

Self-Employment and Social Security

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SELF-EMPLOYMENT AND SOCIAL SECURITY

by Tony Eardley and
Bruce Bradbury

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Foreword

Changes in the structure of the labour market in Australia over the last few decades have seen an increasing proportion of the population becoming self-employed. At the same time, the nature of self-employment itself has also been changing. The nature of these trends is explored in this report, in both a national and international context. Such an analysis must take into account the difficulties inherent in producing an accurate, effective and operational definition of what constitutes self-employment. Once this has been addressed, it needs to be acknowledged that the changing situation has many implications for social security policy and for the administration of social security regulations.

Against this background, the Department of Social Security commissioned the Social Policy Research Centre to review evidence about the relationship between the incomes and living standards of self-employed people. The review has been carried out using data from many sources including Australian Bureau of Statistics surveys and the administrative records of the Department of Social Security.

The research reported here indicates that while the incomes of families with a self-employed member are sometimes difficult to establish and the extent of their resources equally so, some self-employed people are experiencing insecurity and that being self-employed is not always profitable. These problems present challenges for a social security system designed to reflect changing labour market realities. The most important of these are described and discussed in the report, which ends by canvassing some possible policy reform options in the family assistance area.

Since its establishment in 1980, research conducted at the Social Policy Research Centre has reflected the importance of questions relating to incomes and living standards, and the design of social policy in the area of social security administration. The research reported upon in this publication is in that tradition and will hopefully contribute to the development of appropriate social security policies directed towards the well-being of the growing numbers of self-employed people in Australia.

Peter Saunders
Director

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1 Introduction and Summary

1.1 Background

During the last two decades most industrialised societies have experienced important changes in the nature of work and the structure of labour markets. One of the key components of this change has been the growth of so-called 'atypical' or 'non-standard' work (Blackwell, 1994). Atypical work may be defined as that which deviates from the traditional model of full-time, permanent, waged employment outside the home (Campbell, I., 1991), thus encompassing part-time, temporary, contracted and franchised work, as well as much of that carried out from the home. The movement towards non-standard working patterns is also associated with the growing participation by women in the labour force. Indeed, it can be argued that many of these employment patterns are not atypical at all for women; what has changed is that more women are in the labour force and an increasing proportion of men are also experiencing non-standard work.

Alongside and linked with the growth in atypical employment has been a widespread resurgence of self-employment - a form of work which in a number of countries had previously been in long-term decline (Bogenhold and Staber, 1991). Australia has always had a relatively high level of self-employment, associated partly with its strong agricultural sector (Covick, 1984), but here too there has been a noticeable increase in work classified as 'in own business' (including both sole person self-employment and small employing businesses) (Castles, 1993; VandenHeuvel and Wooden, 1994).

The resurgence of self-employment has brought challenges for social policy. Traditionally the self-employed have tended to be viewed as intrinsically independent of state support (unless it comes through some form of business subsidy or fiscal concession). Whether they are farmers, independent professionals, artisans or small business owners, the self-employed have been regarded sociologically as a *petit bourgeois* grouping whose claim to independence brings with it an assumption of self-provisioning and self-reliance. However, the resurgence of self-employment has undermined the perspective which sees the self-employed as a unitary grouping, as there is evidence from a number of countries that a substantial part of the increase has not come in traditional kinds of independent enterprise. Rather it has been in forms of 'quasi-self-employment' or 'disguised employment' (Rainbird, 1991) which have been encouraged by governments' attempts to foster enterprise as an alternative to unemployment, and by changes in employers' labour use practices. Even the most traditional self-employment can be insecure and relatively unprofitable, but many of the newer self-employed also lack the control over their work associated with

genuine independence (Eardley and Corden, 1996a). Often, especially in countries with insurance-based social security systems, self-employed people's access to social protection has been restricted because they are assumed to be able to provide for themselves. Such policies are, however, proving inadequate to deal with some of the new self-employed (Brown, 1994). Where self-employed people do have access to support based on a test of their resources, there can be administrative difficulties in establishing incomes, and some suspicion that incomes may often be under-reported.

In the Australian context there are a number of ways in which the employment status of applicants for social security benefits is of importance for the Department of Social Security. For payments which have activity tests, such as Jobsearch and Newstart Allowances, the determination of self-employment status is an important criterion for assessing whether individuals are unemployed and therefore available for other work. Similarly, for Sickness Allowance and Disability Support Pension, the requirement that recipients must not be able to work can exclude people who are running an on-going business. The question here is what levels of activity indicate that a self-employed enterprise is still trading.

Being self-employed is not an automatic barrier to eligibility for income support. Access to many payments is based on demographic characteristics (such as age) or on contingencies (such as caring responsibilities or disability). Also, for most social security payments the recipient's spouse may be employed without this affecting eligibility. In these cases engagement in work (whether employed or self-employed) by either spouse influences entitlement to payments via the operation of the means test: that is, on the basis of the combined income and assets of both spouses.

Doubts are often raised, however, as to whether the standard social security measures of income are the best way of targeting assistance to families containing self-employed people. Typically, self-employed people have a more complex variety of income arrangements than employees: their earnings may fluctuate over time; they may have access to various forms of non-cash resources; they may be sustaining losses and living on savings or bank overdrafts; and in smaller enterprises domestic and business economies may be closely intertwined. In general, the taxable income measure, even where modified under social security rules, may have a more attenuated relationship to immediate income needs than exists for other clients.

The complexity of income arrangements for some self-employed people is also reflected in the difficulties faced by staff in the Department of Social Security (DSS) and other Departments charged with assessing incomes. Thus self-employed cases often require greater expertise, take longer to process and may

impose higher compliance costs on the client. In some areas of administration, including those of family payments, there has also been a significantly higher level of overpayments and reviews of assessments in cases involving self-employed clients.

The main objective of this report is to review evidence about the relationship between incomes and living standards of self-employed people and to discuss the implications for social security policy and administration. Discussion of self-employment, particularly in relation to social security, has been limited in the Australian literature, so the report includes examination of basic data on the nature of self-employed work in Australia today and over the last two decades.

1.2 Structure of the Report and Summary of Findings

One of the difficulties with self-employment is that it is not always easy to define. Section 2 looks at the way self-employment is distinguished from waged work for different purposes, including for the administration of social security. Defining people as self-employed can depend on whether it is a question of their income source, the legal status of their business or their labour market status. In particular, the status of dependent contractors and directors of incorporated companies can be ambiguous. Survey distinctions, while apparently consistent, may not always reflect taxation status. DSS policy has normally been to follow Taxation Office practice in defining who it treats as self-employed, but there are some potential anomalies in the way it attempts to classify dependent contractors as employees.

Section 3 analyses trends in self-employment and discusses its significance in the Australian labour market. While there has been an increase in the importance of self-employment as an employment form, the growth has not been dramatic when seen against changes in employment as a whole or compared to some other industrialised countries. One of the main features has been the continuing decline of agricultural self-employment and the expansion of construction and services as areas of self-employment. The number of women entering self-employment over the last decade has been relatively high, but is less significant when seen as a proportion of all women joining the work force. Much, if not all, of the increase in the rate of self-employment can in any case be explained by industry shifts towards areas of work where self-employment is more common, although there are also suggestions that the growth in unemployment has pushed some people into forms of marginal self-employed work. At least a part of the overall increase is likely to have been in 'quasi-self-employed' sub-contracted work.

Individuals running a business using a company structure fall outside the definition of 'self-employment' as used here, but may otherwise be in very similar circumstances. Whilst there are very little data available on the numbers of people running such companies, the number of companies themselves has doubled over the past decade. The industry contributing the greatest amount to this growth has been the business services sector.

Section 4 uses Australian Bureau of Statistics (ABS) income survey data to examine the characteristics of individuals and households engaged in self-employed work. In 1990, self-employed people made up 15 per cent of the work force. Work of this kind is less common among people aged under 25 and more common among those over 60, both because of delayed retirement among small business owners and, possibly, because some retiring employees take up working on their own. Partly because of the older age profile, self-employed people are also more likely than employees to be married or cohabiting, and among them there is a strong correlation between the labour force status of husbands and wives. Self-employed people tend to work both longer and shorter hours than employees – with self-employed women sharply divided between those working less than 10 hours per week and those working over 50 hours. The self-employed as a whole tend to be less well qualified than employees, though a higher percentage of employers have tertiary qualifications. Self-employed women, however, tend to be better qualified than their male counterparts. As has been observed in many countries, the rates of self-employment tend to be higher amongst some migrant groups.

Section 5 discusses the overall objectives of means testing and how these relate to self-employment, both theoretically and within the practical administration of social security. There are several reasons why the self-employed might conceivably have higher living standards than wage earners with the same taxable income. These mainly stem from the difficulty of separating business from personal activities, and include additional opportunities for expenditure deductions and the ability to accrue income in other legal entities (such as trusts or companies). In particular, the fact that some people working in their own business might be able to accrue income in other entities may be a reason for the DSS to assess income in a different manner to the Taxation Office.

Current practice is for DSS to rely primarily upon assessable income from the previous tax year as the starting point for income tests. There are a number of alternative approaches that could be used. These depend upon whether an accruals or cash flow measure of income is used, and whether income is assessed for some past period, the present period or some future forecast period.

In 1990, families with the head or spouse working in their own business received a total of around one billion dollars in Social Security transfers. Section 6

describes the characteristics of these families, analysing administrative data on recipients of the higher rate of Family Payment and comparing waged and self-employed clients. Self-employed families with children of eligible ages were, in 1990, more likely than other eligible families to receive Family Allowance Supplement (FAS), but slightly less likely to be receiving Family Allowance only - possibly because of greater inequality in self-employment income. In September 1995, just over 30 per cent of recipients of Additional Family Payment (AFP) (Workforce) were self-employed or had a self-employed spouse, and a fifth of these were farmers.

Many of the clients with self-employed spouses appeared, at least formally, to be in business partnerships, since there was a strong correlation between client and spouse occupation. Nearly all the clients with self-employed spouses in agriculture were born in Australia, whereas a fifth of those with spouses in other forms of self-employment were born overseas, along with 17 per cent of clients with waged spouses.

Clients with self-employed spouses, especially those on the land, received average weekly AFP payments around 20 per cent higher than waged families, and this was not significantly affected by the relative size and composition of families. The discrepancies were mainly driven by differences in levels of combined taxable income, as assessed for the income test. Self-employed families, especially farmers, were also considerably more likely to be living in owner-occupied housing than were the employee families. Even where self-employed families were not in housing they owned, they were more likely to be living rent-free, but families in non-agricultural self-employment who were renting tended to have higher rents.

Section 7 pursues this question, drawing on information from a number of ABS household surveys to examine the living standards and patterns of income and expenditure of households supported by self-employed work. In the literature, one commonly reported feature is that the average incomes of the self-employed often appear low compared to their expenditures. This is confirmed in the data examined here. If the income/expenditure ratio of employee households is applied to the average expenditures of the self-employed, this implies a level of access to resources significantly higher than their recorded incomes.

In both 1988-89 and 1993-94 this under-recording was about one-third. In the first of these years, this conclusion is based upon expenditure as conventionally measured, whilst in the second year a more sophisticated weighted expenditure measure is used. However, some of this income discrepancy is simply due to the time lags in income collection in the ABS surveys. If this is corrected for, the income under-recording shrinks to between six and 11 per cent in 1988-89 and 30

to 34 per cent in 1993-94. The main reasons for the difference between the two years are that the estimate for the latter year is based upon a more sophisticated estimate of consumption and includes farmers, whilst the former does not (and the drought of the early 1990s may have led to atypical dissaving patterns). A 'best estimate' of the extent to which average (current) income understates the living standards of the self-employed falls somewhere between these two points.

When the focus is switched to low-income households, it appears that the self-employed have living standards some 11 to 15 per cent higher than employee households. However, this does not necessarily imply that there is less poverty among self-employed households. There is some evidence that expenditure poverty in the early 1990s was actually higher for the self-employed than for employees. The reason these two conclusions are not mutually exclusive is that there are significant numbers of self-employed who have low expenditures, but who also have recorded incomes (possibly from earlier years) which place them above the low income threshold.

A question more directly relevant to policy is whether self-employed recipients of family payments are as disadvantaged as employee families. In the ABS household surveys, it is possible to identify families receiving FAS in 1990 and AFP in 1993-94. In general, self-employed families receiving these payments are somewhat better off than employees, especially in terms of housing wealth, where the self-employed have significantly higher rates of home ownership, and also have slightly better housing quality. In addition, self-employed families receiving AFP tended to spend about 10 per cent more than comparable employee families.

These estimates of the relatively higher living standards of self-employed families need to be interpreted with some caution. Whilst self-employed family payment recipient families do score higher on housing wealth and other consumption, they also need to work much longer hours to obtain these benefits. Many self-employed families will be financing this higher consumption by running down their assets, or by going into debt.

Depending upon the goals of policy, the fact that this consumption might be financed by dissaving may or may not be relevant. It is easier for families who can use up savings or borrow to avoid poverty in the short term. Yet this forced dissaving may simply be leading to longer-term problems. Also, while there are substantial differences in housing tenure between self-employed and employee families receiving low-income family assistance, the estimates of current consumption are probably a more appropriate measure of current living standards. As noted above, the self-employed were estimated to have a 10 per cent higher level of consumption in 1993-94. Given the difficulty of targeting assistance to the needy self-employed, this extent of difference might be considered a targeting success.

The report concludes with a discussion of a number of policy options arising from the research as a whole. These include alternative ways of targeting assistance to self-employed people, such as the farm assistance model, variations on the Austudy Actual Means Test, and adjustments to the current system to prevent alienation of income and to make earnings more current. All of these options involve trade-offs between targeting precision, administrative complexity and compliance costs for recipients. It is difficult to assess the preferred balance between these goals without more detailed information on the nature of the business activities and organisation of DSS clients with business activity. Given the complexity of small business arrangements, the report concludes that it would be wise to consult widely within the sector before pursuing any new policy directions.

2 Defining Self-employment

As stated above, one difficulty with self-employment is in reaching a clear definition. The distinction between wage earning and self-employment may appear self-evident, but definitions can vary according to the purpose for which a distinction is being drawn. There are also areas of ambiguity which can affect individuals' status for tax and social security purposes. Conceptually, self-employment can be seen as first a question of *income source*, secondly of *legal status* and thirdly of *labour market status*. Different definitions may be based on one or the other of these, or on a mixture of them. We are concerned here principally with policy towards those whom the DSS defines as self-employed, but in addressing this question it helps to highlight the policy implications of alternative approaches.

2.1 Income from Self-employment

The framework for the national accounts essentially conceptualises self-employment income as the outcome of all production traded on the market, without the use of a legal entity such as a company, which is not wages or salaries, interest, rent or dividends. This income is described as that of 'unincorporated enterprises', so income deriving from small businesses which have a company structure is not counted. Income from partnerships, on the other hand, which do not have a separate legal status, is included as self-employment income. ABS household income data collections follow the same procedure, grouping income from private companies with wages, directors' fees, or income from shares, as appropriate.

The framework used by the Australian Taxation Office (ATO) is similar, in that it distinguishes 'employment income' (basically wages and salaries) from 'business income' (that derived from running a business or providing services, either alone or in a partnership) (CCH Australia, 1995). The test of whether an individual's tax assessment would be carried out by the section dealing with the self-employed is the presence of business income, which may represent only a small part of the individual's overall earnings. Thus, for example, an academic employed by a university may also set up a small consulting business or company from which he or she receives some self-employment income.

While tax law does not define a company on the basis of whether it is incorporated or not, the income accruing to incorporated company directors from the work of the business should not be taxed as self-employment income, but along with wages and salaries. This is consistent with arrangements in other

countries such as the United Kingdom, but it is not always unproblematic. In the UK, many directors of small companies with few or no employees tend, with some justification, to consider themselves as self-employed and thus attempt to enrol for taxation on this basis. In the early 1980s, for example, a special exercise carried out using the 1981 Census resulted in the reclassification of 300 000 directors who had described themselves as self-employed, reducing the total of measured self-employment by 13 per cent (Office of Population, Censuses and Surveys, 1984). The UK Inland Revenue also regularly reclassifies substantial numbers of directors for this reason.

It is arguable that directors who are in a position to set their own fees or to accumulate income within a business may be in a relatively advantageous position for taxation compared to both unincorporated business owners and wage earners (Boden and Corden, 1994). In Australia, until 1986-87, private companies failing to distribute a specified proportion of their after-tax income could be liable for an undistributed profits tax, but these rules no longer apply. While most self-employed people have significantly greater means of reducing assessable income than do employees, those operating through companies or trusts have particular opportunities in this respect.

In assessing income for social security, the DSS starts in general from taxation rules, though these are modified according to particular policy aims. How far current methods are appropriate for this purpose is discussed in more detail in Section 5.

2.2 Legal Status

Another area of ambiguity concerns whether people are 'genuinely' self-employed or actually dependent contractors. As was mentioned earlier, evidence from Australia and overseas suggests that labour market change and deregulation has led to a growth in contracting out of production and services which were previously carried out within firms (this evidence is usefully reviewed in VandenHeuvel and Wooden, 1994). Some of these contractors actually work for one main employer but may enjoy neither the autonomy of the genuine entrepreneur nor the legal protection and employer-provided benefits of the wage earner. Indeed, one of the attractions for employers in contracting out work is precisely that it reduces their employment on-costs (Dickens, 1988).

The evidence for the size of such a dependent contractor work force in Australia is uncertain, but it appears to have grown since the early 1980s and a recent estimate put it at between 6.8 and 7.5 per cent of the total work force (VandenHeuvel and Wooden, 1995). There is some debate as to whether the impetus for such change derives mainly from the demand or the supply side.

While such workers may lose entitlement to award wages, union representation, employment protection and superannuation, surveys suggest that many are satisfied with their circumstances. This tends to suggest that different working conditions, plus the opportunity to be treated as self-employed for taxation, may often be regarded as adequate compensation. Certainly the impact of sub-contracting on national tax revenues can be substantial: in 1992 the United States Inland Revenue Service estimated that around US\$2 billion of tax was lost as a result of misclassification of workers (Hulen et al., 1993).

The distinction between independent self-employed workers and dependent employees is based, in Australian law as in British law, on the legal construct of the 'contract *for* services' as opposed to the 'contract *of* service. Problems in clearly defining these concepts have led in both countries to substantial bodies of similar case law, and a series of tests or checklists have been developed to establish the degree of autonomy or dependence displayed in individual cases¹. In both countries it has been argued that the courts have failed to establish lasting or workable distinctions, leading to calls for the differences in treatment under law to be removed or for better protection for sub-contracted workers (Hepple, 1986; Leighton, 1986; Brooks, 1988; Stewart, 1992).

2.3 Labour Force Status

For the Census and the Labour Force Survey, the ABS distinguishes between wage and salary earners, employers and the self-employed. People who work for themselves are only defined as self-employed if their enterprise is not incorporated and does not employ anyone else (although it may be a partnership). The current terminology used to describe these people is 'workers on their own account'. Dependent contractors (with no company structure) would be included within this definition if they say they are working for themselves rather than for an employer². As VandenHeuvel and Wooden (1994) argue, this probably results in an underestimation of self-employment according to taxation status, as an unknown number of dependent contractors are likely to define themselves as

1 In Australia see, for example, *Performing Rights Society v. Mitchell and Booker Ltd* (1924), *Zuijs v Wirth Bros. Pty Ltd* (1955), *Narich Pty Ltd. v Commissioner of Payroll Tax (NSW)* (1983), *Stevens v Brodribb Sawmilling Co. Pty Ltd.* (1986), *Re Porter and Transport Workers of Australia* (1989), *Building Workers Industrial Union of Australia v Odco* (1991). The authors are grateful to Alex Heron for drawing our attention to these cases. Recently, an important case in the NSW Court of Appeal concerning couriers (*Vabu v the Commissioner of Taxation*) appears to have created considerable scope for employers to avoid employee on-costs and entitlements by hiring 'independent contractors' even where a company exercises a high degree of control over the performance of work.

2 This is indicated by a footnote to the actual LFS question.

employees. Employers, on the other hand, would not be classed as self-employed even if they only employed one other person, but are included within the broader category of people 'working in own business' (see, for example, ABS, 1993). Company directors should be classed as employees in the Labour Force Survey (LFS), because a question in the survey asks whether their enterprise is incorporated, though it is not clear how precise this distinction is in practice.

The ABS Household Income Surveys use the broad term 'working in own business' to include people running businesses with both limited liability structures (that is, companies) and unincorporated structures. Table 2.1 gives a breakdown of the employment status of employed individuals according to this definition in 1986 and 1990. The descriptions in bold are those which we adopt in this report.

Table 2.1: Labour Market Status of Employed People: 1986 and 1990

Status in Main Job	1986		1990	
	No. (000)	%	No. (000)	%
Working in Own Business				
Limited Liability Company				
(Company Directors)				
With Employees	189.3	2.7	282.6	3.7
Without Employees	116.3	1.7	144.9	1.9
No Company Structure				
(Self-employed)				
With Employees	315.0	4.5	333.3	4.3
(Employers)				
Without Employees	701.9	10.1	803.4	10.4
(Workers on Own Account)				
Unpaid Family Helper	26.0	0.4	20.4	0.3
Sub-total	1,042.9	19.4	1,157.1	20.6
Wage and Salary Earner	5,610.3	80.6	6,153.6	79.5
Total	6,653.2	100.0	7,310.7	100.0

Source: ABS Income Distribution and Income and Housing Surveys, unit record files.

It is possible that these data provide an underestimate of the number of people working in their own company, since the income survey questionnaires simply ask people if they worked 'for an employer for wages or salary' or 'in your own business'. People working in their own company but drawing a salary could legitimately say that they work for an employer (their company). On the other

hand, the 427.5 thousand people estimated to be working in their own company in 1990 is actually greater than the number of private companies with tax returns in 1990-91 (335.5 thousand) (ATO, *Taxation Statistics 1993-94*). This could be explained by incompleteness in the tax return data or by more than one company director (e.g. both husband and wife) recording that they work in their own business.

In addition, it should be remembered that, for all categories of employment, Table 2.1 only describes the main job of the person. An employee who also has some minor business activity would not be included in any of the own business categories described in Table 2.1.

For the purposes of this report we maintain the term 'working in own business' to include the directors of companies, but reserve the term 'self-employed' to cover only those, both with and without employees, in the unincorporated sector. This terminology is consistent with published labour force data and, at least in theory, with current tax treatment. Within the self-employed we distinguish between employers and 'own account' workers, who are sometimes known as sole traders. Unincorporated partnerships are also included as 'own account' workers.

Although it possible to make distinctions of this kind, the discussion above demonstrates that the notion of 'self-employment' is not straightforward. Circumstances will vary considerably even amongst those groups of people who are clearly and genuinely operating independent businesses, and the position of farmers is likely to be particularly different from that of other self-employed people. Yet there is also ambiguity in the definition of self-employment for tax and survey purposes. So how do definitions adopted by the Department of Social Security relate to these other distinctions, and are Departmental definitions consistent across payment types?

2.4 Labour Force Status and Social Security Payments

First, it should be noted that DSS adopts practices that are specific to particular payment types. These do not therefore amount to one single working definition of self-employment. For social security purposes, the need to distinguish between employed and self-employed applicants can occur either because of a need to treat *income* (or assets) in a special way in the means test, or because the *employment status* of an applicant may affect their eligibility for a benefit. References to the employee/self-employed divide occur throughout the Department's *Guide to the Administration of the Social Security Act* (1996), but the most explicit guidance is provided in the general section on determining rates of payment for pensions and allowances (Chapter 27), in the section on the administration of family payments (Chapter 17), and in that on Childcare

Assistance (Chapter 22). Guidance at a more detailed level than is contained in the Guide to the Act can also be found in the *Complex Assessment Technical Handbook* (DSS, 1994).

