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Poverty and Inequality: Social Security in Australia in the 1990s

by

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Anthony King
Editor

Poverty and Inequality:
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Abstract

This paper is in two parts. It begins by reviewing trends in income inequality and poverty in Australia over the 1980s using data from the household income surveys conducted by the Australian Bureau of Statistics. The analysis reveals increased inequality over the decade, primarily arising in the core labour force, i.e. amongst the wage and salary incomes of full-time workers. In combination, the other main components of income reduced the increase in inequality somewhat, but inequality still rose. Poverty also increased when measured using the Henderson Poverty Line. Both trends are similar to those experienced in many other countries over the period, which suggests that the underlying causes are economic and international in origin. The remainder of the paper assesses what these and other developments imply for the Australian social security system in the 1990s. Attention focuses specifically on questions for research and policy in relation to: adequacy, coverage and incentives; the appropriate unit of analysis; labour market change; and certainty of support and the stability of system as a whole.

1 Introduction

The last five years have seen poverty and inequality re-emerge as central concerns of social policy in general and social security policy in particular. This paper reviews the main findings of past research in these areas and highlights the policy relevance of the assumptions and methodologies which characterise the current research effort. It would, however, be foolhardy to claim that research alone has focused attention on the extent, causes and consequences of various dimensions of inequality. Two other factors have been far more important.

The first is the increasing prominence of economic liberalism as the basis for the formulation of economic and social policy - the rise of economic rationalism - which has sharpened the trade-off between efficiency and equity. The second factor, a consequence of the first but also independent of it, has been the increased public awareness of the extent of inequality. The media has played an important role in drawing attention to the growing divide in Australian society, characterised on the one hand by increases in homelessness and in welfare agency overload and on the other by pockets of high income, wealth and privilege.

The existence of poverty and inequality raise particular issues for the Australian social security system, which has always given emphasis to the poverty alleviation objective and which, in the context of a small government sector like Australia's, also plays an important role in the income redistribution process more generally.

In undertaking research on poverty and inequality, as in formulating social security policy, values are of central importance. That is one of the strengths of such research. Unlike much economic policy debate, in which values become intertwined with, and indistinguishable from, pseudo-scientific positivism, values have to be made explicit in discussions of, and research on, poverty and inequality. This does not mean, as some have argued, that research is flawed because it is subjective and essentially arbitrary. What it does mean is that poverty research will always be in the firing line of politics (Abel-Smith, 1984). The values which underlie it need to be defended because, being explicit, they are constantly under attack.

Recent developments in research methodology, greatly assisted by the availability of household income data in unit record form, have been characterised by an enormous increase in technical sophistication. Gone are the days when Ronald Henderson could speak with such eloquence about the rise in poverty and face not a single query or criticism. Such sophistication has made it far simpler to investigate the consequences of adopting alternative values assumptions or operating procedures (Atkinson, 1987). These techniques have made it easy to identify which value decisions are most critical, but they have not avoided entirely the need to make value judgements.

In the remainder of this paper, I will try and illustrate how many of the decisions which characterise research on poverty and inequality have their counterparts at the leading edge of policy development. My central theme will be that research has a crucial role to play in identifying the general context within which social policy operates, and in exposing and testing the (often unstated) values and assumptions which underlie specific social security policies. In pursuing this theme, I hope to give a flavour of what I see as some of the main policy issues of the 1990s.

2 Past Trends

Unfortunately, there are as yet no reliable data which allow us to track developments in poverty and income distribution in the 1990s. The Australian Bureau of Statistics (ABS) last conducted an income survey in 1990 and is currently preparing to undertake the next one in 1994. Even that survey is scheduled to be conducted in a different way from past surveys and is likely to reduce considerably the degree of detail collected on annual incomes, the basis for most past research on income inequality and poverty. This means that it may no longer be possible to update many of the research results presented below beyond 1990 with any degree of reliability.

Lack of data thus forces me to focus initially on what we know about the trends in, and causes of, inequality and poverty in the period up to 1990. I should also emphasise that I am dealing here with only one aspect of these two phenomena - that relating to the distribution and adequacy of **monetary** incomes. This is of most immediate significance for social security policy, but that should not cause one to neglect the importance of other dimensions of inequality and disadvantage, nor the relationship between these and the income dimension.[1] The study of past trends in inequality is in any case useful for understanding current developments, at least if there has been no major structural break with the past. This seems a reasonable assumption, one which is, after all, used by economic modellers in deriving their

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1 Specific discussions of poverty and inequality which extend beyond income can be found in Brownlee (1991), Brownlee and McDonald (1993), Carter (1993) and Travers and Richardson (1992; 1993)

economic forecasts; though one would not want to lay too much store on that as a cause for comfort!

2.1 Income Inequality

In relation to **inequality**, the picture regarding what happened during the 1980s is fairly clear and well-known. I will thus be brief in describing it. As far as we can judge from the data produced by the ABS income surveys, inequality rose between 1981-82 and 1989-90, by an amount which is considerable in a longer-term context (Saunders, 1993a). The ABS itself has recently published summary statistics which indicate an unambiguous - in the sense that it is value-independent - increase in inequality of gross income among income units between 1981-82 and 1989-90 (ABS, 1992; Table 6.1.1).

My own research confirms this finding and shows the same overall trend for the distribution of gross income amongst income units and for the distribution of equivalent disposable income among individuals, equivalencing being undertaken using the detailed Henderson equivalence scale (Saunders, 1993b: 1993c). These findings all reveal the same general trend in inequality, with the income shares of the lower deciles falling slightly, those of the middle deciles falling more sharply, and a substantial increase in the share of the highest decile: those in the top 10 per cent of the income distribution (Saunders, 1993c, Table 5).

