

# Welfare Fraud, Work Incentives and Income Support for the Unemployed

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SOCIAL WELFARE RESEARCH CENTRE

# DISCUSSION PAPERS

WELFARE FRAUD, WORK INCENTIVES  
AND INCOME SUPPORT FOR  
THE UNEMPLOYED

Bruce Bradbury

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**Social Welfare Research Centre**

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**WELFARE FRAUD, WORK INCENTIVES  
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## **ABSTRACT**

Recent years have seen an increasing prevalence in Australia of the view that many of those receiving unemployment benefit are 'cheating' the system, either by direct fraud, or by lack of willingness to find employment. This paper addresses these issues in three sections. First, via a review of available information on the work incentive effects of unemployment benefits; second, with an analysis of statistical trends which some commentators claim show evidence of increasing fraud; and third, through a broader consideration of the structure of the income support system for the unemployed.

It is concluded that whilst the level of benefit may have some effect on job search effort, other factors are probably more important, and that evidence of increasing fraud is unclear. These issues are placed in the wider context of the re-structuring of the system of income support for the unemployed.

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## 1. INTRODUCTION

The last few years have been notable for the resurgence to public prominence of the issues of 'dole bludger' and 'welfare cheat' so widespread during the late 1970s. These two terms directed towards the unemployed reflect two separate, though related, concerns about their behaviour. The first suggests that unemployment may be voluntary, with consequent implications for the management of the labour market. The issue of 'cheating' is less directly a labour market concern, but, like the issue of voluntary unemployment, is seen as a potential problem for income support and government fiscal policy.

It has been argued that in the past in Australia these issues have often been raised by governments in an attempt to deflect the blame for the failure of economic policy away from themselves (Windschuttle, 1980). Though the longevity of the problem of unemployment means that governments now feel less need to deflect the blame for the failure of the labour market, the fiscal crisis facing the Australian government in the mid 1980s has returned these issues to prominence. Now, however, the emphasis has shifted from the relationship between beneficiary behaviour and the labour market, to the relationship between behaviour and income support expenditure.

This new emphasis was clearly evident in the statements of the Minister for Finance, Senator Peter Walsh, in 1986. To assist the government to achieve its goal of restricting expenditure he singled out benefits to unemployed people and supporting parents as areas where substantial savings could be made. For the former, he argued that this was because of the increasing prevalence of 'cheating' by recipients.

However, concerns of the impact that the income support system might have on the labour market are also still prominent. Concern with the work incentive effects of income support payments have undoubtedly increased over the last decade.

It should not only be the so called economic rationalists who are interested in these questions. For those interested in the positive goals represented by the welfare state these issues are also important. The existence, or even the perceived existence, of welfare cheating or welfare induced idleness is fundamentally damaging to the legitimacy of any foreseeable income support system.

## 2. THE REGULATION OF INCOME SUPPORT FOR THE UNEMPLOYED

The system of income support for the unemployed in Australia constitutes a complicated structure of legislation and administrative regulation - a complexity which stems from the perceived need to steer between providing adequate income support for the unemployed, while minimising any undesired impact upon the labour market. Additionally, in the current political climate it is considered by many desirable in itself to limit the volume of state transfers.

This complexity is reflected in the divergent situations where the terms 'cheating' or 'bludging' are applied. At one extreme there are those who use false identities to receive multiple benefits, or receive benefits whilst employed in full-time jobs. At the other are those long term unemployed who may have stopped looking for work in frustration. In between, there are 'over-payment cases', where people are not prompt in notifying the Department of Social Security when they find work, and cases of people not declaring income received from part-time work or other sources whilst on benefit.

The administrative requirements that the unemployed have to satisfy in order to receive unemployment benefit may be summarised as the *identity*, *income* and *work* tests. The identity test requires that no one person can receive two mutually exclusive benefits, the income test requires that the non-benefit income of beneficiaries and their spouses be below a certain level, and the work test requires that unemployment beneficiaries be available for, and actively seeking, employment. Whilst these different tests have similar legal standing, all being requirements laid down in the Social Security Act, not all are equally amenable to administrative regulation.

The enforcement of the requirement that the unemployed be actively looking for work is particularly problematic. To impose the work test effectively, the state must be able to make an offer of work. In times of high unemployment this is obviously difficult. Even when jobs are relatively plentiful, the administrative costs of enforcing the work test are considerable. Because administrative regulation is difficult, attention has often turned to economic regulation to 'encourage' the unemployed to look for work.

Economic theory suggests that if benefits are high relative to wages then some people will make the economically rational decision not to work. Moreover, a smooth-functioning labour market needs a population highly motivated to participating in it. Whilst relative incomes may not be the most important factors producing such motivation, they are factors

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easily alterable through the parameters of the income support system. The extent of the influence of such policies on job seeking behaviour is discussed in the next section.

On the other hand, other aspects of the control of unemployment beneficiaries, such as in the enforcement of the identity and income tests, have placed primary emphasis upon procedures of administrative regulation. The subsequent section of this paper takes up Senator Walsh's claim that this regulation has been ineffective, while the final part addresses some broader issues of the dilemmas of enforcement facing our highly targeted income support system, where it is suggested that there may be some benefit in relaxing these distinctions between economic and administrative regulation.

### 3. WORK INCENTIVES

Is unemployment due to the unwillingness of the unemployed to search for and take up employment? In the popular parlance, are the unemployed 'dole-bludgers'? Whilst economic theory suggests that an increase in levels of income support relative to wages may lead to an increase in unemployment, the extent of this increase is an empirical question.

Studies which have compared the income support systems and unemployment patterns of other countries to that of Australia generally suggest that there is some systematic relationship between the two factors. In Canada, for example, replacement rates for previously employed workers are higher than in Australia, and this fact is accompanied by a higher rate of inflow into unemployment in that country (Miller and Volker, 1983). Similarly, the unrestricted duration of unemployment benefit receipt in Australia is associated with a longer duration of unemployment here.

Two factors complicate the interpretation of these findings. First, such patterns may reflect more than changes in the job seeking behaviour of the unemployed. As Feldstein (1978) has argued, high replacement ratios may encourage *employers* (possibly with the tacit acceptance of employees) to engage in temporary lay-offs when demand slumps. Such a practice would tend to increase inflows and reduce durations of unemployment in countries where high replacement rates existed. Whilst the behavioural origin is probably not important for labour market policy, it is perhaps more significant when the political and moral issues of 'dole bludging' are concerned.

Secondly, as Miller and Volker note, limited durations of benefit receipt may reduce unemployment durations by producing incentives for the unemployed to leave the workforce. This complicates attempts to estimate the effect of changing the level of income support on the total numbers of income support recipients (and hence total government expenditure), as



the unemployed may be able to gain other forms of income support when out of the workforce (e.g. illness related pensions and benefits).

Australian studies which have drawn upon historical variations in the levels of benefits relative to wages (replacement ratios), have encountered their own problems. Figure 1 illustrates changes in these replacement ratios over the last two decades for selected categories of unemployment beneficiaries. These ratios are calculated as a ratio of unemployment benefit entitlements to the disposable income of persons on average weekly earnings (half A.W.E. for juniors)<sup>1</sup>.