For family payments the Department currently needs to distinguish between wage earners and self-employed clients because notifiable events which trigger a review of payments are different for the latter group. Employment status is an issue also for Job Search Allowance (JSA) and Newstart, because unemployment is more difficult to define where people have been working as self-employed (Chapter 12 of the *Guide*). Similarly, employment status determines the type of income assessable for Childcare Assistance.

Although Parenting Allowance (PgA) and Maternity Allowance (MAT) do not have activity tests, employment status does have some relevance here too, as policy questions have been raised about whether families in which the main activity of both parents is self-employment should have access to a payment which is meant to be paid to a parent whose primary activity is caring for children.

Section 17.9001 states that a client's own occupational classification will be accepted in an assessment for family payments, but that sometimes it may be necessary for assessors to decide whether a client is employed or self-employed. Members of cooperative enterprises or those establishing new businesses under the New Enterprise Incentives Scheme are to be treated as self-employed (s.17.9600-9700). The guidance here makes a distinction between certain types of contractors and sub-contractors, who would not normally be regarded as self-employed, and 'independent service providers', who would. This is an important deviation from the LFS definition (and potentially from that of the Taxation Office), in that it attempts to avoid classifying as self-employed those who are 'dependent contractors'. The latter are defined as those who hire out their personal labour and are paid by the hour, by piece work, or on completion of an agreed task (s.17.9500). Examples given of such tasks include window cleaning, baby-sitting or general 'handyman' work (s.17.9501). It is suggested that people engaged in these forms of work are distinguishable from independent service providers because the former are subject to the hirer's supervision (s.17.9503), but if they employ someone else in the course of this work they should be treated as self-employed because they are employers of labour.

The guidance also offers interpretations of the meaning of salaries and wages, and of payments which are similar to salaries and wages (s.17.9200-9300). A client who receives fees as a director of a company is to be treated as an employee of the company (s.17.9400), so here the guidance follows the taxation practice.

Finally, the guidance deals with cases where low-income wage earners supplement their employed work with some part-time self-employed work, and *vice versa*. In deciding whether clients are to be treated as self-employed, assessors are advised to consider the following questions (s.17.9801):

- is the involvement in the business substantial?
- does the person invest capital but not time and effort?
- what is the person's main source of income and how important is the business activity in their overall income and tax arrangements?

In each case, if the person's self-employed activity is likely to cause taxable income to fluctuate (and thus affect Family Payment entitlement), they are to be treated as self-employed so that the notifiable event of a general income increase will apply.

Sections 27.8690-8696 of the *Guide* draw on the legal construct, referred to earlier, of the 'contract of service' and the 'contract for services', in order to advise assessors how to tell whether clients are independent contractors and, in particular, how to treat people working on commission. As in employment and taxation law, deciding factors include the degree of control over how, when and by whom a job is to be done; whether work is done as part of or for a business; and who owns the business premises, tools and equipment. Although this section is referring particularly to workers on commission, it could be argued that there is some inconsistency between this guidance and that offered in Chapter 17. There it mentions people like window cleaners as likely to fall into the non-self-employed dependent contractor grouping. Yet, since window cleaners generally own their own equipment and provide services for many different clients, usually to their own time schedule, they could be seen as independent according to these criteria. It is perhaps worth noting that in the UK, where the treatment of self-employed people for social security has also been the subject of research and policy interest, marginal workers of this kind make up a substantial proportion of the self-employed caseload of means-tested benefits for low-income families (Eardley and Corden, 1996a).

In order to establish eligibility for JSA or Newstart on the basis of unemployment, a self-employed person must be operating a business only on a small scale, and supplementary to rather than replacing wages, or must have invested only capital, rather than time and effort, in a business (s.12.254). They can also be regarded as unemployed if the business is a sub-contracting enterprise and they have no contracts. Here sub-contractors are included along with *other self-employed claimants* (our emphasis), who hire themselves and/or their equipment out for a particular job (s.12.255). It can also be possible in some

circumstances for the spouses of self-employed people to claim JSA on the basis that they are not involved in the business and are available for other work. Assessment staff working on self-employed or other complex cases, especially relating to unemployment benefits, can call on specialised help from Complex Assessment Officers based in Area Program Delivery Units.

Overall, while the Department broadly follows accepted taxation policy in defining who it regards as self-employed for the purposes of benefit entitlement, there are some points of ambiguity concerning dependent contractors - which indeed reflect the ambiguity which exists in other areas. There are likely to be cases where officers have difficulty in determining a client's employment status, and where different decisions might be made in similar circumstances.

2.5 Summary

Defining people as self-employed can depend on whether it is a question of their income source, the legal status or their labour market status. The distinction between being an employee or being self-employed is neither straightforward nor necessarily consistent. In particular, the status of dependent contractors and directors of incorporated companies can be ambiguous. Survey distinctions, while apparently consistent, may not always reflect taxation status. DSS policy has normally been to follow Taxation Office practice in defining who it treats as self-employed, but there are some potential anomalies in the way it attempts to classify dependent contractors as employees.

Bearing in mind the problems involved in defining self-employment, we now consider its significance as a form of work within the Australian economy.

3 The Growth of Self-employment

Despite the importance of self-employment in the Australian economy, there has been relatively little discussion in the literature about the circumstances and characteristics of the self-employed. Some data are available, however, about the trends in self-employment within different industrial sectors, from ABS labour force and household surveys and from a few special studies. In referring to self-employment here we include, as explained above, employers in unincorporated enterprises and people working on their own account, and some analysis is presented separately for these two groups.

In general, much less information is available about the circumstances of people working in their own business using an incorporated company structure. However, some data on private companies from the Australian Taxation Office are also presented in this section.

3.1 Aggregate Trends in Self-employment

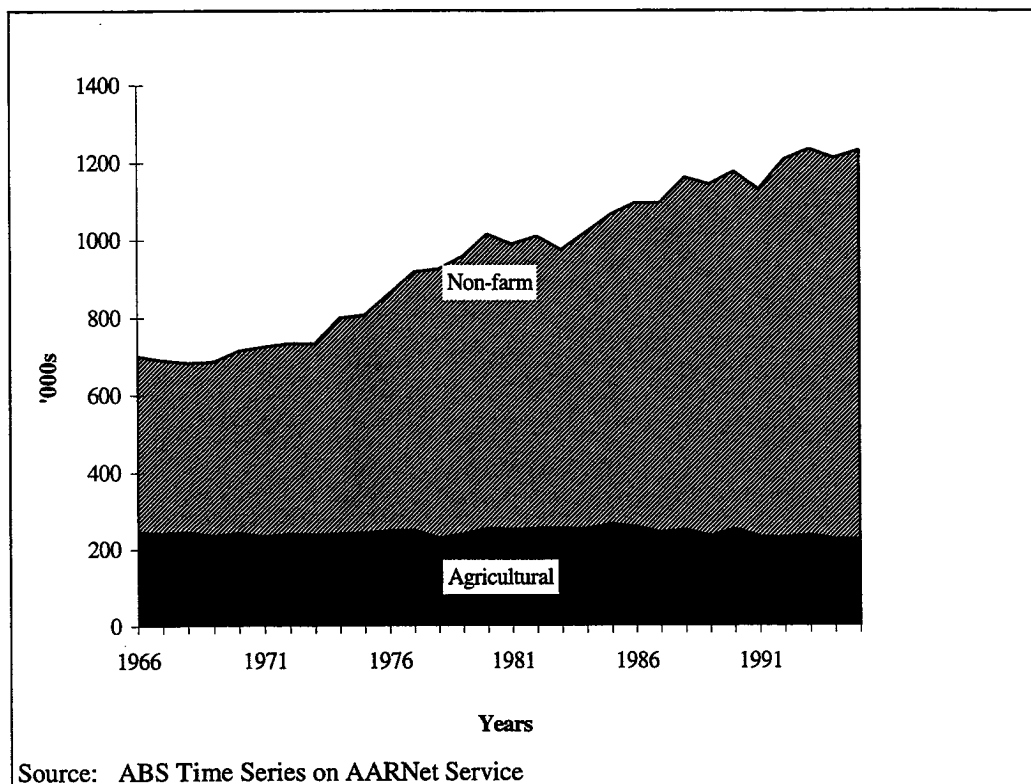
In the post-war period, the picture in Australia, as in many industrialised countries, was one of stagnation or decline in self-employment up until the late 1960s or early 1970s. In 1949-50 there were some 648 000 people recorded as employers or self-employed, representing 19 per cent of the employed work force (Foster and Stewart, 1991). Over the next 20 years there was some small numerical growth, but by 1969, self-employment made up only 15 per cent of all employment. It was not until around 1970 that the increase in this form of work began to take off. Figure 3.1 shows the overall trend in self-employment over the past 30 years.³ Between August 1966⁴ and 1995 the total number of self-employed people rose by just under 76 per cent, from 701 000 to 1 230 000⁵.

The growth has not been steady: year to year rises have varied considerably and the total actually fell between 1980 and 1981, between 1982 and 1983, between 1990 and 1991 and again between 1993 and 1994. Between-year changes also conceal substantial quarterly variations, though these are likely to be partly the

3 It should be noted that there have been changes over the years in survey definitions of self-employment which make trend data not altogether consistent.

4 The first year for which a Labour Force Survey was carried out in its present form.

5 This does not include unpaid family helpers. Until 1986 those working less than 15 hours per week were not counted as being employed at all. Exclusion of this group affects the overall self-employment rate, but not to a significant extent.

Figure 3.1: Self-employment: August 1966 to 1995

result of sampling errors. Figure 3.1 shows that agricultural self-employment has not followed the overall pattern of growth but has registered a slow decline since the mid-1980s.

The revival of self-employment began earlier in Australia than in most other industrialised countries. There are some difficulties in making accurate international comparisons because of differences in national approaches to classifying the borderline self-employed, such as sub-contractors, company directors and people working very few hours. Nevertheless, data collected by the Organisation for Economic Cooperation and Development (OECD) indicate that in the 1970s most countries saw a continuation of the long-term trend away from self-employment, whereas Australia, and to a lesser extent the USA, were. More recently, from 1979-1990, the non-agricultural self-employment rate barely exceptional in experiencing relative growth between 1973 and 1979 (Table 3.1). shifted in Australia, whereas in 12 other countries for which there was information it increased - most notably in Portugal, Sweden and the UK.

Table 3.1: Non-agricultural Self-employment as a Percentage of All Civilian Employment, OECD Countries: 1973 to 1990

	1973	1979	1990
Australia(a)	9.5	12.4	12.4
Austria	11.7	8.9	6.4
Belgium	11.2	11.2	12.9
Canada(a)	6.2	6.7	7.4
Denmark	9.3	9.2	7.2
Finland	6.4	6.1	8.8
France(a)	11.4	10.6	10.3
Germany	9.1	8.2	7.7
Greece		32.0	27.2(d)
Ireland	10.1	10.4	13.3
Italy	23.1	18.9	22.3
Japan(a)	14.1	14.0	11.5
Luxembourg	11.1	9.4	7.1
Netherlands(a)		8.8	7.8
New Zealand(a)		9.5	14.6
Norway(a)	7.8	6.6	6.1
Portugal	12.7	12.1	18.5
Spain	16.3	15.7	17.1
Sweden	4.8	4.5	7.0
Turkey	27.6
United Kingdom(b)	7.3	6.6	11.6
United States(a)	6.7	7.1	7.6
Mean(c)			12.4

- Notes:
- a) Excluding owner-managers of incorporated businesses
 - b) Excluding some owner-managers of incorporated businesses
 - c) Only for countries for which data are shown
 - d) 1989

Source: OECD (1992), *Employment Outlook*, Tables 4.1 and 4.2.

As in other countries, a majority of the self-employed in Australia are men and nearly two-thirds have no employees. Table 3.2 shows the percentage changes in all self-employment in Australia over five year periods, by sex, but also according to whether those involved had employees or worked on their own. Both these dimensions make a significant difference to the overall profile of change in the self-employed sector.

Table 3.2: Percentage Changes in the Numbers of Self-employed People With and Without Employees: 1966 to 1995

Year (August)	All persons		Men		Women	
	With employees	Without employees	With employees	Without employees	With employees	Without employees
	Percentages					
1966-71	-6	11	-11	8	18	22
1971-76	9	26	6	22	18	22
1976-81	10	27	6	22	18	41
1981-86	0	17	-3	15	8	21
1986-91	0	8	-1	1	2	12
1991-95	10	9	10	10	9	5
1966-95	23	117	3	86	115	240

Source: ABS, various years, *Labour Force Survey*, Catalogue Nos 6203.0 and 6204.0.

The table shows that the rate of change varied substantially over different periods. Female self-employment increased much faster than that of men, though from a much lower base. This was true both of female employers and those working on their own, but the changes in the number of employers of both sexes were smaller and less consistent than for the 'own account' workers. Although men have continued to dominate the sector, women's share of self-employment grew from 19 per cent in 1966 to 31.4 per cent in 1995.

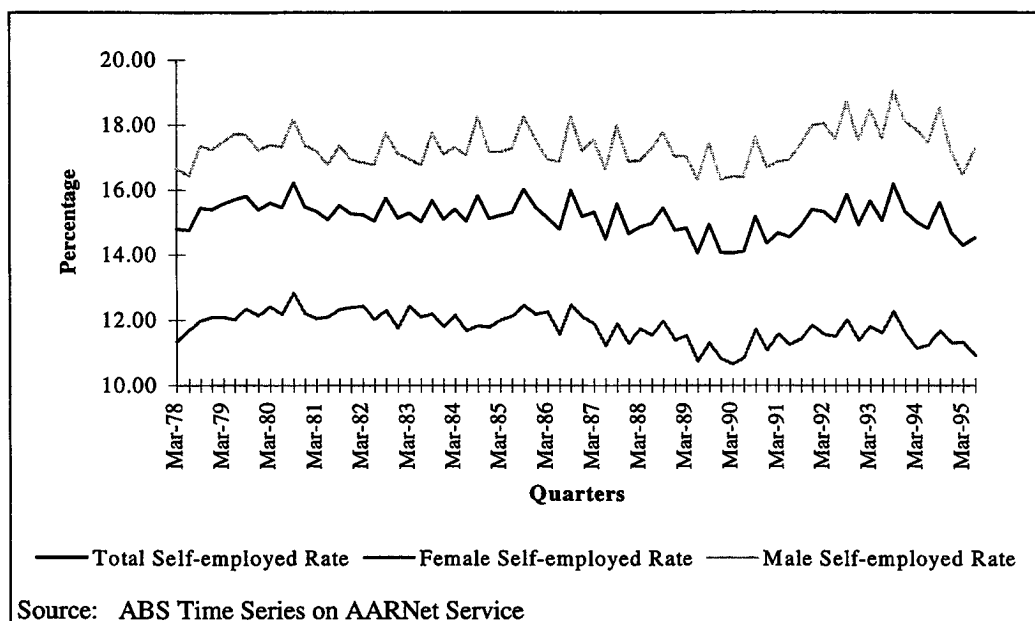
The growing participation of women in small businesses and other forms of self-employment in the 1980s generated a number of special studies looking at their motivations, their success rates and the obstacles they faced when trying to start a small enterprise. In addition to the desire for independence and autonomy, which women share with many male entrepreneurs, reasons for choosing self-employment were found to include flexible hours, making it easier to combine work and family responsibilities, discontent with career opportunities in employment, and the fact that women were increasingly becoming the main economic providers in families (Department of Industry, Technology and Commerce, 1991). Obstacles included lack of training, problems in access to capital, and discrimination by financial institutions, such that women have often had to use savings rather than borrow (Victorian Women's Consultative Council, 1988).

Although the growth in self-employment since the 1960s appears remarkable, seen in the context of changes in labour market participation as a whole it is less

dramatic. The rate of self-employment, measured as the number of people in self-employment as a percentage of all those in paid work, was in fact only a little higher in August 1995 than in 1966 (15.1 per cent compared with 14.7 per cent). This is because the total number of people entering the paid labour market also increased substantially over the period. Johnson, Manning and Hellwig (1995), in their study of trends in income inequality, have suggested that the number of self-employed grew much more rapidly between 1982 and 1994 than that of employees, but this only applies to 'own account' workers without employees. Once employers are included, the rates of change were virtually the same.

Figure 3.2 shows the quarterly fluctuations in the self-employment rate as a whole, and for men and women separately, since 1978. It is noticeable that while the movement in the rates tend broadly to mirror each other, the overall trend for women since 1980 has, if anything, been slightly downwards, in spite of the substantial numerical increase noted above. The reason is that women have been entering waged and salaried employment even faster than they have been taking up self-employment. This is illustrated by Figure 3.3, which shows the growth in women's share of both self-employment and waged employment.

Figure 3.2: Rates of Self-employment: 1978 to 1995



We can see what has happened to self-employment as a whole compared to waged employment by plotting the changes over time to an index of 100 (Figure 3.4). From the late 1970s a gap opened up between the two forms of work, but

Figure 3.3: Women's Percentage Share of Self-employment and Waged Employment: 1978 to 1995

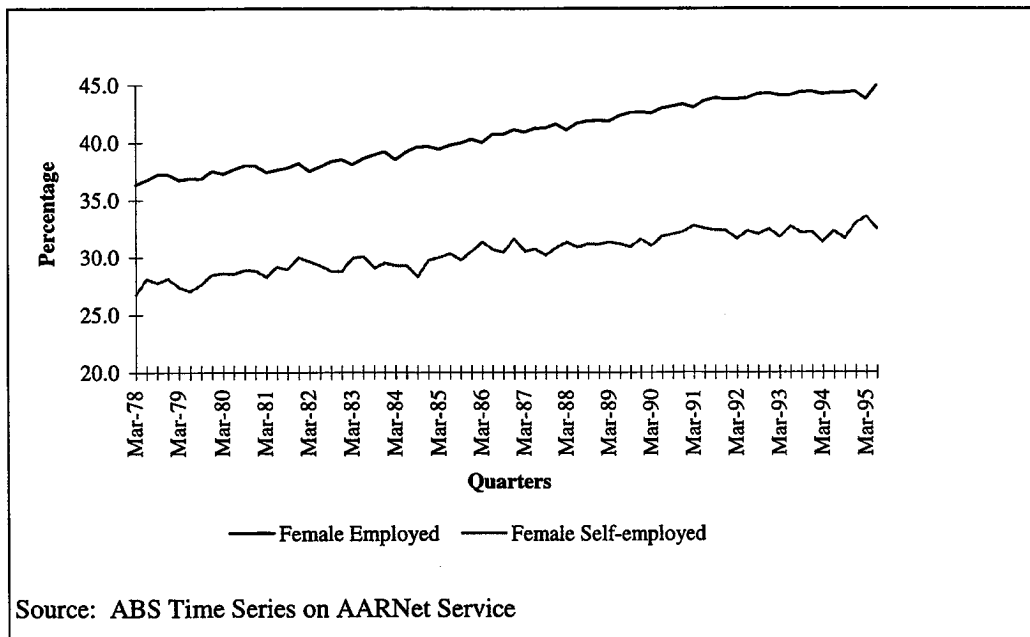
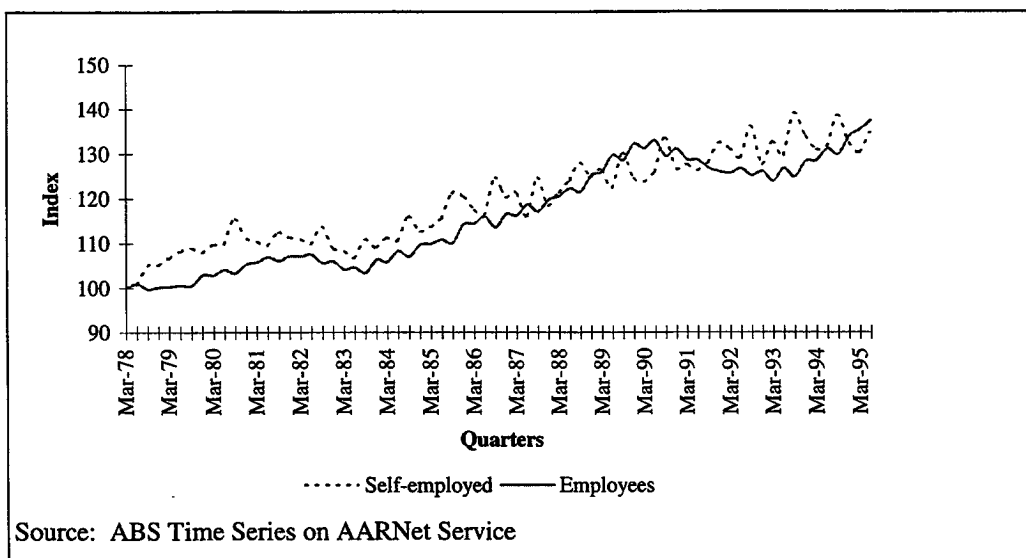


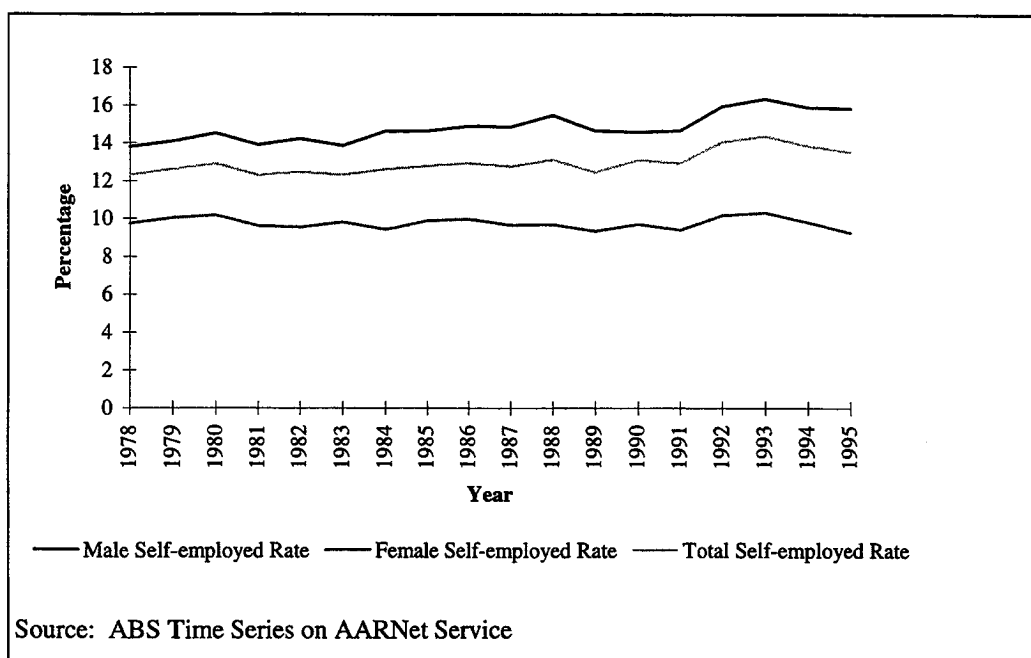
Figure 3.4: Growth in Self-employment and Waged Employment: 1978 to 1994 (1978 = 100)



after 1981 the two lines followed each other fairly closely, including during the recession of 1982-83, until the late 1980s when job growth overtook the growth in self-employment. The recession which began in 1990-91, however, saw self-employment continuing to rise as waged employment dropped.