These results assume that the appropriate unit of analysis is the income unit as defined by the ABS. It is the unit within which income is assumed to be pooled for the benefit of individual members and the unit within which costs or needs are aggregated and set against aggregate income unit income for the purposes of deriving equivalent income, i.e. income relative to needs.[2] The assumption of complete sharing within the unit implies that the standard of living of each individual unit member is the same. Even when the distribution of income is expressed amongst individuals - the approach now preferred by most researchers - the income unit is used as the basis for initially calculating equivalent income.

The way in which income units are defined is critical and we thus need to be sure that the definition used is appropriate, not only because alternative definitions will influence research results, but also because the unit within which income sharing (or

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2 In fact, the detailed Henderson equivalence scale assumes that household costs are shared among all **household** members rather than just among members of the income unit.

private redistribution) takes place is critical for determining the shape and scope of transfer and tax policies for **public redistribution**. In this context, it is of relevance to note that research being conducted at the National Centre for Social and Economic Modelling (NATSEM) and reported recently at the Economists' Conference in Perth suggests that estimates of the level and trend in poverty and income distribution are sensitive to the income unit or family definition adopted (Harding, 1993).

This is all the more reason why the issue of the income unit requires a good deal more research than it has received to date, a point I will return to later. Related to this is the need to recognise that there are two redistributive mechanisms - public and private - co-exisiting alongside each other and that the interactions between the two are important in the policy context.

The precise degree to which income inequality among income units increased over the period is difficult to ascertain because of the sensitivity of the different inequality measures to changes in inequality at different points in the distribution (Kakwani, 1980: Jenkins, 1991). What is clear, however, is that since the biggest changes have occurred at the top of the distribution, inequality measures which are more top-sensitive, like the coefficient of variation, tend to indicate a larger change than measures like the Gini coefficient which are more sensitive to changes around the middle of the distribution.

Rather than become side-tracked into a discussion of the properties of alternative inequality measures, I will use a measure which is easy to understand and has a certain intuitive appeal in the current context. This is the 'Robin Hood Index' (RHI) recently employed by Atkinson and Micklewright (1992) in their study of income distribution in former Eastern-block countries. The RHI is equal to the percentage of total income which would have to be redistributed from those with incomes above the mean to those with incomes below the mean in order to achieve complete equality of incomes. The more unequal the distribution, the harder a redistributive Robin Hood would have to work and the greater the RHI. An Index value of 40 per cent, for example, would imply that 40 per cent of total household income would have to be redistributed in order to achieve complete equality.

Table 1 indicates that the RHI increased over the 1980s for the wage incomes of full-year full-time (FYFT) workers, for the earned incomes of all earners, for total private income, total gross income and total net income, as well as for the person-weighted distribution of equivalent net individual income. For the latter four measures, the RHI inequality measure increased by between 7 per cent and 8 per

Table 1: Changes in the Robin Hood Index of Inequality, 1981-82 to 1989-90

	1981-82 (%)	1989-90 (%)	Percentage Increase
Wage and salary income (FYFT workers)[(a)]	15.8	17.6	11.4
Earned income (all earners)	24.0	24.9	3.8
Private income	34.7	37.2	7.2
Gross income	28.9	31.2	8.1
Disposable income	25.4	27.2	7.0
Equivalent disposable income (person-weighted)	19.1	20.5	7.3

Note: (a) FYFT = full-year, full-time.

Sources: *1981-82 Income and Housing Survey and 1990 Survey of Income and Housing Costs and Amenities;* unit record files.

cent between 1981-82 and 1989-90. For total earned income, the increase was below 4 per cent, reflecting both the growth in employment and the decline in unemployment. The estimated change in inequality of the wage and salary incomes of FYFT workers was over 11 per cent. Income inequality thus increased over the 1980s whether one focuses on the wages of full-time workers, total earnings, or total income, and whether one measures income before tax, after tax, after tax and transfers, or after tax and transfers and adjustment for needs as reflected in the detailed Henderson equivalence scale.

As noted earlier, the main distributive change occurred at the top of the distribution, specifically in the top decile. Whether one looks at the wage incomes of FYFT workers, or the net incomes of income units, the average incomes of those in the top decile rose by between 102 and 105 per cent between 1981-82 and 1989-90. The corresponding increase for those in the bottom decile of each distribution was around 75 per cent. Over the period the CPI rose by just over 83 per cent. Thus, the living standards of those at the bottom of the distribution actually went backwards over the period, at least in terms of real cash incomes.

It is also important to note that sociodemographic changes over the decade cannot explain much of the increase in inequality. When the population is separated into a number of distinct sub-groups defined according to income unit type or the number of earners, the main change in inequality took place within rather than between these groups (Saunders, 1993c). Similar analysis conducted as part of the Study of Social and Economic Inequality using data from the 1984 and 1988-89 Household Expenditure Surveys confirms that within-group inequality was largely responsible for the change in inequality over this period (Raskall, McHutchison and Urquhart, 1994, forthcoming).

The income survey data also confirm that the greatest increase in inequality occurred amongst the full-year, full-time workforce, a finding consistent with Gregory's analysis of the changing distribution of employment opportunities in Australia (Gregory, 1993a). In response to this increasing inequality arising in the primary labour market, government tax and transfer policies have managed to stem, but not turn back, that tide.