Because of the close associations between changes in benefit levels and world economic trends, identification of the influence of income support policies has been difficult. As one study put it,

the large changes in unemployment benefits and in the proportion of the unemployed receiving benefits occurred during the 1972-75 period when so many other significant and unusual changes were occurring in the Australian economy. Under such circumstances we cannot feel fully confident that all the possible influences on unemployment are sorted out. Multicollinearity in its broadest sense will always remain a problem for time series analysis of this period. (Gregory and Patterson, 1983, p. 27)

As a result, estimates of the impact of benefit levels on unemployment rates have varied markedly. Estimates of the elasticity of unemployment (or duration) with respect to replacement ratios (or benefit levels) have ranged from zero (McMahon and Robinson, 1984) to 0.4 (Gregory and Patterson, 1983). Trivedi and Kapuscinski (1985) calculated an estimate with an elasticity of 0.2 to 0.3, which they considered a lower bound. A cross-sectional study by Bradbury and Vipond (1986) produced results in the lower range of these estimates (though for a truncated measure of duration).

Research in other countries has also drawn varying conclusions. In the United States, the consensus of research is that the level and duration of unemployment insurance payments does have a substantial influence on unemployment (see Danziger, Haveman and Plotnick, 1981, for an overview).

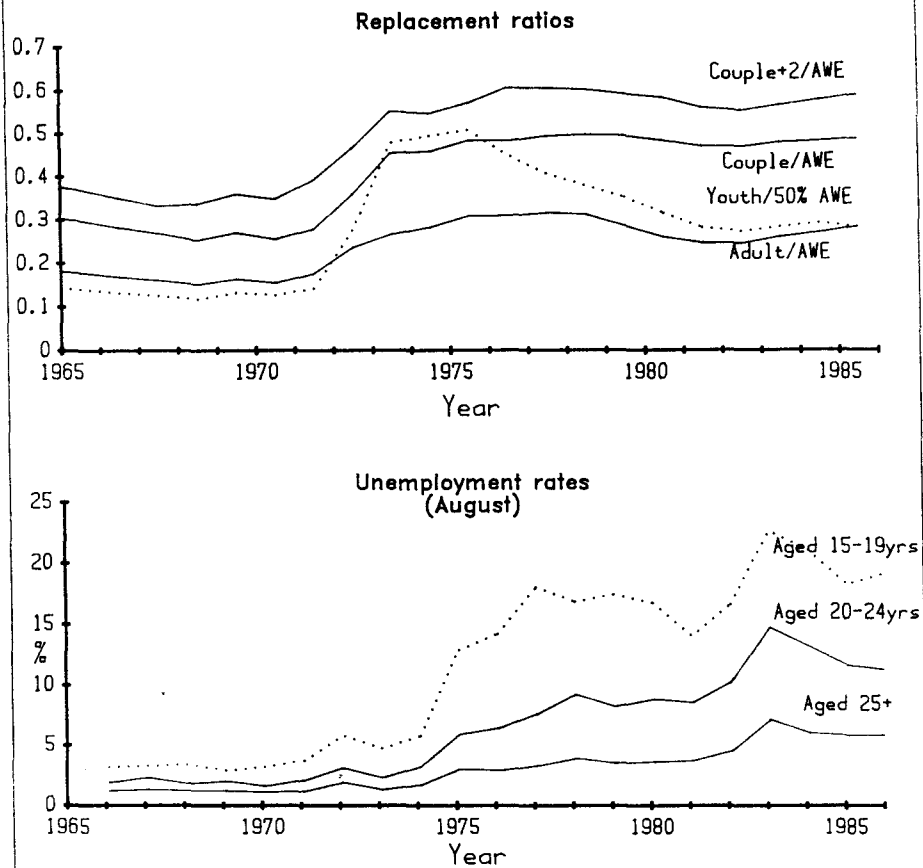
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<sup>1</sup> It is assumed that the unemployment beneficiary was receiving benefit (at the full rate) for the entire financial year. For part-year unemployment, replacement ratio calculation becomes more difficult, as tax paid will depend upon the timing of the spell of unemployment relative to the tax year.

Examination of data from the 1981-82 Income and Housing survey, shows that youth aged 17 or less had a mean (full-time) wage income of 41 percent of all full-time wage and salary workers. Youth aged 18 or 19 years had a wage of some 58 percent of all workers.

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Figure 1 Unemployment Benefit  
Replacement Ratios and Unemployment  
Rates, 1964/65 to 1985/86.



Source: Replacement ratios calculated from Moore and Whiteford (1986). For details, see text.  
Unemployment rates from ABS cat.no. 6203.0 and 6204.0, various years.

In the United Kingdom, however, where the income support system is more like that of Australia, research shows less consensus. Atkinson and Micklewright (1985), have argued that much of this divergence can be explained by the empirical assumptions used in the different research projects. Their preferred model is one which shows quite a small effect of replacement rates on unemployment durations - a conclusion which is reinforced by a survey of cross-sectional analyses (Micklewright, 1986).

It is difficult to reconcile the varying results of these different empirical studies, other than to note that all have been severely limited by the available data. Research results from the UK (which has a broadly similar system of income support to that of Australia) reinforce the view that the response is probably at the lower end of the range of estimates given above.

Moreover there are a number of issues that complicate the interpretation of such results. It would be expected that the extent of any behavioural influence of benefit levels would vary with the overall level of unemployment. Administrative procedures designed to ensure job search will be more effective with low levels of unemployment than when unemployment is higher.

On the other hand, the implications for the economy of a lack of job search effort among some unemployed may not be so important when demand for labour is low. In the current economic climate, lack of *demand* for labour is clearly the main cause of aggregate unemployment. Why should there be concern over possible individual incentives? As Atkinson and Micklewright note,

Such concern with the disincentive aspects of unemployment insurance might strike an outsider as bizarre. To worry about a possible adverse effect on labour supply at a time when the demand for labour is evidently weak might seem like further evidence of the propensity of economists to be found re-arranging the deck chairs on the Titanic. (1985, p. 2)

The issue of voluntary unemployment, seemingly, should have primary relevance in times of low unemployment, when labour is scarce. Whilst some people might face disincentives to work, there is no shortage of other people willing to take their place.

But this may not always be the case. While the labour market overall may be slack, isolated areas (skills or regions) may still suffer a shortage of labour. Additionally, higher benefits, or the behavioural orientations to work produced by them, may not be easily reversible when the economy improves and labour markets become tight once again. Moreover, if some people are encouraged to stay unemployed because of the level of benefits, their loss of job skills and self-esteem will lead to long term disadvantages, both for themselves and for the economy. Finally, if the burden of unemployment can be spread wider throughout the

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economy by reducing durations of unemployment, this may favourably alter the macroeconomic trade-off between unemployment and inflation as wage increases are moderated. Even if incentive effects (and for that matter other government policies towards the unemployed) only act to 'churn' the pool of unemployment, this may be desirable of itself.

Thus the attention focused by economists on the arrangement of the 'deck chairs' is probably justified. Certainly, continued prominence of the 'dole bludger' issue in public discourse indicates that there is no shortage of people willing to lounge in them. However, it is clear that any incentive issues must play only a small part in an overall explanation of the problem of unemployment.

