

# The Direct and Indirect Effects of Unemployment on Poverty and Inequality

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## **THE DIRECT AND INDIRECT EFFECTS OF UNEMPLOYMENT ON POVERTY AND INEQUALITY**

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## Abstract

High and persistent unemployment has presented a major challenge for the welfare state from two directions. First, it has eroded the funding base and second, it has increased the demands on welfare programs because of the consequences for poverty and inequality resulting from high unemployment. This paper explores these latter effects using a range of national and international evidence. It is argued that the effects, while generally presumed to exist, are complicated by the ways in which poverty and inequality are measured (on the basis of the economic status of families) and the growth in dual-earner families that has weakened the link between the economic status of families and individual family members. Despite this, there is strong evidence that unemployment increases the risk of poverty and contributes to inequality, and that it also gives rise to a series of debilitating social effects on unemployed people themselves, their families and the communities in which they live. This suggests a need for welfare reform to give emphasis to employment generation, but this should not be the only outcome by which the welfare system should be judged. The provision of an adequate and secure safety net that does not unduly distort incentive structures is also an important welfare objective.

# 1 Introduction<sup>1</sup>

Fred Gruen was one of the few Australian economists of his generation who took an interest in issues associated with the welfare state, both in Australia and how we compare internationally. Over the last decade, more and more economists have followed his lead, and their views and influence have become increasingly dominant in assessments of the role and impact of the social security system, and in the design of social policy generally. I always admired Fred's ability to bring sound economic reasoning to bear on issues that had often not been previously exposed to it. Nowhere is this more apparent than in relation to social security issues, where his views have had a profound impact – even among those like me who have not always agreed with them.

However, although we did not always agree, Fred and I shared a common intellectual interest in understanding the functioning of the Australian welfare state – how it operates and with what effects - in an era when relatively few other academic economists were interested in such questions. Fred's work in the area was characterised by the clarity of his thinking and a ruthless determination to get to the bottom of the arguments. He was always prepared to challenge many of the existing preconceptions in ways that opened up new vistas of exploration in a field that cried out for such friendly yet rigorous criticism. While he always came at the issues from an economic perspective, he was aware that economics alone was never going to be enough to fully understand a welfare system that also serves social and political purposes. The welfare state has an institutional structure that reflects history and culture, and these are not variables that economists feel comfortable with.

In grappling with these issues, Fred drew attention to the economic significance of the welfare state and promoted its study among economists. It is significant, for example, that poverty and income redistribution was one of the topics included in the classic collection of

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1 This paper was originally presented in March 2001, at the Australian National University in the F. H. Gruen Lecture Series on *Welfare and the Labour Market: The New Frontier for Reform*. I would like to acknowledge the research assistance provided by Judy Brown, Tony Salvage and Matt Williams, but accept full responsibility for all errors of fact or interpretation.

review essays Fred organised in the late-1970s on behalf of the Academy of the Social Sciences in Australia (Richardson, 1979). Neither topic was popular at a time when most Australians were uninterested in them to the point of complacency – although both have dominated much of the policy debate since then. His 1982 Giblin Lecture was also a classic in identifying the myths (and errors) committed by contributors to the welfare debate from both the left and right ends of the political spectrum (Gruen, 1982). He concluded that lecture with the following words:

The fundamental myths of the two sides in the welfare debate appear to me to be the following. On the Left there is an unwillingness to concede the effect of incentives on economic actions and to be scathing regarding the possibilities of any equality-efficiency conflicts. ... The major myth on the Right is that ANY attempt to redistribute to the poor must be fraught with disaster ... the slippery slope of redistribution leads in some ineluctable fashion to the Gulag Archipelago. ... Estimating the costs of greater equality and, more importantly, finding ways to minimize these costs is an endeavour Australian economists have scarcely begun. (Gruen, 1982, 220)

Fred continued to explore these themes in a series of later papers on the Australian welfare state. These include his contribution to the analysis of Australian welfare policy presented to the 1989 National Social Policy Conference (Gruen, 1989), his 1994 paper with Ann Harding and Deborah Mitchell on welfare targeting (Mitchell, Harding and Gruen, 1994) and another the following year in which he argued that I had paid insufficient attention to the redistributive achievements of the Australian welfare state in my book *Welfare and Inequality* (Gruen, 1995). I came away from this latter skirmish feeling, as I suspect many others whose work was the subject of a detailed examination through the Gruen magnifying glass, more flattered that Fred had taken an interest in my work than dismayed at his criticism of it. To have one's work criticised by Fred Gruen was, after all, quite an achievement!

In these papers, Fred was primarily interested in exploring three main issues about the welfare state. First, what do we know about the

economic impacts of the welfare state and what do these imply for its overall effectiveness? Secondly, how does Australia compare internationally in terms of welfare inputs and outcomes, and what can we learn from such comparisons? And thirdly, what is the nature of public opinion on welfare issues and what are its implications? Examining these issues took Fred outside of the boundaries of conventional economics into the realms of political science, public policy and sociology. All three issues address important aspects of the broader ‘welfare debate’ that I will draw on in the analysis that follows.

A huge amount of welfare research has been conducted in the two decades since Fred debunked the welfare myths of the Left and Right. However, while the stances of both Left and Right have moderated somewhat and the so-called ‘Third Way’ has emerged to try to bridge the gaps between them (in terms of both diagnoses and remedies), there are still major differences in value positions that affect the marshalling of evidence and interpretation of research findings.

While Fred was right to criticise the Left in the 1980s for ignoring the incentive effects of social programs, we have now moved too far in the other direction.<sup>2</sup> Social policy now gives greater emphasis to minimising disincentive effects and budgetary costs to the neglect of the underlying goals that the programs are designed to address. As I have tried to explain at length recently (Saunders, 2002a), in focusing on what should be done to improve the means of welfare, we have fallen into the trap of neglecting its ends.

I will illustrate this proposition by looking at what must surely be the single most serious welfare problem we face today - unemployment. I want to focus initially on the relationships between unemployment and two of the primary goals of the welfare state identified by Fred Gruen – alleviating poverty and reducing inequality. I will argue that these relationships are complex, for a number of reasons to do with how poverty and inequality are conceptualised and measured and with the nature of unemployment itself and how the labour market is changing. I will then try to relate some of these ideas to the current welfare reform

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<sup>2</sup> The boundaries used to define what constitutes the Left have also been radically redrawn over the last decade or so, but that is a separate issue.

debate, in the process drawing on a range of overseas evidence to illustrate some of the arguments.

I should also note at the outset that some of the work I will refer to later forms part of a project on The Economic and Social Costs of Unemployment that I have been involved in on behalf of the Academy of the Social Sciences in Australia (Saunders and Taylor, 2002). This project brought together social scientists from a range of disciplines to review the evidence on the costs and implications of unemployment at three distinct levels: unemployed individuals themselves; other members of their family; and those living in the communities that have borne the brunt of mass unemployment.<sup>3</sup>

The paper is organised as follows: Section 2 focuses on the relationship between unemployment and poverty, beginning with an explanation of why this relationship is likely to be complex and contingent. Section 3 discusses the relationship between unemployment and income inequality, while Section 4 briefly reviews some of the main findings that emerged from the Academy's unemployment project. Section 5 draws out some of the implications for the current debate over welfare reform, while Section 6 summarises the main conclusions.