The fact that inequality has increased does not necessarily imply that the tax-transfer system has become less effective in achieving its redistributive aims, as Harding and Mitchell (1992) have demonstrated.[3] What it does mean is that the tax-transfer system needs to become increasingly more redistributive if inequality arising in the labour market is not to translate into greater inequality of living standards in the community.

The final, and important, point to emphasise is that the trend towards increased income inequality in the 1980s was by no means uniquely Australian. A recent OECD report has noted how widespread the trend towards increasing inequality of earnings was amongst OECD countries in the 1980s (OECD, 1993). I recently attended a Conference on *The Distribution of Economic Well-Being in the 1980s - An International Perspective* at which research results were presented which indicated that income inequality increased over the 1980s (sometimes only after the mid-1980s) in France, Greece, Japan, Hungary, the Netherlands, Sweden, the United

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3 The redistributive impact of the tax-transfer system can be estimated by comparing the reduction in inequality as one moves from private to gross and then to net income. The results in Table 1 suggest that the redistributive impact of the tax-transfer system was almost identical in 1989-90 and in 1981-82, the slightly lower redistributive impact of cash transfers being offset by a slightly more redistributive income tax system. The same conclusion holds whether inequality is measured by the Gini coefficient or by the coefficient of variation.

Kingdom, the United States, Uruguay and West Germany as well as in Australia.[4] The trend to inequality, while widespread, was not universal, a point emphasised in a number of recent comparative studies which point to the important role of political processes and institutions like the social security system in offsetting the full effects of market forces on inequality (Atkinson, 1993; Gottschalk, 1993; Fritzell, 1993; Jantti, 1993; Smeeding and Coder, 1993).

This pattern of rising inequality has also not been restricted to Western nations. Atkinson and Micklewright conclude from their study of income distribution in the former Easter European economies that:

> The different countries exhibit rather different changes over time, but it is noticeable that Hungary, Poland and the USSR all shared with the UK a pattern of rising inequality over the 1980s. (Atkinson and Micklewright, 1992: 132)

Even here, however, there was an exception, with the distribution of income in Czechoslovakia showing no tendency to become more unequal.

The significance of this comparative research is that it provides a clue to the underlying causes of the rising trend in inequality in the 1980s. Specifically, the fact that inequality has risen in so many countries and that, as in Australia, the effects are most marked in regard to market incomes suggest that the causes are fundamentally **international** and **economic**, even though the domestic policy response can clearly influence their **national** and **social** manifestation (Atkinson, 1993; OECD, 1993).

What specific economic forces have been most important in this process? Comparative research undertaken by Gottschalk and Joyce (1991; 1992) using the Luxembourg Income Study database has focused on the role of three factors: de-industrialisation (the declining significance of manufacturing), technological change and the increased internationalisation of world trade. Of these, the first (de-industrialisation) is regarded as of secondary importance, the authors concluding in their most recent study that:

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4 Evidence was also presented at the Conference which indicated that there had been no marked increase in inequality (at least up until 1990) in Finland, Israel, Italy and Norway. The OECD study reported that earnings inequality remained broadly stable over the 1980s in Denmark, Finland, Italy and Norway, whilst there was a slight decline in West Germany (OECD, 1993).

> While there is still no 'smoking gun', this study shows that both international competition and technological change remain as primary suspects of the cause of rising inequality. (Gottschalk and Joyce, 1992: 24)

If correct, this conclusion (derived from research which includes data on Australia) has particularly significant implications for the development of inequality in Australia over the 1990s.

There is no indication that the international market forces driving increased inequality in the 1980s have abated in the current decade. Indeed, the length and severity of the world recession have probably caused them to intensify. If this is the case, then not only will we continue to be affected by these broad international forces, but our more specific attempts to develop stronger trading links with South East Asia may see them operate even more strongly here. The steadily rising tide of inequality experienced over the 1980s could thus turn into a deluge, putting ever-increasing pressure on social security and other protective and redistributive mechanisms.

2.2 Poverty

I turn now to consider past trends in **poverty**. In doing this, I will avoid a detailed discussion of the conceptual and methodological intricacies of poverty research and focus on the broad picture and some of the issues for policy to which it gives rise. Australia has a long and distinguished tradition in poverty research. Despite on-going debate over where the poverty line should be set, past research has helped to identify areas of unmet need, brought to the fore the issue of benefit adequacy and thus shaped an integral part of the social security policy agenda.

Most researchers continue to use the Henderson framework to measure poverty despite its many limitations and problematic aspects (King, 1991). I use the term 'framework' here rather than refer just to a specific poverty line, in order to emphasise that Professor Henderson developed an entire methodology for estimating poverty, of which the poverty line is but one element. Many opponents of the Henderson approach direct their criticism solely at the poverty line, arguing that an absolute poverty line is more appropriate than one fixed in relative terms. This is more a debate about the adequacy of benefits than a philosophical discussion about the concept of poverty itself. The absolutists need to ask themselves whether they would still favour a price-adjusted poverty line if real incomes were falling, just as the relativists need to be sure that they would favour benefit cuts if nominal incomes were declining.

As noted, central to the Henderson framework is the conceptualisation of poverty in relative terms. Support for such an approach seems widespread. Even those who, like Harding and Mitchell (1992), reject the Henderson framework, have maintained a relative poverty standard. In theory at least, the use of a relative poverty standard means that distributionally-neutral economic growth - a rise in average incomes with no change in inequality - has no effect on poverty. In contrast, increasing inequality - whether accompanied by positive or negative economic growth - could increase poverty, although it need not. However, given the actual changes in income inequality which took place in the 1980s, it would be surprising if relative poverty had not increased.