Of course to say that incentive effects are either small or unimportant is not to assert that there are no unemployed who do not want to work. The degree to which different unemployed persons want to work will obviously vary. The studies described above have addressed the question of the importance of the level of benefits relative to wages as a component of this variation. However this does not rule out the possibility that policies which try to influence 'tastes' for work and leisure by maintaining work skills and the 'work ethic' via training and work experience programs may be effective in increasing job search effort (if that is desired).

#### 4. FRAUD: EXAMINING THE STATISTICS

Whilst the issues of work incentives and labour supply have been the key behavioural aspects of the unemployment benefit system addressed by economists, it is the issue of welfare fraud or cheating that has been the most prominent political issue over the past few years. In setting the agenda for this debate, comments made by the Minister for Finance, Senator Peter Walsh in May 1986 were central.

It is difficult to escape the conclusion that there has been an upsurge in the incidence of cheating. By cheating, I mean people working effectively full-time and suppressing that fact when claiming benefits, or people claiming benefits using different names... If one-fifth of the increase since 1981-82 in the ratio of unemployment benefits recipients to the ABS survey of persons seeking full-time work were the result of cheating, and if that one-fifth could be removed, aggregate unemployment benefit payments would be reduced by \$100m. (Walsh, 1986, p.804)

It would seem that such arguments were one of the main instigating forces behind the government's recent 'crack-down' on unemployment benefit recipients. What could have caused this alleged increase in cheating? Although Senator Walsh did not raise any specific

suggestions, one possibility is that increasing unemployment has stretched the resources of the administrative organisations, producing a lack of effectiveness in preventing cheating and fraud. Indeed, increased pressures on administrative systems have not only restricted investigations of fraud. The role of the CES for instance, has been transformed as increasing unemployment has meant that it has less to offer the (particularly long-term) unemployed. This may have led to a lower level of job search by some beneficiaries, with a consequent increased classification of beneficiaries as out of the workforce by the ABS.

More fundamentally, it may be misleading to use such simple statistical comparisons to measure cheating. In this section, this divergence between the unemployment statistics produced by the Australian Bureau of Statistics and the administrative statistics of the Department of Social Security are examined more closely to see if other explanations can be found.

As Figure 2 indicates, a decade ago there were substantially more persons counted as unemployed (and looking for full-time work) than were receiving benefits. This situation is now reversed, with the relative slowness of the drop in beneficiary numbers after the 1982-83 recession being particularly frustrating for the government. This trend towards greater numbers of beneficiaries relative to unemployed is not confined to any one demographic group<sup>2</sup> (Figure 3), nor can it be explained in terms of the changing demographic composition of the unemployed<sup>3</sup>. The trends over time presented in Figure 3 show the change in the numbers of beneficiaries relative to the numbers of unemployed to be much the same in each group. However in proportionate terms the greatest increase has been among prime age females, for whom the proportion of beneficiaries receiving benefits grew by a factor of about 50 percent, compared to a factor of about 20 percent for prime age males.

The term 'unemployment benefit' may imply that this benefit should be received by those, and only those, who are unemployed, but in fact there are a large number of reasons why these two categories might be legitimately expected to diverge. Unemployment is defined primarily by two characteristics of an individual; their lack of employment and their search activity for employment. Eligibility for Unemployment Benefit, on the other hand, is determined by a combination of identity, work and income tests. Whilst the work test often corresponds to job search activity, and the income test often corresponds to the lack of employment, this is not always the case.

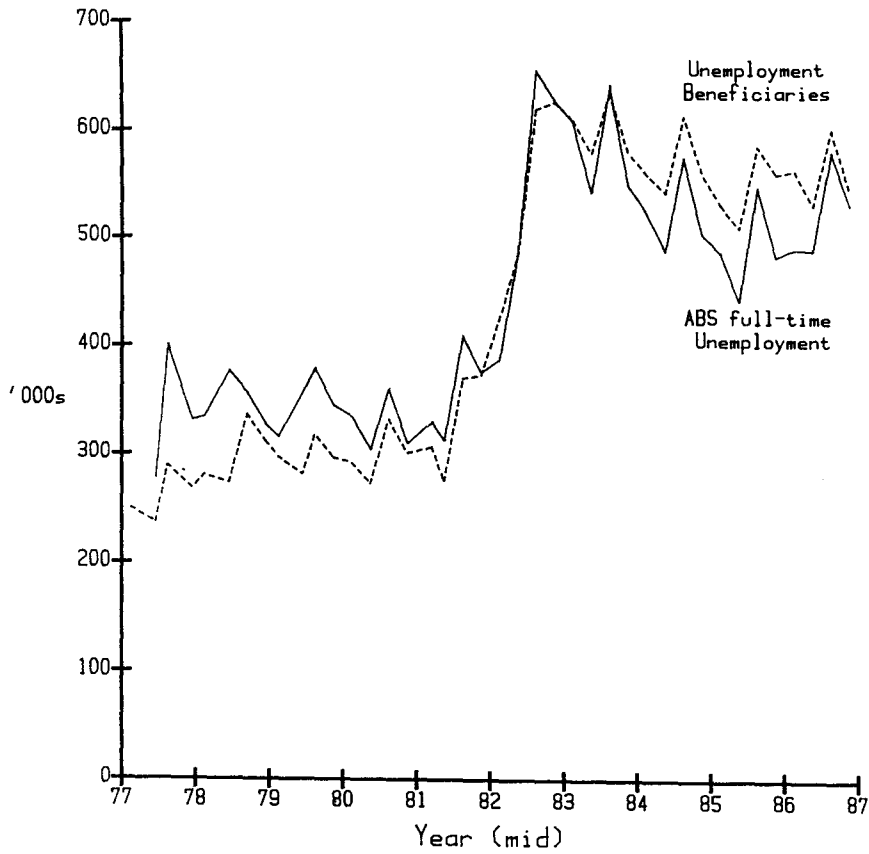
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<sup>2</sup> The ratios for the over 55 age groups fluctuate erratically.

<sup>3</sup> A shift-share analysis of the change in the unemployed to beneficiary ratio across these demographic groups is presented in an earlier version of this paper (Bradbury, 1987).