It was pointed out earlier that self-employment on farms and in agriculture generally has been declining as a proportion of all employment. A disproportionate amount of work within agriculture is carried out as self-employment, however, so if farming is excluded the rate of self-employment changes. Much of the most rapid increase in non-farm self-employment took place between the late 1960s and the late 1970s, with the rate increasing from just under 10 per cent to just over 12 per cent over the decade. Over the next ten years it fluctuated by less than one percentage point in either direction, until 1992-93 when it peaked at just over 14 per cent and then fell back to 13.5 per cent in 1995. Figure 3.5 illustrates the relative movement in non-farm employment by sex since 1978.

Figure 3.5: Non-agricultural Rates of Self-employment: August 1978 to 1995



The data described above are measures of the stock of self-employment at a given time, but the stock is made up of the net effect of the flow in and out of self-employment. Increases are the result of the in-flow consistently outstripping the out-flow, which may still be considerable. The study of flows in and out of self-

employment is interesting in that it can indicate changes in the origins and destinations of participants over time. It is also useful to be able to examine the characteristics of people whose attempts at working for themselves are short-lived or are more successful. Research in the UK, for example, found that flows in the 1980s were particularly dynamic compared to other European countries, and that women and younger people both had higher entry and exits rates than other groups: an indication of the difficulty many will have had in surviving financially (Meager, Court and Moralee, 1994).

To our knowledge, no detailed flow analyses of self-employment have been carried out in Australia, but some data on quarterly flows were collected for a comparative analysis by the OECD. This showed that in the quarter from August to November 1991, 57 per cent of those entering self-employment in Australia came from waged or salaried employment, just under 10 per cent from unemployment, 26 per cent from outside the labour force and eight per cent from being unpaid family helpers (OECD, 1992, Table 4.8). The destinations of people exiting self-employment were broadly similar, although a slightly higher proportion became unemployed (11 per cent) or went into waged work (61 per cent). Blanchflower and Meyer (1992) looked at employment transitions for young people, using the Australian Longitudinal Surveys of 1985 to 1988, as part of a study comparing young entrepreneurs in Australia and the USA. They found higher levels and greater continuity of self-employment among young people in the former than in the latter country, but their research did not examine flows in any detail.

Rounding off this overview of Australian self-employment growth, it is important to consider the situation of people managing small companies. For many people, the decision whether to use a sole trader, partnership or company structure may have little to do with the structure of their business, but depend upon administrative and taxation rationales. Some information on the relative importance of these different entities is shown in Table 3.3. This table is derived from taxation data and shows the number of private companies, the number of individuals with business income, the number of individuals with partnership or trust income and the number of partnerships and trusts.

In 1993-94, partnership or trust structures were the most common entity, followed by people receiving business income directly, and then by private incorporated companies. It is interesting to note that the total number of people with partnership, trust or business income in 1993-94 was much higher than the numbers of 'own account' workers shown in Table 2.1 (2.58m vs 1.14m). Apart from the different year, this is due to double counting of people with both business and partnership income, trusts unrelated to business activity, and people with business or partnership income who are still mainly employees.

Table 3.3: Selected Small Business Statistics: 1993-94 Relative to 1983-84

Type of Entity	Number in 1993-94 (000)	Relative to 1983-84 Numbers
Private companies	426.6	2.00
Individuals with some net business income or loss	830.1	1.78
Individuals with some net partnership or trust income or loss	1,749.0	1.24
Partnerships and trusts	889.4	1.04

Source: Australian Taxation Office, *Taxation Statistics* 1992-93 and 1993-94.

Whilst company structures are the least popular structure for people working in their own business, they appear to be growing strongly in popularity. The last column of Table 3.3 shows that over the ten years up to 1993-94, the number of private companies with tax returns doubled, whilst the number of individuals with business income increased by 78 per cent, and the number of individuals with partnership or trust income increased by 24 per cent and the number of partnerships and trusts by only four per cent.

By way of contrast, Figure 3.1 shows that, as measured in the Labour Force Survey, self-employment grew by only 27 per cent over this same period. It is possible that some of the discrepancy between the self-employment growth shown in Figure 3.1 and the higher rate of growth in business income in Table 3.3 is a result of the labour force reporting issues raised by VandenHeuvel and Wooden (1994). That is, some of the increasing number of dependent contractors may be reporting to the Labour Force Survey that they are employees, but reporting their income to the taxation office as business income. On the other hand, this discrepancy could represent a greater number of employees having some additional business incomes.

3.2 The Distribution of Self-employment by Industry and Occupation

Although self-employment encompasses a wide range of occupations, it is mainly clustered in a few industrial divisions, particularly construction, agriculture, retail trade, and property and business services, which together account for two-thirds of the total. Table 3.4 shows the percentage distribution of self-employment by industry in August 1995. As would be expected, this is differentiated by sex, so

Table 3.4: Percentage Distribution of Self-employment by Industry: August 1995

Industry	All Persons	Men	Women
	Percentages		
Agriculture, Forestry and Fishing	18.4	18.0	19.1
Mining(a)	0.2	0.3	-
Manufacturing	5.8	5.9	5.6
Electricity, Gas and Water Supply(a)	-	-	-
Construction	19.2	24.1	8.4
Wholesale Trade	3.5	3.0	4.5
Retail Trade	16.7	14.5	21.5
Accommodation, Cafes and Restaurants	3.1	2.6	4.6
Transport and Storage	5.6	7.0	2.6
Communication Services(a)	1.0	1.0	1.0
Finance and Insurance(a)	0.8	1.0	1.0
Property and Business Services	12.1	12.2	11.9
Government Administration and Defence(a)	0.1	0.1	0.1
Education(a)	1.5	0.8	3.0
Health and Community Services	4.5	2.8	7.6
Cultural and Recreation Services(a)	3.0	2.8	3.4
Personal and Other Services	4.5	3.8	6.2
Total	100	100	100

Note: a) Subject to sampling variability too high for most practical use

Source: ABS, *The Labour Force Australia*, Catalogue No. 6203.0

that women have higher concentrations than men in retail trades and accommodation and catering, as well as in the areas of education, health, cultural and other personal services, but lower levels in construction and transport.

The increases in self-employment discussed above have not taken place evenly across all industrial sectors. The decline in agricultural self-employment has already been noted, but there are other sectors too which have not reflected the general upward trend. Table 3.5 shows the numerical and percentage changes by industry since 1985-6.

A number of points can be observed from this table. First, of the 128 000 increase over the reference period, nearly half was in female self-employment. This came particularly in the areas of health, education, and recreational services, along with property and related business services, but also included a relatively large expansion in non-traditional areas of women's work, such as construction. Many women, however, work in family businesses or partnerships with their husbands,

Table 3.5: Changes in Self-employment by Industry and Sex: 1985-6 to 1994-5(a)

Industry	Men (000)	Women (000)	Total % (rounded)
Agriculture, Forestry and Fishing	-37.8	-6.0	-17
Mining	0.9	0.3	57
Manufacturing	7.0	7.9	27
Electricity, Gas and Water Supply	0.1	0	-
Construction	42.9	5.7	29
Wholesale Trade	-0.2	1.7	3
Retail Trade	1.0	1.9	1
Accommodation, Cafes and Restaurants	3.1	1.6	15
Transport and Storage	-2.4	0.4	-2
Communication Services	5.9	1.4	197
Finance and Insurance	-0.5	-0.1	-4
Property and Business Services	29.5	20.1	56
Government Administration and Defence	0	0.1	0
Education	3.1	2.5	54
Health and Community Services	1.2	16.0	56
Cultural and Recreation Services	2.5	3.9	56
Personal and Other Services	11.1	3.6	31
Total	67.4	61.0	12

Note: a) To take account of quarterly fluctuations, figures are based on averages for four quarters (December - September)

Source: ABS Time Series on AARNet Service

and these individual data do not reveal the extent to which women are actually involved in the businesses or how far their classification results from tax-splitting opportunities.

The property sector was also a strong area of growth for men, but the key area of expansion for them was in construction, while the agricultural sector experienced a substantial decline. The overall percentage changes by industry are slightly misleading, as they depend on the size of the original base, but it is interesting to note only marginal changes in the wholesale and retail trade area and a big expansion (from a small base) in communications.

In Table 3.6, comparable growth rate data is presented for incorporated companies. Data is only available for both private and public companies combined, but since over 90 per cent of Australian companies are private this does not alter the results significantly. Between 1984-85 and 1993-94, the number

Table 3.6: Growth in Company Numbers: 1984-85 to 1993-94

Industry	1984-85 (000)	1993-94 (000)	Ratio	Difference (000)	Percentage of Growth %
Primary Production	6.9	13.9	2.00	6.9	3.5
Mining	1.3	3.5	2.65	2.2	1.1
Manufacturing	23.5	35.8	1.52	12.3	6.2
Electricity, Gas and Water	0.1	0.5	9.77	0.5	0.2
Construction	18.3	44.5	2.44	26.2	13.3
Wholesale and Retail Trade	47.2	69.1	1.46	21.9	11.1
Transport and Storage and Communication	9.0	17.2	1.92	8.3	4.2
Finance, Insurance etc	122.5	223.6	1.83	101.1	51.4
Health, Education and Welfare	8.4	22.3	2.65	13.9	7.0
Entertainment, Recreation Restaurants, Hotels and Personal	12.4	23.0	1.86	10.6	5.4
Not Stated and Other	13.4	6.3	0.47	-7.1	-3.6
Total	262.9	459.8	1.75	196.9	100.0

Note: Table is based upon numbers of private and public companies combined. Private companies comprised 90 per cent of all companies in 1984-85 and 93 per cent in 1993-94.

Source: Australian Taxation Office, *Taxation Statistics* 1984-85 and 1993-94.

of Australian companies grew by 75 per cent, or almost 200 thousand. Over half of this growth was contributed by companies in the finance, insurance and business services sector. Of this, half the growth was accounted for by 'other business services'.

Returning to self-employment proper, we have seen how rates of self-employment are affected by changes in employment as a whole. A further question is how far the observed changes in the rate of self-employment are influenced by changes in the industry mix across the whole economy. A shift in the distribution of employment as a whole towards industries with higher rates of self-employment will tend to increase the self-employment rate and *vice versa*. This effect is examined in Table 3.7. We use a simple shift-share analysis for the period between 1985, when the growth of non-farm self-employment was more or less tracking the increase in waged and salaried employment, and 1994, when the two trend lines had diverged and self-employment peaked.

Table 3.7: Shift-share Analysis: The Effect of Shifts in Employment Between Industries on the Total Non-agricultural Self-employment Rate: 1985 to 1994(a)

	Men	Women	All
1985 rate of self-employment	13.8	9.7	12.2
1990 rate of self-employment	13.7	9.0	11.7
Increase/decrease	- 0.1	- 0.7	- 0.5
of which:			
Industry shift effect ²	0.5	0.2	0.5
Residual	- 0.6	- 0.9	-1.0
1994 rate of self-employment	15.3	9.5	12.8
Increase/decrease (from 1990)	1.6	0.5	1.1
of which:			
Industry shift effect(b)	1.4	0.6	1.0
Residual	0.2	- 0.1	0.1

- Notes: a) Based on mean for quarters December 1984 - September 1985 and December 1993 - September 1994
- b) The change in the overall self-employment rate that would have occurred if the self-employment rates within each industry had remained unchanged from the previous period.

Source: ABS, *Labour Force Surveys*, Catalogue No. 6203.0.

The table suggests that between 1985 and 1990 the overall self-employment rate fell in spite of an industrial shift in favour of sectors where self-employment tends to be more common, indicating a reduction in the propensity to work for oneself. Between 1990 and 1994, most of the overall increase (and more than the actual increase for women) can be explained by this continuing shift in the industrial mix.

3.3 Why Has Self-employment Increased?

Although the growth in self-employment in Australia in recent years has not been dramatic in relation to employment as a whole, or in comparison to some other countries, there is nevertheless a question as to what has driven the changes which have taken place. Although the overall trend since the late 1970s has been upward, views on the likelihood of continued growth depend partly on what are accepted as the explanations for past increases.

Covick (1984) attempted an econometric analysis of the reasons for self-employment growth in the period between the late 1960s and 1980-81. He put

forward two main hypotheses. The first was that the increases could be explained in terms of a 'market equilibrium' model. In this model, developments which could have increased the equilibrium level of self-employment include:

- increases in the level of returns from output in the unincorporated sector;
- shifts in technology favouring the employment of labour in the unincorporated sector;
- shifts in preferences in favour of non-pecuniary aspects of self-employment;
- shifts in the relative tax burden favouring self-employment; and
- a shift in lending policy favouring employment in the unincorporated sector.

The second hypothesis posited a 'disequilibrium' model, in which shifts in self-employment levels were related to problems in the employed labour market and consequent levels of unemployment. According to this theory, self-employment should tend to increase in times of recession when jobs are scarce and decrease when employment is rising again, so that 'the self-employed can be expected to play a role in Australia's labour markets similar to that played by the pool of discouraged workers' (Covick, 1984: 107).

Using data on the gross operating surpluses of unincorporated businesses over the period, Covick argued that the evidence did not support the first two elements of the equilibrium hypothesis, since relative incomes of the self-employed had been declining since 1972-3. The tax burden element is particularly difficult to disentangle from the income question because increases in taxation may lead to extra efforts at tax minimisation by the self-employed, but the income evidence does not intrinsically rule out any of the last three possibilities. Covick suggested that both the income and employment data were consistent with the disequilibrium hypothesis. Figure 3.6, which includes data for years beyond those examined by Covick, provides only partial support for this view. Once seasonal fluctuation and sampling errors are accounted for, there appears not to have been a significant increase in self-employment in the 1982-83 recession, when unemployment reached exceptional levels. Self-employment did continue rising, however, in the early 1990s, when recession hit again and unemployment climbed back to 11 per cent.

Covick (1996) has returned to this question in a recent paper which elaborates the argument that part of the increase in the rate of self-employment represents 'disguised unemployment'. This occurs where people opt for low productivity

self-employment 'as a fall-back response to the existence of excess supply and supplier rationing in the employee-status labour market of their preferred employment strategy' (Covick, 1996: 16). Data presented from the national accounts on incomes from self-employment between 1982-83 and 1993-94 tend to support this argument, since while change has varied over different periods the growth in mean self-employed incomes appears to have lagged behind that of wages. However, as Covick notes, there are difficulties with measuring income from self-employment and the data can also be read as supporting other explanations.

The theory that many of the newer self-employed are refugees from unemployment has been the subject of considerable attention in a number of countries. Various attempts have been made to construct a robust macro-economic relationship between self-employment and the business cycle in different economies over time which would allow some accurate prediction of future trends, but these have had only limited success.

Broadly speaking, the argument is that the expansion of self-employment and small enterprise generally is a counter-cyclical response to recession, closely related to unemployment levels, and that a period of economic growth may be expected to be accompanied by a slowdown or decline in self-employment. Using time-series data mainly from the USA, Steinmetz and Wright (1989) found evidence to support this theory, but also found that the relationship between self-employment and unemployment appeared to have declined over time. They speculated that the widening earnings distribution in many OECD countries meant that self-employment was not just a consequence of an absolute lack of wage employment opportunities, but was also a structural response to declining opportunities for good, well-paid jobs. More recently, Bogenhold and Staber (1991) carried out a similar analysis for eight OECD countries with data from 1957 to 1987 and found a strong positive correlation between unemployment and self-employment for all countries except Belgium and Sweden, where the correlations were positive but weaker. Meager (1992; Meager, Court and Moralee, 1994), however, has criticised these approaches to the question, arguing that no single factor can explain the varying trends across countries, particularly because the heterogeneity of the self-employed makes it unlikely that their activities can be captured within one theoretical model.

The national aggregate statistics on which such analyses are based are generally not sufficiently detailed or accurate to account for movements in and out of self-employment at a micro-level. Such changes are inevitably more closely related to particular features of national labour market, government policies and other localised developments. There is also evidence from the UK that self-employment may respond positively to a *decrease* in unemployment (Daly, 1991). Both these

apparently conflicting theories may have elements of truth, because while a decline in waged employment opportunities may encourage some unemployed people to try starting work on their own, the same recession is likely to cause other small businesses to fail. Similarly, an upturn in the economy may encourage some people to risk starting a business, whereas others may take the safer option of a better chance of waged employment. Thus both economic cycles can foster certain kinds of self-employment if other conditions are favourable. Either way, it appears to be the balance of particular national conditions interacting with the economic cycle which influence the flows into and out of self-employment in any given period.

The most important factors appear to be the level and direction of structural change in the economy, and shifts in employers' contractual arrangements. The restructuring of industry away from manufacturing and towards services, which has taken place in most of the OECD countries, tends to favour the growth of self-employment, since the service sector offers the greatest opportunities for individuals to try working on their own. In terms of changing contractual arrangements in Australia, it has already been suggested that employers have specifically encouraged the substitution of employee jobs with 'flexible' work arrangements through sub-contracting, and that at least part of self-employment growth has been among these 'dependent contractors'. VandenHeuvel and Wooden's (1995) study of sub-contracting suggests that as a proportion of all self-employed contractors in the non-farm sector in 1994, dependent contractors were most common in government services, transport and storage, property and business services, construction and wholesale/retail trade. Among these, only property and business and construction have seen significant net increases in the last decade, and it perhaps in these sectors that much of the growth in dependent contracting may be found.

A further factor in the expansion of self-employment in a number of countries is the availability of public subsidies for business start-up - aimed particularly at the unemployed. By the end of the 1980s some 17 OECD countries had introduced variants of these schemes, of which the largest have been in France, the UK and Spain (OECD, 1992). In Australia, the New Enterprise Incentive Scheme (NEIS) was introduced in 1986-87 as part of the (then) Department of Employment, Education and Training's (DEET) armoury of labour market programs to provide income support for up to 52 weeks for pensioners and allowance recipients with a viable plan for a new business. The scheme operates on a small scale, however. Although it has expanded in recent years, only around 6500 places were provided in the 1994-95 allocation (DEET, 1994), so the NEIS cannot be seen as a major contributor to self-employment growth.

Published data do not tell us whether the proportion of people coming into self-employment from unemployment or from outside the labour force has been rising, or how long people stay working for themselves. The movement of people (especially women) from out of the labour force into and out of part-time work has been a particular feature of labour market change in recent decades. Gregory (1990) has shown that this has significantly altered the relationship between employment growth and unemployment. The relationship between unemployment and self-employment is even less certain in this context and may similarly have changed over time. However, if the share of self-employment taken by people who were formerly unemployed is rising, it is reasonable to expect both greater volatility in the sector and, possibly, an increasing reliance among the self-employed on help from the income support system. Also, if a growing proportion of the non-farm self-employed are actually dependent contractors, then DSS officers may face additional difficulties in trying to categorise clients for family payments or other purposes.

3.4 Summary

This section has reviewed the evidence on the trends in self-employment in Australia and on the characteristics of self-employed people. While there has been a definite increase in the importance of self-employment as an employment form, the growth has not been dramatic when seen against changes in employment as a whole or compared to some other industrialised countries. One of the main features has been the continuing decline of agricultural self-employment and the expansion of construction and services as areas of self-employment. The number of women entering self-employment over the last decade has been relatively high, but is less significant when seen as a proportion of all women joining the work force. Much, if not all, of the increase in the rate of self-employment can in any case be explained by industry shifts towards areas of work where self-employment is more common. Also, at least a part of the overall increase is likely to have been in 'quasi-self-employed' sub-contracted work.

Individuals running their own business using a company structure fall outside the definition of 'self-employment' as used here, but may otherwise be in very similar circumstances. Whilst there are no direct data available on the numbers of people running such companies, data are available on the numbers of companies themselves - which have doubled over the past decade. The industry contributing the greatest amount to the growth in company numbers has been the business services sector.

The next section of the report examines some of the key characteristics of individuals and families whose main earnings come from self-employed work.

4 Main Characteristics of the Self-employed Sector

This section reports on analysis of data from the latest available ABS Income and Housing Survey (1990). As we saw earlier, 1990 was a year in which the rate of growth in waged and salaried employment outstripped that of self-employment. Individual respondents are grouped according to labour force status in their main job (Table 4.1). All the tables in this section are based on the unweighted survey sample (hence the small difference in results between Tables 2.1 and 4.1).

Table 4.1: Labour Force Status of Individuals in Main Job: 1990

Status	Number	Percentage
Wage and salary earners	14 123	46.4
Own business (incorporated) with employees	601	2.0
Own business (incorporated) without employees	312	1.0
Own business (unincorporated) with employees	795	2.6
Own business (unincorporated) without employees	1942	6.4
Unpaid family helper	45	0.1
Unemployed and looking for work	1810	5.9
Not in the labour force	9238	30.3
Not applicable	1578	5.2
Total	30 444	100.0

Source: ABS Income and Housing Survey 1990, unit record files.

According to our working definition of self-employment (and taxation status), owners of incorporated businesses are formally employees, so excluding those who are unemployed, not in the paid labour force and unpaid family helpers, the employed work force breaks down as follows (Table 4.2), and most of the remaining analysis in this section is based on the sub-set identified below.

4.1 Age Distribution

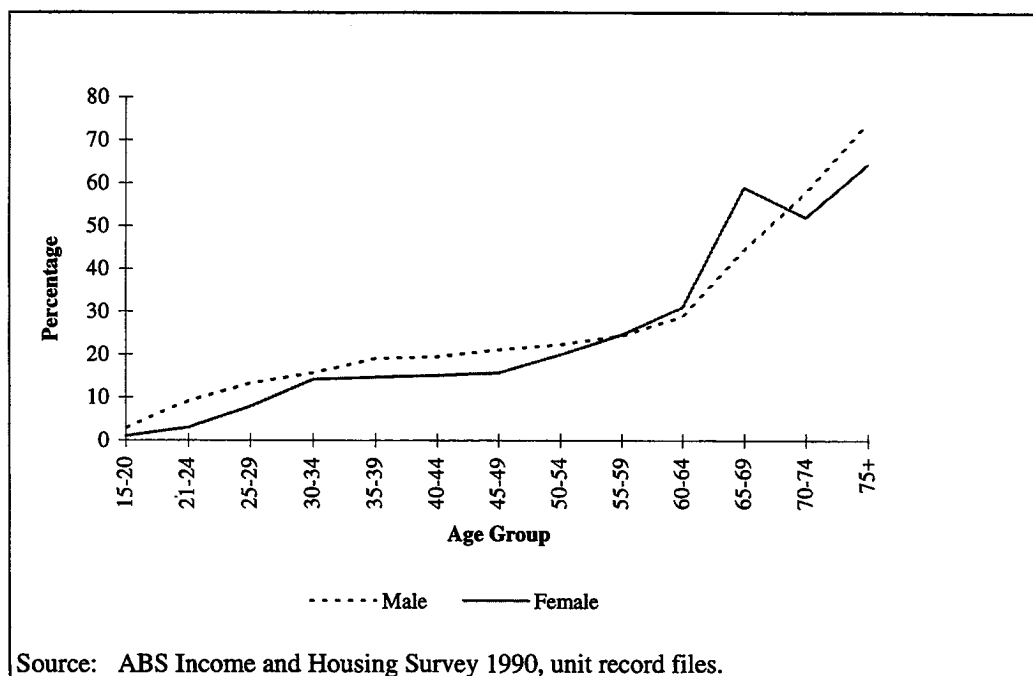
The age profile of people working in their own business is somewhat different from that of employees. In particular, self-employed people (especially women) are less likely to be found among the under 25s and are more common among those aged 60 or above. This is not surprising, as the formation of businesses and

Table 4.2: Employed Work Force: 1990

Status	Number	Percentage
Wage and salary earners	15 036	84.6
Employers	795	4.5
Workers on own account	1942	10.9
Total	17 773	100.0

Source: ABS Income and Housing Survey 1990, unit record files.

accumulation of capital, as well as the acquisition of necessary skills, are likely to be related to stages in the life cycle. Figure 4.1 shows self-employment rates by age and sex. The particularly sharp increase in the rates for both men and women over 60 is based on small numbers in the survey, but it is nevertheless likely to reflect a tendency to continue in self-employed businesses, especially perhaps farms, after retirement age. What these data do not give us, on the other hand, is an age profile of people entering self-employment. The sharp increase in self-employment rates for people over 60 may also be due partly to them establishing businesses (or business-like financial arrangements) after retirement from waged or salaried work.