This is confirmed by estimates derived using the Henderson framework, which indicate an increase in the poverty rate among income units from 10.8 per cent in 1981-82 to 16.7 per cent in 1989-90. These figures count the unemployed as 'in work' for poverty line purposes: if instead, we treat the unemployment as 'not in work', the estimated poverty rate falls by around one percentage point in each year, but the trend remains much the same. Furthermore, sensitivity analysis which varies the 1989-90 poverty line downwards to half of its Henderson level and upwards to twice its Henderson level indicates that at each of these levels - and at any level in between them - poverty increased over the period, in aggregate and for each major income unit type (Saunders, 1993c).

It has been argued that this increase in poverty is to some extent artificial because it is partly a consequence of the real increase in the poverty line over the 1980s, particularly between 1983 and 1989, resulting from the high economic growth experienced in those years. Those who hold this view are in effect questioning whether poverty should be conceptualised (and hence measured) in relative terms. If poverty is relative then the poverty line **should** increase in real terms when real incomes in the community are growing.

There is, however, a more subtle version of this line of argument. In principle, as noted earlier, economic growth should not affect the poverty line and hence relative poverty as long as the growth is distributionally neutral. The poverty line will rise in real terms but remain fixed in relative terms, and if the distribution does not change the same percentage of the population will be below it. In practice, however, measured poverty may rise because the National Accounts based measure of household disposable income per capita (HDYC) which is used to adjust the poverty line is broader in scope than the income concept measured in the ABS income surveys (Manning, 1982). The two measures of average income may thus follow divergent trends.

Between 1981-82 and 1989-90, for example, the National Accounts estimate of HDYC increased by 8.95 per cent in real terms,[5] whereas the same measure derived from the ABS income surveys rose by only 7.16 per cent in real terms. The difference - 1.67 per cent - represents an increase in the poverty line which, even in a period of distributionally-neutral economic growth, would artificially inflate estimates of poverty.

To gauge how large this effect is, I decomposed the change in Henderson poverty between 1981-82 and 1989-90 into this (artificial) 'growth effect' and an 'inequality effect' resulting from the increase in income inequality already described.[6] The 'growth effect' was estimated by inflating the 1981-82 poverty line by 1.67 per cent and, assuming no change in inequality, using the 1981-82 data to estimate poverty using this new poverty line. The difference between the impact on poverty of the 'growth effect' estimated in this way and the actual observed increase in poverty was then assumed to be the 'inequality effect': that part of the increase in poverty resulting from the change in income inequality between 1981-82 and 1989-90.

The results indicate that of the actual rise in the poverty rate of 5.9 percentage points, the 'growth effect' accounts for 0.5 percentage points, or 8.5 per cent of the actual increase in poverty. The remaining 5.4 percentage points (91.5 per cent of the actual increase) are due to the 'inequality effect'. These estimates thus suggest that the artificial growth effect played only a minor role in the increase in poverty in the 1980s, most of which reflects the increase in income inequality.[7]

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5 Source: IAESR, *Poverty Lines, Australia. June Quarter 1992*, Table 3.

6 Such a decomposition is not formally exact due to the presence of an interaction term, which is included here as part of the inequality effect. An exact application of the method is described and applied in Kakwani (1993).

7 As noted below, even if the Henderson poverty line is adjusted between 1981-82 and 1989-90 in line with movements in the CPI, poverty still increases slightly over the period.

3 Current Prospects

The foregoing discussion has dwelt at length - arguably at too much length - on past developments. A major reason for this is that we do not have data which allow us to estimate trends in inequality and poverty beyond 1990 with any confidence. More substantively, research into the factors underlying past trends can help to uncover the factors and processes likely to influence future developments. One way of achieving this is through the use of microsimulation models which estimate the impact of demographic, labour market and policy changes on the levels and distribution of incomes.

There are dangers in the use of microsimulation models for such purposes if the estimates thus produced come to acquire the status of 'stylised facts' rather than the outcomes of a set of assumptions. Microsimulation models are becoming widely used in policy analysis and research and their role should not be under-emphasised. They are particularly useful for policy impact analysis, policy costings and for counterfactual exercises which evaluate the impact of alternative scenarios or policies. This is the way they have mainly been used within government and in research institutes like the SPRC (Saunders, 1991a; Bradbury and Doyle, 1992).

This research, along with other attempts to estimate more directly the impact of unemployment on poverty and inequality, indicates the complexities of the underlying relationships. Unemployment undoubtedly causes a fall in the income of the individuals affected, but how this translates into a change in poverty or inequality depends upon where the individual was initially located in the income distribution, their family and household circumstances, and what income is being received by them and other members of their income unit (Saunders, 1992). The same factors which I earlier identified (Saunders, 1991a) as giving rise to only a modest reduction in poverty resulting from the rapid employment growth between 1983 and 1989 (two-income families; part-time work; low wages) will have also acted to moderate the impact of the post-1990 recession on poverty. Adding to this is the fact that household disposable income per capita, and hence the poverty line, increases more slowly in real terms in recessionary periods.[8]

This does not mean that the current recession has had no impact, nor that its impact has been only marginal. All of the evidence points to the fact that poverty and inequality are both likely to be considerably higher now than they were in 1989-90.

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8 Between 1989-90 and 1992-93, for example, HDYC increased in nominal terms by only 8.2 per cent and in real terms by only 0.2 per cent.

In round terms, for example, the estimated effect of unemployment on inequality amongst families implies that each one percentage point rise in unemployment will lead to a rise in the RHI inequality measure of 0.6 percentage points - equivalent to a redistributive effect equal to 0.6 per cent of total family income (Saunders, 1992).