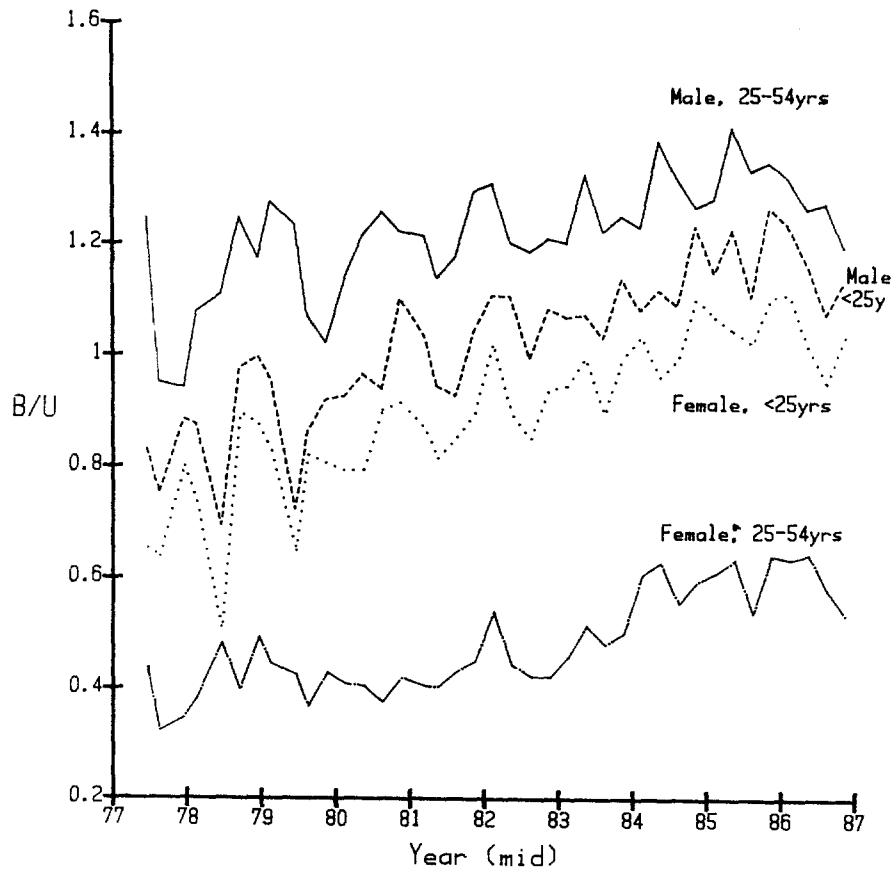
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Figure 2 Unemployment and Unemployment  
Beneficiary Numbers, 1977 to 1987



Source: Unemployment numbers: ABS cat. no. 6203.0 and 6204.0, various years.  
Beneficiary numbers: Department of Social Security, Quarterly Survey of Unemployment Benefit Recipients, various issues.

Figure 3 Beneficiaries as a Proportion of Unemployed, 1977 to 1987



Source: See figure 2

Moreover, the two sources of data are collected in quite different ways, one as an administrative by-product and the other as a result of a household survey, with information on all household members being provided by 'any responsible adult'. Whilst every effort is made by the ABS to remove bias, the possibility that the Labour Force Survey may be less able to catch certain groups of the unemployed (particularly the mobile) than the administrative procedures of the Department of Social Security cannot be ruled out. As well, if people receiving benefit fraudulently are consistent in their deceit they would not appear as divergent cases in the statistical comparison.

If there are unemployed people who do not receive benefit, this will tend to make the numbers of beneficiaries lower than the numbers of unemployed. The main reasons for this to occur are:

- The standard seven day waiting period.
- Longer waiting periods for certain groups such as school leavers (6 weeks prior to 1987) and voluntary job leavers (up to 12 weeks).
- Age restrictions. Persons aged 15 years, or over age pension age may be counted as unemployed but are not eligible for unemployment benefit.
- Availability for work criteria. Persons in full-time education may be defined as unemployed, but are not usually able to receive unemployment benefit.
- Income tests. Unemployed persons whose non-benefit income, combined with that of their spouse, is above the income test cut-off point are not eligible for benefit. This is the main reason for the low prevalence of benefit receipt among prime age females shown in Figure 3.
- If both spouses of a married couple unit are unemployed, both will be included in the ABS unemployment statistics, but often only the male will be included in the beneficiary statistics.
- Persons receiving other government cash benefits (such as sickness benefit and sole parent benefit) are not eligible for unemployment benefits even though they may be unemployed.
- Finally, some unemployed may not apply for benefit, even though they are eligible.



If the proportion of unemployed in these categories has *decreased* this will explain some of the observed changes.

On the other hand, persons receiving benefits may not be recorded by the ABS as being unemployed. Instead, they may be classified as either employed, not in the workforce, or not in the survey population. An *increase* in the proportion of beneficiaries in these categories would explain the observed changes.

Those classed as employed include legitimate cases such as beneficiaries working part-time whilst still looking for full-time work (this is allowable provided any income above the income test threshold is declared), together with workers illegally receiving benefit.

Other beneficiaries will be recorded as 'not in the workforce' if their stated job search activity does not satisfy the ABS definition of unemployment. The main requirements for people to be counted as unemployed are that they must have *actively* looked for work at any time during the previous four weeks *and* been available for work in the survey week (excepting temporary illness).

For the long term unemployed in particular, what may constitute 'reasonable steps' to find work, as required under the act, may fall short of the Statistician's definition of 'active search'. How hard should a 50 year old man who has been unsuccessful in finding work for over a year be expected to search for non-existent jobs? The Social Security Review (Crompton, 1986, Cass, 1988) has argued that the older unemployed should have this requirement formally relaxed. But it might also be expected that long duration young unemployed would be similarly unenthusiastic in their job search.

Finally, the 'not in the population' group includes beneficiaries not covered by the ABS survey methodology (possibly the itinerant unemployed), together with those persons defrauding the system with multiple identities (they still have only one front door for the ABS to knock on).

More formally, the relationship between unemployment and beneficiary numbers can be expressed as,

$$B = U + BNU - UNB \quad (1)$$

Where B is the number of (unemployment) beneficiaries, U is the number of unemployed, UNB is the number of unemployed not receiving benefits, and BNU is the number of beneficiaries not defined as unemployed by the ABS. The increase in the difference between beneficiary and unemployed numbers (B-U) observed over the last decade must therefore be

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due to an increase in the number of beneficiaries not unemployed (BNU) and/or a decrease in the numbers of unemployed not receiving benefit (UNB).

In principle the number of ineligible beneficiaries could be calculated as a residual from the numbers of eligible beneficiaries known not to satisfy the ABS definition of unemployment, and the numbers of unemployed not receiving benefit. However, in practice, important measurement limitations mean that this calculation cannot be carried out. Equation (1) can be expanded to encompass such errors of measurement and the unexplained residual,

$$B - U = BNU_M - UNB_M + BNU_E - UNB_E + BNU_R \quad (2)$$

where the terms  $BNU_M$  and  $UNB_M$  denote the number of measured discordant cases, and  $BNU_E$  and  $UNB_E$  denote the errors of measurement.  $BNU_R$  denotes the residual of those not unemployed and receiving benefits illegitimately. By assuming constancy of the other unmeasured components, changes in  $BNU_R$  as hypothesised by Senator Walsh can be estimated (with the aid of appropriate assumptions regarding the indicators of BNU and UNB). These changes are examined here between the average values for the December 1977 to August 1978 unemployment beneficiary surveys (and corresponding labour force surveys) and the average values for the May 1986 to February 1987 surveys. More recent surveys show a reversal of the trend of increasing beneficiary numbers. This is discussed further below.

In Tables 1 and 2 some measures of the changes in beneficiary and unemployed numbers, together with some indicators of changes in BNU and UNB, are shown. Most of these indicators can only be considered relatively poor proxies of the true numbers. As well, for some important components of UNB no indicators at all are available. These include the numbers of persons not taking up their benefit entitlements and the numbers of those eligible for alternate forms of income support. In order to make estimates of the changes in  $BNU_R$  over time it is assumed here that such errors of measurement are a constant proportion over time of either beneficiary or unemployment numbers.