Figure 4.1: Self-employment Rates by Age and Sex: 1990

4.2 Marital and Family Status

People with their own businesses are also considerably more likely to be married or in a cohabiting relationship than are employees. Nearly 87 per cent of employers and 82 per cent of own account workers were married or cohabiting in 1990, as opposed to two-thirds of employees. This is partly a result of the age profile identified above: since people with their own businesses tend to be older, they are more likely to have reached the age of family formation. However, even when we control for age, both groups of the self-employed show a greater tendency than employees to be married in all age groups except the oldest, where they are marginally more likely to be separated or divorced.

Being in a couple does not in itself seem as likely to affect employment status as other factors associated with marriage, notably the presence of children and the economic status of the spouse. Table 4.3 shows that there is a strong link between the employment status of members of couples. Three-quarters of all employed men with self-employed spouses were self-employed themselves, compared with only about one in seven whose spouse was not self-employed. Similarly, more than half of working women whose husbands were self-employed were also self-employed themselves. Many of these self-employed couples are likely to be in partnerships, although this is not recorded within the survey. In all, self-employed couples constituted half of all individuals self-employed in their main work.

Table 4.3: Self-employment Rates by Employment Status of Spouse (Employed People in Married or De facto Relationships Only)

Economic status of spouse	Self-employment as a percentage of all employment	
	Men	Women
Employee	12.2	5.8
Self-employed	75.0	56.0
Unemployed or not in the labour force	14.1	6.3
All	20.0	16.8

Source: ABS Income and Housing Survey 1990, unit record files.

By contrast, the presence of children appears not to be correlated with self-employment: income units headed by self-employed men in married or de facto relationships were on average slightly less likely to have dependent children (50.3 per cent) than those headed by employed men (53.8 per cent), with children being even less common among the 'own account' workers without employees. This is likely to be partly a function of the latter group's older age profile. Among income units who did have children, the self-employed were also marginally

more likely to have older children. Apart from this there was little difference between the employment groups.

4.3 Hours of Work

The distribution of hours worked by employees and the self-employed is shown in Table 4.4. As would be expected, the self-employed, especially those with employees, tend to work longer hours than waged and salaried workers, though it is interesting to note that slightly more of the self-employed appear to work very few hours. However, the small numbers involved at this level make the results subject to large sampling errors.

Table 4.4: Hours of Work Per Week, by Labour Force Status and Sex: 1990

	Employees	Employers	Workers on own account
Percentages ^(a)			
Persons			
0-9	4	6	10
10-24	12	12	16
25-39	34	7	13
40-49	33	20	22
50 or more	17	55	39
	100	100	100
n =	15 036	795	1942
Men			
0-9	2	1	2
10-24	3	3	8
25-39	31	2	13
40-49	39	22	28
50 or more	25	73	50
	100	100	100
n =	8396	508	1260
Women			
0-9	8	16	25
10-24	23	28	32
25-39	38	16	14
40-49	25	17	12
50 or more	7	23	17
	100	100	100
n =	6640	287	682

Note: a) Percentages do not always add up to 100 because of rounding

Source: ABS Income and Housing Survey 1990, unit record files.

The pattern of working hours for women in self-employment is quite unlike men's and also differs from that of employed women. Nearly a quarter of all self-employed women, including those with employees, worked less than 10 hours per week and around half for less than 25 hours, yet one-fifth still worked for 50 hours or more. The proportion working short hours was even greater among those with self-employed husbands or de facto partners: just over 25 per cent worked under 10 hours per week and a further 34 per cent for between 10 and 24 hours. This suggests that the characteristics and role of self-employed work may differ amongst groups of self-employed women. Evidence from the UK suggest that one of the advantages of these forms of work for women is to make it easier to combine work, often at home, with caring responsibilities. It also seems possible that many of those formally self-employed in partnerships with self-employed husbands have a fairly minor role in the business in terms of time, being engaged in activities such as book-keeping or answering the telephone.

Another feature of working hours among the self-employed is the way patterns of work vary by industry and occupation. We saw earlier from labour force data that self-employment tends to be concentrated in certain industrial sectors and Table 4.5 below shows the distribution of main self-employed work.

Table 4.5: Main Industry Distribution of Self-employment by Sex: 1990

	Men	Women
	Percentages	
Agriculture and forestry	23	25
Manufacturing	6	7
Construction	26	12
Wholesale and retail trade	16	24
Transport	9	5
Finance and property	10	11
Community services	3	6
Recreation and personal services	7	9

Source: ABS Income and Housing Survey 1990, unit record files.

For women, shorter working hours in self-employment are found particularly in construction, which makes up 12 per cent of all female self-employment but includes a quarter of all those working less than 10 hours per week. Those in wholesale and retail trade, on the other hand, tend to have disproportionately long hours. Looking at this question in terms of occupational status, women self-employed in clerical work are the most likely to be working very short hours,

making up half of all those working less than 10 hours and 38 per cent of those working between 10 and 24 hours.

4.4 Educational Qualifications

There are some differences between wage and salary earners and the self-employed according to their qualifications. Overall, both employers and own account workers are slightly less likely to have no qualifications than employees and somewhat more likely to have trade certificates. Employers are marginally more likely than employees to have degrees, but only half as many own account workers have degrees as employees. The picture also differs somewhat by sex: self-employed women are, on average, better qualified than their male counterparts. This is a feature of self-employment which has been observed in other countries and may be related partly to the barriers women face in trying to enter the world of enterprise (Carter and Cannon, 1988).

4.5 Country of Birth

One final feature of self-employment which has been observed in a number of countries is its prevalence among minority communities and migrant groups. This prevalence has been variously attributed to unemployment or blocked mobility within the waged and salaried sector because of discrimination, or to a propensity towards small business enterprise brought with migrants from their countries of origin. Self-employment among migrant groups can only be explored to a limited extent using data from the Income and Housing Survey, as this records only country of birth and year of arrival for those born outside Australia. Many people of non-English speaking origin are not, of course, first generation migrants, while the Aboriginal and Torres Strait Islander population is Australian born.

Table 4.6 shows country of birth by labour force status. Differences in propensity to be self-employed are not in fact that large according to country of birth alone. In 1990, the overall self-employment rate for those born in Australia was 14.9 per cent, compared to 16.8 per cent for those born elsewhere. Certain origins, however, do suggest higher rates of self-employment. Among migrants from Europe (excluding the United Kingdom), for example, the rate was 22.5 per cent, and among own account workers alone it was nearly twice as high as for the Australian born. For those born in Asia, the self-employment rate was marginally below the overall national average, though somewhat higher for those with employees. The numbers involved in the sample at this level of analysis, however, make apparent differences prone to large sampling errors.

Table 4.6: Country of Birth by Labour Force Status: 1990

Country of birth	Employees	Employers	Own account workers
Percentages			
Australia	85.1	4.6	10.4
United Kingdom	85.1	2.8	12.0
Other European countries	77.5	5.9	22.5
Asia	85.1	5.8	9.1
North and South America	86.4	1.2	12.3
Africa	89.2	4.8	6.0
Oceania	86.6	2.2	11.2

Source: ABS Income and Housing Survey 1990, unit record files.

Analysis of the 1986 Census has shown that within European countries (including the middle east), self-employment is particularly prevalent among migrants from the Lebanon, Greece, Italy and Germany (Holton, undated). The experiences of such migrant small business owners in Australia have been explored recently in a study by Collins et al. (1995).

The Census has also been used to examine the role of self-employment and small enterprise in fostering economic self-sufficiency among Aboriginals and Torres Strait Islanders (Daly, 1993). In 1986, only 1.3 per cent of people of working age from these communities were recorded as self-employed, compared with a national figure of around 10 per cent. The estimate for the Aboriginal population, however, is somewhat uncertain, as there are numbers of people working in forms of marginal self-employed craft production which do not bring in sufficient income to take people off income support: it is not clear what proportion of respondents chose to define themselves as self-employed or unemployed. Nevertheless, it does appear that indigenous people have been under-represented among the self-employed. A review of economic initiatives to support employment among Aboriginals and Torres Strait Islanders was critical of the initiatives' effectiveness, and, following the recommendations of the Royal Commission on Aboriginal Deaths in Custody, a Community Economic Initiatives Scheme was established in 1993 to promote indigenous enterprise.

4.6 Summary

In 1990 self-employed people made up 15.4 per cent of the work force. Self-employment is less common among people aged under 25 and more common among those over 60, partly because of delayed retirement among small business

owners and, possibly, because some retiring employees take up working on their own. Partly because of the older age profile, self-employed people are also more likely than others to be married or cohabiting, and among them there is a strong correlation between the labour force status of husbands and wives. Self-employed people tend to work both longer and shorter hours than employees, with self-employed women sharply divided between those working less than 10 hours per week and those working over 50 hours. Self-employed people as a whole tend to be less well qualified than employees, though a higher percentage of employers have tertiary qualifications. Self-employed women tend to be better qualified than their male counterparts. As has been observed in many countries, the rates of self-employment tend to be higher amongst some migrant groups. In Australia, people born in Europe other than in the UK have the highest rates.

The last two sections have provided some background data on the importance of self-employment in Australia and on the main characteristics of people working for themselves. We now begin to consider the role means-tested social security payments play in providing assistance to self-employed people and families.

5 Objectives and Methods of Means Testing the Self-employed

5.1 Introduction

A key feature of the Australian income support system is its strong focus on targeting assistance to the most needy. Along with New Zealand, Australia is exceptional among industrialised countries in the extent to which social protection is allocated on the basis of a test of resources (Eardley et al., 1996). Not all payments, however, are intended only for poverty relief. The basic rate of Family Payment, for example, is designed to recognise the general extra costs of rearing children and excludes only those families in the highest income band. Means testing in Australia therefore serves both to establish 'need' - usually interpreted in terms of some concept of poverty - and, more broadly, to set income or asset thresholds for non-poverty-related allowances.

Questions about the appropriate treatment of the self-employed in the social security system stem from a concern that current administrative procedures are not able properly to determine the degree of need experienced by self-employed applicants. It is also not clear that measures of income and assets used for the range of allowances represent equity of treatment between the self-employed and other applicants. This section reviews the theoretical concepts used in measuring economic resources and considers how these are in practice applied to people with earnings from self-employment.

A simple definition of need is that people are poor if at some point in time they only have access to a particularly low level of economic resources.⁶ In association with this definition we should recognise that:

- whilst it makes sense to describe someone as being poor as at some particular date, this does not necessarily mean that only 'current' income is relevant. Since the generation, receipt and expenditure of income, and the consumption of goods purchased, can all occur at different times, it will often be the case that incomes over a longer period of time (such as a year)

⁶ Definitions of poverty such as this can always be further refined. In the present case, the concept of 'access' could be elaborated at length. In particular, we do not define a person as having access to economic resources if this implies an unsustainable economic environment for their family (as might occur if the person borrows to sustain their current consumption).

are more relevant for current living standards than simply income received in the last week; and

- resources can be interpreted quite broadly to include income, wealth and non-cash benefits (from both public and private sources). In this present report, government-provided non-cash payments are not considered in any detail, since the situation of the self-employed is unlikely to differ substantially from that of wage and salary earners (except perhaps for farmers).

5.2 Income and Consumption

There are two broad measures used by economists to describe the degree of access to economic resources: 'income' and 'wealth'. Income is a measure of the flow of economic resources through a household, whilst wealth is the corresponding stock measure. We begin by considering the concepts of income relevant to the situation of the self-employed. Wealth and assets are considered in Section 5.4.

The classic economic 'Haig-Simons' definition of income is the sum of consumption and the increase in wealth over a specified time period (see, for example, Atkinson and Stiglitz, 1980). That is, income equals consumption plus saving. Both income and consumption are, in principle, broad concepts which can include all the three main types of economic resource: market, state, and household. When considering wage and salary-earning households, income is generally used as the primary index of living standards in preference to consumption⁷ because income includes savings, which, when positive, are usually considered to be a discretionary item in the household budget (in the short term) which could be diverted to consumption. It is worth noting here that consumption is now the basis of the 'actual means test' (AMT) applied by the Department of Employment, Education, Training and Youth Affairs (DEETYA) to assess eligibility for Austudy payments. We discuss the AMT further in Chapter 8.

A key question with respect to the self-employed is the extent to which accumulated savings, and the ability to draw down these savings, should be

7 Stein Ringen (1988) has argued that 'consumption' is more relevant to poverty measurement than 'income'. This difference with the approach adopted in this report, however, stems primarily from a difference in terminology. The full income concept used here is actually closer to Ringen's concept of consumption than to his concept of income. This is because he uses 'income' to refer to cash income only (rather than full income). Ringen does not explicitly address the question of how to treat savings.

considered part of the living standards of the self-employed. One difficulty is that savings (and particularly the consumption of them over time) are often poorly measured in income and expenditure surveys, as is the use of business overdrafts to provide income streams at times of adverse cash flow.

There are several reasons why income, as usually measured, might be a poorer indicator of living standards for the self-employed than for other groups in society. These stem primarily from the fact that, for the self-employed, there is often no clear distinction between the activities of the enterprise and consumption within the household. This makes household and individual incomes intrinsically difficult to define and measure. In particular, there are several means whereby the self-employed and other people working in their own business can reduce their personal taxable income in ways which are not available to employees. These include:

- accumulation of savings within the enterprise (e.g. by building up the value of the business);
- personal consumption of goods owned by the enterprise (but with the expenditure on these goods recorded as a cost of production);
- being allowed to deduct some non-consumption expenses from income in a way that is denied to employees. For example, if the home is being used as a business base, costs associated with travel to other work locations may be an allowable deduction from income. Employees, on the other hand cannot deduct travel to work costs from their income, even though this does not count as income in an economic sense; and
- a greater flexibility to arrange the financial affairs of the enterprise so as to take account of beneficial tax policies.

In some cases these mechanisms will mean that income will be recorded as accruing to entities other than the individual (such as a private company). One reason for doing this might be to attract a slightly lower marginal tax rate. Nonetheless, company tax may still be paid on this income and so these mechanisms may not imply a major cost to tax revenue unless some other tax avoidance measures are used.

However, because social security entitlement is assessed on the basis of personal income, the question of which entity accrues income may make a substantial difference to income support entitlements. There are thus good reasons why the DSS and the ATO might have different objectives in their assessment of income.

5.3 Measurement of Self-employment Income for Social Security

It could be argued that social security payments which are primarily intended to alleviate current financial need should ideally meet the shortfall of need over available income on a continuously contemporary basis. Such an approach requires frequent adjustments to payments as needs or resources change, along with information systems which can accurately measure these changes in resources. In Australia, this approach is applied to unemployment allowances, where most recipients must report any changes in income within seven days of the change and must complete a fortnightly application for continuation of the allowance which also includes details of their income over the previous fortnight. People in continuing self-employment of any significant scale are barred from unemployment allowances, if this work means that they are not judged to be available for and actively seeking work. Where they are eligible their fortnightly earnings are normally assessed not in relation to income actually received over the preceding fortnight but as a fraction of the taxable net profit made in the previous 12 months.

For pensions, the income taken into account for the test is the applicant's current annual income, whether earnings derive from waged work or self-employment. Six-monthly notices tell recipients that they must inform the Department if their income increases above specified levels. Complex averaging procedures apply where employees receive fluctuating earnings, depending on the length of the period of work, but the assessment for self-employed recipients is again generally based on the full previous completed tax year. Taxable income, however, is only a starting point for the assessment of earnings from self-employment. For pensions and allowances, some business expenses of unincorporated enterprises which are allowable for tax purposes are not allowable for the income test and these are added back in to taxable income. Adjustments may also be made for trading stock variations. The Social Security Act sets out fairly precisely how some sources of income, such as direct investments, should be assessed. On other questions, such as what constitutes allowable deductions from business profits and how to treat variations in trading stock, only general guidance is given, with more detail in the *Complex and Technical Cases Handbook* (DSS, 1994).

Income from incorporated enterprises (such as companies) is treated differently from that of unincorporated enterprises, because the income of the business is not the same as that of the proprietor. Company profits are only assessable as income if the client is a shareholder and a distribution of dividends has been made. Also, profit and loss statements for companies cannot be adjusted by disallowing certain deductions. In the case of company directors, assessable income consists of any wages or salary received, directors' fees, distributed profits, interest-free

loans to the company made by the client and payments on other interest-bearing loans.

For Family Payment, the income test is based in the first instance, for both employees and the self-employed, on taxable income for the previous tax year. The Department relies on the Tax Office's formal assessment notice for this purpose, but if self-employed applicants do not have a notice of assessment they must prove this and provide an earnings estimate. The relevant year is generally the financial year ending on 30 June of the most recently completed tax year, and thus the end of the base year can be up to 18 months earlier than the period for which the person is paid. To deal with variations in income between these dates, a complex system of 'triggers' for review and adjustment of payments was introduced. Originally an adjustment was triggered where income was likely to fall more than 25 per cent below that of the base year (or 25 per cent below the income threshold for AFP), or was likely to increase by more than 25 per cent above the base year income. In 1996 the Family Payment income test became responsive to any decrease in income and to increases of more than 10 per cent.

Before January 1989, the income tests for Family Income Supplement (FIS), which then became Family Allowance Supplement (FAS), later Additional Family Payment (AFP) and is now called 'more than minimum' Family Payment, were based on continuous weekly income assessment. The stated rationale for the change, which was introduced in the 1988-89 Budget, was to simplify administration and increase take-up (Treasury, 1988: 165). The income test for Childcare Assistance (CA), which is closely aligned with Family Payment, also treated self-employed families differently from wage earners prior to 1994. However, waged families seeking a reassessment of CA are assessed on current four-weekly income rather than estimated taxable income.

In general, in dealing with income from self-employment, it is current DSS policy to start with the assessments previously made by the ATO for a recently completed tax year, unless such assessments are unavailable. This is administratively convenient for DSS, but raises problems of the kind outlined earlier.

In considering these problems it may be helpful to look at the choices available in measuring self-employment income and the consequences of particular options. The discussion draws on previous research on assessing incomes from self-employment for social security purposes carried out in the UK (Boden and Corden, 1994; Eardley and Corden, 1996b).

Traditional *ex post* accounting uses two main techniques to measure income. One is a simple cash flow method by which actual monies received in a particular reference period, less expenses actually paid out during the period, represents

cash income. The other is what is usually known as the 'accruals' or 'matching' method. The measure here is not cash received but the amounts earned from business during the reference period (whether or not these amounts have actually been paid), less expenses incurred (whether or not these have actually been defrayed). The principle underlying accruals accounting is of matching income earned against the expenses incurred in earning it.

These two methods can produce quite different results. Accruals accounting provides a widely acceptable measure of economic profit. This profit may not, however, be realisable as cash for expenditure by the self-employed person. Alternatively, if cash flow is taken as the measure of income, the self-employed person could be accumulating substantial sums in non-cash form while having only small amounts available for ready expenditure. Thus very detailed information about the constraints of business operation and liquidity of business assets is required before one can confidently assert that one measure or the other is the 'best' indicator of the needs of self-employed families. These two techniques of income measurement can also be applied as historical, contemporary or predictive tools, generating the matrix of measurement options shown in Table 5.1.

Table 5.1: Choice Matrix for Measuring Self-employed Income

	Historical	Continuous contemporary	Predictive
Economic profit	1	2	3
Cash income	4	5	6

Source: Boden and Corden, 1994

Options 1 and 4 provide indicators of current need based on historical data, normally a previous tax year. Accuracy in targeting social security benefits on this basis depend on there being not too great a discrepancy between past and present incomes. Options 2 and 5 present at least the theoretical possibility of continuously updating entitlement to meet current needs (or altering entitlement *ex post*). Options 3 and 6 base entitlement on predictions of future income flows.

In Australia, at present, either mode of reporting is normally acceptable for taxation purposes. Information supplied by the Taxation Office suggests that the majority of self-employed people operating very small enterprises report assessable income in cash flow terms, including up to around 70 per cent of sole traders who receive most of their income in cash. For social security, therefore,

self-employed earnings are measured both under under Option 1 and under Option 2. For Family Payments, adjustments are available to bring some contemporaneity to an historical measure if income is likely to increase or decrease by more than 10 per cent. However, the evidence on which an adjustment would be made would normally be in the form of cash flow information. The system therefore also incorporates elements of Option 5. Where a tax notice of assessment is not yet available, self-employed clients are required to provide an estimate of taxable income for the previous year. Examples, given in the *Guide* (DSS 1996), of acceptable evidence to support applicants' estimates include tax returns lodged and profit and loss accounts (both of which will lead to an accruals-based notice of assessment). The predictive elements of Option 3 are thus also present in the system.

The choice of basis period on which to measure incomes is inevitably a trade off between effectiveness and efficiency. Option 5 offers the greatest opportunity for relating payments closely to current resources, but it has high costs. These include administrative complexity, intrusiveness, and extra expenditure of time and money for clients in producing financial information - all of which may reduce compliance and take-up. Family Payment, especially the higher rate payment, is targeted towards those with lower incomes, but it is not meant to be a main source of subsistence income. It may, therefore, be less important than with unemployment allowances that entitlement is matched continuously to changing resources. The incomes of the self-employed, however, are much more likely than those of other clients to vary considerably over time. Even relatively recent historical financial information may have poor predictive capabilities and little value as a measure of current income.

Typically, self-employed people cannot provide accurate estimates of their current income, and so policies aimed at avoiding short-term poverty may not always fit the circumstances. On the other hand, a key feature of self-employment is the greater risk and uncertainty of income, and so poverty may be a very real problem. To what extent should social security help in reducing this uncertainty?

Time is one dimension of the choice matrix for income measurement, but what are the relative advantages and disadvantages of accruals versus cash as measures of income for social security? First, it must be emphasised again that neither provides an intrinsically more 'true' measure of income than the other. Their relative utility depends on the purpose for which financial information is sought. They measure different things and can produce different results. In accountancy terms, the advantage of cash flow measurement is that it provides a better idea of the viability of a business in the short term, concentrating on available cash rather than historical profit. This could be seen as a more useful indicator of need from an income-testing perspective. It also requires lower levels of accountancy skills,

both for the producer of the information (the self-employed person) and the user (DSS assessment staff). On the other hand, the cash flow technique is also subject to fluctuation in reported cash surpluses over time if business payments from or to customers are irregular or erratic. The unevenness of results from cash flow measurement can lead to under- or over-estimation of future cash available and may be open to possible manipulation.

Accruals accounting is designed to even out the fluctuations in profit at different periods and thus provides a better view of the underlying profitability of an enterprise. At the same time it may give a poor picture of business liquidity, since measured profits may be tied up in working capital such as stock for resale, and the self-employed person may in fact have little cash on which to live.