Other researchers have used microsimulation models to predict changes in poverty prior to the release of income survey data (King, 1987; Saunders and Matheson, 1991) but the results from such exercises need constant qualification if they are not to be misinterpreted. At the very least, if we are to rely on microsimulation models to estimate trends in poverty and inequality we need to be confident that these models can track **past** trends accurately before relying on their estimates of the **current** situation or forecasts of **future** developments. It may be far cheaper to develop and generate predictions from a microsimulation model than to conduct an income survey, but that should not mean that the former can replace the latter. The two should be seen as complementing each other, not as substitutes.

4 Research and Policy: Emerging Issues

An important reason for undertaking research of the type described in the previous Section is to inform, and hence influence, policy. The government and public servants thus have a particular interest in the methods and results of poverty research, although they are not the only ones. As Tony Atkinson has recently argued:

> Concern about poverty is not limited to governments and civil servants. It is an issue which is of concern to individuals and groups, such as churches, welfare organisations, claimants' unions, etc. But there is a great risk that discussion of ... policy and its social dimension will be confined to experts... This is not to suggest that the debate should descend to the level of anecdote or tabloid journalism.... the tools developed to analyse poverty... should be ones which can be made accessible outside government... In this way, the debate can be widened to include more of the many people who are concerned about poverty. (Aktinson, 1991a: 24)

I cannot agree more with these sentiments and what they imply for how we conduct research on inequality and how we disseminate it. There are two aspects of research which deserve particular emphasis in this context. The first concerns **transparency**: the need to ensure that methods and assumptions are clearly set down in a way which can be easily understood. The second relates to **replicability**: the need to ensure that others can apply these methods for themselves and derive the same results from them.

It is crucial to understand the links between research methodology and policy practice. Although poverty research may appear to be an esoteric (and confusing) exercise pursued by well-paid, tax-financed researchers, the issues it raises have important implications for policy. I take the view, some might see it as old-fashioned, others as simply naive, that policy that has been informed by research is ultimately better policy.

In practice, this may not always be possible. Political and other imperatives often require policy to move too fast to permit any useful research input. In other areas, research may simply not have been able to answer, or even ask, the key questions. Thus it may not always be possible for research to input into the policy process. However, I believe that the research described earlier has several important implications for social security policy, as I will now illustrate.

Analysis of social security policy generally proceeds within a framework provided by the objectives of the system (Cass, 1986; Saunders and Whiteford, 1991). In general, these include adequacy, incentives, coverage, ease of administration, cost, sustainability and relevance. Policy analysts have long recognised that in social security, as elsewhere, these objectives cannot all be satisfied simultaneously. Trade-offs must be faced in establishing eligibility conditions and entitlements and determining how these are to be administered.

The Social Security Review provided a vehicle for addressing some of the trade-offs between adequacy, coverage and incentives within a system restructured so as to be more relevant to contemporary conditions and against a background of increasing concern over the cost and sustainability of the system as a whole. It is not my intention here to comment on past policy developments, but to use the research results described earlier to illustrate some current policy issues. In doing so, I will focus on issues of adequacy, coverage and incentives.

4.1 Adequacy and Coverage

The poverty trends described earlier raise several questions about developments in the adequacy of benefits during the 1980s. The fact that Henderson poverty has increased does not, of course, imply that the real benefits have fallen, because the Henderson line is tied to average incomes which were growing in real terms during the 1980s. Nonetheless, even if the Henderson poverty line is only adjusted for movements in consumer prices between 1981-82 and 1989-90, the poverty rate for most income unit types still increased slightly over the period, the overall poverty rate increasing from 10.2 per cent to 11.1 per cent (Saunders, 1993c).

There is, however, a good deal of evidence which shows that real benefit rates increased after 1983 (Harding and Landt, 1992, Tables 2 and 3; Saunders and Matheson, 1991, Tables 2 and 3). For those who receive the maximum rate of benefit, it is thus not true that 'the poor have got poorer', although the earlier discussion of inequality suggests that this is probably true for at least some of the poor.

The increases in real benefit levels may thus not have been sufficient to raise beneficiaries above a poverty line held constant in real terms. But even this still does not imply that 'the poor have got poorer'. It does, however, raise questions which extend beyond the legislated rates of benefit to the issue of the actual receipt of benefit income. This in turn focuses attention on the quality of the information on benefit incomes recorded in the ABS income surveys. Two aspects deserve particular attention: first, the possibility that the income survey data are deficient in their coverage of the receipt of social security and other transfer incomes and second, that many people are being excluded from receiving benefits or do not receive their full benefit entitlements.

We already know there is some truth in the former proposition. Thus Bradbury and Doyle have shown that cash transfer incomes reported in the *1990 Survey of Income and Housing Costs and Amenities* understate total expenditure on benefits in that year by just over 11 per cent in total (Bradbury and Doyle, 1992, Tables A.4 and A.5). Such understatement of benefit income need not, of course, lead to an over-estimate of poverty. Whether it does or not depends on the relationship between the poverty line and the maximum rate of benefit, the degree of understatement of benefit income, and the size of other non-benefit income.

The second aspect alluded to above is that people are either excluded from receiving benefits or do not receive the benefits to which they are entitled. There are likely to be a number of reasons why this could occur, some of them being legitimate (e.g. a failure to satisfy work test or residence requirements), and others reflecting low take-up as a result of lack of information about the nature and scope of available benefits, situations where the perceived cost of applying for benefits are outweighed by the value to be gained from receiving them, a desire to be independent of government, or fear of the stigma attaching to the receipt of benefits.