## **2 Unemployment and Poverty**

Writing in the mid-1970s – ironically in hindsight, at the very time when the prospects for full employment were about to disappear (Gregory and Sheehan, 1998) – the Poverty Commission identified unemployment as a major cause of primary (or income) poverty. About one in six (16.6 per cent) of the unemployed were below the poverty line in 1972-73. From the vantage point of the present day, this might seem a somewhat low figure – even though it was well above the prevailing national poverty rate of 10.2 per cent. However, it is important to bear in mind that many of those who were unemployed in the early 1970s remained out of work for relatively short periods and were thus able to supplement their incomes fairly quickly once they returned to work. Poverty resulting from unemployment was thus temporary for most of those who experienced it and the numbers affected were in any case relatively small.

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<sup>3</sup> My indebtedness to several of the contributors to this project will become apparent later, although I am responsible for the use I have made of their work.



Anthony King has estimated that by 1996 the poverty rate among the unemployed was almost three-quarters (74.2 per cent) and that one-quarter of all of the poor were unemployed (King, 1998, Table 4.2). Poverty also increased sharply with unemployment duration, rising from around 13 per cent for those unemployed less than 8 weeks (similar to the overall figure in 1972-73), to 80 per cent for those unemployed for more than a year (Gregory and Sheehan, 1998, Table 5.6). And by 1996, far more of the unemployed were out of work for long periods, so that what had previously often been a short disruption to earnings had for many evolved into a semi-permanent state of entrenched joblessness and deprivation.

While these figures may seem high to some, others will think they are surprisingly low – in the sense that since the level of the unemployment benefit is generally below the poverty line, all of the unemployed should, by definition, be poor. To understand why this is not the case, it is necessary to look into the relationship between the two concepts in a little more detail. This is done with the help of Figure 1, which shows all four possible combinations of employment and poverty status. The existence of cells (2) and (3) indicates that it is possible to be employed but still in poverty (cell (2)), or to be unemployed but not poor (cell (3)). The former situation relates to the ‘working poor’, while the latter arises when other forms of income, including the incomes of other family members, or benefit income provided to the unemployed by the income

**Figure 1: The Relationship between Employment Status and Poverty Status**

		Employment Status	
		UNEMPLOYED	EMPLOYED
Poverty Status	POOR	(1)	(2)
	NOT POOR	(3)	(4)

It is also important to recognise that while poverty is generally measured using income (which is a flow variable, normally measured on an annual basis in poverty studies), unemployment is a stock variable that records labour force status at a point in time. It is thus possible to be unemployed at the time at which one is interviewed by the Australian Bureau of

Statistics (ABS) in its household income surveys, but to be employed for some other part of the year, and thus to have an annual income sufficient to take one above the poverty line.

There are also important time lags that further complicate the relationship between the two variables. Thus, since 1994-95, ABS has conducted its Survey of Income and Housing Costs (SIHC) as a continuous survey, interviewing groups of people at each month over the year (ABS, 1997). This change has, for some respondents, increased the period between the time for which reported labour force status is relevant and the period to which the income variable applies. In the 1999-2000 SIHC, for example, labour force status is as at the time of interview in that year, whereas annual income refers to the previous financial year, i.e. to 1998-99. This means that someone who enters the SIHC sample at the end of the interview cycle will report their labour force status in (say) June 2000, whereas their reported income will refer to the year beginning in July 1998 – two years earlier.<sup>4</sup>

Finally, there is the important point that the unit of analysis used to determine labour force status is the individual, whereas poverty research focuses on the incomes of income units, who are assumed to share resources (including income) for the benefit of all members. Thus, an individual can have a low (or zero) income and still not be poor, as long as other members of the family unit have an income which, when shared, is sufficient to raise the family above the poverty line – even after accounting for the family's needs. The significance of this last point has grown along with the growth in the number of dual-earner families, since this has further widened the gap between the incomes of individuals and the potential poverty status of the families in which they live. It follows directly from these definitions of unemployment and poverty that becoming unemployed does not necessarily involve a movement from above to below the poverty line, i.e. from cell (4) to cell (1) in Figure 1.

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4 Although it is possible to avoid some of this timing discrepancy by relating labour force status to current (as opposed to annual) income, this is a significant methodological change from conventional poverty studies that use annual income to determine whether or not one is in poverty. This change in the time period also has implications for where the poverty line is set, because needs vary with the period over which they are assessed.

It could instead imply a movement from cell (4) to cell (3), or from cell (2) to cell (1), neither of which would cause a change in poverty status.

It is also possible to illustrate, at least in broad terms, some dimensions of recent economic experience using Figure 1. Thus, it is possible to identify a US-style ‘virtuous cycle’ route out of poverty that involves moving from cells (1) to (2) to (4), a situation that captures the ‘work to welfare’ notion that encouraging (or requiring) a movement from (1) to (2) is likely to lead to a subsequent movement from (2) to (4) – assuming a sufficiently buoyant labour market. In contrast, the experience of many European countries is better captured by the movement from cells (4) to (3) to (1) in Figure 1, with the initial onset of unemployment not leading to a rise in poverty because of the generosity of social benefits, but this leading in turn to a lack of competitiveness that causes unemployment to become entrenched and to rising poverty as benefit eligibility expires under social insurance schemes.

Two practical examples give credence to the relevance of these kinds of explanations of recent events. The first draws on the early-1990s experience of Finland, where the combination of recession and the collapse of the Soviet Union (a major trading partner) saw the unemployment rate double between 1991 and 1992, then almost double again the next year and rise by 50 per cent the year after that. The overall increase was from an unemployment rate of 3.2 per cent in 1991 to 16.3 per cent in 1993. What happened to poverty over this period? Almost nothing, according to figures presented by Hannu Uusitalo (2000). In fact, the poverty rate (using a half-median income relative poverty line) actually declined slightly between 1991 and 1994! One reason for this was that the poverty line fell along with median income. Ironically, had an absolute poverty line been used (one that was adjusted in line with movements in prices only), poverty would have displayed an upward trend over this period.

However, of far greater importance was the role of social security, which provided the unemployed with a high replacement rate due to the generous earnings-related benefits provided by the Finnish social insurance system. To quote Uusitalo (2000, 11); ‘economic recession with decreased income levels and increased unemployment has caused economic problems for Finnish households, but because of the welfare state, not more so to low income people than to others.’ The welfare

state matters, and it can act to prevent the increases in relative poverty (and income inequality) that would otherwise result from declines in economic activity, even when they are dramatic.