If the former is the case (i.e.  $(BNU_E - UNB_E)/B = k_1$ , a constant), then, by dividing by the number of beneficiaries and differencing over time, equation (2) can be transformed to give,

$$\Delta(BNU_R/B) = \Delta(UNB_M/B) - \Delta(BNU_M/B) - \Delta(U/B) \quad (3)$$

That is, the increase in the residual unexplained proportion of beneficiaries is equal to the sum of the increase in the number of unemployed not receiving benefit (as a proportion of beneficiaries), the decrease in the proportion of beneficiaries legitimately not unemployed, and the decrease in the proportion of beneficiaries unemployed.

**Table 1** Changes in Unemployment and Beneficiary Numbers as a proportion of Beneficiaries, 1977/8 to 1986/7<sup>a</sup>

	MALES		FEMALES		BOTH SEXES	
	<25	25-54	<25	25-54	SINGLE	MARRIED
<hr/>						
<b>Decrease in the ratio of unemployed to beneficiaries over the period</b>						
	<b>[ <math>-\Delta(U/B)</math> ]</b>					
	.35	.19	.46	1.11	.32	.47
 <b>Increase over the period in indicators of the number of unemployed ineligible for benefit (as a proportion of beneficiaries)</b>						
	<b>[ <math>\Delta(UNB/B)</math> ]</b>					
Unemployed for less than two weeks	-.06	-.03	-.06	-.46	-.03b	-.19b
Aged 15 years <sup>c</sup>	-.05		-.06		.00	
Still at school	-.04d		-.04d		-.04d	
Looking for first job <sup>e</sup>	-.14b		-.19b		-.13b	
With spouse employed (July '79 to June '86) <sup>f</sup>	.00	-.03	-.01	-.63	.00	-.24
 <b>Decrease over the period in indicators of the proportion of beneficiaries not unemployed<sup>g</sup></b>						
	<b>[ <math>-\Delta(BNU/B)</math> ]</b>					
Part-time employment <sup>h</sup>	-.03	-.05	-.07	-.07	-.04	-.08
Duration of six <sup>i</sup> months or more	-.19	-.29	-.13	-.21	-.18	-.24
Duration of one year or more	-.16	-.26	-.11	-.16	-.18	-.27
Duration of two years or more	-.09	-.23	-.05	-.13	-.13	-.22

## Notes to Tables 1 and 2:

- a Average of the numbers for the December 1977, February 1978, June 1978 and August 1978 beneficiary surveys (and corresponding labour force surveys) vs the averages for the May, August and November 1986 and February 1987 surveys. Source: Australian Bureau of Statistics, *The Labour Force*, Cat. No.s 6203.0 and 6204.0, various years, and Department of Social Security, Quarterly Survey of Unemployment Beneficiaries, various years.
- b '1977-78' average based upon February 1978, June 1978 and August 1978 data.
- c Assumed to be an equal proportion of unemployed in each gender.
- d February 1978 to February 1987.
- e And aged 15 to 19.
- f Source: Australian Bureau of Statistics, *Labour Force Status and Other Characteristics of Families*, July 1979 and June 1986, Cat.No. 6224.0. For females, those with their spouse unemployed are included also, as usually the husband only would be included in the beneficiary statistics. The estimates for the different age/sex groups are imputed from the distribution of the married workforce by age, with an additional pro-rata adjustment to convert the published numbers of unemployed persons to full-time unemployed persons.
- g A negative number thus indicates that the proportion of beneficiaries with the given characteristic has increased over the period.
- h Assuming no part-time employment at the beginning of the period. Source: DSS unpublished data on beneficiaries declaring casual income in February 1987.
- i Duration numbers for each age/sex are imputed from data on durations by age and sex separately.

	MALES		FEMALES		BOTH SEXES	
	<25	25-54	<25	25-54	SINGLE	MARRIED
<b>Increase in the ratio of beneficiaries to unemployed over the period [ <math>\Delta(B/U)</math> ]</b>						
	.35	.24	.33	.25	.38	.20
<b>Increase over the period in indicators of the proportion of unemployed ineligible for benefit [ <math>\Delta(UNB/U)</math> ]</b>						
Unemployed for less than two weeks	-.02	-.02	.00	-.09	.00 <sup>b</sup>	-.07 <sup>b</sup>
Aged 15 years <sup>c</sup>	-.03		-.03		.00	
Still at school	-.02 <sup>d</sup>		-.00 <sup>d</sup>		-.02 <sup>d</sup>	
Looking for first job <sup>e</sup>	-.07 <sup>b</sup>		-.06 <sup>b</sup>		-.08 <sup>b</sup>	
With spouse employed (July '79 to June '86) <sup>f</sup>	.00	-.03	.00	-.18		-.13
<b>Decrease over the period in indicators of the number of beneficiaries not measured as unemployed (as a proportion of unemployed) g [ <math>-\Delta(BNU/U)</math> ]</b>						
Part-time employment <sup>h</sup>	-.03	-.06	-.07	-.04	-.05	-.06
Duration of six <sup>i</sup> months or more	-.32	-.48	-.23	-.22	-.36	-.26
Duration of one year or more	-.23	-.39	-.14	-.14	-.29	-.24
Duration of two years or more	-.12	-.31	-.06	-.09	-.18	-.18
<b>Average value of U/B in '1986-87'</b>						
	.85	.77	.96	1.61	.77	1.29

Alternatively, if it is assumed the unmeasured components have increased at the same rate as unemployment (i.e.  $(\text{BNU}_E - \text{UNB}_E)/U = k_2$ ) the following expression is obtained,

$$\Delta(\text{BNU}_R/U) = \Delta(\text{UNB}_M/U) - \Delta(\text{BNU}_M/U) + \Delta(B/U) \quad (4)$$

With the further assumption that the residual was equal to zero at the initial period, the LHS of this equation can be transformed to express the changes as a proportion of beneficiaries as in equation (3). That is,

$$\Delta(\text{BNU}_R/B) = (U/B)_{1986-87} \Delta(\text{BNU}_R/U) \quad (5)$$

Table 1 presents the available information in a form compatible with equation (3), such that by adding selected numbers down the column an estimate of the increase in the proportion of beneficiaries in the residual category can be made. Table 2 presents the same data in a form compatible with equation (4). For those population groups for which unemployment numbers are close to beneficiary numbers, the two tables provide similar results. Examples of how these calculations are made are described below.

#### Decreases in the proportion of Unemployed not eligible for benefit

Persons otherwise eligible for benefit are required to serve a one week 'waiting period' before gaining benefit entitlement<sup>4</sup>. Thus, a decrease in the proportion of the unemployed within this waiting period would cause an increase in the proportion of unemployed receiving benefit. As Table 2 shows, this has indeed been the case to some extent, with increasing durations of unemployment over the decade leading to a 2 to 9 percentage point decrease in the proportion with duration less than two weeks. Since the ABS definition of duration relates to completed weeks, roughly a half of this increase might be surmised to apply to the one week waiting period. On the other hand, if people also serve a 'voluntary waiting period' before they apply for benefit, then perhaps a larger fraction would be appropriate. Various discretionary rules have existed for departmental officers to include this latter waiting period within the one week, but the extent of this is not known.

