0 to 40 hours per week) and the spouse remains without a job.

The first thing to note from Figure A3.11 is that the EATRs for this family type exceed 60 per cent for every additional hour of work by the reference person between 0 and 40 hours per week. This is because even when one partner is working full-time and earning the federal minimum wage, their income is not sufficient to fully remove their spouse's Newstart Allowance entitlement. Thus, every additional hour of work between 0 and 40 hours per week means that either their own Newstart Allowance is being withdrawn or, once they have lost their allowance entitlement, their spouse's Newstart Allowance is being withdrawn under the partner income test (which has a taper of 70 per cent). In combination with paying income tax, withdrawal of tax offsets and/or paying Medicare, this constitutes high EATRs over the whole range of hours worked for this couple.

The second thing to note from Figure A3.11 is that the couples in this scenario almost always face the same EATRs regardless of whether they rent privately or not. The only exception is between 30 and 33 hours per week because the Dependent Spouse Tax Offset gets phased in sooner for the non-privately renting couple. Whether or not the couple rents privately does not impact on their EATRs when the reference person earns \$11.35 per hour. This is due to the fact that even when the reference person works 40 hours per week, their income does not fully remove their spouse's Newstart Allowance entitlement. Thus, at 40 hours work per week (by the reference person), the privately renting couple are still eligible for maximum RA.

Figure A3.11: EATRs faced by a couple, both unemployed and aged over 21 years, with no children



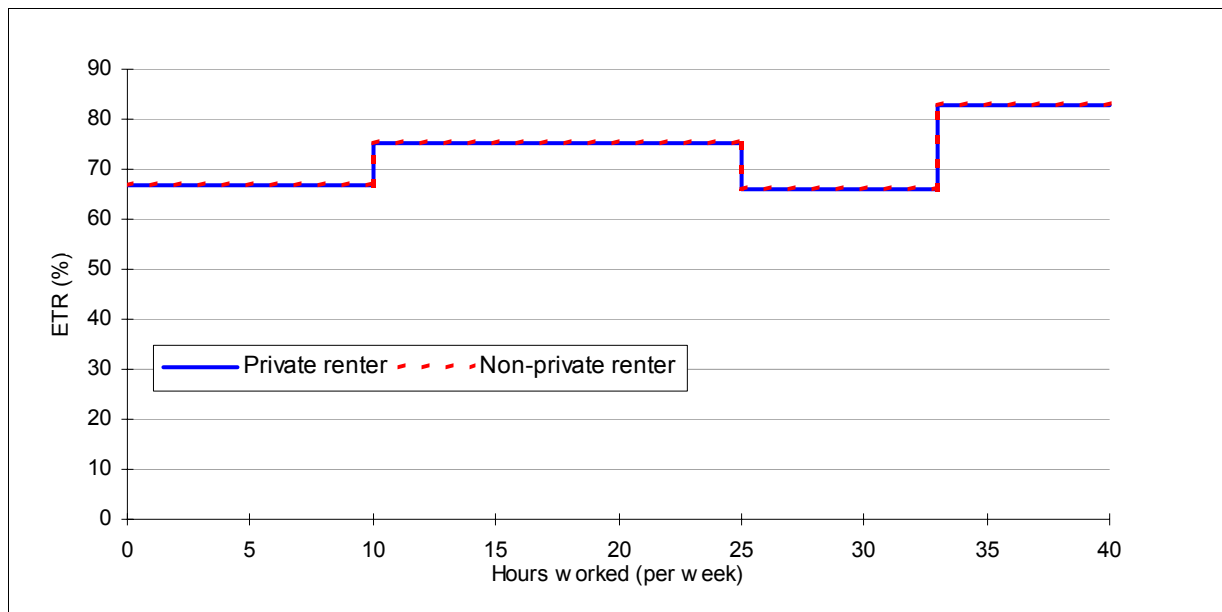
A3.2.4 Couple, both unemployed and aged over 21 years, with two children

Figure A3.12 shows the EATRs for an unemployed couple with two children (one aged 4 and one aged 6 years). Once again, the EATRs calculated here assume that the reference person has the opportunity to work an extra hour (from 0 to 40 hours per week) and the spouse remains without a job.

As in the case of the unemployed couple with no children, the EATRs for this unemployed couple with two children exceed 60 per cent for every additional hour of work by the reference person. Because the reference person earns only \$11.35 an hour, even at 40 hours a week, their income is not sufficient to fully remove their spouse's Newstart Allowance entitlement. This means that between 0 and 40 hours per week either their own Newstart Allowance is being withdrawn or, once they have lost their allowance entitlement, their spouse's Newstart Allowance is being withdrawn under the partner income test. Combined with paying income tax, withdrawal of tax offsets and/or paying Medicare, this constitutes high EATRs over the whole range of hours worked for this family.

Figure A3.12 also shows that the couples in this scenario face the same EATRs regardless of whether they rent privately or not. This is due to the fact that even when the reference person works 40 hours per week, their income does not fully remove their spouse's Newstart Allowance entitlement. Thus, at 40 hours work per week (by the reference person), the privately renting couple are still eligible for maximum RA.

Figure A3.12: EATRs faced by a couple, both unemployed and aged over 21 years, with two children



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