The second example concerns the experience of the US, where several commentators have noted that the US poverty rate became disconnected from the state of the economy in the 1970s and particularly in the 1980s (Haveman, 2000). According to figures presented in *The State of Working America 1998-99*, the 1970s saw rising poverty despite falling unemployment in the US, and the picture in the first half of the 1990s was only slightly better (Mishel, Bernstein and Schmitt, 1999). The authors estimate that by 1995, the US poverty rate was 4 percentage points (14 per cent, compared to 10 per cent) above what would have been predicted on the basis of experience during the 1960s and 1970s. In stark contrast to Finland, where rising unemployment did not cause poverty to rise, in the US we see that economic growth and falling unemployment co-existed alongside rising poverty. The US welfare system is partly to blame, but the predominant effect is associated with the rise in income inequality. Increased inequality in the income distribution was strong enough to offset the impact of growth in the economy and the labour market on the economic circumstances of those at the bottom.

Underlying these comparisons is a substantial difference in attitudes to inequality in the two countries. In Finland, institutions designed to protect people from market-induced income declines insulate incomes and thus relative poverty from swings in economic performance. In the US, in contrast, market inequalities feed directly into poverty because of a weak commitment to equality and redistribution. The fact that poverty is measured relatively in Finland and absolutely in the US is not independent of these effects. It should also be noted that the US story is not markedly different if a relative poverty line is used, because median income (to which most relative poverty lines are now tied) changed only slightly in real terms over the 1980s and the first half of the 1990s.<sup>5</sup>

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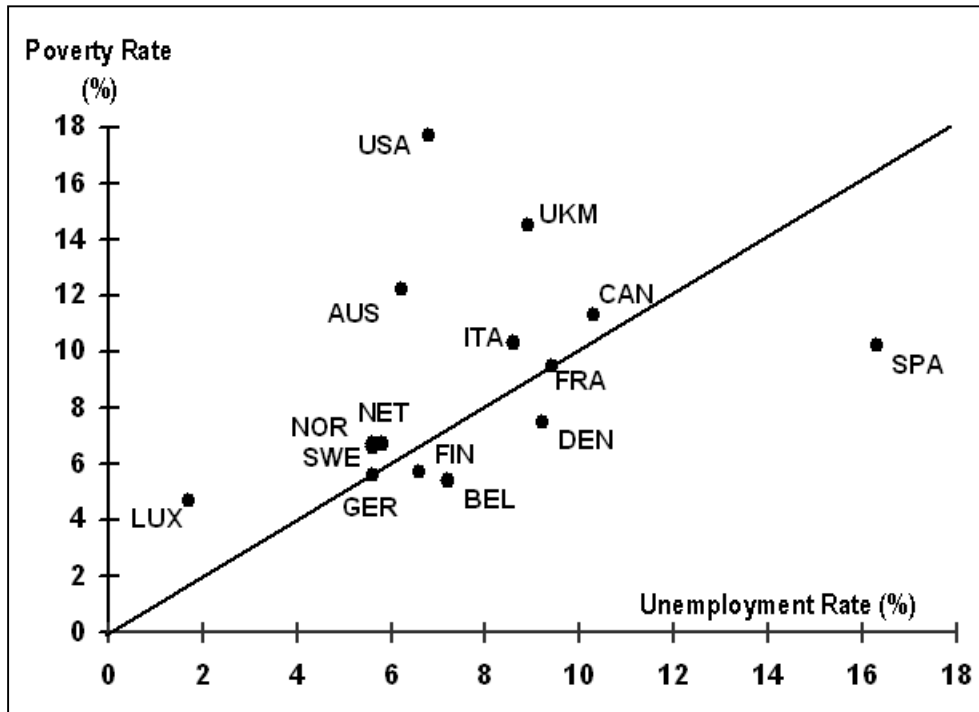
5 Median family income in the US rose by less than half of one percentage point between 1979 and 1989, and was virtually constant between 1989 and 1997 (Mishel, Bernstein and Schmitt, 1999, Table 1.2).

The important point to emerge from this discussion is that there are a number of reasons why unemployment and poverty can be expected to move independently of one another, including what is happening to the broader structure of inequality. One should not therefore, expect the two variables to be that closely related to each other when comparing the experience of different countries (or of a given country in different periods). This expectation is borne out by Figure 2, which indicates that the relationship between unemployment and poverty in a cross-section of OECD countries is weak. Although there appears to be a positive one-to-one relationship among European countries (and Canada), the US, UK and Australia have higher poverty than one might expect given their unemployment rates. In contrast, Spain has less poverty than expected given its level of unemployment, but both are very high compared with other countries.

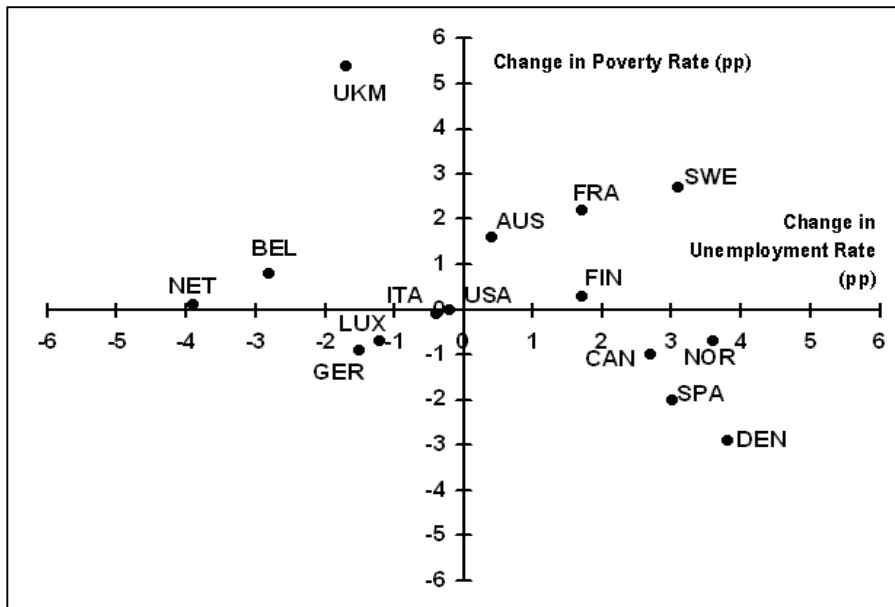
In terms of changes in unemployment and the poverty rate, Figure 3 shows that there is no evidence of any relationship whatever. The UK again looks bad, while neither the Netherlands nor Belgium experienced a decline in poverty despite a significant fall in unemployment. In contrast, Canada, Denmark, Norway and Spain experienced rising unemployment but declining poverty. Overall, there are at least as many countries where unemployment and poverty moved in opposite directions as there are where the two variables moved together, making it difficult to believe that there is any simple relationship between the two. The relationship between unemployment and poverty is thus contingent - on the welfare system as well as other structural factors, including the overall inequality profile.

Reference has already been made to the fact that one reason why unemployment may not be associated with poverty concerns the possibility that other family members may have income sufficient to keep the family above the poverty line, even when one of its (adult) members is unemployed. Thus, although low-wage workers in Australia are concentrated in the bottom of the income distribution, they are also to be found in the upper reaches of the distribution of family income (Harding and Richardson, 1999; Figures 4.1 and 4.2 – see also Figure 9 below). This effect has, however, been dampened by the tendency for unemployment to be concentrated among both partners in couple families, as Miller (1997) has noted. In June 2000, for example, married

**Figure 2: Relationship between Poverty and Unemployment in OECD Countries, circa 1990**



**Figure 3: Relationship between Poverty and Unemployment in OECD Countries: Change Over 1980's**



men with an unemployed spouse faced an unemployment rate of over 19 per cent; for married men with employed spouses, the unemployment rate was below 2 per cent. Similarly, whereas the unemployment rate of married women with employed husbands was around 4 per cent, it was over 31 per cent when the husband was unemployed (Saunders, 2002a, Table 7.5).