Those aged 15 years may be classified as unemployed, but are ineligible for unemployment benefits, as are those still at school. For both these groups there has been a small proportionate decline, though they overlap significantly. Also overlapping, though to a lesser extent, are those looking for their first job. Many of these will still be within the six week waiting period for school leavers and thus ineligible for benefit. As a proportion of

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<sup>4</sup> The actual wait to payment may be longer, but since the beneficiary statistics relate to entitlement to benefit as at a particular date, this is not relevant here.

unemployed this group declined slightly over the period, though as a proportion of beneficiaries (Table 1) the decline was more significant, because of the interaction of this highly seasonal variable with the relatively stable beneficiary numbers.

More important for the older unemployed was the decrease in the proportion with employed spouses. Thus fewer unemployed were ineligible for benefit because of the income test. This change was most marked for unemployed wives. In 1979, 89 percent had employed husbands, but by 1986 this had declined to 74 percent<sup>5</sup>. Also, beneficiary wives whose husbands are unemployed are generally not included in the benefit statistics (their husbands are recorded as receiving the married rate of benefit).

Other changes for which no indicators are available may also be significant. Two important influences upon the *take-up rate* of benefit are the level of income support available and the expected duration of unemployment (Gregory and Patterson, 1983). Whilst the level of benefit, relative to wages, has been relatively stable over the last decade (except for youth, see Figure 1), duration has steadily increased. This *may* have led to some increase in take-up, and hence an increase in the numbers of beneficiaries relative to unemployed, but the extent of this change would depend upon the extent of take-up at the beginning of the period. No reliable data exist on this.

Also, decreasing employment opportunities may have led to a reduced level of job search among other (non-unemployment benefit) income support recipients. This would diminish the numbers unemployed, but have no effect upon beneficiary numbers.

### **Increases in the Proportion of Beneficiaries not Unemployed**

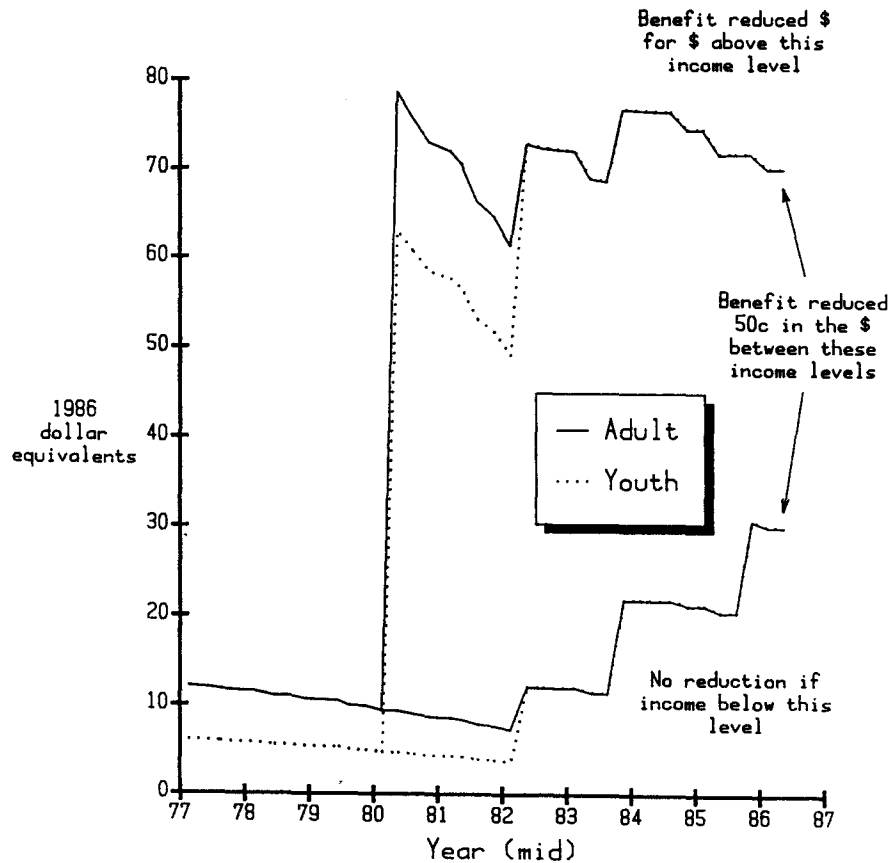
Data on changes in the proportion of beneficiaries who would not be classed as unemployed are also limited. Undoubtedly the proportion of beneficiaries working part-time has increased significantly over this period because of the liberalisation of the income test (together with the increasing duration of unemployment). Up until 1980, all income above \$6 per week (\$3 for juniors) reduced the beneficiary's benefit dollar for dollar (Figure 4). 1980 saw the introduction of a 50 percent taper region, and after 1982 the region where income attracted no reduction in benefit was steadily increased, up to \$30 currently.

Measuring the extent of the increase in part-time work is difficult. The Department of Social Security does not collect direct information on the labour force participation of beneficiaries. Moreover indirect information on the amount of 'casual' income received by beneficiaries (which is how income from part-time work is usually categorised) is available only for the

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<sup>5</sup> ABS *Labour Force Status and Other Characteristics of Families*, July 1979 and June 1986.

Figure 4 Unemployment Benefit Income Test Parameters, 1977 to 1986



Note: Income test parameters deflated by ABS  
Award Rates of (Hourly) Pay Index (from Cat.No. 1311.0)



last few years. This indicates that currently around 4 percent of male and 7 percent of female beneficiaries receive income from part-time employment (Table 1). If it is assumed that the extent of declared part-time work a decade ago was negligible because of the stringent income test, this would indicate the proportion of beneficiaries defined as not unemployed should have increased by the same percentage. This may be an underestimate because beneficiaries who have incomes below the first income test threshold need not declare these to the department (though an ABS survey would regard them as employed if they worked more than one hour per week), or if they do declare these earnings, departmental officers may not amend the administrative records as entitlements would not be affected.<sup>6</sup>

The increase in benefit duration over the past decade shown in Table 1 would also be expected to increase the proportion of beneficiaries with reduced job search activity, and who the ABS might classify as out of the workforce. Whilst beneficiaries are required to maintain their job search activity, not doing so constitutes 'cheating' of quite a different order to that described by Senator Walsh.

However, strictly speaking, even UB recipients who are discouraged job seekers should be recorded by the ABS surveys as being unemployed because of the requirement that people must first register with the CES before they can receive unemployment benefit (CES registration is counted by the ABS as evidence of active job search). However, many of the long term unemployed may have either let this registration lapse, forgotten that they are so registered, or the 'responsible adult' answering the labour force questions on their behalf may be unaware of this registration. It is only since late 1986 that beneficiaries have been required to maintain this registration. It would be ironic indeed if the decrease in the ratio of beneficiaries to unemployed seen since that date (see Figure 3), was due to this statistical artifact.

If such discouraged job seekers have remained a constant proportion of unemployment or beneficiary numbers, then they would not explain the observed changes. However if they are likely to be more prevalent among the long-term unemployed, who have increased in numbers, then they may have contributed to the observed changes.