The variation in the results of applying these two techniques will depend on the nature of the business. With some self-employed work, particularly sub-contracted labour or small service or retail outlets with low levels of stock and capitalisation, the differences may not be significant. But with larger and more complex operations, including farms, the discrepancies between accruals and cash measures of income can be significant.

To summarise, the Australian social security system currently measures self-employed income mainly on an historical basis, using both the accruals and cash flow methods of accounting. This has considerable advantages from an administrative perspective, as it largely avoids offices of the Department of Social Security having to engage in separate, complex assessment exercises. For some payments, particularly those for families with children, there is also a degree of equity between employee recipients and the self-employed in that the Tax Office's income assessments are used for both. The disadvantage is that, irrespective of the merits of particular tax concessions available to self-employed people, the taxable income measure may not represent a realistic picture of cash income available to self-employed people at the time when they are receiving social security payments.

5.4 Collection of Child Support from Self-employed Liable Parents

Another area where there has been considerable anecdotal suggestion of discrepancies between assessment of taxable income and living standards among some self-employed people has been that of child support. Indeed, self-employed men have been described as 'the leaders of the maintenance avoidance industry' (Campbell, H., 1991). Discussions with officials of the Child Support Agency (CSA) suggest that there may be some grounds for concern, and it has been recommended that self-employment be an agenda item for the next international

Heads of Child Support Agencies Conference. However, in spite of individual cases of detected income minimisation, CSA internal data do not in themselves support the notion of widespread income minimisation by the self-employed specifically (CSA, 1996). Only 6.9 per cent of 'Stage 2' cases registered with the Agency (those where levels of child support have been assessed by the CSA rather than by the courts under previous arrangements) in 1995 had some business income, and so people who were mainly self-employed made up an even smaller percentage of clients. The data suggest that the CSA clientele is mostly at the lower end of the income distribution and that liable self-employed parents are as good or as poor at complying with child support orders as other parents. The main difficulty is that the core income assessment takes place upstream of the CSA in the Taxation Office and the CSA does not have the power to make extensive enquiries beyond this assessment. The Senate Joint Select Committee on Certain Family Law Issues, which recently reviewed the CSA's performance did, however, make some recommendations concerning clients with business income, and these are discussed briefly in the final section of this report.

We now move on to discuss how assets are dealt with in the Social Security means test.

5.5 Income and Wealth

The consumption of a household over a particular time period can be financed either from the income received during that period, by running down assets (dissaving), or by borrowing against current non-liquid assets or future earnings. Means testing in the Australian social security system typically takes account of the potential for dissaving by including an assets test. For payments to low-income families, several different types of assets are distinguished.

'Liquid assets' are assets such as cash, bank deposits and shares in public companies. They do not include shares in private companies or business working capital. Applicants for Job Search Allowance must serve an additional four week waiting period if their liquid assets are over \$6000 (single) or \$10 000 (couples). Similarly, the higher rate of Family Payment is not available if liquid assets are over \$10 000 (couples).

In terms of assets more broadly defined, the most stringent requirements are those faced by allowees. They must normally have less than between \$124 000 and \$264 000 (from September 1996) in assessable assets, depending on their household and tenure status, in order to be eligible. For pension recipients, assets above these limits are treated as producing a specified income which is set against the pension entitlement, and the upper threshold for any entitlement ranges from \$241 500 for a single homeowner to \$459 000 for a non-home-owning couple.

There is one fixed asset threshold for full payment of Family Payment: \$393 750 for both singles and couples. If assets are over this threshold but less than \$584 500 the minimum rate only is payable.

However there are also 'hardship provisions' which allow payments at higher asset levels under certain circumstances. The *Guide* includes a detailed definition of what counts as assessable assets for hardship purposes, including cash savings, shares and bonds, debts owed to the applicant, cars and other vehicles, real estate and personal possessions. The main exemptions are the first \$10 000 of household possessions, the value of the main home in the case of owner occupiers, household fixtures, superannuation for those under Age Pension age, life interests transferred by another person, prepaid funeral expenses and aids for disabled people.

Self-employed people running businesses are particularly likely to be affected by the assets test, as the value of land, buildings, shops, improvements and 'all assets used in the business' (s.27.15810) (DSS, *Guide*), including plant, stock and purchased goodwill are all counted. Businesses, especially farms, may produce little income in times of economic or climatic difficulty, but may still have a high asset base on which applicants are generally expected to draw before they can make a claim for public income support. There are, however, a range of hardship procedures which modify this expectation, as well as special support schemes for agricultural businesses. Rules for the hardship scheme give examples of where farmers in particular might not be expected to sell land or property or might have assets disregarded, including (for pensions) temporary reduction in income because of drought, bushfire, illness or a downturn in the industry, or where a family have been working the farm for at least 10 years as a serious enterprise and it represents the main livelihood.

Since July 1996, all financial assets of pensioners and allowees have been included in both the income and assets tests (business assets and shares are not included). An assumed minimum rate of return is used to impute an income to financial assets. This imputed income, together with the high threshold for the assets test, means that it will almost always be the income test which will affect entitlement rather than the assets test itself.

Apart from the liquid assets test, therefore, current means testing is more generous towards assets than towards income (except at high asset levels where the assets test has steep withdrawal taper). This can be justified if we hold the principle that Social Security recipients are entitled to pass on their assets to their descendants (unless they are particularly wealthy). Over an 'infinite' lifetime, an investment asset can only support consumption to the extent that it generates income. Hence its ability to finance consumption should only be included in the income test. The situation of consumption assets is conceptually the same: it is

the imputed income from the asset that should be used for targeting, rather than the value of the asset itself.

One way of viewing this is simply that the non-financial 'nest eggs' of individuals should not be interfered with unless they are particularly large, though the income derived from these assets is relevant to targeting assistance.

This question of wealth is of particular importance for some groups of the self-employed, such as farmers, who have large amounts tied up in the assets of their business. Whilst the above principle is a reasonable one, there still remains the question of where to draw the threshold at which people are required to liquidate assets. For example, if there are two farming families with the same income, but the first family has a much greater asset base, at what point should the difference in assets be used to target a greater amount of assistance to the second family?

The answer to this question hinges on the answer to another set of questions: at what asset level should people be required to 'draw down' their asset base before they qualify for Social Security assistance? Should this vary with the liquidity of the asset in question? What if this necessitates a winding up of the business?

5.6 Summary

This section has discussed the conceptual principles involved in social security means tests and outlined the key features of how these are applied to self-employed people. The key goal of the means test is to direct limited resources to those families most at risk of poverty.

There are several reasons why the self-employed might conceivably have higher living standards than wage earners with the same taxable income. These mainly stem from the difficulty of separating business from personal activities, and include additional opportunities for expenditure deductions, the opportunity to accrue income in other entities (such as trusts or companies) and greater opportunities to arrange their business affairs to minimise tax. In particular, the fact that some people working in their own businesses might be able to accrue income in other entities may be a reason for the Department of Social Security to assess income in a different manner to the Taxation Office.

Current practice is for DSS to rely primarily upon taxable income from the previous tax year. More generally, there are a number of alternative approaches that could be used. These depend upon whether an accruals or cash flow measure of income is used, and whether income is assessed for some past period, the present period or some future forecast period.

We now continue by presenting an analysis of receipt of Family Payments where an adult is in the work force, comparing key characteristics of families supported by wages and self-employment.

6 Receipt of Family Payments by the Self-employed

6.1 Social Security Payments to Self-employed People

Earlier, it was suggested that the most important areas of social security for self-employed people were family payments. Table 6.1 shows that, in 1990, the main forms of social security income received by income units⁸ with a head or spouse working in their own business (including company directors) were Family Allowance (FA) and Family Allowance Supplement (FAS). Together, these two payments comprised 57 per cent of income transfers to people working in their own business. Next most important was Unemployment Benefit, making up 11 per cent of transfers. As noted above, the latter payments could occur either because the unemployed person's spouse was self-employed or because the business was dormant.

Because family transfers comprise the bulk of payments to the self-employed and other people working in their own businesses, this section of the report focuses primarily on them. We concentrate particularly on the payment for families with an adult in low-income work and not receiving another basic benefit or pension, which was known until recently as Additional Family Payment (AFP) (Workforce) (and is now termed 'more than minimum rate of Family Payment - workforce'), and on Parenting Allowance. The first of these replaced FAS, whilst the second is a new payment available to the primary carers of children aged under 16 (subject to a family income and assets test).

Table 6.2 shows the percentage of families with a head or spouse in full-time work, and with children of eligible ages, who reported receiving FA and FAS in 1990. In this table we revert to our definition of self-employed people as those, with or without employees, in unincorporated enterprises. Company directors resume their individual taxable status as employees.

Eligible families with a self-employed earner were slightly more likely to receive FA than other families where there was only one child, but for larger families it was the non-self-employed who were more likely to get the payment. The

8 Income units comprise single people, couples, sole parents with dependent children, or couples with dependent children. Adult children (not in full-time education or aged over 20) are defined as separate income units (hence the low receipt of Austudy payments recorded in Table 6.1).

Table 6.1: Current Income^(a) from Government Transfers of Income Units^(b) with Head or Spouse Working in Own Business: 1990

Payment Category	Total \$m per annum received from each payment	Percentage
Family Allowance (only) ^(c)	373.0	35.2
Family Allowance plus Family Allowance Supplement	230.6	21.7
Unemployment Benefit	119.5	11.3
Age Pension	73.5	7.0
Service Pension	60.6	5.7
Sole Parent Benefit	37.2	3.5
Overseas Pension/Benefit	33.2	3.3
Disability Pension	28.1	2.7
Invalid Pension	19.0	1.8
Widows Pension	15.2	1.4
War Widows Pension	12.7	1.2
Secondary Austudy	12.5	1.2
Government Pension or Benefit not included elsewhere	12.0	1.1
Tertiary Education Austudy	11.1	1.0
Sickness Benefit	10.6	1.0
Special Benefit	8.4	0.8
Wife/Carers Pension	3.9	0.4
Total	1061.1	100.0

- Notes: a) Income is current weekly income times 52.14.
b) Population is 1.184 million income units. Sample size is 2774.
c) Family Allowances are included with FAS payments in the second line of the table if the income unit received any FAS, otherwise they are included in the first line (because of an ABS processing error).

Source: ABS, 1990 Survey of Income and Housing Costs and Amenities, unit record file.

differences, however, were not substantial. One child families with a self-employed earner were also marginally more likely to be receiving FAS, but here this pattern continued among larger families and the differential between those with self-employed earners and the others was significantly higher. Families with a self-employed earner also consistently received higher average rates of payment. It is interesting that self-employed people with two or more children were less likely to receive FA but more likely to receive FAS. One possible reason is the greater inequality of incomes among the self-employed than among

Table 6.2: Reported Receipt of Family Allowance or Family Allowance Supplement by Families with Children of Eligible Age, by Employment Status(a): 1990

Number of children	Percentage Receiving FA		Percentage Receiving FA and FAS		Mean Entitlement Rate(b)	
	Self-employed(c)	Not Self-employed(d)	Self-employed(c)	Not Self-employed(d)	Self-employed(c)	Not Self-employed(d)
1	64.3	63.0	5.5	4.7	25.1	22.1
2	70.5	78.3	13.2	7.3	27.5	24.3
3	67.9	74.5	19.0	14.0	33.7	28.9
4+	59.1	63.0	34.9	25.3	44.0	36.0
All families	67.2	71.7	13.5	8.6	25.1	29.1

- Notes:
- a) The table may understate the overall take-up of family payments because there is evidence that not all recipients understand or report receipt of the payments in surveys.
 - b) Mean entitlement rate is the average percentage received of the maximum payment available for the eligible family.
 - c) 'Self-employed' includes only employers and sole traders/partners in unincorporated businesses.
 - d) 'Not self-employed' covers waged and salaried, including company directors.

Source: ABS, 1990 Survey of Income and Housing Costs and Amenities, unit record files.

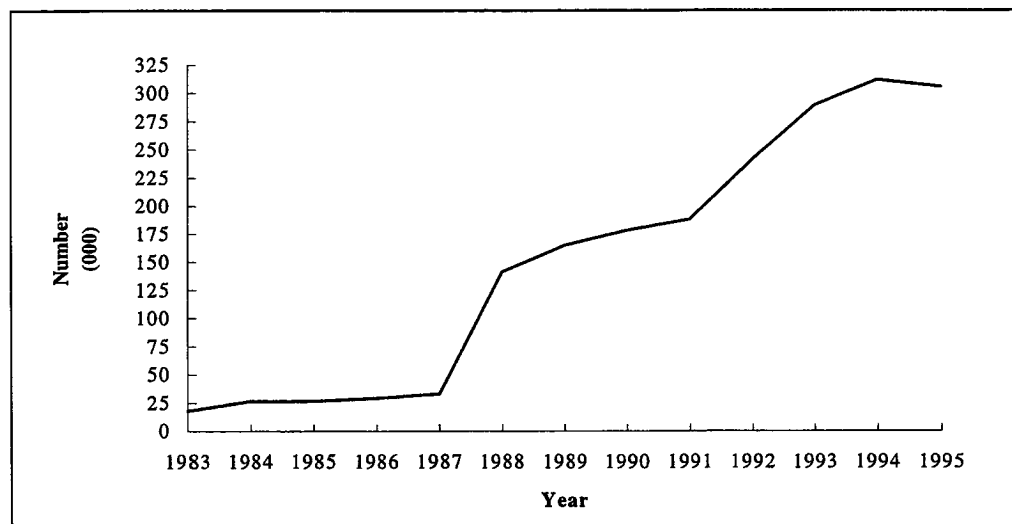
waged workers, which has been noted by Covick (1984). Thus a higher percentage of self-employed people have earnings above the cut-off point for FA, whilst they are also over-represented among lower-earning families entitled to FAS.

6.2 Recipients of Additional Family Payment (Workforce)

The number of work force low-income family payment clients has increased dramatically since the introduction of Family Income Supplement in 1983 (Figure 6.1). This is mainly a result of changes in the value and criteria for entitlement for the payment in its different forms.

It is not known what percentage of recipients had earnings mainly derived from self-employment over this whole period, as until recently it was not an administrative requirement that the occupational category of the main earner should be coded. In order to explore this issue and to compare the characteristics of waged and self-employed recipients we asked the Department of Social Security to prepare a special, sample dataset of families receiving AFP (Workforce) in September 1995. Clients with self-employed spouses were over-sampled, giving a total sample of 2500 clients with spouses self-employed on the

Figure 6.1: Numbers of Recipients of Payments for Low-income Working Families: June 1983 to June 1995



land, 2500 'other' self-employed and 5000 non-self-employed. Among those not recorded as having a self-employed spouse were nearly 43 000 sole parents, six per cent of whom were themselves self-employed. Since the circumstances of sole parents tend to differ from couples for other reasons, the following analysis focuses only on the two-parent families. The categorisation of spouses or clients as self-employed or in some other occupational group is that carried out by DSS staff according to the rules outlined earlier in this report.

Table 6.3 shows the total population of couple recipients of AFP (Workforce) on 15 September 1995, according to the spouse's occupation. Family Payment is generally made to the women in two-parent families, but the male partner is more likely to be the main earner and his occupation is thus more useful as a definer of the family's primary labour market and income status. As is shown below, many of the clients themselves are also recorded as having paid work, but their taxable income exceeded that of their spouse in only five per cent of cases where the spouse was waged or salaried. Among the self-employed families, this was more common, occurring in 28 per cent of cases.

Excluding sole parents, clients who had a self-employed spouse made up 35 per cent of the clientele, and just under one-fifth of the self-employed were landowners. This suggests that the assessment of self-employed income for AFP is likely to be a significant issue within the administration of Family Payments. Families supported by self-employment may not, however, be significantly over-represented among the AFP clientele. As noted in Table 6.2, the incidence of FAS

Table 6.3: AFP (Workforce) Client Population: 15 September 1995 (Couples Only)

Spouse's Occupation	AFP Type		Total
	Workforce AFP Only	Low-income Parenting Allowance(a)	
Self-employed: landowner	16 073	2 044	18 117
Self-employed: other	63 857	13 342	77 199
Not self-employed	147 788	27 592	175 380
Not coded(a)	.	2 826	2 826
Total	227 718	45 804	273 582

Notes: a) Some Parenting Allowance recipients did not have a spouse's occupation recorded as they became clients before the requirement for occupation to be coded came into force.

Source: Department of Social Security administrative data

receipt was higher for the self-employed than employee families, but not dramatically so. Survey data for 1995 are not yet available, but the 1990 ABS Income Survey also shows that of all families with a head or spouse in full-time employment, and with children in the age range for (then) FAS eligibility, just under 22 per cent derived their main earnings from self-employment.

Employment Status

Receipt of Parenting Allowance (PgA) was higher among the non-farm self-employed than amongst wage earners and was relatively low among the farm families (Table 6.4). This is perhaps surprising given that, as is shown later, taxable farm incomes tend to be lower on average than those of other occupational categories. One possibility is that as a new benefit PgA has yet to become well known to farming families. It may also be that the tighter assets test excludes more of these families from entitlement.

Although cases were selected, for the purposes of sampling, on the basis of the spouse's occupation, many of the clients themselves were also recorded as having paid work. Table 6.5 gives clients' occupations in two-parent families according to that of their spouse.

The table shows that clients' occupations were strongly correlated with those of their spouses. Three-quarters of women (nearly all clients are women) with waged spouses did not have paid work and only a handful of those that did were self-employed. By contrast, around three-fifths of women whose spouses were self-employed were also self-employed themselves. It seems probable that many of

Table 6.4: Percentage of Families Receiving Low-income Parenting Allowance as Well as Workforce AFP, by Spouse's Occupation (Couples Only)

	Spouse Occupation			
	Waged and salaried	Self- employed: land	Self- employed: other	Other(a) %
	Percentages			
Workforce AFP only	83.3	88.7	81.3	86.6
Also receive Parenting Allowance	16.7	11.2	18.7	13.4
Total(b)	100	100	100	100
Base (unweighted)	3475	2493	2498	544

Notes: a) The spouse occupation 'Other' includes full-time students, those on home duties and retired.
 b) The sample excludes sole parents and a small number of cases with anomalous coding.

Source: DSS administrative sample

Table 6.5 AFP Client Occupation by Spouse Occupation: September 1995

Client Occupation	Spouse Occupation			
	Waged and salaried	Self- employed: land	Self- employed: other	Other
	Percentages			
Waged and salaried	18.1	12.2	12.9	29.8
Self-employed: land	0.1	61.8	0.2	0.6
Self-employed: other	1.7	2.3	59.2	4.4
Home duties	74.7	22.9	24.9	41.4
Other	5.4	0.7	2.9	23.9
All families	100	100	100	100

Source: DSS administrative sample

these couples were involved in partnerships, either actively or for taxation purposes, but this information is not available from the DSS database.

One interesting question is whether the particular type of labour force participation by women in this group varied according the age of their youngest child. Table 6.6 gives a breakdown of the different combinations of work among AFP recipient couples.

Table 6.6: AFP Client and Spouse Work Force Participation by Age of Youngest Child

Age of youngest child	All clients with landowner self-employed spouse	All clients with other self-employed spouse	All clients with waged spouse	Both partners self-employed (spouse landowner)	Both partners self-employed (spouse other s/e)	Spouse s/e on land and client waged	Spouse other s/e and client waged	Both spouse and client waged	Spouse waged and client not in work force
					Percentage				
Under 5	43	48	63	40	41	34	40	50	66
6-12 years	44	42	32	48	47	50	48	41	30
13 or over	12	10	5	13	12	16	12	9	4
Total	100	100	100	100	100	100	100	100	100
Base (unweighted sample)	2493	2498	3475	1599	1483	305	322	628	2785

Source: DSS administrative sample

Overall, families where the man is self-employed are less likely to have a child under five than those where the man is an employee. This fits with the general picture of self-employed people being slightly older on average than employees. Families with a child under five are even less likely to be found among those where the woman is also self-employed, although the difference is not substantial. The DSS data hold no information about the number of hours worked, so it is not possible to tell whether those self-employed women with children under five are only working for limited hours, though this seems likely.

A more difficult situation to manage with a pre-school aged child appears to be where the man is self-employed and the woman also goes out to work as an employee. This is not surprising given the hours many self-employed men work. It is also no surprise to find the highest proportion of families whose youngest child is under five among those where the man is in waged work and the woman not in the paid labour force.

Family Characteristics

As for the self-employed in general, rates of marriage are high among self-employed recipient families with children. Among the two-parent self-employed families, 98 per cent of landowners and 94 per cent of other self-employed clients were married, compared with 84 per cent of other couples. The distributions of clients according to country of birth also differs according to occupational status. Thus 97 per cent of clients with self-employed landowning spouses were born in Australia, compared with 80 per cent of other self-employed and 83 per cent of those with waged and salaried spouses. Self-employment is relatively common among some migrant groups, as was described earlier in the report, and in this the AFP clientele reflects the wider population. Among those with self-employed spouses the most common non-Australian countries of origin were the United Kingdom, New Zealand, Vietnam, the Lebanon, China, Hong Kong and Italy.

6.3 Levels of AFP Payment

Table 6.7 examines whether levels of payment differ between self-employed and not self-employed families. On average, self-employed parents, particularly farmers, received higher weekly payments than waged parents. The mean difference between payments to farmers and wage earners was nearly 26 per cent, and for other self-employed just under 15 per cent.

Payment calculations are based on the numbers and ages of children, so one hypothesis is that the difference in payment rates between employment groups

Table 6.7: AFP Payment Levels to Two-parent Families, by Spouse Occupation: September 1995 (\$ Per Week)

	Waged and Salaried	Self-employed (land)	Self-employed (other)	Other
Mean	62.85	79.11	72.19	71.74
Median	66.52	67.20	67.20	67.20
Maximum	268.00	315.85	262.10	302.40
Percentages in payment bands ^(a)				
\$0.00-50.00	42.3	28.3	32.7	39.3
\$50.01-100.00	36.7	36.9	39.6	35.3
\$100.01-150.00	18.3	30.5	24.8	19.7
\$150.01 +	2.7	4.3	2.9	5.8

Note: a) A small number of cases are recorded as having zero payments. This is likely to be because of retrospective adjustments following a change in income.

results from differences in family composition. This hypothesis is tested in Table 6.8, which shows the ratio of average payments for families in non-waged groups compared to those mainly supported by wages and salaries when the numbers of children are held constant.

Table 6.8: Comparison of Average AFP Payments by Spouse Occupation, Controlling for Number of Children (Couples Only)

Spouse Occupation	Relative ratio of weekly AFP payments (waged and salaried = 1.00)			
	Percentage of Clients with			
	1 child	2 children	3 children	4 or 5 children ^(a)
Waged and salaried	1.00 (19.4)	1.00 (39.8)	1.00 (26.5)	1.00 (13.0)
Self-employed: land	1.29 (21.9)	1.28 (36.7)	1.30 (28.7)	1.27 (11.8)
Self-employed: other	1.20 (23.5)	1.22 (39.9)	1.22 (26.2)	1.22 (9.9)
Other	1.18 (35.4)	1.27 (35.8)	1.31 (18.0)	1.35 (7.7)

Note: a) Only two per cent of all recipient couples have more than five children

Source: DSS administrative sample

Self-employed families actually had slightly fewer children overall: the mean for waged and salaried families was 2.41, for self-employed landowners 2.37 and for other self-employed 2.27. While self-employed landowners were marginally more likely than waged families to have three children, the differences were not substantial. AFP payments are based on the ages as well as the number of children, so it is necessary to test whether self-employed families tend to have more children in the older categories. The clients in recipient families where the spouse is self-employed tend to be slightly older than those in waged families (with a mean age of 36.6 years compared with 33.3 years). However, the relationship between the levels of payments accruing to waged and self-employed families barely changes as the number of children increases, suggesting that the ages of children does not have a major effect.