Miller noted a tendency for the burden of unemployment in family units to increase over time between 1979 and 1994 – a trend that he attributed in part to the high effective marginal tax rate on the second earner under the (family) income-tested nature of the Australian social security system. However, this situation was eased by the 1995 reforms that effectively individualised the income test on each partner, at least over certain income ranges (Saunders, 1995) and it is interesting to try to assess what impact this change has had on unemployment concentration within families.

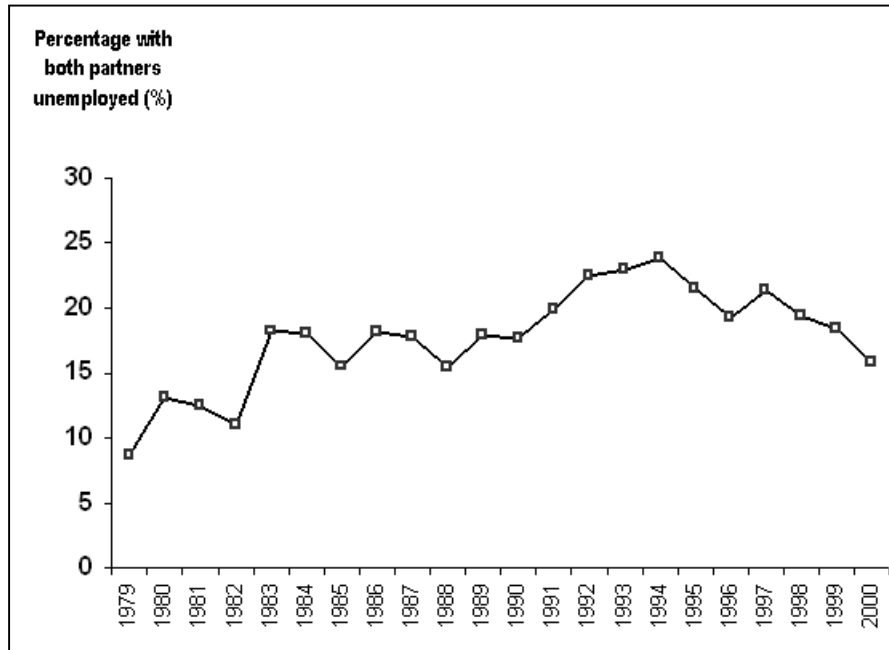
This is attempted in Figure 4, which tracks movements in one of the measures of unemployment concentration developed by Miller (1997) – the percentage of total unemployment among couples that is accounted for by partners. This index varies between zero (when there are no couples with more than one member unemployed) and one (when all unemployment among couples is explained by couples where both partners are unemployed). The graph shows an upward trend through to 1994 (when Miller's original analysis ended). But it also suggests that the 1995 reforms may have had some success as the concentration of unemployment among couples fell over the next five years – though this may also be partly due to the strong employment growth over the period.

Having reviewed at length some of the factors that complicate the relationship between unemployment and poverty, the relationship is now examined empirically. In undertaking such an exercise, it should be noted that there is a vigorous debate currently taking place in Australia over the methods used to estimate poverty and over the reliability of the income statistics on which the empirical estimates are based.<sup>6</sup> Using unit

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<sup>6</sup> Saunders (2002b) provides an overview of the recent poverty measurement debate, while the data limitations are discussed in ABS (2002).

**Figure 4: The Burden of Unemployment on Family Units Aged 15 and Over, 1979-2000**



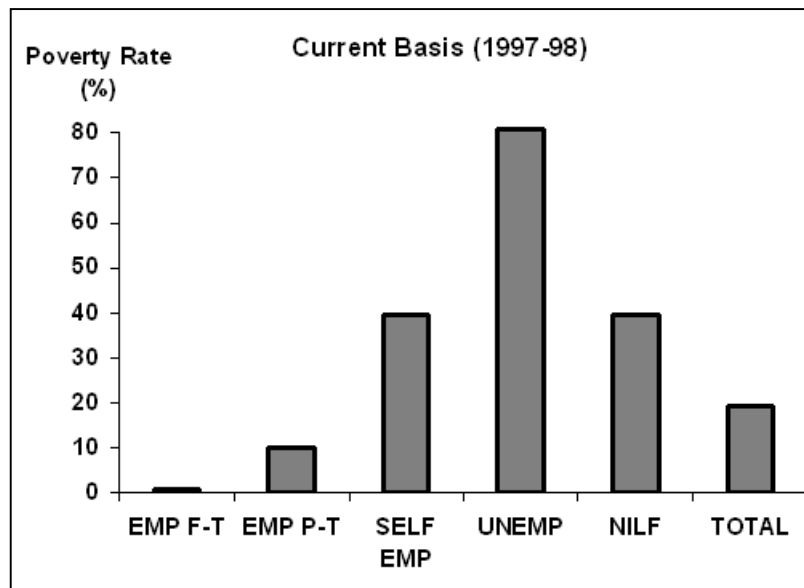
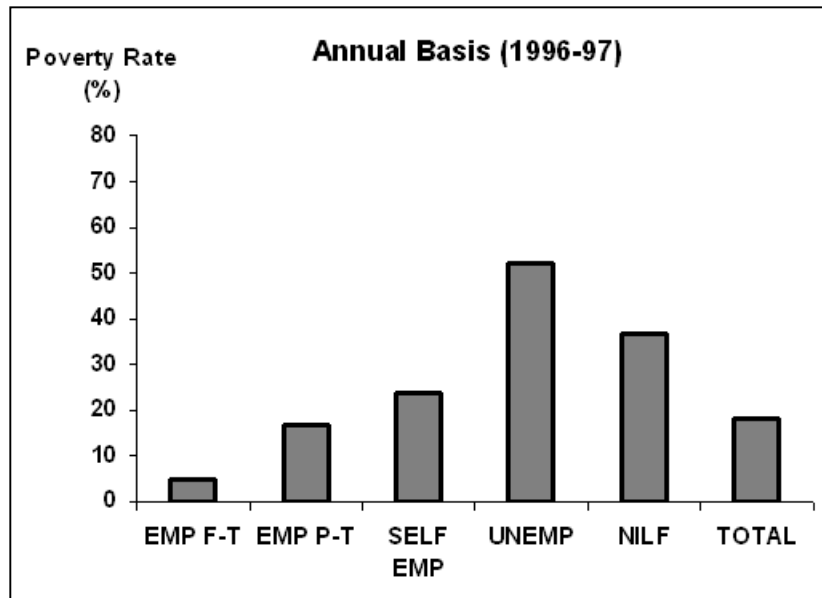
record data from the 1997-98 SIHC, it is clear from Figure 5 that for single-adult income units, being unemployed is associated with an increased risk of poverty, but that the relationship is weak (in the sense that not all of the unemployed are poor, while many of the poor are not unemployed) – particularly when poverty is measured on an annual income basis. The relationship between unemployment and poverty is weaker still among income units with two adults (Figure 6), but the importance of having at least one adult in full-time work is reinforced.