In general, all of these factors help explain the observed changes in Figures 2 and 3. Because of the data limitations, however, even quantification of the influences included in Tables 1 and 2 requires a number of assumptions. It is instructive to examine a number of examples

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<sup>6</sup> The extent of this understatement is probably negligible. In the 1981-82 ABS Income and Housing Survey (unit record file) some 3.3% of males and 7.4% of females receiving unemployment benefit were working part-time. Whilst the income test threshold has increased since then, the introduction of the 50% taper region preceded this date (Figure 4).

First, a set of hypotheses attributing a wide scope to the proxy variables. It is assumed that: all unemployed for less than two weeks, aged 15 years, looking for first job, still at school, and with spouse employed are ineligible for benefit, and that the increase in part-time employment is accurately reflected in the tables, and that all beneficiaries of one year or more duration are recorded as out of the workforce. Adding down the columns of Table 1, these assumptions lead to a residual increase in the proportion of beneficiaries not unemployed of -13%, -18%, -4%, -21%, -10% and -31% for young males, older males, young females, older females, single and married beneficiaries respectively<sup>7</sup>. Carrying out the same procedure in Table 2 (and multiplying by U/B<sub>1986-87</sub>) yields estimates of -4%, -20%, 3%, -32%, -7% and -39%. It seems that these assumptions generally *over-explain* the observed changes.

However, many of these assumptions are improbable. More realistic assumptions would be that over a whole year only about a quarter of the youth looking for their first jobs would fall within the six week waiting period, the 15 year olds are probably largely also covered by this category and the 'still at school', and only about one half of those within the two week waiting period would be ineligible for benefits. The exclusions based upon spouse employment and part-time work are probably reasonably accurate, but there is no clear guide as to how duration affects reported search effort. Using these assumptions, and now assuming that only those with duration of *two years* or more are not recorded as unemployed, corresponding estimates of the residual of (13%, -14%, 21%, 5%, 6% and -17%) from Table 1 and (13%, -13%, 18%, -17%, 8% and -27%) from table 2 can be calculated.

If any effect of duration is ignored these estimates become (22%, 10%, 26%, 18%, 19% and 5%) for Table 1 and (23%, 11%, 24%, -2%, 22% and -3%) for Table 2. Generally the difference in assumptions about the unmeasured errors between Tables 1 and 2 do not lead to different results, except for older women (and to a lesser extent for the married). A range of other assumptions could be imposed upon the data presented in Tables 1 and 2 – particularly assumptions about the relationship between unemployment classification and duration.

However the following general conclusions seem to be reasonable. *If a large proportion of the long duration beneficiaries are assumed to be not recorded as unemployed then the observed changes can easily be explained (or even over-explained). If on the other hand, this duration effect is considered negligible (or itself to be considered as 'cheating') then a substantial residual appears to exist. This residual (as a proportion of beneficiaries) seems to be larger for the young and single than for the older and married.*

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<sup>7</sup> The first of these numbers (for young males) is calculated as follows.  
 $.35 - .06 - .05 - .04 - .14 - .00 - .03 - .16 = -0.13$

What does such a residual reflect? Obviously, it *could* mirror an increase in cheating as described by Senator Walsh, that is, 'people working effectively full-time and suppressing that fact when claiming benefits, or people claiming benefits using different names'. But there are a number of plausible alternative explanations. First, it may reflect increases in other forms of undesired behaviour, such as undeclared part-time work by beneficiaries, or lack of job search effort. To the extent to which these factors are assumed to be related to unemployment duration, the tables allow estimates to be made of their impact<sup>8</sup>. Moreover, the longevity of the problem of mass unemployment *may* have led to a general increase in these 'problems' among beneficiaries additional to that caused by duration changes. Second, the proportion of unemployed not receiving benefit may have increased. The most significant reasons for this to be expected to occur are the increased labour market discouragement among persons eligible for other categories of income support, and increased (or more speedy) take-up of benefit entitlements. Any of these changes could have been responsible for an increase in the residuals calculated above.

Ideally, we should be able to turn to the results of the recently initiated Social Security Unemployment Benefit Selective Review Teams to separate some of these concerns. These teams have been used to increase the government's control over beneficiaries' behaviour, and as of February 1987, were removing from benefit 1 in 4 of the beneficiaries they investigated<sup>9</sup> (Howe, 1987a). Unfortunately, the limited information available from this review process makes it difficult to derive wider implications.

It should be emphasised that this high proportion of presumably illegitimate claimants is unlikely to be replicated in the overall population of beneficiaries. The reviews have been targeted on groups considered likely to be cheating, and the extent to which these results are generalisable will vary inversely with the effectiveness of this targeting procedure.

Unfortunately, there is little information available on the reasons for the removal of persons from benefits. According to the Secretary of the Department of Social Security,

We are finding that in a considerable number of cases people have just found work or are about to start work. In these cases there is usually no intention to defraud the system but the Department has not been told of changed circumstances. (Volker, 1987)

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<sup>8</sup> Also reporting errors arising from the 'any responsible adult methodology' may be greater among the long term unemployed because their diminished, but still existing, job search effort may not be reported by the respondent.

<sup>9</sup> Of course, these statistics reflect numbers at one point in time, while the analysis above referred to *changes* over time.

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In other cases, persons could not be found, or were told to look harder for a job,

The team says a lot of people started work the day after they visited them and some of the 100 who have been ordered to get their dole forms endorsed by employers to say they have turned up for interviews have got jobs as a result. 'They had just lost their self-esteem after so long on the dole'. (Forbes, 1986)

The limited information available makes it very difficult to know the implications of these results. For instance, are those who were removed from benefit because they were 'just about to start work' or because the additional pressure increased their job search effort included in the statistics of the number removed from benefit? If so, some of these benefit exits would have been expected as a result of natural turnover. The Department has indicated that it has tried to not include cases of natural turnover in its statistics of beneficiaries removed, but their criteria for doing this is not known.

Whilst apparently successful in terms of their administrative goals, the results available from these reviews are not very useful in aiding an understanding of the nature of any beneficiary fraud. Many important questions remain. Are there many people not fulfilling the requirements of the unemployment benefit system? If so, how are they failing these requirements? Is the problem lack of job search effort, continuing to receive benefit after getting a job, receiving undeclared part-time earnings, or multiple identity fraud? The information available so far merely muddles these important differences. The answers to these questions, however, are needed before sensible progress towards appropriate policy responses can be made.

Perhaps the strongest case for a substantial prevalence of cheating lies in the recent narrowing of the gap between unemployment and beneficiary numbers – particularly as this has occurred in conjunction with the establishment of these selective review teams and other administrative reforms such as the personal lodgement of income statements. Since the data in Figures 1 and 2 were collected the gap between the numbers of beneficiaries and unemployed has narrowed significantly, with the numbers of beneficiaries actually falling below the numbers of unemployed in February 1988 (the most recent quarterly survey at the time of writing).