The whole issue of non-receipt of benefit and the reasons for it have been largely ignored in Australia. This may have been justifiable in the past. Writing over two decades ago in their study of poverty in Melbourne, Ronald Henderson and his colleagues noted that:

> Other countries are said to regard the means test as an abhorrent affront to social justice. It does not seem to be so regarded in Australia... the means test as it is operated in Australia is not only fairly liberal, but also the 'poor-house' and 'work-house' connotations, which attach to the concept of the means-test in some other countries, do not exist in Australia. (Henderson, Harcourt and Harper, 1970: 10-11).

That may still be true today, but it needs to be recognised that much of the restriction in benefit coverage which has taken place in the last decade has not occurred through changes in the income test, but rather through restrictions in benefit eligibility and increased administrative surveillance of new claimants and existing recipients (Saunders, 1991b).

We need more research to investigate whether these measures, designed to reduce fraud, improve the system's integrity and contain costs, have at the same time introduced new problems of intrusiveness, take-up and stigma. In order to achieve their objectives, benefits must not only be set at adequate levels, but positive steps must also be taken to ensure that they are received by those for whom they are intended.

The potential magnitude of these effects should not be underestimated. Preliminary estimates derived at the Social Policy Research Centre indicate that over 951,000 income units (12.4 per cent of all income units) had recorded incomes below the imputed social security benefit entitlement safety net level in October-December 1990, when the last income survey was conducted. On an annual basis, the estimates indicate that 890,000 income units (11.6 per cent of all income units) had annual incomes below their imputed social security entitlement levels over 1989-90 as a whole. Many of these people were receiving some benefits and it is possible that recorded benefit incomes are innacurate (although this effect could work both ways). However, on a current income basis over 348,000 income units (4.5 per cent of all units) had no recorded benefit income whatever, the corresponding annual figure being almost 250,000 (3.3 per cent). Around two-thirds of these were single people, most of them aged between 21 and 59, but there were also significant numbers of aged income units and non-aged couples (with and without children) with incomes below the safety net.

These estimates are preliminary and should be regarded as such. They raise at least as many questions about the accuracy of the income survey data as they do about the coverage of the social security system. They do, however, suggest that the social security safety net may not be providing adequate protection, for whatever reason, to all Australians. This is why we need to look beyond what is happening to the **level** of benefits and look also at the issue of the **receipt** of benefits. Herein lies another possible explanation of the apparent paradox of increasing inequality and poverty in a situation of rising real benefits.[9]

In his Presidential Address to the World Congress of the International Economic Association held in Moscow last year, Tony Atkinson noted that the metaphor of a safety net is not entirely appropriate, because the social safety net, unlike the circus net, can become overburdened and break if too many are forced to rely upon it (Atkinson, 1992). Atkinson's advice to the former Eastern-block countries was not to rely too heavily on the social safety net in periods of large scale economic restructuring. The Western experience indicates that the institutions and programs which comprise the social safety net are fragile and may not be able to withstand all of the extra demands placed on them (Atkinson, 1991b; 1992).

This is a lesson from which Australia can also benefit. Structural adjustment (or microeconomic reform) is proceeding fast here too and due account must be paid to providing adequate levels of social protection to those adversely affected by rapid economic change. The estimates of non-receipt of benefit presented earlier suggest that there may already be holes in the Australian safety net.

It is important that this is understood by those who advocate rapid economic change whilst blandly asserting that those adversely affected by such change will be protected by the social safety net. The fact of the matter is that many of them won't be. Without more resources, the social safety net will strain and break under the increased burden placed upon it.

4.2 Adequacy and Incentives

Let me turn now from the trade-off between adequacy and take-up to that between adequacy and incentives. Here the issues are more familiar. Despite this, we still know far too little about people's knowledge of social security provisions, the

9 The possibility that benefit coverage is incomplete also underlines the need to make the actual coverage rate a variable in microsimulation models in order that they do not inadvertently divert attention away from the question of take-up.

factors which motivate them, and how these interact to turn theoretical discentives into actual behaviour. Again, we are not alone. As the International Social Security Association (ISSA) recently observed when reviewing world wide developments and trends in social security between 1990 and 1992;

> Other branches of social security have... also given rise to increased attention to the issues of dependence and incentives, namely unemployment and family benefits... one of the most striking aspects of this issue is how very little is as yet known or understood about what motivates individual human beings to continue to lead an active life in the labour market or to take-up income-producing activities. Research on incentives and disincentives in social security programmes still remains at a very embryonic stage in most countries. (ISSA, 1992: 12)

What is surprising about this is that if there is one thing we have learnt from our experience with past policies, it is that incentives are important and that, if due attention is not paid to them, their consequences have the potential to undermine, even to destroy, social policies (Gilbert, 1992).

The arguments and claims of Charles Murray may not have stood up to academic scrutiny, but few can deny that there is some truth in the proposition that social policies can have unintended, undesirable and counter-productive consequences if their effects on incentives are ignored entirely. The view that social policies can and do influence social and economic behaviour was, after all, the basis for much of the social engineering which characterised the Keynesian-Beveridge post-war welfare state consensus.