What really reduces the risk of poverty is thus not (paid) work itself, but full-time work, and it is only when there is at least one full-time earner that poverty rates fall to around 5 per cent. It is thus access to full-time work that is needed to protect people from the risk of poverty. With part-time work growing in importance, coupled with increased casualisation of work and a trend to lower wages that is creating a new class of ‘working poor’, finding a job may change the employment status of many of the unemployed without changing their poverty status (see Figure 1).

Labour market policies are required to avoid this outcome, and many European countries have designed their wage policies with this specific

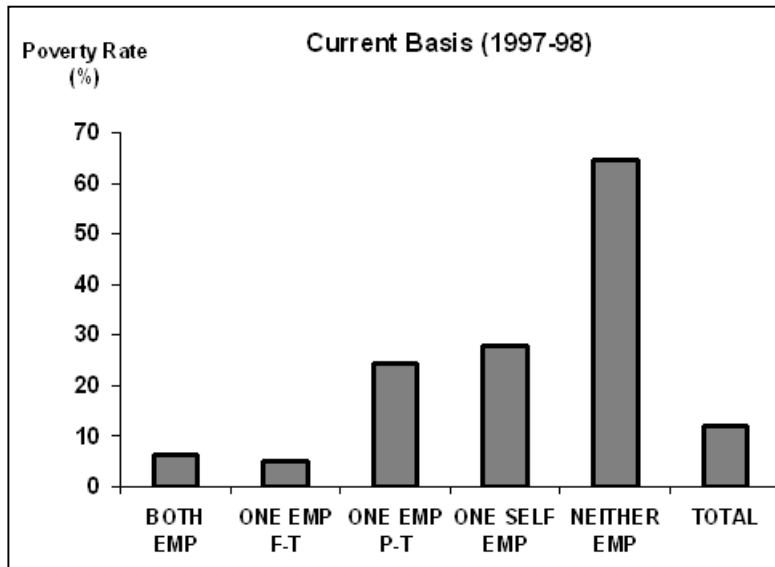
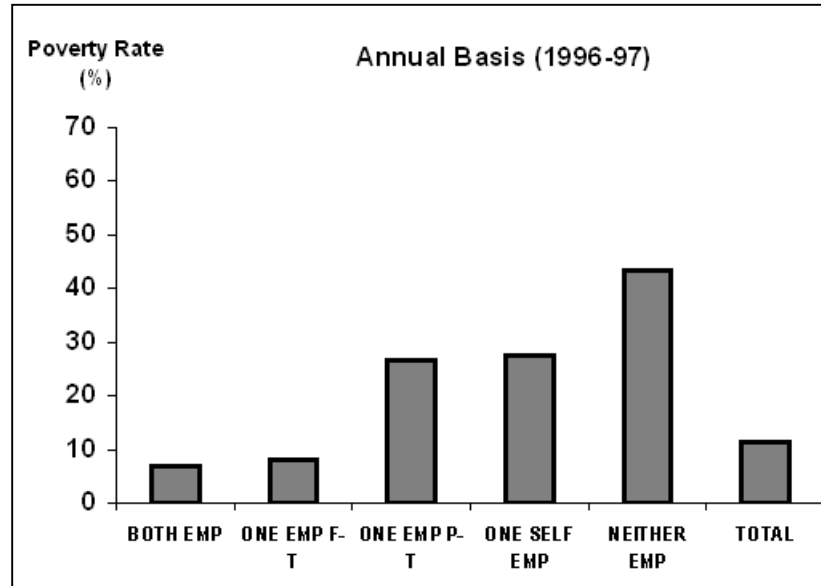


**Figure 5: Poverty and Labour Force Status: Single-adult units**



purpose in mind. In their UNICEF-commissioned comparative study of child poverty, Bradbury and Jäntti (1999) conclude that the main factor affecting differences in child poverty is access to market incomes, not the generosity of social benefits. Nordic countries achieve low child poverty rates because the income package of families with children contains greater market income (primarily earnings) than those of families in

**Figure 6: Poverty and Labour Force Status: Two-adult units**



countries (like Australia) where social benefits are more tightly targeted. The implication is that unemployment, which restricts access to market income, is a cause of poverty and increased targeting of benefits creates disincentive structures that may exacerbate the problem.

### 3 Unemployment and Inequality

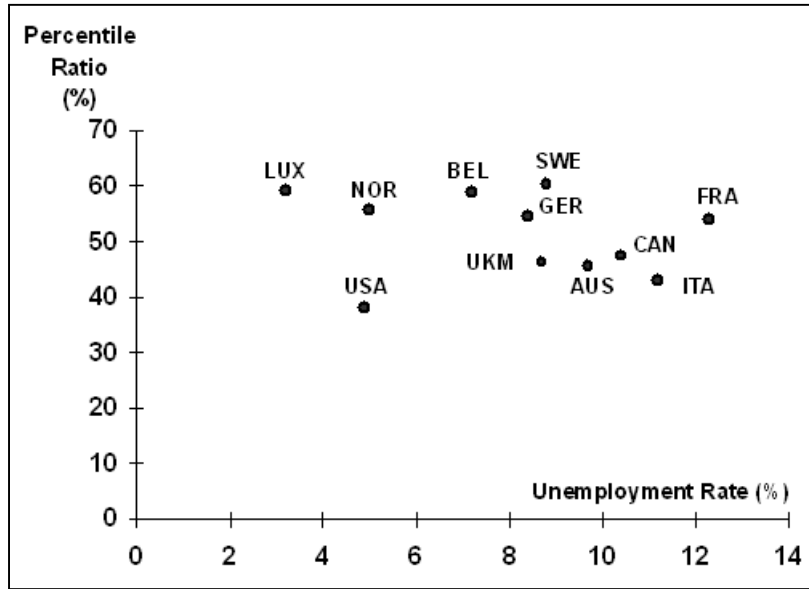
Similar arguments to those presented above also apply, and with a similar effect, to the relationship between unemployment and income inequality. Focusing on income distribution and bearing in mind that the unit of analysis is the nuclear family (or some variant thereof) and that the time period over which income is measured in distributional studies is generally one year, the relationship between income inequality and unemployment cannot be presumed to be any more self-evident than that between unemployment and poverty.

Figures 7 and 8 confirm this expectation. The cross-country evidence provides no empirical support for the existence of a positive association between unemployment and inequality in OECD countries (Figure 7). The P10/P50 percentile ratio falls in a rather narrow range despite unemployment being around 12 per cent in some countries and less than half that level in others. Overall, this evidence suggest that there are two percentile ratios, the first at around 60 per cent in Europe and the second closer to 50 per cent outside of Europe (plus Italy), with no relationship with unemployment within each grouping.