6.4 Incomes

The main driving force behind the difference in payments between waged and self-employed clients is likely to be the combined income levels of client and spouse, as assessed for the income test. The data show that while AFP maximum payments were reduced because of assessable income exceeding the threshold for 47 per cent of clients with a waged spouse, this happened in the case of only 15 per cent of self-employed landowners and 22 per cent of other self-employed families. Some information on income is missing from the data, particularly maintenance income and deemed income from fringe benefits, but tests run by DSS indicated that using combined income alone to derive an implicit base AFP entitlement equated actual recorded payments in over 90 per cent of cases. Many of those where it did not are likely to be sole parents who receive maintenance, and they are excluded from this analysis. Very few clients are recorded as receiving any fringe benefits: the only benefits of any significance were for spouse's accommodation (received by 2.6 per cent of wage earners, one per cent of self-employed landowners and 0.4 per cent of other self-employed) and for a spouse's vehicle, received by 1.6 per cent of wage earners, 0.4 per cent of farmers and one per cent of other self-employed. Also, less than half of one per cent of cases are recorded as having any other income (such as foreign income) other than the client's or spouse's taxable income.

Table 6.9 gives the mean levels of assessed taxable income for AFP (Workforce) clients and their spouses, by employment status. Thirty four per cent of families with a self-employed spouse are recorded as having zero annual incomes in the previous tax year and 28 per cent also had zero client income. Only a handful of self-employed families had any other income, so nearly 28 per cent in all had zero combined income (33 per cent of landowners and 22 per cent of other self-

Table 6.9: Mean Levels of Annual Taxable Income, by Spouse's Occupation (AFP Workforce Clients)

Spouse's Occupation	Spouse \$	Client \$	Combined Income(a) \$
Waged and salaried	17 645.31	1 738.89	19 459.16
Self-employed: land	6 547.97	5 228.99	11 776.96
Self-employed: other	8 933.63	6 046.32	14 987.68
Other	6 983.96	5 755.08	12 931.82

Note: a) Differences between combined income and the sum of clients' and spouses' income result from the additional levels of other income accruing to a small number of clients.

Source: DSS administrative sample

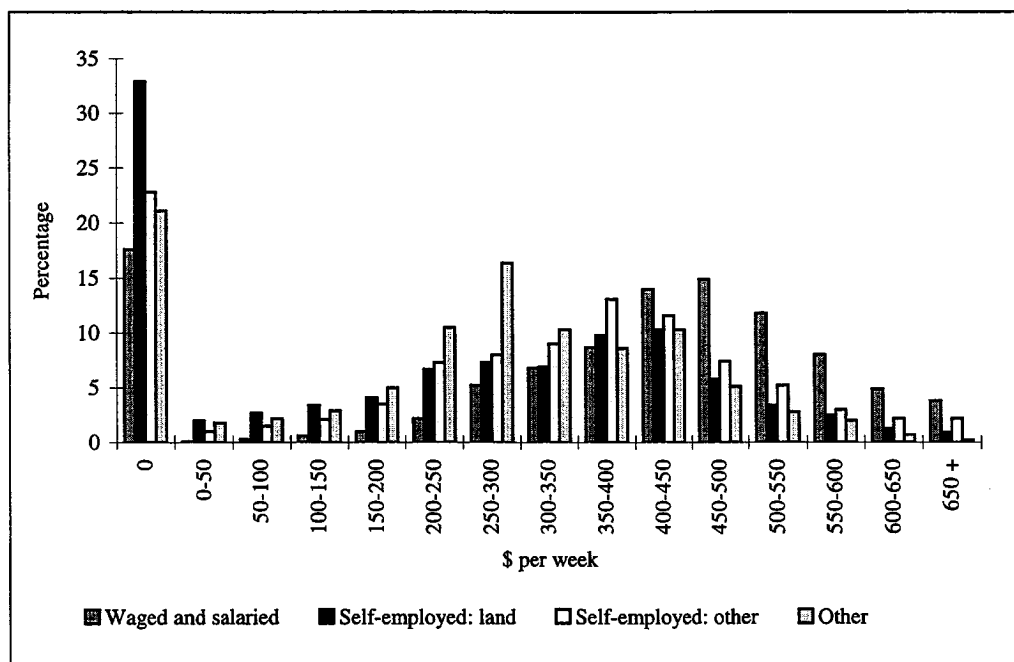
employed). It is not unusual for self-employed people to be assessed as having losses or zero income: this is the nature of business, especially in agriculture. However, a surprisingly high percentage of couples with a waged spouse are also recorded as having zero spouse incomes. This seems to be because many of them were previously recipients of AFP-Auto - that is, they had been pensioners or beneficiaries and thus there was no requirement for a taxable income figure for the previous year to be recorded.

The greater participation in self-employed enterprises by female clients (whether in reality or for tax purposes) compared to the paid work undertaken by those married to waged men, is evident from the respective mean earnings. The combined taxable income of waged and salaried families was also substantially higher than that of the self-employed families, especially the farmers.

The distribution of combined taxable income is illustrated in Figure 6.2. A weekly combined income figure was derived by dividing the annual figure by 52 and grouping it into \$50 bands. Those recorded as having zero incomes are grouped separately. Although income among recipient couples with levels above zero was distributed fairly normally within the overall range, it is noticeable that waged and salaried families were clustered further towards the upper range than the self-employed families.

6.5 Income and Housing Tenure

One of the other variables available from the DSS database which is relevant to consideration of AFP recipients' living standards, is tenure. Self-employed people

Figure 6.2: AFP Recipients' Combined Taxable Income, by Spouse Occupation

tend to have high levels of owner-occupation, for reasons which include age and family formation, the ability to run businesses from home and the greater availability of business loans secured against housing. Table 6.10 shows the tenure distribution among AFP recipients.

Table 6.10: AFP Clients' Housing Tenure^(a), by Spouse Occupation (Couples Only)

Tenure	Waged and salaried	Self-employed: land	Self-employed: other	Other
Percentages				
Fully owned	45.1	76.2	67.6	38.4
Partly owned/ jointly owned/ purchasing	5.5	1.8	7.5	6.7
Renting or other tenure	49.4	22.0	24.9	54.9
All families	100	100	100	100

Note: a) Information on tenure is missing in 3.5 per cent of cases, around two-thirds of which are self-employed.

Source: DSS administrative sample

Only just over half of recipients with a waged spouse were owner-occupiers, as opposed to 78 per cent of farmers and over three-quarters of other self-employed families. Even where the self-employed were not in owner-occupied housing, many did not have rent to pay (Table 6.11).

Table 6.11: Type of Housing in Rented Sector Occupied by AFP Clients, by Spouse Occupation

Rent Type	Waged and salaried	Self- employed: land	Self- employed: other	Other
Percentages				
Private	68.0	22.1	60.9	68.6
Public	13.8	1.2	6.6	13.4
Lodging/ Board and Lodging	1.4	0.2	0.4	3.0
Caravan site/other	0.5	0.4	0.1	1.0
Rent-free	16.2	76.1	32.1	14.0
All families	100	100	100	100

Source: DSS administrative sample

Of the 22 per cent of self-employed farming couples who did not fully or partly own their own homes, only just under 24 per cent had rent to pay (amounting to less than six per cent of the total), compared with nearly 74 per cent of renting couples supported by waged work. The other self-employed couples were more similar to the waged families, but still nearly a third of the non-owner-occupiers lived rent-free.

Table 6.12 shows the levels of weekly rent paid by families in the rented sector with housing costs greater than zero. Those few self-employed farmers paying rent mainly had payments of under \$100 per week, whereas the other self-employed were, along with the waged families, mainly in the \$100-200 per week bracket, but also had a greater proportion in the higher rent ranges.

Overall, nearly 80 per cent of those clients paying rent (weighted for sample composition) received Rent Assistance. The percentage was lower for the self-employed landowners as their rents were lower, and correspondingly higher for the other self-employed families (Table 6.13).

This dataset holds only limited information about housing circumstances, but the broad picture appears to suggest that in spite of the assistance received by some renters, self-employed recipients may tend to have higher potential living

Table 6.12: Rent Paid by Two-parent AFP Clients, by Spouse Occupation

Rent \$ per week	Waged and salaried	Self-employed: land	Self-employed: other	Other
Percentages				
0.01 - 100.00	30.7	61.8	19.3	24.1
100.01 - 200.00	66.3	33.8	66.5	69.0
200.01 - 300.00	2.5	2.9	10.8	6.5
300.01 +	0.5	1.5	3.3	0.4
Mean	\$124.45	\$104.86	\$152.61	\$136.04

Source: DSS administrative sample

Table 6.13: Rent Assistance Received by Two-parent AFP Clients, by Spouse Occupation

Rent Assistance \$ per week	Waged and salaried	Self-employed: land	Self-employed: other	Other
Percentages				
0.01 - 10.00	5.6	10.7	2.4	3.5
10.01 - 20.00	7.6	19.0	3.7	1.5
20.01 - 30.00	11.2	17.9	7.6	11.4
30.01 - 40.00	51.1	36.9	63.0	63.4
40.01 +	24.5	15.5	23.2	20.3
Mean	\$34.35	\$28.68	\$37.05	\$36.53

Source: DSS administrative sample

standards, particularly in light of their greater home ownership, and access to rent-free housing. Further evidence on differential housing outcomes is provided in the analysis of living standards data reported in the next Section.

6.6 Summary

Family Payments are the main source of social security income going to families with self-employed earners. Eligible self-employed families were, in 1990, more likely than other eligible families to receive Family Allowance Supplement, but slightly less likely to be receiving Family Allowance only – possibly because of greater inequality in self-employment income. In September 1995, just over 30 per cent of recipients of Additional Family Payment (Workforce) were self-employed or had a self-employed spouse, and a quarter of these were farmers.

Not counting sole parents, who do not receive Parenting Allowance, receipt of PgA was higher among the non-farm self-employed families than among wage earners and was relatively low among the farm families.

Many of the clients with self-employed spouses appeared, at least formally, to be in business partnerships, since there was a strong correlation among them between client and spouse occupation. As with the self-employed generally, there were relatively high rates of marriage among self-employed recipients. Nearly all the clients with self-employed spouses in agriculture were born in Australia, whereas a fifth of those with spouses in other forms of self-employment were born overseas, along with 17 per cent of clients with waged spouses.

Clients with self-employed spouses, especially those on the land, received average weekly AFP payments around 20 per cent higher than waged families, and this was not significantly affected by the relative size and composition of families. The discrepancies were mainly driven by differences in levels of combined taxable income, as assessed for the income test. Self-employed families, especially farmers, were also considerably more likely to be living in owner-occupied housing than were the employee families. Even where self-employed families were not in housing they owned they were more likely to be living rent-free, but families in non-agricultural self-employment who were renting tended to have higher rents.

The data on housing tend to suggest that self-employed AFP recipients might tend to have higher wealth levels than the wage earners. This is a question explored further in the next section, which looks at other sources of evidence on wealth and living standards.

7 The Living Standards of Low Income Self-employed Families

7.1 Indicators of Living Standards

As previous sections have shown, families containing self-employed workers and workers in their own businesses receive a significant amount of income support, particularly in the form of family assistance payments. At the same time, measurement of the incomes of the self-employed is difficult. These measurement difficulties are compounded by the fluctuating incomes of businesses, and the large time lags involved in using taxable income data.

In this section, we examine the effectiveness of the targeting of family assistance policies. We do this by examining a number of alternative indicators of living standards and compare the situation of families with self-employed and employee members. Living standard indicators are drawn from three recent national surveys conducted by the Australian Bureau of Statistics, the *1988-89 Household Expenditure Survey* (1988-89 HES), the *1990 Survey of Income and Housing Costs and Amenities* (1990 SIHCA), and the *1993-94 Household Expenditure Survey* (1993-94 HES).

Whilst payments such as the higher rate of Family Payment and Parenting Allowance can serve several functions, their key objective in the Australian context is to increase the living standards of poor and near-poor working families with children. The income and assets tests described in Section 5 are intended to assist in targeting most assistance to those families most in need. Are measured incomes (and assets) an effective way of targeting assistance to needy self-employed families?

In Section 5 we described people as being poor if they only have access to a particularly low level of economic resources. In practice, it is not possible to undertake a complete accounting of the full income or consumption levels of individuals or families. However, it is possible to assemble a range of indicators of material well-being which can be used to evaluate the effectiveness of targeting policies. Which indicators are appropriate depends upon the research question being addressed.

One particular question of interest is the extent to which income as measured in surveys (or by the taxation office) provides a good indication of the living standards of the self-employed. Eardley and Corden (1996b) review a number of studies addressing this question which compare measured incomes with

expenditure on selected items. Pissarides and Weber (1989) and Baker (1993) undertake an analysis using UK food expenditure whilst Bradbury et al. (1988) do this for housing expenditures in Australia. If, at a given level of income, the self-employed spend more than employee families, this can be taken as evidence that self-employment income is under-recorded. Given the relationship between incomes and expenditure for employees, it is then possible to work backwards to calculate the extent of underestimation of self-employment income.

The main conclusion of these studies is that income is a significantly poorer predictor of expenditures for the self-employed, and that if the relationship between 'true' income and expenditure for employee households is assumed to hold for self-employed households, then the latter's income must be under-recorded by a significant amount.

Since household surveys are based upon very similar income concepts to those used by tax authorities, evidence that incomes are under-recorded in household surveys can have important policy implications. However, under-recording is not the only explanation for a weak relationship between measured incomes and expenditures. One possibility is that the self-employed may have greater access to saving and dissaving opportunities. During periods of low income, they may be able to maintain expenditure by drawing on savings or increasing business overdrafts.

A more mundane, but empirically very important explanation, stems from the different time periods over which incomes are collected for the self-employed. Typically, household surveys record current wage and salary incomes, but use self-employment income applicable to some previous period (converted to a weekly basis). Whilst it is possible to adjust for changes in average self-employment incomes (possibly even by industry as in Bradbury et al., 1988) this cannot fully compensate for variation at the individual level.

This is compounded by the fact that the annual incomes of self-employed people are relatively variable over time. Incomes for farmers are particularly variable because of climatic fluctuations, but the self-employed more generally experience significant income variation over the business cycle. This means that current income will be relatively weakly correlated with income during the period recorded by the household survey (usually some previous tax year), in turn implying a weaker relationship between the recorded income and current expenditure.

These issues associated with the timing of income measurement are relevant to income support policy, but not in the same way as the possibility of a general under-recording of self-employment income. Clearly, the latter will lead to an overestimate of self-employment poverty. If, on the other hand, there is no

systematic under-recording of self-employment income, then the *average* poverty rate among the self-employed may be accurately reflected in survey data. However, income variability and differential time lags will mean that it will be harder to pinpoint *which* self-employed are poor than it is for employees. One policy option which might lead to more current estimates of self-employment incomes is described in Section 8.

Finally, it should be noted that one offsetting factor is the possibility that the respondent burden associated with low income assistance payments may mean that some self-employed who are eligible for assistance do not apply for it. In particular, the individualist ethos associated with self-employment may make the income and asset reporting arrangements seem particularly burdensome. Those people in the greatest hardship may more likely be prepared to bear this burden. However, with the integration of family payments, and the use of pro-active measures⁹ to increase take up, this self-selection effect may be diminishing.

7.2 Household Expenditures in 1988-89

Some of the established patterns of association between incomes and expenditures for the self-employed can be illustrated in a simple fashion with data from the *1988-89 Household Expenditure Survey* (HES).

Because payments for working families are the main payment received by the self-employed, attention is confined here to households containing a couple plus one or more children aged under 16 (and no other people), not receiving any pension or benefit payment, and with the head or spouse employed. Families are described as self-employed if either the head or spouse is self-employed, and these families are compared with other, employee, households. Because self-employed farmers do not have a significant employee comparison group, we exclude households living in a rural area.¹⁰

Table 7.1 shows the average incomes and expenditures for these households in 1988-89. As well as total expenditure, the table also includes a 'current

9 For example, using ATO data and DSS data to identify clients likely to be eligible for Parenting Allowance, and then sending out application forms to these people.

10 More 'complicated' households comprising couples, children and other people are excluded so as to ensure a more homogeneous population, and to remove the need to control for large variations in the needs and employment status of household members. Households with negative incomes or expenditures are also excluded. Means and medians are calculated using ABS weights. People working in their own incorporated businesses are included with employees (they are not separately distinguished in the HES).

Table 7.1: Average Incomes and Expenditures for Couples with Children: 1988-89

		Self-employed (\$/week)	Employee (\$/week)	Ratio (SE/Emp)
Gross income	Mean	672	830	0.81
	Median	590	734	0.80
Total expenditure	Mean	673	619	1.09
	Median	586	554	1.06
Current expenditure	Mean	409	367	1.11
	Median	361	331	1.09
Sample Size		234	1159	

Source: ABS 1988-89 Household Expenditure Survey, unit record files.

expenditure' variable. This variable represents an attempt to exclude expenditures of a capital nature which might reflect prior savings and investment decisions, as well as household expenditures which might be born by the business. More specifically, current expenditure excludes housing (because housing expenditures are a poor proxy for housing quality), expenditure on household appliances and furnishings (because recent expenditure might not reflect current assets held) and telephone and transport costs (because these may be paid for by the business).¹¹ The remaining expenditure comprises about 60 per cent of total expenditure. This 'current expenditure' approach is only one way of dealing with discrepancies between consumption and expenditure. A alternative approach is introduced in Section 7.3 where we consider the data from the 1993-94 HES.

The patterns in this table are quite striking. The mean income of the self-employed is only 81 per cent of that for employees, whilst their mean expenditure is nine per cent higher. If we use the expenditure/income ratio for employees as a yardstick, this suggests that average self-employed 'true' incomes should be about one-third higher than recorded in the survey.¹²

It is possible, however, that most of this under-recording of income stems directly from the strong growth in self-employment incomes in the years prior to 1988-89. For self-employment income, the HES relies upon the most recent data available. For people interviewed in the second half of 1988 (and some interviewed in 1989), this will usually be for the 1986-87 financial year, whereas for people

11 Gambling expenditures are also adjusted to remove the distortionary effect of large wins recorded as negative expenditures.

12 That is, employee incomes are 34 per cent higher than expenditures (830/619), whilst self-employed incomes are equal to expenditures.

interviewed in 1989, 1987-88 data will normally be used. The National Accounts show that gross operating surplus of unincorporated private trading enterprises, per self-employed person, grew by 33 per cent between 1986-87 and 1988-89 (and 14 per cent from 1987-88 to 1988-89) (calculated from Foster and Stewart (1991) and the data of Figure 3.1).

Therefore, if we were to adjust average self-employment incomes upwards on the basis of these trends (and assume recorded income to be evenly divided between 1986-87 and 1987-88), they should be 23 per cent higher than the figures shown in Table 7.1. Mean incomes of the self-employed would then be \$826 per week, essentially equal to the mean income of employees. However, a difference in expenditure levels of six to 11 per cent still remains.

Two conclusions can be drawn from this analysis. First, even average self-employment incomes can be very volatile in certain parts of the business cycle. When measuring the average living standards of the self-employed, this suggests that even simple methods of updating self-employment incomes will be much better than no adjustment at all. Second, the expenditure data do suggest a general under-recording of income, but it is not of a large magnitude. As we shall see below, however, higher estimates of a recording discrepancy are obtained using data from the 1993-94 HES.

One limitation of the above analysis from the point of view of income support policy is that it looks only at overall averages rather than just the incomes of those at the bottom of the distribution. Indeed, if Table 7.1 is replicated for households with incomes below \$700 per week the gap between the self-employed and employees does widen slightly. In this case, the self-employed have mean incomes 82 per cent of those of employees, but total expenditures 17 per cent higher (with similar percentages for the other averages).

However, it is difficult to draw firm conclusions from such a sub-sample. The lag between income measurement and expenditure for the self-employed means that there will be a weaker correlation at the individual level between incomes and expenditures. This means that a set of self-employed with low incomes will be more likely to include those with higher expenditures than a similarly selected set of employees, simply because of the different time lags involved. Hence, in addition to the targeting problems introduced by changes in average incomes, time lags in income collection mean that it is more difficult to identify which self-employed are poor.

Moreover, it is difficult to use expenditure data directly to identify the incidence of poverty. In Australian expenditure surveys, most data are only collected over a two-week period. Some households may not do much shopping during this period, and thus may have a very low recorded expenditure. This 'shopping

variability' may be so great as to swamp any difference in expenditure patterns due to differences in consumption levels. Whilst a corresponding problem exists in income data - people may have zero incomes simply because they are between income sources - it is general thought to be less severe.

In the next sub-section, this question is addressed using more recent data from the 1993-94 HES, and employing an alternative method of estimating the total expenditure level of the household.

7.3 Household Expenditures in 1993-94

Whilst household expenditures might be considered the best indicator of household consumption, these data have several important limitations. First, as noted above, household expenditure may be quite variable from week to week, and this may be reflected in the recorded expenditure data. Whilst this does not bias estimates of average expenditures, it does make such estimates less precise and, as discussed above, it may lead to an overestimate of the distribution of household consumption levels. From one perspective, this 'shopping variability' is simply an example of the fact that expenditure includes both current consumption and capital goods. People may make large purchases in the survey period, but consume the good over a number of periods (when they have no expenditures).

Another difficulty, more specific to the self-employed, is that some household consumption may be directly provided by the business. The consumption in this case will not be counted as either income or household expenditure. In Bradbury (1996) two methods are proposed for dealing with these limitations of household expenditure data, and the results of this analysis are summarised here.

One way of identifying the extent of business purchases for home consumption is to examine whether self-employed families spend less on some goods than might be expected on the basis of their consumption of other goods. To identify this expenditure distortion it is necessary to assume that there are no such 'business purchases' for employee households, and that there is at least one 'reference goods' for which there is no consumption distortion. This good then serves as a benchmark against which expenditure patterns can be assessed.

An examination of the expenditure patterns of the self-employed and employee families in the 1993-94 HES indicates that the only good where there appears to be a consistent under-recording of expenditure by the self-employed is the category 'other transport'. This mainly comprises vehicle running costs. On average, the self-employed appear to be consuming about \$20 per week more of transport services than their recorded expenditures would suggest. This is due to

the private use of vehicles owned by business. It is possible that other areas of business contribution might be identified if the analysis were disaggregated by industry, but this information is not available from the 1993-94 HES.¹³

When comparing the expenditure patterns of self-employed and employee households, the easiest way to correct for this difference in expenditure patterns is to simply exclude transport expenditure altogether, and this is done here.

To correct for 'shopping variability' a different approach is needed. In Bradbury (1996) a factor analysis method is introduced to more accurately identify the underlying consumption level of the household. This method produces a 'weighted expenditure' variable which is a weighted sum of the different components of household expenditure. This weighted expenditure variable is normalised to have the same mean as total expenditure, and a variance equal to that of the underlying total consumption. Higher weights are given to those items of expenditure which are relatively stable over time and those items which are strongly correlated with total expenditure. For example, each dollar of household fuel expenditure contributes almost three dollars to weighted expenditure (because fuel expenditure is relatively stable over time), whilst each dollar of personal care expenditure counts for two and a half dollars. Expenditures on food, telephone and postal services, and medical services also have high weights (see Bradbury, 1996, Table 3).