However this primarily reflects 'a statistical artifact', due to the introduction of Job Search Allowance for the young unemployed. The combination of the longer waiting period (13 weeks) together with the lower levels of benefit available has undoubtedly led to many young unemployed not receiving benefit. For adults, there does seem to have been a stabilisation of the ratio of beneficiaries to unemployed, but it is too early to speak of any decline. In February 1988, for example, this ratio for adult males stood at 1.30 compared to 1.32, 1.33,

and 1.27 for February 1985, 1986 and 1987 respectively. For adult females the February ratio for the last four years has been 0.55, 0.54, 0.58 and 0.54.

## 5. UNEMPLOYMENT BENEFITS – THE QUEST FOR LEGITIMACY

Whilst the statistical analysis presented here cannot reject the claims that there has been an increase in cheating among beneficiaries, it also suggests that it is very difficult to draw any definitive conclusions that there has been any great increase. In particular, assumptions about the job search behaviour of the long-term unemployed are crucial. The use of the 'any responsible adult' method by the ABS in its labour force surveys also hampers efforts to obtain a full understanding of the job search behaviour of the unemployed.

Similarly, definitive conclusions of the impact of benefit levels on job search behaviour are difficult to arrive at. Undoubtedly some impact on behaviour is made by the levels of income support, but it is probably not large. Moreover, the current excess of supply over demand for labour means that *demand* issues will continue to be more important for labour market policy.

None-the-less, in the political arena, concern with the behaviour of the unemployed has remained a central issue. In part this stems from the fact that whilst unemployment in general stems from factors external to individuals, in individual cases it is more difficult to draw this conclusion. Unlike other categories for whom income support is available, individual unemployed people are more likely to be suspected of *choosing* to enter that category (Saunders, 1987). The political legitimacy of the income support provided for the unemployed will be influenced by the way individuals make, or are perceived to make, behavioural decisions<sup>10</sup>. In turn, the scope for decision making of individuals will be undoubtably influenced by the structure of the income support system.

Enforcement of the *work test* is particularly problematic in times of high unemployment, and the low job search effort of the long duration unemployed has been pointed to as a possible explanation of some of the statistical divergences observed. Indeed even the enforcement of the *income test* may pose particular enforcement problems for people who are still attached to the workforce. Non-declaration of earnings from part-time work is also commonly held to be prevalent among such groups as unemployment beneficiaries, though such assertions are usually supported by anecdotal evidence only.

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<sup>10</sup> The structure of the system may also affect political legitimacy in other ways. For example insurance based schemes may be perceived as more legitimate because of the rights of the unemployed to their prior contributions (even if the link between contributions and payments is only weak).

The income test is fundamental to Australia's system of highly targeted income support, providing an additional enforcement burden that less targeted schemes (e.g. insurance based schemes) may not have to deal with. Just as the limitations of administrative enforcement have drawn attention to the economic incentives associated with work test failure, so it is also important to consider the incentives for people to 'cheat' on the income test.

The importance of minimising incentives to cheat was recognised in the discussion over the need to reform the *income tax* system in 1985 (see Treasury, 1985, p.18) but it has received little attention in the area of income support – where effective marginal tax rates can be substantially higher than those of the income tax system. Moreover, the subsistence level of unemployment benefit itself may provide *moral* incentives to not declare additional income. Whilst the evidence on the extent of this activity under the current situation is mixed, it is clear that perceptions of this activity are strong in the community.

However, any attempt to use economic incentives as opposed to administrative procedures to reduce income test cheating is bound to come in conflict with the other goals of the income support system. Increasing the base rate of benefit to a level of adequacy must be balanced against the possible implications for work incentives (and expenditure).

Similarly, decreasing the taper rate of benefits might encourage increased part-time employment, and fuller disclosure of income from that source. But this would lead to a less targeted, and more expensive, income support system, with income support being spread over a wider range of non-benefit incomes. There are, however, some marginal changes which could be introduced to address these issues. For example, it may be possible to address the problem of the high effective marginal withdrawal rates on part-time work by the use of time-varying marginal tax rates, where the conditions of benefit receipt might change over the duration of a spell of benefit receipt.

The 1987-88 Federal Budget showed the government's commitment to reducing the impact of marginal withdrawal rates on *pensioners* with the introduction of policies to reduce the effect of short-term increases in earnings on entitlements. But no corresponding proposals were introduced for the unemployed (whose marginal withdrawal rates are much higher than pensioners). This of course was no accident. Up until recently, part-time work was not considered a serious option for unemployment (and other) beneficiaries.

The Social Security Review proposals to restructure income support for the unemployed have now begun to address this issue seriously (Cass, 1988). Under the system proposed by the Review, adults who had been unemployed for over a year would be subject to a less stringent income test to enable them to undertake part-time or casual work to supplement their incomes. It is also hoped that this work experience will facilitate their eventual return to the

full-time workforce, (though the extent to which this will happen remains a major research question). We might expect that such proposals will also lessen the administrative stresses on the system created by the stringent income test faced by the unemployed.

Whilst it is thus argued that the effects of economic incentives need to be considered in areas where administrative concerns have tended to be predominant, the case can also be made for the application of new administrative procedures in areas where concern for economic incentives has been predominant. In this paper it has been suggested that research has not established that the effects of the level of benefits on job search effort are all that great. This is not to argue that there is no variation in the extent of job search effort by different categories of unemployed. For example, the frustration and hence diminished search effort faced by the long term unemployed has been described, and it seems to be a common perception that some demographic groups, such as the young, will be less inclined to look hard for work (though evidence to back up this perception seems to be lacking).

One way of addressing these issues is for the income support system to become much more closely linked to labour market policy. The discussion of possibilities here has become much more focused over the last few years with the 'work for the dole' concept. It is not the place here to cover the full range of issues involved with these proposals, but rather to focus upon the links to the issues of work incentives and welfare fraud.

For some proponents of the work for the dole schemes, a key goal of such schemes is to address these issues. People who must carry out work for their benefit will have less time for black-market employment, and will have an added incentive to go off the welfare rolls. However, such schemes could be much more than an extension of the punitive approach to income support. As Windschuttle (1986) has noted, workfare has the potential for a much more positive role if it can become part of commitment by the state to provide meaningful jobs and training opportunities rather than simply income support for the unemployed.

The current government has indicated that it intends to restructure income support policies to provide greater incentives, and pressures, for beneficiaries to move into employment or training schemes. From this point of view, the most important aspect of the new Job Search Allowance for unemployed youth is not the lower rate of benefit for some, but the increased administrative intervention proposed to place these youth in jobs or training. Similarly, the removal of Sole Parents Benefit, or Widows Pension when children are aged 16 is to be linked to training schemes to return these women to the workforce.

Such policies have been described by the Social Security Minister as replacing the 'safety net' concept of income support with a 'springboard' back into the workforce (Howe, 1987b). However, given the government's speed in reducing benefit entitlements, and slowness in

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providing support services, an obvious re-phrasing of this analogy might be of the government 'providing a springboard without a safety net'.

Simply providing income support to those able to work, but unable to find work, can only lead to increasing stress on the income support system. Ways of more directly addressing the problems of the labour market must be found. It is clear from recent policy changes and the proposals of the Social Security Review that the government is keen to maintain and strengthen the links between the unemployed and the labour market. This general principle should be applauded. However it is less clear that there is a commitment to finding the resources needed to make this policy work in a positive rather than punitive manner. Let us hope that such a commitment will be found.



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