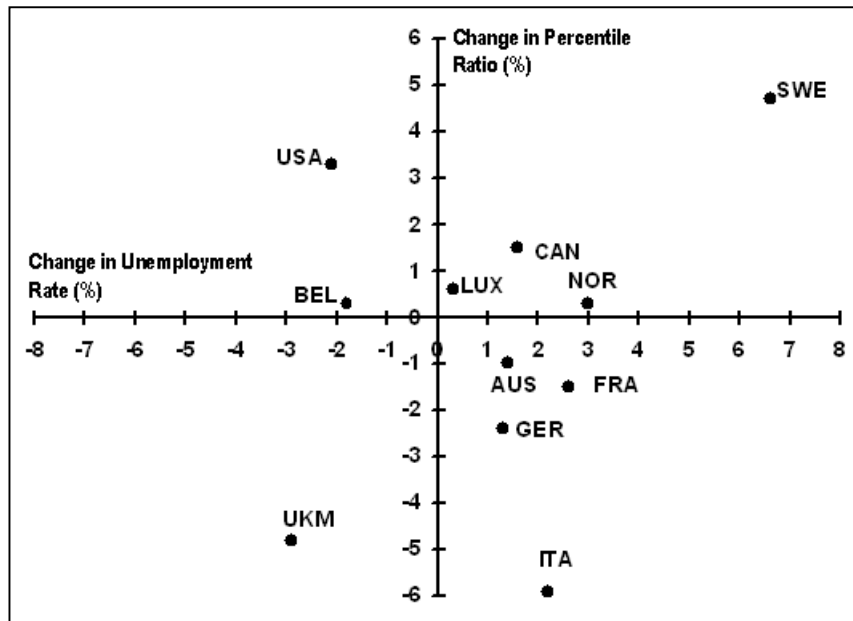
Figure 8 suggests that there is no systematic relationship between changes in inequality and changes in unemployment. Compare the experience of the US and UK on the one hand, with that of Italy and Canada on the other. Inequality was changing rapidly in most countries over this period, but the extent of change bears no relation with the magnitude of the change in unemployment.

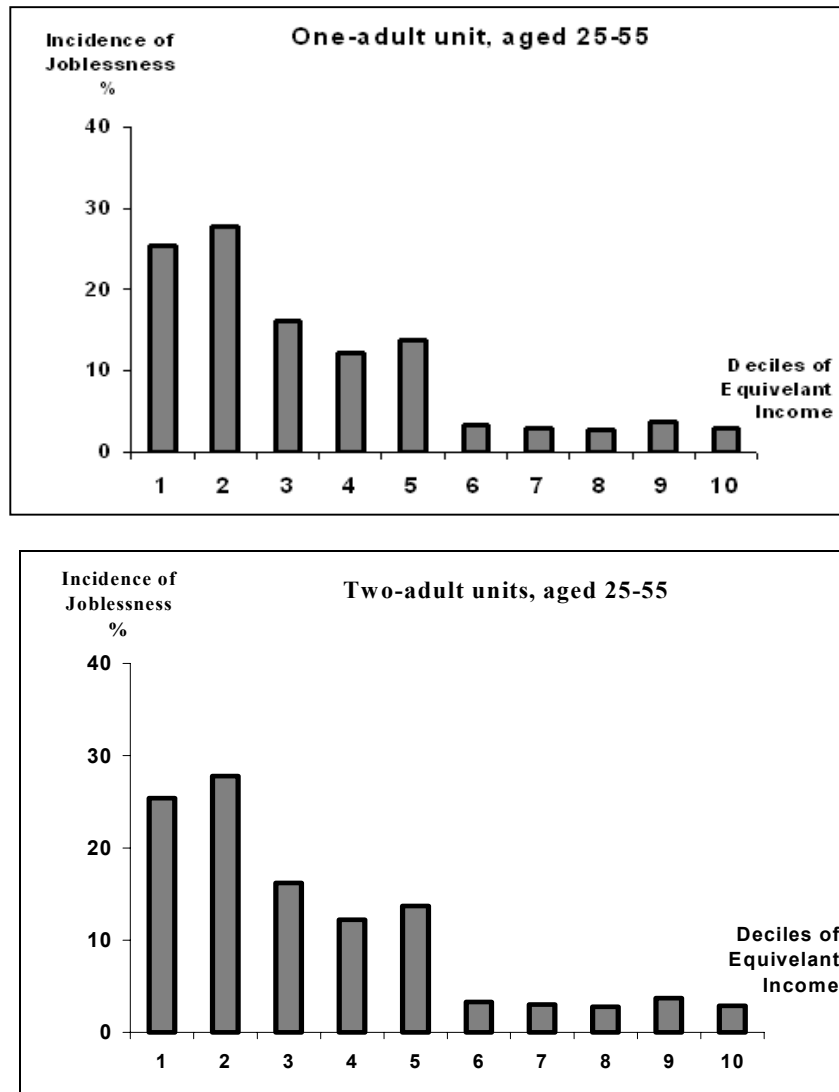
Figure 9 confirms the findings of studies by Borland and Kennedy (1998) and Harding and Richardson (1998) - both of which were presented to the 1998 Reserve Bank Conference on unemployment (Debelle and Borland, 1998). It shows that jobless income units (including the unemployed and those outside of the labour force) are mainly to be found in the bottom two deciles of the distribution of income among the working-age population, but jobless units are also scattered throughout the remaining eight deciles. Thus like that between poverty and unemployment, the relationship between unemployment and (income) inequality cannot be assumed to automatically exist.

**Figure 7: Relationship Between Income Inequality (P10/P50) and Unemployment in OECD Countries in the mid-1990's**



**Figure 8: Relationship Between Change in Inequality and Change in Unemployment, mid-80's to mid-90's**



**Figure 9: Joblessness and Income Distribution, 1996-97**

## 4 The Indirect Effects of Unemployment

One of the criticisms of the analysis presented so far is that its focus on primary poverty and income inequality is out of step with the contemporary realities of the labour market and the priorities that are driving the policy agenda. That agenda emphasises the importance of employment as an end in itself, irrespective of its short-run consequences for income and hence for poverty. Income sustainability in the longer-term requires the work ethic to be reinforced in the short-term: that, at least, is the theory. Another limitation is that no account has been taken

of the possible lags between the experience of unemployment and the emergence of its adverse consequences. Both are addressed in the new literature on social exclusion, which focuses on processes that reinforce and entrench the problems that often begin with a spell of unemployment.

These processes, and the effects to which they give rise, have been examined in the recent study of *The Economic and Social Costs of Unemployment* referred to earlier (Saunders and Taylor, 2002). The study brings together a variety of empirical evidence on the social costs of unemployment, including its impact on the health and psychological wellbeing of those affected by it, on family life and the cohesion of families with an unemployed member, and on the nature of local communities affected by widespread and systemic unemployment, including the consequent increase in crime rates that often accompanies geographical concentrations of unemployment.