Whilst this weighted expenditure measure cannot eliminate shopping variability, it does reduce it. More generally, it places more weight on those items of expenditure which have strong correlations with other expenditures. Housing, for example, has a low weight because current housing costs have only a low correlation with ability to consume. People with high housing wealth, for example, may have low mortgage repayments if they are near the end of their loan. For this reason, the average value of the weighted expenditure within different population sub-groups may also be more informative about living standards.

Table 7.2 repeats the analysis of Table 7.1, but for 1993-94 and with the addition of the adjusted expenditure variables introduced above. The population of Table 7.2 is also broader in two respects. Table 7.2 includes couples without dependent children and also includes farmers, since the latter cannot be separately identified on the public use version of the 1993-94 HES.

The first panel of Table 7.2 shows average net incomes and expenditures for self-employed and employee families. The problems of income timing described

13 Industry was asked in the survey, but apparently not coded.

Table 7.2: Incomes and Expenditures of Working Couples: 1993-94

		Self-employed (\$/week)	Employee (\$/week)	Ratio (SE/Emp)
All Households (100%)				
Net income	Mean	557	799	0.70
	Median	518	747	0.69
Expenditure: ABS definition	Mean	648	773	0.84
	Median	611	687	0.89
Expenditure: excluding transport	Mean	567	657	0.86
	Median	527	576	0.91
Weighted expenditure	Mean	604	649	0.93
	Median	574	600	0.96
Households with net income < \$500 pw (22%)				
Expenditure: ABS definition	Mean	577	548	1.05
	Median	526	511	1.03
Expenditure: excluding transport	Mean	498	459	1.08
	Median	446	417	1.07
Weighted expenditure	Mean	561	495	1.13
	Median	522	465	1.12
Households with net income < \$400 pw (10%)				
Expenditure: ABS definition	Mean	580	571	1.02
	Median	498	482	1.03
Expenditure: excluding transport	Mean	497	451	1.10
	Median	426	358	1.19
Weighted expenditure	Mean	558	496	1.13
	Median	521	454	1.15
Households with equivalent net income < \$500 pw (16%)				
Equivalent weighted expenditure	Mean	618	537	1.15
	Median	556	503	1.11

Source: Bradbury, 1996, using ABS 1993-94 Household Expenditure Survey, unit record files.

above for the 1988-89 HES are less severe in 1993-94, as self-employment incomes were relatively stable in the previous two years. If self-employed incomes were adjusted to a current basis using trends in average incomes, it is likely that that they would only be around three per cent higher than shown here.

As in 1988-89, the self-employed have lower incomes than employees, and this gap is greater for income than for expenditure. However, the gap between self-employed and employee expenditure does narrow significantly as we move towards the more robust measures. Median self-employment total expenditure (using the conventional definition) is 89 per cent of that for employee households. When transport costs are excluded, this rises to 91 per cent, and when the weighted expenditure variable is used, it rises further to 96 per cent. In other words, the self-employed spend almost as much as employee households on those commodities which have a strong relationship with underlying consumption, though they spend less on other commodities.

Whilst the average consumption of the self-employed remains lower than that of employees, consumption levels are much closer than average incomes would suggest. It is possible to calculate an implied 'true' self-employment income by assuming that the relationship between income and expenditure should be the same for both employees and the self-employed. For employees, average income is 1.23 to 1.25 times greater than weighted expenditure (mean and median respectively). If we apply this ratio to self-employed expenditures, we obtain income estimates which are 34 to 38 per cent higher than the recorded incomes. As noted above, only about three percentage points of this is likely to be due to the recording lag for self-employed incomes.

In other words, using the weighted expenditure variable as a yardstick, it would appear that average self-employed incomes are under-recorded by around 30 to 34 per cent. This compares with the estimate of only six to 11 per cent obtained from the 1988-89 HES data.

There are several reasons for the discrepancy. First, the estimates here use the weighted expenditure variable, which we believe provides a more accurate reflection of living standards. If we were to use the conventional (ABS) definition of total expenditure instead, the 1993-94 estimate drops to a 17 to 25 per cent under-recording. A second important difference is that these estimates for 1993-94 include farmers, whilst the 1988-89 estimates do not. The year 1993-94 was one of particularly low farm incomes and many farmers may have been living off their savings. Probably of lesser importance are the facts that, the estimates for 1988-89 only examined families with children, whereas the 1993-94 data covers all working couple households of workforce age, and net incomes rather than gross incomes are examined. Finally, the adjustments made for income inflation are only very approximate. It is interesting that the estimates of income under-recording are both at about one-third if no adjustment for recording lags in income collection is made.

The next three panels of Table 7.2 examine the extent of expenditure poverty among the low-income self-employed. Three different definitions of low-income

poverty are used. The first group identified are households with net income less than \$500 per week, a definition that includes 22 per cent of the population in Table 7.2. The second group are those with net income less than \$400 (10% of the population), whilst the third group are those with equivalent net income less than \$500 per week (16%).¹⁴

For all three definitions of poverty, the average expenditure levels of the self-employed are higher than the expenditure levels of employee households. The difference is greatest for the weighted expenditure variable. Depending upon the poverty threshold or average used, low income self-employed households have an average weighted expenditure some 11 to 15 per cent higher than employee households.

Whilst the low-income self-employed thus have a higher living standard than low income employees, this *does not* imply that there is less poverty among the self-employed. Indeed, Bradbury (1996, Table 4) presents regression results which show that, using weighted expenditure as the living standard index (with no reference to income), the poverty rate for the self-employed is approximately six percentage points higher than for employees. The reason for the discrepancy between these two results is simply that expenditure is poorly correlated with incomes for the self-employed. A significant number of self-employed who did not have a low income, nonetheless had very low expenditure levels in 1993-94.

The main caveat to the finding of high poverty among the self-employed is that this could be a result of infrequent shopping by farmers. If they go shopping less frequently than city dwellers, more of them will be recorded as having very low expenditure levels. Preliminary analysis suggests little difference in the proportion of households with zero incomes, and it is plausible that there were a significant number of farming families in particular with very low incomes in 1993-94 - so the possibility of high poverty rates among the self-employed should not be discounted. More research on this question using other data sets is warranted.

The immediate policy question, nonetheless, is the extent to which policies used to target assistance are effective in their goals. The observed loose association between incomes and expenditures is only of limited use in addressing this question, since organisations such as DSS use a range of measures to target assistance. Whilst entitlement to family assistance is often based upon previous year's taxable income (defined in a similar fashion to the HES data), some people supply estimates of current year incomes, questions are asked about changes in

14 The equivalence scale for both income and expenditure is simply $\sqrt{n}/2$, where n is the number of people in the household (equivalent income equals actual income in four person households).

incomes (and subsequent notifiable events) and the assets test also acts as a restriction to payment receipt (see Section 5). Moreover, some self-employed with low recorded incomes, but who actually have a higher standard of living, may choose to not take up their entitlements.

Table 7.3 presents evidence on the living standards of self-employed and employee families receiving Additional Family Payment in 1993-94. This payment is not separately identified in the HES file, but can be inferred from information on the amount of combined Family Payment and AFP received by the household (with some approximations). The population of Table 7.3 is those couple households included in the previous tables, who were also apparently receiving \$15 per week or more AFP in 1993-94 (obviously, only families with children are included).

Table 7.3: Living Standard Indicators for AFP Recipient Families: 1993-94

		Self-employed (\$/week)	Employee (\$/week)	Ratio (SE/Emp)
Sample Size		73	191	
Net income	Mean	271	608	0.45
	Median	368	550	0.67
Total expenditure (ABS)	Mean	600	641	0.94
	Median	598	543	1.10
Weighted Expenditure	Mean	594	580	1.02
	Median	586	532	1.10
Equivalent Weighted Expenditure	Mean	554	530	1.05
	Median	542	493	1.10
AFP per child	Mean	34	28	1.21
Home owner or purchaser	%	67	55	1.22
Rent free	%	7	9	0.78

Source: Bradbury, 1996, using ABS 1993-94 Household Expenditure Survey, unit record files. Weighted estimates.

Whilst the sample size is small, the results of this table are broadly consistent with the income patterns described above. The incomes of self-employed AFP families are much lower on average and this is reflected in their higher rates of payment per child. However, the average expenditures of the self-employed are generally higher. The only exception to this is the mean of total expenditure, where employees have a higher expenditure level. Further examination reveals this to be due to some outlier high expenditures on house purchase and transport costs: items which have a low (or zero) weight in the weighted expenditure

variable. The most appropriate (and robust) measure for poverty purposes is probably the median of weighted expenditure, which is some 10 per cent higher for the self-employed.

In addition, self-employed households have a significantly higher rate of homeownership, and hence a higher consumption of housing services than employee AFP recipients (and higher net wealth). It is possible to examine housing conditions in more detail using the 1989-90 Income and Housing Survey.

7.4 Housing Consumption and Wealth in 1990

The *1990 Survey of Income and Housing Costs and Amenities* (1990 SIHCA) was a large national survey conducted by the Australian Bureau of Statistics in October to December 1990. At that time, low income families with children who were not receiving a Pension or Benefit could receive Family Allowance Supplement (FAS) in addition to their Family Allowance payments paid to most families with children.

Table 7.4 shows a number of living standard indicators, mainly related to housing, available in the 1990 SIHCA. These are shown for couple income units with children who were receiving FAS, were not receiving any social security pension or benefit and had either spouse employed. Families are classified as self-employed if either the head or spouse was self-employed. It is also possible in this survey to distinguish farmers and people running their own limited liability business.

The general characteristics of these different family types are shown in the first panel of the table. Farming families tend to have lower incomes and smaller families, whilst the small number of families running their own (limited liability) business had significantly¹⁵ higher incomes in 1989-90. Since FAS entitlement in 1990 was generally assessed on the basis of taxable incomes for 1988-89, this suggests a high level of variability in the incomes of families with limited liability businesses. Since the sample size for this group is very small however, most of the discussion here concentrates on the other family types.

Family heads and spouses were slightly older in self-employed families, and they received a slightly higher rate of FAS payments per eligible child (eligible children are defined as for Table 6.2).

15 The standard error of the difference can be calculated as $\sqrt{s_1^2 + s_2^2}$ where s_1 and s_2 are the standard errors as shown in Table 7.4.

Table 7.4: Housing Conditions of Couples Receiving Family Allowance Supplement: 1990

	Employee	Self-Employed, Not Agriculture	Self-Employed, Agriculture	Running own LLC business
Numbers in brackets are approximate standard errors				
General				
Number of cases	274	101	32	15
Population represented	120,335	40,121	11,912	5,495
Mean number of children	2.5	2.7	2.3	2.6
Mean income in 1989-90	26,930 (926)	25,398 (1,819)	21,624 (2,480)	42,204 (4,897)
Mean age of head	35.4 (0.4)	37.3 (0.6)	37.3 (0.9)	33.4 (1.4)
Mean age of spouse	32.6 (0.4)	33.9 (0.6)	35.4 (0.8)	32.4 (1.2)
Mean weekly FAS per child	26.9 (0.9)	29.0 (1.1)	29.3 (1.5)	26.9 (3.5)
Housing Tenure (%)				
Owner	19.7	34.7	34.4	33.3
Purchaser	38.0	45.5	43.8	40.0
Govt. rental	11.0	3.0	0.00	13.3
Private rental	23.0	10.9	3.1	6.7
Living with relatives/other arrangements	3.7	2.0	0.00	0.00
Rent free	4.7	4.0	18.8	6.7
Total	100.0	100.0	100.0	100.0
Housing Wealth				
Mean net equity for owners and purchasers (\$000)	98.9 (5.6)	114.2 (9.3)	123.6 (24.2)	89.2 (15.9)
Mean net equity across whole sample (\$000)	58.2 (4.4)	91.8 (8.8)	84.7 (20.4)	65.0 (15.5)
Housing Quality				
Mean dwelling sale price for owners and purchasers (\$000)	124.4 (6.3)	137.2 (9.5)	158.1 (20.9)	119.3 (20.3)
Mean rent for private renters (\$/week)	117.8 (5.0)	123.7 (14.6)	100.0 (-)	150.0 (-)
Mean total housing expenditure (\$/week)	101.7 (5.1)	98.7 (8.2)	122.0 (42.5)	132.9 (29.2)
Mean bedrooms per child	0.94 (0.03)	0.93 (0.05)	1.02 (0.14)	1.13 (0.17)

Continued

Table 7.4: Housing Conditions of Couples Receiving Family Allowance Supplement: 1990 (Continued)

	Employee	Self-Employed, Not Agriculture	Self-Employed, Agriculture	Running own LLC business
Numbers in brackets are approximate standard errors				
Mean bedrooms per child	0.94 (0.03)	0.93 (0.05)	1.02 (0.14)	1.13 (0.17)
Mean bathrooms	1.15 (0.02)	1.18 (0.04)	1.08 (0.05)	1.35 (0.12)
Mean number of lounge, living, family and dining rooms	1.45 (0.04)	1.58 (0.06)	1.35 (0.12)	1.48 (0.20)
Mean number of rooms in dwelling	8.34 (0.12)	8.77 (0.17)	8.31 (0.40)	9.40 (0.43)
Mean car spaces	1.15 (0.06)	1.23 (0.10)	1.10 (0.18)	1.70 (0.23)
Fraction of dwellings with ceiling insulation (where known)	0.47 (0.03)	0.66 (0.05)	0.55 (0.09)	0.67 (0.13)
Hours Worked				
Mean hours worked per week for head	41.8 (0.06)	47.9 (1.3)	54.2 (1.4)	53.2 (1.6)
Mean hours worked per week for spouse	6.9 (0.8)	14.8 (1.6)	25.6 (3.2)	17.7 (4.8)
Mean hours worked by head and spouse combined	48.7 (1.0)	62.6 (1.9)	79.8 (3.3)	70.9 (5.0)
Fraction of heads working >50 hours per week	0.15 (0.02)	0.53 (0.05)	0.84 (0.06)	0.71 (0.12)

The greatest difference between self-employed and employee families is with respect to housing tenure. Whilst 58 per cent of employees were owners or purchasers, 78 per cent of self-employed farmers owned or were purchasing their home, as were 80 per cent of non-farmers (and 72 per cent of business people). These owner-occupancy rates for self-employed families are similar to the overall rate for *all* employee families with children (78.2 per cent), not just those receiving FAS. Living rent-free was also more prevalent among farmers. These results are broadly similar to the tenure patterns of AFP recipients in 1995, as described in Section 6.

Within the population of owners and purchasers, the self-employed had a higher level of housing wealth but the difference was small. Non-farm self-employed had a mean housing wealth of \$114 300 compared to \$99 000 for employees, but this difference is not statistically significant. Farmers had a higher housing wealth also, but this is probably due to the incorporation of farm values into the house value.

Nonetheless, when housing equity is calculated across the whole sample (including those with zero housing equity) wealth differences are more apparent. Non-farm self-employed families receiving FAS had an average housing wealth of \$91 600, compared to only \$58 200 for employee families.

Whilst housing equity takes account of both the value of the dwelling and the amount owed on it, for a measure of the actual quantity and quality of the housing services consumed by these different households, it is more appropriate to look at either the house value or the market rental of the dwelling. Among home-owners, the non-farm self-employed lived in more expensive dwellings, though again the difference is not statistically significant. Similarly, among private renters the self-employed paid higher rents (not significant). The mean total housing expenditure for the different employment groups is about the same, but this is not very meaningful as an indicator of housing quality.

More direct indicators of housing quality tend to suggest greater housing consumption for non-farm self-employed families. Comparing non-farm self-employed with employee families, the number of bedrooms per child is about the same, whilst the number of bathrooms, living areas and car spaces is greater for the self-employed, though none of these differences is statistically significant. In total, non-farm self-employed have an average of 8.75 rooms per dwelling, whilst employee FAS recipients have an average of 8.34: a difference that is almost statistically significant. The picture for farm households is more mixed, whilst that for business families suggests a higher housing standard, though the numbers are small. Finally, all non-employee groups have a higher incidence of ceiling insulation, suggesting that they probably live in more recently constructed dwellings. (For farmers, this may also reflect their greater distance from the coast, and increased energy prices).

The final panel of Table 7.4, however, shows that the self-employed are not always better-off than employees. Hours worked are significantly higher for the self-employed, with over 50 per cent of non-farm self-employed, and 84 per cent of farmers, working more than 50 hours per week.¹⁶

¹⁶ The estimate of mean hours worked per week is only approximate, since the ABS has chosen to group hours of work into categories, with 50+ being the highest (57 hours is assumed for this group).

In summary, the greatest difference between employee and self-employed FAS recipient families observed in these data is the much higher rate of home ownership among the self-employed. Indeed their rate of home ownership was essentially the same as the home ownership rate for all employee households with children, not just those receiving FAS. This suggests that self-employed FAS recipients are probably wealthier than employee families, since the self-employed will have their business wealth to add to their higher level of (own-)housing wealth (though for some this may be negative). Housing quality also appears greater for the non-farm self-employed, though we cannot discount the possibility that this result is peculiar to this particular sample. For farm households, the lack of separation between business and home makes it more difficult to draw conclusions, whilst the (admittedly small) sample of families running their own companies appear to have the best housing quality of all. Offsetting these advantages for the self-employed are the longer hours that they work.

However, whilst factors such as home ownership may be a good predictor of longer-term living standards, they are of less relevance to living standards in the short term. The illiquidity of housing may mean that housing wealth cannot be used to finance current non-housing consumption when the self-employed have a bad year. Whilst they may still benefit from a high quality of housing, they may be forced to reduce their consumption significantly in other areas. Nonetheless, the weighted expenditure measure shown in Table 7.3, suggests that, on average, their consumption of these other goods is still slightly higher than for employee households.

7.5 Summary

This section examined three ABS household surveys, comparing incomes with other indicators of living standards for self-employed and employee households. In the literature, one commonly reported feature is that the average incomes of the self-employed often appear low compared to their expenditures. This was confirmed in the data examined here. If we take the income/expenditure ratio of employee households, and apply it to the average expenditures of the self-employed, this implies a 'true' income significantly higher than recorded.

In both 1988-89 and 1993-94 this under-recording was about one-third. In the first of these years, this conclusion is based upon expenditure as conventionally measured, whilst in the second year a more sophisticated weighted expenditure measure is used. However, some of this income discrepancy is simply due to the lags in income collection in the ABS surveys. If this is corrected for, the income under-recording shrinks to six to 11 per cent in 1988-89 and 30 to 34 per cent in 1993-94. The main reasons for the difference between the two years are that the latter figure is based upon a more sophisticated estimate of consumption, and the

latter estimate includes farmers, whilst the former does not (and the drought of the early 1990s may have led to atypical dissaving patterns). A best estimate of the extent to which average (current) income underestimates the living standards of the self-employed on average, should be placed somewhere between these two estimates.

When we focus on low-income households, it appears that the self-employed have living standards some 11 to 15 per cent higher than employee households. However this does not necessarily imply that there is less poverty among self-employed households. There is some evidence that the expenditure poverty rate in the early 1990s was actually higher for the self-employed than for employees, though this issue requires further examination. The reason these two conclusions are not mutually exclusive is that there are significant numbers of self-employed who have low expenditures, but who also have recorded incomes (which may be from one or two years ago) which place them above the low-income threshold.

A more directly policy relevant question, however, is the extent to which self-employed recipients of family payments are as disadvantaged as employee families. It is possible to identify families receiving FAS in 1990 and AFP in 1993-94. Both these payments were income supplements available to working families with children. In general, self-employed families are slightly better off than employees. This is particularly the case for housing wealth, where the self-employed have significantly higher rates of home ownership, and also have slightly better housing quality. In addition, the self-employed receiving AFP tended to spend about 10 per cent more than comparable employee families. Finally, although the number of cases is limited, FAS recipient families running their own limited liability business appear to have a relatively high level of housing quality.

These estimates of the relatively higher living standards of self-employed need to be interpreted with some caution. Whilst self-employed family payment recipient families do score higher on housing wealth and other consumption, they do need to work much longer hours to obtain these benefits. Many self-employed families will be financing this higher consumption by running down their assets, or by going into debt.¹⁷ Depending upon the goals of policy, the extent to which this is the case may or may not be relevant. On the one hand, these families are able to dissave or borrow, which does make it easier for them to avoid poverty in the

17 It might be considered that this dissaving should be balanced on average by self-employed families accumulating assets (since the dissaving has to be financed in some way). However, this might not be the case. For example, an employee might accumulate assets and then use their family home as security to start a business. The business may run at a loss for some time and then go bankrupt. In this example, saving takes place whilst the person is an employee, and dissaving whilst they are self-employed.

short term. On the other hand, this forced dissaving may simply be leading to longer-term problems.

Finally, there is the question of the policy significance of the observed consumption differences. Certainly there are large differences in housing tenure between self-employed and employee families receiving low-income family assistance. However, this may not translate into an ability to finance current consumption. The weighted expenditure variable described above provides a reasonably robust indicator of this consumption. Self-employed families had, on average, a 10 per cent higher level of consumption using this variable. Given the difficulty of targeting assistance to the needy self-employed, some might consider this amount of difference a targeting success.

8 Policy Options for Targeting Family Assistance

8.1 General Principles

When considering social security payments, a number of orienting principles for means testing can be identified. In particular:

- the key reason for targeting income support assistance via means tests is to enable limited resources to be most effective in alleviating poverty. Poverty in this context is most usefully considered in terms of the inability to sustain more than a low level of family consumption;
- in Australia, the main thrust of means testing has been to use current income flows as an indicator of poverty; and
- it is usually assumed that assets need not be drawn down before assistance will be paid. Assets only reduce payment when they are at a fairly high level, and important assets such as the family home are not included. The exception to this is the liquid assets test. However, given the ability of self-employed people to rearrange their finances, the liquid assets test is only rarely likely to be a constraint.

These last two points are the nub of the problem of means testing the self-employed. Current income is hard to measure (and often not known with any accuracy to the income support recipient), while asset holdings are a much more important component of their expectations and longer-term living standards. When one adds the requirement that policy should not be too complex or administratively burdensome for the recipient or the Department, the difficulties of developing an adequate means-testing system become clear.

Of course, all this begs the question of whether the state should provide support to the self-employed at all. Arguments against this support include that self-employment must inherently involve individuals weighing up the possible beneficial outcomes and risks of business activity, and that the state should not interfere in the workings of the competitive markets in which most self-employed are engaged. To the extent that the state wishes to maintain a social safety net, this can still be done via assistance to low-wage employees, and assistance to the unemployed. Self-employed people whose businesses fail can always seek work as an employee. This approach, moreover, seems to fit with the strong individualist ethos of the *petite bourgeoisie*.

Several reasons can be advanced against this point of view. Perhaps most important is that, with the growth of dependent contractors in the Australian economy, and with the growing flexibility in labour contracts, the distinction between employee and self-employment status is steadily diminishing. Many workers find themselves facing the option of either unemployment or low-income self-employment. For the state to insist that the self-employed must choose the former in order to receive assistance does not seem socially productive. In a similar vein, the self-employed may resent paying taxes without being eligible themselves to receive support for their children when their business is not performing.¹⁸

Finally, it could be argued that small business is one of the most dynamically efficient parts of the economy and in the absence of support, insufficient resources will be devoted to this form of business. At the same time, it might be argued that the state is not very good at 'picking winners' and so assistance to particular industries is not desired. These two arguments in combination suggest a role for family assistance to reduce some of the risks associated with small business.