The issue of adequacy and incentives in relation to unemployment assistance has been canvassed recently by Gregory (1993b) and by the Industry Commission in its draft report on *Impediments to Regional Industry Adjustment* (Industry Commission, 1993). Gregory notes that earnings have fallen in real terms at the bottom of the wage distribution in Australia since the mid-1970s. He argues that this narrowing of the gap between income from work and income from government income support will inevitably increase pressures for real benefit levels to be reduced (although he casts serious doubt on the view that cutting benefits will cause much of a decline in unemployment). The Industry Commission report raises concerns about poverty and unemployment traps, although the Commission was precluded by its terms of reference from making any specific recommendations in these areas.[10]

There is certainly some truth in the view that the gap between benefits and low wages has narrowed, due to the fall in real wages at the bottom of the wage distribution. This in turn has caused the replacement rate to increase, offsetting the policy-induced decline in the replacement rate resulting from the extension of targeted family allowance payments to low-paid workers throughout the 1980s. The magnitude of the change does, however, need to be kept in perspective.

If, for example, we consider the distribution of the wage incomes of full-time single workers, the wage income of a full-time worker at the tenth percentile of the distribution in 1982 was almost two and a half times greater than the unemployment benefit rate for a single person aged 21 or over. By the end of 1990 the differential had fallen, but the tenth percentile wage income was still more than double the benefit rate. Similar calculations for couples indicate a decline in these ratios from 79 per cent in 1982 to 56 per cent in 1990.

These are rough and ready replacement rate estimates which take no account of income tax, of rent assistance, of family benefits or of the costs of working. On the other hand, 90 per cent of full-time wage earners have wage incomes higher than those assumed in these calculations. The essential point, however, is that no matter how sophisticated such calculations are, they indicate only the magnitude of the **incentives** which people face. What is more important is the extent to which labour force **behaviour** responds to these incentives and this, as noted earlier, is an issue about which we still know very little.

Nowhere is the trade-off between adequacy and incentives more acute than in relation to income support for the long-term unemployed. The basic problem here is how to provide additional income support measures to the long-term unemployed without at the same time creating perverse financial incentives for the short-term unemployed.

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10 It did, however, raise the issue of whether benefit uniformity can be justified when living costs differ so much across different regions. This is likely to be an issue of increasing importance in the context of labour market flexibility. The question of whether benefit adequacy should reflect geographical differences in living costs and thus over-ride the case for benefit uniformity, and if so how and with what consequences, are questions worthy of further investigation. An obvious mechanism for dealing with this is through changes to the way in which rent assistance is calculated.

What the increased incidence of long-term unemployment has done is expose the inadequacy of the levels of income support for the unemployed generally. Where unemployment is a relatively temporary phenomenon, low income can be adjusted to in ways which become increasingly difficult over time. Large bills eventually arrive which become harder and harder to pay. The deferment of falling living standards gradually becomes a reality, one which cumulates over time. As Cass noted in the Social Security Review Issues Paper on income support for the unemployed:

> ... after a prolonged period of unemployment people cannot afford to register or run a car. The telephone, too, may be given up because of cost. (Cass, 1988: 185)

The whole issue of benefit adequacy for **all** of the unemployed is thus in need of detailed investigation, including the provision of adequate incomes to meet the costs of working and of seeking work.

As already noted, the need for the social security system to adapt to broader sociodemographic and labour market changes was a major factor behind the work of the Social Security Review. Much has been achieved in this sphere since the Review was introduced. Two specific issues of continuing concern in this context are changing household structure and the increase in part-time work. The main changes in household structure over the last two decades include a reduction in family and household size, an increasing trend towards living alone, increasing numbers of sole parent families and, as a consequence, an increased incidence of blended families (ABS, 1992; National Housing Strategy, 1991). These trends, along with others like increases in tertiary education retention rates, early retirement and increased longevity are leading to more complex and fluid living arrangements.

4.3 The Unit of Analysis

These changes have important implications for the unit of analysis appropriate to poverty and inequality research and for the basis on which social security entitlements are determined. In research terms, the unit of analysis determines whose incomes are aggregated and assumed to be pooled for the benefit of all members. Household arrangements are also important, at least when the Henderson equivalence scale is used, because as noted earlier, per capita housing costs depend upon the total number of household members. The use of any equivalence scale which incorporates economies of scale in living arrangements will mean that results are sensitive to different income unit definitions, the degree of sensitivity increasing with the extent of household economies built into the equivalence scale.

The difficulties involved in determining how much income pooling takes place between related income units who live together has been recognised, for example in the exclusion of independent juveniles living with their parents from Henderson poverty estimates (Commission of Inquiry into Poverty, 1975; Saunders and Matheson, 1991). However, changing living arrangements are increasing the frequency of these problematic cases and, as the research of Harding and Mitchell has shown, different definitions of the unit of analysis and the use of different equivalence scales can make a great deal of difference to estimates of poverty (Harding and Mitchell, 1992; Harding, 1993).

Social security policy inevitably embodies certain assumptions about the extent of income pooling. Some have a long history - for example, the payment of benefits subject to a family (or income unit) income test - while others are of more recent vintage - like the application of a parental income test to younger recipients of job search and sickness allowance. Some practices, like the payment of family payments to mothers, sit somewhat uncomfortably with the assumption of income pooling within the income unit on which the family payments income tests is based. Other policies, the Child Support Agency being the best example, are not based on assumptions about income pooling but embody normative principles regarding how much income pooling should take place. Yet the whole issue of income pooling (or sharing) remains, Meredith Edwards' (1981) exploratory study aside, under-researched and desperately in need of intensive investigation.