Many of these effects have long been acknowledged in the literature (Borland and Kennedy, 1998). The work of Australian psychologist Norman Feather has highlighted the debilitating effects of unemployment in the following terms:

...the research supports the conclusion that other variables that relate to quality of life and the categories of experience that are available to the unemployed are also very important influences on psychological well-being. Thus, both economic variables and psychological variables have to be taken into account. ... life satisfaction depends on a quality of life that involves more than financial considerations. Happiness and psychological wellbeing also depend on opportunities to satisfy basic needs and values within environments that enable individuals to develop short-term and long-term goal structures that give meaning and purpose to daily activity (Feather, 1997, p. 42 and 44).

Evidence from some of the studies included in Saunders and Taylor (2002) reinforce these findings.

Material from the Life Chances Study undertaken by the Brotherhood of St Laurence in Melbourne paints a distressing picture of how those affected by unemployment begin to lose contact with ‘the mainstream’, as they are forced to confront a world dominated by financial hardship and whose routines are shaped by hostile public opinion and an unsympathetic bureaucracy (Taylor, 2002). A study of retrenched workers in the Textile, Clothing and Footwear (TCF) industry which followed their post-retrenchment history found that less than half of the 605 workers included in the study had found a job within four years, while a substantial number had left the labour force. These effects are captured evocatively in the following summary from the authors:

Evidently, retrenchment was not simply a transition from one job to a new job in the same or a different occupation, perhaps with a spell of unemployment between. Retrenchment involved a long-term change in employment careers. The impact of redundancy did not end when a worker was re-employed in a first post-retrenchment job. Rather, the impact reverberated through subsequent work histories. Many retrenched workers were led into intermittent and marginal employment becoming part of a precarious workforce, marginally attached to the labour force. Retrenchment acted as sharp shock in people’s ongoing employment histories, producing a shift in their long-term career trajectories. ‘Transition costs’ are transitory for society, perhaps; but for many of these former workers, they represented permanent effects. Since the economy did not offer secure, full-time skilled or semi-skilled jobs that were suitable for these workers, many of them have been disadvantaged for the rest of their lives. (Webber and Weller, 2001, 151)

Other contributions identify the adverse effects of unemployment on community life (Bryson and Winter, 2002), on health (Taylor and Morrell, 2002), on psychological wellbeing (Headey, 2002), on patterns of criminal activity (Weatherburn, 2002) and analyse how unemployment

contributes adversely to the deprivation and exclusion of Indigenous Australians (Hunter and Taylor, 2002).

Table 1 summarises some of the attitudinal effects of unemployment through a comparison with those held by employed Australians. It is clear that there are significant variations in attitudes and beliefs according to labour force status, with the unemployed showing less contentment, poorer health, a greater sense of disillusionment with economic and social trends and a far more pessimistic assessment of labour market prospects. Some of these findings suggest that the unemployed adhere to a set of beliefs that foster a sense of isolation and lack of autonomy that can lead to social exclusion. Responses to the questions relating to loss of control, being resigned to economic and social change and lack of jobs suggest that the unemployed are disengaging from a world that they see as beyond their control, but also as a direct cause of their joblessness. The result is likely to be a sense of alienation and anger that adds to the financial and emotional stresses associated with unemployment.

The important point about all of these identified social effects is that, once established, they become increasingly difficult to eradicate. Because they tend to feed off each other, their consequences are reinforced making it harder to reverse the pattern of events that originally gave rise to them. Thus, unemployment adversely affects morale and health, making the prospect of re-employment less likely, whilst simultaneously leading to attitudes that reinforce isolation from the world of work that shape people's lives. The challenge for social policy thus involves far more than just lowering unemployment back to its former levels, because this alone will not unwind the cumulative social effects that accompany the rise in unemployment.

## **5 Implications for the New Welfare Agenda**

One interpretation of the results presented so far is that unemployment is not as serious a problem as is generally thought. After all, the evidence indicates that unemployment is not synonymous with poverty, nor with being at the bottom of the income distribution. Moreover, individuals are constantly moving into and out of unemployment, and many families have multiple sources of income that protect individuals from the income falls arising from unemployment. However, none of this means that the



**Table 1: The Impact of Unemployment on Well-Being and Alienation**

Indicator	Specification	Mean score	
		Employed	Unemployed
<b>Well-being</b>			
Satisfaction with overall standard of living	Five-point scale; very satisfied = 5 to very dissatisfied = 1	3.73	2.73
Overall happiness	Four-point scale; very happy = 4 to very unhappy = 1	3.05	2.77
Self-assessed health status	Four-point scale; excellent = 4 to poor = 1	3.25	3.05
<b>Alienation(a)</b>			
Lost control	I feel I have lost control over my economic future	-0.25	0.11
Resignation	Economic and social change is inevitable and I just have to put up with it	0.47 *	0.36 *
Wrong balance	Too much emphasis is put on the economy and too little on creating a better society	0.94	1.22
<b>Views on Unemployment(a)</b>			
Blame unemployed	The unemployed only have themselves to blame	-0.58	-1.17
Not enough jobs	Not enough jobs for all who want to work	0.01	0.74
End of full employment	Some people will always be unemployed – we'll never get back to full employment	0.81*	0.88*

Note: (a) These variables are measured on a five-point scale from strongly agree (= +2), agree (= +1), neither agree nor disagree (= 0), disagree (= -1) to strongly disagree (= - 2).

\* The values shown are NOT statistically different ( $p = 0.05$ )

Source: Saunders, Thomson and Evans, 2001, Table 5.

effects of unemployment for that individual are any less serious. Unemployment implies dependency, whether on a welfare system designed to spread the risk collectively, or whether that burden is privatised and shifted onto family and friends.

Another interpretation of the results is that unemployment matters, but that traditional poverty and income distribution research has a very limited role to play in shedding light on the social consequences of

unemployment, or in informing decisions about how to reform the welfare system in response to the unemployment problem. This line of argument suggests that we need to look more closely at the evidence on the consequences of unemployment before we can assess its true impact.

This latter view is consistent with the work of the McClure Report on Welfare Reform, which makes no mention of either poverty or income distribution (Reference Group on Welfare Reform, 2000). Instead, the new welfare agenda has shifted the focus away from concern over unemployment because of its consequences for income and living standards (which is what poverty and income distribution are measuring) towards seeing unemployment itself as the problem, and the encouragement of a shift into (paid) work as the solution. Under this view, improving the provisions of the welfare system may be counterproductive because this encourages welfare dependence and entrenches poverty and disadvantage. Instead, the solution lies not in improving welfare benefits, but in making them conditional on participation in work, whether this is enforced (as in the US and increasingly, in Australia) or actively encouraged (as in the UK).<sup>7</sup>

The McClure Report (p. 3) argues that: ‘Central to our vision is a belief that the nation’s social support system must be judged by its *capacity to help people participate economically and socially*, as well as by the adequacy of its income support arrangements’ (italics added). A key form of economic participation is work, preferably (but not exclusively) paid work, which is: ‘a major source of self-esteem. Without it, people can fail to develop, or become disengaged from, employment, family and community networks. This can lead to physical and psychological ill health and reduced life opportunities for parents and their children.’ (Reference Group on Welfare Reform, 2000, 3). The report is less clear about what ‘social participation’ means in practice, and how it can be encouraged, and with what effects. Adequacy is mentioned frequently

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7 ‘Thirty years of research and experience have shown that many more welfare mothers will go to work, or leave welfare if they are required to enter work programs as a condition of aid. Just participating in mandatory work activities strongly promotes employment, and the effect is greater if the programs emphasise working in available jobs rather than education or training for better jobs.’ (Mead, 2000; 52)

throughout the McClure Report, but its meaning and significance are not discussed.