In this section, we confine attention to the current goals of income support policy and consider a number of options for improvements over the current system. We begin by considering several alternative models for income support for the families of the self-employed, and then move on to consider a number of options for more modest adjustments to the current policy model.

8.2 The Farm Assistance Model

Currently, there are a number of support policies directed specifically at farmers which recognise their particular industry needs. One option would be to use one of these models to assist the self-employed in other industries.

The main current policies to assist farmers are listed here¹⁹.

- The Rural Adjustment Scheme (RAS). This program has a number of different elements designed to assist structural adjustment in farming industries. These include training assistance, financial assistance to help farmers leave the industry, interest rate subsidies and re-establishment expenses in exceptional circumstances (such as drought). In 1994-95, total

18 It would be interesting to survey the self-employed themselves about their views on the role of family assistance for self-employed families.

19 Specific information is usually from Rural Adjustment Scheme Advisory Council *Annual Report 1994-95* AGPS Canberra.

expenditure on the RAS was \$182.9m. The largest component of this (45 per cent) was exceptional circumstance payments associated with drought.

- Drought Relief Payment (DRP). This program is administered by DSS on behalf of the Department of Primary Industry and Energy (DPIE). It provides an income support payment equivalent to JSA (and associated payments) to families living in 'drought exceptional circumstances'. Payment is only available to farms in areas declared as being in drought exceptional circumstances and for a recovery period of six months following the cessation of drought exceptional circumstances. In 1994-95 DRP support exceeded \$81m and over 10 200 families were assisted.
- Farm Household Support (FHS). This program is also administered by DSS on behalf of DPIE. FHS is a loan advanced to farmers at the same weekly rate of payment as JSA whilst farmers work to either re-establish a poorly-performing farm on a firmer footing, or arrange the sale of the property. The farm must be demonstrated to be performing poorly via a 'certificate of inability to obtain finance'. If farmers sell the property within two years, nine months of payment are received as a grant. Otherwise the whole of the payment is repayable. This is a much smaller scheme than the two schemes described above, with only 107 farmers in receipt of FHS as of June 1995.²⁰

Whilst the RAS and DRP schemes focus on issues that are particular to farmers, it has been suggested that the FHS scheme could potentially be adapted to be of more general applicability. Such a 'Self-employed Income Support' (SEIS) payment could be paid at the same rate as JSA but with similar eligibility and repayment conditions as for the FHS scheme. Such a payment could continue alongside current Family Payments to the self-employed, or could conceivably be provided instead.

In considering this model, it needs to be remembered that the FHS is primarily a scheme designed to assist people in making the transition out of their farming business. This, together with the requirement to repay the payment if the farmer continues in the business means that the take-up has been quite small. The FHS model is unlikely to be appropriate for those self-employed families with continuing low incomes who wish to stay in their business. It may have a role, however, as a program for assisting people out of non-viable businesses.

A SEIS is thus unlikely to be able to replace the poverty alleviation role of Family Payment and Parenting Allowance. Currently many self-employed who could potentially be eligible for a SEIS are eligible for JSA (that is, if their

20 Department of Social Security *Annual Report 1995-95* AGPS Canberra.

business is running at a low enough level so as not to preclude them from job search). If the eligibility of the self-employed for JSA were tightened along with the introduction of SEIS, this would place additional pressure on these self-employed to close their businesses down. Whether this is desirable is difficult to ascertain. On the one hand they may be better off being fully out of their non-viable business. On the other, some of these JSA recipients may be able to eventually resuscitate their business and so exit unemployment.

To assess which of these outcomes is more likely, it would be necessary to have more information on outcomes for self-employed JSA recipients. For example, it would be useful to examine the average length of JSA/NSA receipt of recipients who also have a business compared to other JSA recipients of similar characteristics. Also, information on reasons for payment exit would be relevant.

8.3 The Austudy Actual Means Test

Many of the issues associated with the income testing of Social Security payments also apply to the dependant category of Austudy paid to students aged 16 and over. Like family payments, Austudy is income tested on parental income, with previous years' taxable income used as the primary income definition. The income threshold for maximum payment is aligned with that for the maximum rate of Family Payment, though if there is only one Austudy child, payments reduce by only 25 cents for every additional dollar of parental income (compared to 50c for Family Payment).²¹

It is interesting to note that, despite the broad similarity of the income-testing regime for these two programs, anecdotal concerns about self-employed families being able to take unfair advantage of the scheme are much more prevalent for Austudy than for Family Payment.²² Indeed, it does appear that the proportion of Austudy recipients with self-employed parents is higher than for Family Payment.

21 For the purposes of the 1996 Austudy parental income test, the calculation of annual parental income is reduced by \$3700 for every other full-time student aged 16 or over, \$1200 for the first younger student, and \$2500 for each other younger student. The Austudy payment for each recipient is reduced by \$1 for every \$4 of parental income. Since this reduction applies to each recipient, the effect is cumulative. For example, in the unlikely event that a family should have five students receiving Austudy, total Austudy payments to the family are reduced by \$5 for every \$4 increase in parental income over the threshold (Source: Austudy regulations on AustLii (http://www.austlii.edu.au/au/legis/cth/consol_reg/ar234/)).

22 See for example, *Student Financial Assistance*, Report of the House of Representatives Standing Committee on Employment, Education and Training, 1991. There do not seem to have been similar concerns advanced about Family Payments.

The 1991 Survey of Student Finances reported that of Austudy recipients with employed fathers, 42 per cent had fathers working in their own business. Whilst there are some doubts about the accuracy of this estimate, it is clearly much higher than the estimates given in Section 5 for Family Payments.²³

It is possible that this difference is due to the wider segment of the population eligible for Austudy because of the lower income taper rate for many families. The older age of Austudy parents may also play a part. However, an alternative explanation is that many self-employed parents with low taxable incomes may not bother to apply for Family Payment because of the compliance burden and intrusiveness associated with the payment. The higher rate of payment, along with pressure from children for an independent income source,²⁴ may make Austudy a more attractive option.

This suggests that, if the rate of payment is an important factor driving take-up, the introduction of Parenting Allowance may lead to a much higher proportion of self-employed families applying for payment.

For whatever reason, recent years have seen significant concern expressed about the possibility for unfair receipt of Austudy by self-employed families. In response to this concern, in 1996, DEETYA introduced a new 'Actual Means Test' to assess more accurately the actual resources available to self-employed families.

Operation of the Actual Means Test

As implemented in 1996, the Actual Means Test (AMT) involves several administrative processes. The first step involves a determination of whether the student should be assessed according to the AMT. Austudy applicants are subject to the test if they have a parent or partner who:

- entered Australia under a business skills category, or
- has an interest in an asset located outside Australia, a proprietary company, an unlisted public company or a trust, or
- derives income from a source outside Australia, or

23 From Peut, Mitchell and Toth (1994: 71). Our doubts of the accuracy of the estimate arise from the fact that there appear to be a substantial number of missing cases for this question.

24 Austudy is paid to the child when he or she is aged 18 or over.

- is a self-employed person (except primary producers) or is a partner in a partnership.

In other words, the AMT applies to the self-employed and business people broadly defined, with the exception of sole trader farmers (the AMT applies to farmers in partnerships and with companies or trusts).

The Austudy regulations define the actual means of a parent as 'the total expenditure and savings made in that period by the parent and his or her family' (Section 12N). However the first stage of AMT calculation (which is not described in the regulations) is actually based upon a different method of estimating the family's living standard. In the Austudy application form, information is requested on: the current value of the principal family home, the current market value of investments and other properties, the current market value of motor vehicles, and total education expenses. Apart from the last item, all of these are items are actually assets rather than expenditure items. For each of these assets a rate of return is applied to calculate a 'conservative estimate of the family's means'.

In economic terms, this approach is best described as an attempt to estimate the family's (potential) consumption level rather than their expenditures. For example, if the family home is owned by a company and provided to the family at a low rental, the family's expenditure may actually be very low even though their consumption of housing services is significant. This first stage process would capture this information.

If a family disagrees with a decision based upon this initial calculation they can then request a review by completing an 'Actual Means Test Form'. This form requests information on the family's expenditure patterns. The information requested is very detailed, and covers the full range of family expenditures. For some items of general living expenses (such as clothing and entertainment expenses) respondents need not reply, in which case DEET will impute values based upon family size. The method used for this is not specified, but appears to be based upon average expenditure patterns as recorded in the ABS Household Expenditure Surveys.

Evaluation

The most appealing feature of the AMT is that it avoids all the difficulties of measuring business incomes and instead focuses on the consumption (and savings) level of the household.

Discussions with DEETYA staff indicate that the scheme has proved successful from a Departmental perspective, and is likely to result in greater savings than

forecast in the 1995-96 Budget. Of new applicants in 1996, about 50 per cent of farming families were assessed under the AMT. Of these, 23 per cent were deemed ineligible at Stage 1. No information was available on results from the full AMT application (Stage 2). Across all categories, around 75 per cent of target group families did not have their payment restricted by the AMT.

However, there are some features of the scheme which limit its potential application to Social Security payments.

- The AMT has been introduced in a very different administrative environment than applies for Social Security payments. Only the second (review) stage of the scheme is described in the regulations, and that only in reasonably general terms. The initial AMT assessment and the detailed definitions of expenditure items are a result of administrative decisions. It appears that a much greater degree of administrative discretion is used than is typically used for Social Security payments. The advantages and disadvantages of a more discretionary approach would have to be carefully weighed up.
- The second stage of the AMT (the detailed expenditure assessment) is both burdensome on respondents and difficult to enforce. For many items of expenditure, respondents will have little information and could not be reasonably expected to provide it.
- Whilst the scheme appears to have been effective in its first year of operation, it is possible that it is the initial stage assessment, together with the respondent burden of the second stage, which is discouraging self-employed families from applying, rather than the actual information collected from the AMT itself.
- To evaluate whether this is the case, it would be useful to know the numbers of families that fall into the AMT target group, the number that actually complete the full AMT form, and the percentage of such families that are successful.
- It is possible that once financial advisers become familiar with the AMT, they will be able to provide advice on how to report low expenditures on the hard-to-verify items. This may necessitate a continual process of adaptation and increasing complexity as more detailed verification requirements are implemented.
- Alternately, it may be necessary to exercise considerable administrative discretion in deciding whether to accept the expenditure data reported.

Notwithstanding the above, the general approach of using alternative indicators of living standards has some merit. A full evaluation of the operation of the AMT would be of great assistance in assessing the administrative feasibility of aspects of the scheme.

A Simplified AMT?

Whilst the AMT attempts to calculate the full extent of expenditure and savings of the household, a more feasible approach might be to adopt selected features of the AMT as an indicator of living standards. The most useful features of the AMT in this regard are probably the measures of asset holdings (and educational expenses) used in the preliminary stage of the AMT, possibly in conjunction with the indicators of financial savings. For example, the value of the house in which the family lives (irrespective of who owns it) is readily verifiable, and can be used as an indicator of housing consumption.

Given some estimate of the consumption of the household over a restricted range of commodities, an inflator can be applied (based upon the relationship of this consumption with taxable income for wage and salary households) to estimate an imputed total consumption for the household. This could then be reduced by a specified factor to ensure a conservative estimation. Such an approach is much simpler for both the client and the Department than the full AMT, but there remain obvious limitations.

- Clients would be required to provide information on the value of their home, to which there has been considerable resistance in the past.
- The most easily measured assets and expenditures are those which relate to ongoing commitments. Families experiencing a recent drop in income may well be experiencing hardship even though they continue to live in an expensive house and have a valuable car. The expenditure items they forgo may be those most related to child consumption. Some 'special cases' provisions would need to be implemented to deal with these families.
- A degree of arbitrariness is involved in inflating from the indicators of consumption to total expenditure. This could be addressed in part by ensuring that the estimates remain a conservative estimate of total consumption.

8.4 The UK System of Assessing Self-employed Incomes for Family Credit

The approach taken by the UK Department of Social Security to measuring earnings from self-employment for means-tested benefits differs materially from that in Australia. In the UK there is no requirement that individuals complete a tax assessment every year, and most Pay as You Earn (PAYE) taxpayers rarely do so. Although in theory information on benefit claimants' earnings could be made available to the DSS by the Inland Revenue, this would inevitably be incomplete because many employees entitled to benefits like Family Credit have earnings below the tax threshold. In any case, it has long been DSS policy that entitlement to means-tested benefits should be based on some measure of 'normal weekly income' over a period close to that when the benefit application is being made. Currently this is an average of earnings received over the previous six weeks, for employees paid weekly, and three months for those paid monthly. Implicit in this policy is a view that the requirements of the Department in assessing income for benefit purposes is different from that of the Inland Revenue when assessing tax liabilities.

This system is relatively straightforward when applied to wage earners, but more complex when applied to the self-employed. Self-employed people are required by law to complete tax assessments and generally produce some form of accounts for this purpose, though they will generally apply, at the latest, to the previous tax year. DSS has its own rules, however, about how to assess self-employed earnings, including what business expenses may be allowed against gross profit, how to treat capital introduced into a business, how to deal with stock value and so on, which differ from tax rules. As was explained earlier, the rules on what information could be supplied to DSS for an income assessment to be made have changed several times, and currently allow both the provision of profit and loss accounts, based on accruals methods, and cash flow statements. Both of these require some skill on the part of assessment staff in interpretation and even if interpreted correctly can produce different results.

A recent evaluation of the system for assessing self-employed earnings for Family Credit concluded that there were a number of difficulties and anomalies within the present system (Boden and Corden, 1994). In particular, the dual acceptance of both accruals and cash accounting produced inconsistencies and confusion on the part of both applicant and the Department. The evaluation recommended, amongst other things, settling on a cash flow measure as, while not perfect, best suited to the needs of the Department for an indication of applicants' current circumstances and likely to maximise compliance among eligible applicants. It was also suggested that a number of technical rules needed amendment to harmonise the system more closely with those in use more widely.

The evaluation also considered whether moving to a reliance on tax assessment, as in Australia, was desirable or feasible, and concluded that within the UK policy context it was not. This was both because the technical rules used for tax assessments did not meet the policy demands of the Family Credit scheme, and because tax assessment was judged to be mainly an historic measure and to have poor predictive capabilities.

From an Australian perspective, a similar view could be held in reverse: that moving to a British-type model of separate income assessment by DSS under its own rules is unlikely to be feasible because of the administrative costs involved in establishing the necessary expertise within the Department. The question remains, however, of whether the Australian system is capable of being adequately calibrated to current income needs of self-employed applicants. One option for doing this is considered below.

8.5 Adjustments to the Current System

In the remainder of this section we consider a number of options for income testing which involve modifications to the current system based primarily upon taxable income. In general, any measures which improve the measurement of taxable income and closes 'loopholes' and avoidance opportunities will make taxable income a more useful measure of family resources for Social Security policy also.

However, as noted in Section 5, there are a number of reasons why the income assessment requirements of Social Security might be different from those of the Tax Office. One reason is that tax policy is sometimes indifferent to which entity pays the tax. However, Social Security payments impose high effective marginal tax rates upon particular individuals and not other entities, and so the entity to which the taxable income accrues is important.

Another distinction between taxable income and Social Security targeting requirements concerns timing. The key goal of income support is to alleviate poverty at the time of payment. The taxable income of some prior period is of only limited use in assessing the need for assistance in the current period. This is due both to variations in incomes over time, and to the role of assets in smoothing out consumption levels. Addressing this problem is difficult. The UK cash flow approach described above is one, though it has its own problems. An alternative option is considered below.

One option suggested by a recent Senate review of the Child Support Agency would be for the relevant agencies such as the CSA or DSS should conduct their own audits of the taxable incomes reported by clients. These could involve a

much greater scrutiny of business expenses, together with selective and random audits. However, if income is still to be defined as taxable income, it seems most appropriate to leave these complex audits with the tax office, where most expertise lies. It might be hard to justify a more detailed audit of taxpayer's finances simply on the basis that they were receiving income support.

Nonetheless there are a number of changes to income definitions and measurement methods that may be used to augment taxable income so as to provide a better indicator of living standards. Some of these are discussed below.

Recommendations of the Price Waterhouse Austudy Report

A recent consultancy report on parental income testing for Austudy prepared by Price Waterhouse for DEETYA raises a number of issues that are equally applicable to Social Security family payments. Some of these issues have already been covered in recent changes to the Family Payment income test.²⁵ Other recommendations associated with means testing include the following.

- Asking clients whether they had 'transferred any assets or assigned income within the last five years at a lower than market value' and then adding the value of this transfer back into income or assets. Unless this is done people could artificially lower their income and/or assets by transferring them to other family members.
- Adding a catch-all regulation to cover other forms of income received which are not included as part of taxable income. For Social Security payments this would require careful consideration of different income sources to decide whether they should be included. For example, one option would be to include income from the sale of capital goods not subject to capital gains tax. However, to include the full capital value might not be fair to people re-arranging their asset base. Another option would be to include loans and other distributions from companies and trusts. This is discussed further below.
- Sufficient questions should be asked to fully identify the extent of all family members' interests in partnerships, and the net asset value of the partnership.
- Undistributed company income should be included as part of income. This is discussed further below.

²⁵ Income now includes employer provided fringe benefits, foreign income and net property losses in addition to taxable income.

- The asset value of private companies should be based upon the net assets of the company, not just the face value of shares.
- Income and assets of trusts need to be included for all trusts for which the clients and their family have a beneficial interest, not just control.

Alienation of Income into Companies and Trusts

As noted in Section 3, company incorporation has been growing at a significant rate in Australia. In addition, new legislation which will make it easier for sole traders to incorporate may increase the use of company structures by small businesses.

Because Social Security income tests do not apply to entities apart from the recipient and their family, the use of these entities can pose problems for income assessment. One important example is when profits are retained in a company or trust. The company may then still pay income tax on the profits, but this income is not counted as part of family income for Social Security purposes. In essence, the household keeps its savings in the firm rather than the household. However, in certain circumstances the household can still receive the benefit of this income. One example may be where the company purchases a house which is then rented to the family. Alternately, the company may make a loan to the family.

If the client is an employee of the company, the difference between the actual and market rent, or between the actual and market interest rate, will be assessable under Fringe Benefit Tax. In order to address this issue, fringe benefits have recently been added to the income definition for Family Payments (and Austudy). However the 'fringe benefit' comprises only the interest rate (or rental) subsidy. The *principal* is not counted as part of the individuals' income, even though it contributes to their living standard.

It appears that a recent Administrative Appeals Tribunal decision has made it more difficult for such loans to escape being included as taxable income (*Sydney Morning Herald*, 15 May 1996: 29). In certain circumstances a loan paid to 'associated persons' of a private company may be assessed as a 'deemed dividend' and be fully taxable. This depends upon evidence about whether there is an intention to repay the loan. However, it may still be possible for a company to continue to provide loans to the household if bona fide arrangements for repayments are made (even if the repayment is at a slow rate).

Similarly, there would appear to be no obstacle to companies purchasing assets (such as houses) and renting them to company associates at near-market rents. Rental payments typically do not fully cover the principal component of the loan

repayment, and so housing costs for the family will be reduced (with the house remaining in the company's hands).

One way to deal with this issue might be to require that all undistributed profits from private companies are notionally distributed to shareholders for the purposes of the DSS income test. For each private company they are associated with, clients would need to provide information on both the undistributed profit of the company and the clients' share of profit entitlements. Another approach would be to focus on particular forms of transfer. Any loans received by a person from an associated private company could be treated as income in the year received (and repayments possibly deducted from income). The same approach could be used for trusts. It would be necessary to obtain detailed advice on accounting practices before implementing any policies of this type.

Unrealised Capital Gains

A more fundamental problem for assessing the income of the self-employed and other people running their own business is that of unrealised capital gains. Many self-employed people deliberately have low drawings from their business as they seek to build it up. During this time the asset value of the business increases, particularly in the form of difficult to measure assets such as goodwill. Some of the increase in asset value of companies and trusts may be incorporated via accounting practices for measuring profits, but this will not be the case for sole traders.

Should this saving activity be subsidised by Social Security payments? On the one hand, this saving behaviour may often be a deliberate choice. On the other hand, such a procedure may be an established practice in many industries, may be necessary in building up a new venture and the self-employed person's family will indeed have a low level of current consumption. Irrespective of the answer to this question, unrealised capital gains are difficult to measure. Even alternative approaches such as the Actual Means Test would not include this income since the family *does* have a low level of consumption.

The only way to include these components as part of income would be to require a full valuation of the business's assets every year. Whilst this would certainly constitute a burden for both client and Department, current valuations are already required for the purposes of the asset test. This approach would seemingly only add a requirement for a previous year's valuation as well. However, implementation would involve more than this. The income test is often binding on payment levels, whereas most clients have income well under the asset test. That is, for clients with assets well under the threshold, there is currently no need for great precision in the assessment of assets. Including an estimate of unrealised

capital gains as part of income would require accurate business asset valuations for almost the whole client base. Hence this is probably not an administratively feasible option.

Making Self-employment Incomes More Current

As noted in Section 7, one of the problems with income assessment methods is that current incomes are not known, and known income levels may be quite out of date. One way to obtain a more current indicator of business income is to rely upon previous years' taxable income as the primary income source, but to adjust this according to fluctuations in gross income or turnover. That is, define

$$\text{current income} = Y \times (C/P)$$

where Y = taxable income in previous year
 C = current turnover and
 P = turnover in corresponding period in previous year.

This relies upon clients being able to provide turnover data on a comparable basis in the two years. It could be introduced as an option for self-employed clients who think their business income has fallen, and would replace the current approach of asking clients to forecast their income in the current period. An alternative would be to make this the compulsory method of assessing self-employed incomes.

The above calculation method is limited in that it is not appropriate for large changes in business profitability. For example, it makes no sense to apply this relationship when business income is negative. A more accurate method of forecasting current income might be for the Tax Office to estimate the relationship between taxable income and turnover separately for each industry (e.g. estimate a regression relationship $Y = \alpha + \beta P$). An estimate of income in the current period could then be defined as

$$\text{current income} = Y + \beta (C - P)$$

where Y = taxable income in previous year
 C = current turnover and
 P = turnover in corresponding period in previous year.

(with Y , C and P expressed in annual terms). These adjustments will, on average, provide better indicators of current business profitability and hence the opportunities for family members to draw income from the business.²⁶ They do

²⁶ Further elaborations on these formulae can be devised. For example, it would probably be appropriate to have an additional adjustment to take account of inflation.

require additional information on turnover and industry definition, but this information is usually readily available. The method does not account for variations in costs, but these are usually less variable than gross income.

8.6 Concluding Remarks

This section has reviewed a number of policy options which could be implemented to further refine the targeting of assistance to the families of the self-employed. All of these options involve trade-offs between targeting precision, administrative complexity and recipient burden and intrusiveness. However, it is difficult to assess the preferred balance between these goals without more detailed information on the nature of the business activities and organisation of DSS clients with business activity. This includes both those formally classified as 'self-employed' as well as people using private companies and trusts to run their business (as well as wage and salary earners who have additional business activities).

For example, information could be collected on the industry and occupation of self-employed clients. This, together with taxation data on the degree of income fluctuations across different industries, would help in assessing the viability of specific industry-based policy measures. In addition, a full assessment of the options canvassed above for dealing with retained company and trust earnings, and loans and rental arrangements will also require substantial additional data collection. Finally, given the complexity of small business arrangements, it would be wise to consult widely within the sector before pursuing new policy directions.

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