Let me give one example of how important this can be in practice. In research conducted at the Social Policy Research Centre with George Matheson, we developed a set of consensual poverty lines from responses to questions asking people how much money they needed in order to make ends meet (Saunders and Matheson, 1992). We found, as have others who have applied this methodology overseas, that the consensual poverty line does not increase very much as the number of children in the family increases. If income is pooled within the family, this finding suggests that 'children are cheap' (Rainwater, 1990) or at least far cheaper than other estimates of relative need suggest (Buhmann, Rainwater, Schmaus and Smeeding, 1988; Whiteford, 1985).

An alternative explanation for our findings is, however, that parents with children forgo their own needs in order to ensure that their children's needs are met first. In other words, income is not pooled to the equal benefit of all members of the unit, but some (in this case the children) are given first claim on available resources. If this is a better description of what actually happens, then our estimates of inequality will be biased, and we may have overestimated poverty among **children** and under-estimated poverty among **parents** (although we may still have produced accurate estimates of poverty among **families** with children). I am not arguing that this **is** the case, only that it **might** be.

If it is, then we may need to re-think our social policies, particularly the balance between income support and non-cash social wage provisions. The benefits from assistance in the form of non-cash (social wage) service provisions are somewhat harder to shift on to someone else than those associated with income support. Put differently, it becomes more difficult for private redistributive mechanisms to frustrate the aims of public redistributive programs. In light of its importance, we need to look again at the whole issue of income sharing in the context of current housing and living arrangements.

4.4 Labour Market Change

The rapid increase in part-time work, and the associated increase in married women's labour force participation, are challenging the traditional basis of our social security system. The current system developed in a world in which only one family member (generally the male) worked and they did so full time. In contrast, there are now more two-income couples than single income couples in the prime age ranges (Saunders, 1993d) and almost 24 per cent of all jobs are part time. These developments are raising a number of questions for policy, including the grounds for providing income support to individuals of workforce age solely on the basis of their family situation. This involves a number of very complex issues which I cannot do justice to here. Instead, I want to focus briefly on the role and relevance of the income test in a world where part-time work is becoming increasingly prevalent.

Conventional wisdom has it that the existing income test discourages part-time work. I have never found this argument particularly convincing, first because there is little or no reliable evidence to support it, and second because of the observed growth in part-time work. In any case, if one were starting afresh and designing a new income support system for a world where part-time work was widespread, would one not end up with an income test not unlike the one we currently have, at least in terms of overall structure? One might well want a lower benefit withdrawal rate in order to enhance incentives, but this increases cost and it is this, rather than concern over incentives *per se* which has mitigated against such proposals in the past.

One might also want to distinguish two types of income test, one designed to achieve vertical equity amongst those who are not expected ever to leave the income support system again (the aged and permanently incapacitated) and another designed to facilitate return to the workforce for those whose reliance on income support is expected to be temporary. We currently have somewhat different income tests for these two groups, but I am not sure that we have anything approaching an optimal structure given the constraints we face.

The main problem with lowering the income test withdrawal rate for those of working age is that whilst it encourages those fully reliant on benefits to seek a part-benefit, part-income support income package, it also changes financial incentives so as to make the part-benefit, part-income support package relatively more attractive to those currently in full-time work. This in itself may be no bad thing, if the full-time jobs thus vacated by those who prefer to work part-time are available to be filled by beneficiaries who prefer to work full time.[11] Again, I think we need to know more about the characteristics of those who prefer part-time and full-time work at any point in time, what their preferences are, whether these are liable to change over time, and if so under what circumstances. If the majority of social security recipients want to return to full-time work, it may not make sense to reformulate the income test so as to encourage them to seek part-time work.

We also need to know a lot more about the **dynamics** of the adjustments through time from benefit to work and between alternative working arrangements. This is an area crying out for more data and research. Work and income decisions are made in real time and need to be conceptualised dynamically not in static terms. If this is done, the role of waiting periods and of benefit administration in facilitating changes in benefit-work combinations become central. These aspects, I suspect, are ultimately of more significance for labour market behaviour than the disincentives created by the income test.

4.5 Certainty and Stability

I want to finish with reference to two other goals of social security. Both have relevance in the 1990s in a context of continued upward pressure on poverty and inequality. They relate to the need to re-assert that the basic attribute of any social

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11 It is interesting to note that while about 24 per cent of all those currently in employment are working part-time, only about 15 per cent of the unemployed are looking for part-time work (ABS, *The Labour Force, August 1993*, Catalogue No. 6203.0).

security system is that it provides **certainty** of income support and **stability** for those adversely affected by economic change or other contingencies. This is all the more important in a world increasingly characterised by deregulated international and domestic economic forces which expose more and more people to the risks and consequences of economic change.

Attempts to integrate into South East Asia will have fundamental effects on the Australian economy and we know from past experience that these will have implications for social policy. More thought needs to be given to what these changes are likely to be and how best to respond to them. They seem, at the very least, likely to keep issues associated with low wages, labour costs and labour market flexibility - all of which have implications for social security policy - very much on the agenda. And they will be taking place in a context in which two of the pillars of social protection in Australia, centralised wage determination and tariff protection, are slowly being dismantled, putting further pressure on the social security system.

After almost four decades of almost no reform, the period since the mid-1980s has been characterised by rapid and fundamental change in social security policies and programs. In current circumstances further reforms seem likely. In pursuing these, it is important that the certainty of support which is critical to the system achieving its basic social protection role is not undermined.

When even the experts have difficulty keeping abreast of the changes in policy, one can but wonder what confusion and uncertainty they spread amongst those receiving or applying for benefit. The social security system must adapt to social and economic change, but it must do so in ways which do not undermine its role in providing the protection which minimise the consequences of social change and make the necessary economic changes **politically** acceptable.

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