The main problem with this approach is that it gives emphasis to employment as an end in itself rather than as a means of achieving other ends such as financial security and the adequacy and distribution of living standards. Employment is both a means and an end, but its contribution to this latter role raises questions about the nature of work and jobs that cannot be ignored because like unemployment, they raise issues about the kind of society we are seeking to achieve. It follows that both the welfare system and the labour market must be judged against these broader criteria.

One of the factors claimed to be behind the late-1990s welfare reform debate in the US has been the growing gap between the values of ‘middle America’ and those that were seen as being encouraged – or at least facilitated – by the US welfare system (Haveman, 2001). To the extent that this is true, it represents a serious challenge to any welfare system. To remain sustainable, welfare must continue to be seen as legitimate in the eyes of the taxpayers that fund it. This does not mean that they have to agree with every single provision, but it does suggest that the policies and practices of welfare cannot stray too far outside of the boundaries of public acceptability. Where this occurs, a ‘crisis of welfare legitimacy’ will emerge that presents more serious issues than the ‘crisis of welfare funding’ that we are all more familiar with.

Changes in community values are one of the factors underlying the current welfare reform debate in Australia, which raises the question of whether there is any evidence that the values of ordinary Australians are at odds with the goals of our welfare system. The results reported in Table 2 suggest that community opinion has not turned against those who are dependent on the welfare system in Australia. In contrast, there is considerable sympathy with the plight of the both the poor and the unemployed, with around 60 per cent disagreeing with the view that they only have themselves to blame.<sup>8</sup>

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<sup>8</sup> Changes in social attitudes to the causes of poverty in Australia between the early-1970s and the late-1990s are examined in Saunders (2002c).

**Table 2: Attitudes to the Causes of Poverty and Unemployment in Australia, 1999**

Strongly agree	Agree	Neither agree or disagree	Disagree	Strongly disagree	Don't know
3.1	10.4	23.9	43.2	17.6	1.8
4.0	9.9	24.7	46.0	13.9	1.6

Note: Unweighted n = 2307 to 2331

Source: See Saunders, Thomson and Evans (2001)

Table 3 summarises views on how many mutual obligation requirements it is reasonable to impose on the unemployed in return for the receipt of benefit. The question asked listed nine possible requirements, including having to look for work, participate in a 'work for the dole' program, get a haircut and 'smarten up' and move to another town to get work. The Table shows the mean response score (out of a maximum score of 9.0) for different groups of respondents in relation to the requirements for each group of the unemployed. The first point to note is that the overall level of community support for applying mutual obligation requirements to the unemployed varies considerably across different groups, with support strongest for imposing requirements on the young and long-term unemployed, but much weaker for the other groups shown. However, the degree of support does not vary greatly with the characteristics of the respondent, as reflected in their age, labour force status, housing tenure, income, education, experience of unemployment or where people live. Some of the differences shown are statistically significant, but they can hardly be claimed to be socially significant. In other words, these results do not suggest that there is anything like the same divergence of values in Australia as has been described as mobilising the welfare reform movement in the US. There is support in Australia for treating some groups of the unemployed more harshly than others, but there is no apparent difference in the attitudes held by different groups among the population.

**Table 3: Support for Mutual Obligation, by Respondent Characteristics**

Respondent Characteristics	Unemployment Group		Long-term Unemployed	With young children (< 5)	Affected by disability
	Young (under 25)	Older (over 50)			
	Mean scores out of 9:				
Total	6.9	3.8	6.2	3.6	2.8
Age:					
18-24	6.8	4.1	6.9	4.0	3.6
55-64	7.1	3.7	6.0	3.5	2.0
Labour force status:					
Employed	7.0	4.2	6.6	3.9	3.1
Unemployed	5.8	3.2	5.5	2.8	2.3
Housing tenure:					
Owner/purchaser	6.9	4.0	6.3	3.7	2.7
Public renter	6.6	2.5	4.9	2.3	1.6
Gross family income (weekly):					
Less than \$400	6.7	3.2	5.5	2.9	2.0
\$400-699	6.9	3.8	6.4	3.8	2.8
\$700-1249	6.9	3.8	6.4	4.1	3.2
\$1250 or more	7.1	4.7	6.9	4.3	3.5
Level of education:					
Secondary school	7.0	4.0	6.5	3.7	2.8
Bachelor degree	6.6	4.4	6.5	4.0	3.4
Family member unemployed in last 3 years?					
Yes	6.7	3.8	6.1	3.6	2.8
No	7.0	4.0	6.5	3.8	2.9
Major urban	6.7	3.7	6.1	4.5	2.7
Rural and remote	7.1	4.1	6.4	3.9	2.9

Note: Unweighted n = 2147 to 2373

Source: See Saunders, Thomson and Evans (2001)

## 6 In Conclusion...

Unemployment is a bad thing. It is bad for the economy and for society, for unemployed people themselves, for their families and for the communities in which they live. This seems indisputable, despite the relative absence of empirical evidence linking unemployment to poverty and inequality. The new welfare reform agenda, at least the version that has been imported to Australia from the US, puts employment at the

centre of the welfare system and denies welfare to those who are not willing to work or to engage in activities that are expected to lead to employment.

While there is merit in this new approach, it fails to address the causes of unemployment and pays insufficient attention to the nature of the jobs being created. Employment is an important outcome of any welfare intervention, but it is not the only outcome by which the welfare system should be judged. The conditions that allowed welfare reform to be pursued so successfully in the US in the 1990s – including a booming economy and a very harsh climate of public opinion towards those on welfare – do not exist in Australia. We can learn from the US experience, but its successes should not blind us to the poverty and inequality that are endemic features of American society. Above all, the damaging direct and indirect effects of unemployment in Australia require an Australian response.

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## **Appendix A: Data Sources**

**Figures 2 and 3:** Poverty rates taken from Jantti and Danziger (2000) (Headcount poverty rate defined using 50 per cent of median adjusted disposable income poverty line)

Unemployment rates are OECD standardised. Source, OECD (2000).

**Figure 4:** Figures for 1979-94 from Miller (1997; Table 1)

Post-1994 data calculated from *The Labour Force Status and Other Characteristics of Families*, ABS Catalogue No. 6224.0 – see Saunders (2002a; Figure 7.1)

**Figures 5 and 6:** ABS, *1997-98 Survey of Income and Housing Costs*, confidentialised unit record file. (Poverty estimates are based on the detailed Henderson poverty line)

**Figures 7 and 8:** Income inequality estimates taken from Atkinson, Rainwater and Smeeding (1995) and Grodner and Smeeding (2000)

Unemployment rates – see above.