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The Distributional Impact of the Welfare-to-Work Reforms Upon Australians with Disabilities

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**Report to the National Foundation for Australian
Women
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Abstract

In the May 2005 Budget the Federal Government announced a range of proposed welfare to work measures, to take effect from 1 July 2006. Among the numerous measures announced in the Budget were significant changes for Australians with disabilities – including that those people with disabilities who apply for income support after 1 July 2006 and who can work between 15 and 29 hours a week at award wages will be placed on Newstart Allowance or Youth Allowance rather than Disability Support Pension. This report analyses the impact of the proposed changes upon the disposable incomes and effective marginal tax rates of those affected. It shows that the disposable incomes of people with disabilities can be up to about \$120 a week lower under the proposed new system than under the current system. It also finds that effective marginal tax rates will be sharply increased under the proposed new system, over a reasonably wide range of earned income.

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General caveat

NATSEM research findings are generally based on estimated characteristics of the population. Such estimates are usually derived from the application of microsimulation modelling techniques to microdata based on sample surveys.

These estimates may be different from the actual characteristics of the population because of sampling and nonsampling errors in the microdata and because of the assumptions underlying the modelling techniques.

The microdata do not contain any information that enables identification of the individuals or families to which they refer.

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1 Introduction

In the May 2005 Budget the Federal Government announced a range of proposed welfare to work measures, to take effect from 1 July 2006. Against the backdrop of projected slower rates of workforce growth in the future due to population ageing (Productivity Commission, 2005), the government is keen to encourage labour force participation. In addition, reducing welfare dependency and increasing employment is seen as likely to improve the lifetime incomes and economic well-being of welfare recipients, as well as boosting economic growth for Australia as a whole. Earlier research by NATSEM and AMP, for example, has shown clearly that many baby boomers have not yet saved sufficient to finance a comfortable retirement – and that this problem is particularly acute for baby boomer women (Kelly and Harding, 2002; Kelly et al, 2002; Kelly, Farbotko and Harding, 2004).

Among the numerous measures announced in the Budget were significant changes for Australians with disabilities. Currently, people with physical, intellectual or psychiatric impairment at a sufficient level to make them unable to work for at least 30 hours a week (or undertake training that would equip them for work) for at least the next two years are able to receive Disability Support Pension (DSP), which is subject to the *pension* income test and payment rate rules. Those people with disabilities who are in receipt of DSP prior to 1 July 2006 will generally continue to remain on that payment and be subject to the ‘pension’ income test (which is more generous than the ‘allowance’ income test).¹ Current DSP recipients who give work a go will have a right to return to DSP within two years if they start a job but are unable to sustain it for any reason (Dutton, 2005a).

The more significant changes are for people with disabilities applying for income support *after* 1 July 2006. Those people with disabilities who are assessed by the new ‘comprehensive work capacity assessment’ as being able to work 15 to 29 hours per week at award wages in the open labour market will be required to seek 15 hours or more of part-time work a week and will be placed on Newstart Allowance or Youth Allowance. These Allowances provide a lower payment rate than Disability Support Pension and have a much less generous income test. As a result, in the future many Australians with disabilities will receive much lower incomes than they do under the current income support system. In addition, the returns from paid work will be much lower than currently. This will be exacerbated by the fact that DSP is not subject to income tax, while Newstart and Youth Allowance are.

¹ The exception is people applying for DSP between 11 May 2005 and 30 June 2006, who will be assessed for DSP under the existing 30 hours test but be reassessed in periodic reviews against the 15-29 hours test after 1 July 2006. Those able to work 15 to 29 hours per week will be shifted to Newstart and be required to seek work.

Section 2 of this paper explains the likely new payment structures applying to this group of people with disabilities in 2006-07. Section 3 shows the falls in the disposable (after-income-tax) income of affected people with disabilities, relative to payments under the current program rules. Section 4 examines the impact of the reforms on the effective marginal tax rates of affected people with disabilities. Section 5 concludes.

2 The DSP and NSA programs

There is inevitably some uncertainty about the exact payment rates for Newstart Allowance (NSA) and DSP that will apply in 2006-07, as they depend upon future trends in average weekly earnings and the consumer price index. The following estimates are based on NATSEM's latest projections of these indexes. Using slightly different assumptions about earnings and price changes would slightly change the results. Our modelling is also based on the Government's current statements about the structure of income support after 1 July 2006 (Dutton, 2005a, 2005b). However, as the legislation has not yet been introduced, it is possible that there may be changes to some of the programs and parameters that have fed into our modelling.

Single DSP recipients aged over 20 years age are expected to receive about \$257 a week on average in DSP in 2006-07 (Table 1). A crucial factor is the amount of private income that they can receive before their income support payment is reduced. ('Private income' means income from sources other than government cash transfers, such as earnings.) In 2006-07, a single DSP recipient will be able to earn \$64 a week without any reduction in the income support they receive. For every dollar of income they earn above this threshold, their payment from government is reduced by 40 cents.

The proposed payment rate and income test for Australians with disabilities that are assessed as being able to work 15 to 29 hours a week are also summarised in Table 1. They will be placed on Newstart Allowance, which is expected to average \$211 a week in 2006-07. This is \$46 a week less than the DSP payment rate. In addition, they will be able to earn only \$31 a week before their income support payment begins to be reduced. That is, their 'free area' will decline sharply relative to the current rules, by about \$33 a week. The first \$94 of private income above that \$31 a week 'free area' will reduce their Newstart Allowance by 50 cents for every dollar of private income above the free area. Once they reach the second income test threshold of \$125 a week, this withdrawal rate will increase further, with their allowance rate being reduced by 60 cents for every additional dollar of earnings. In other words, once their private incomes reach \$125 a week, they will keep a maximum of 40 cents out of

each additional dollar of private income, until they reach the 'cut out point' where they receive no further allowance from government.

The Newstart Allowance income test is thus much more restrictive than the DSP income test, and this is reflected in the very different 'cut out points' shown in Table 1. Single DSP recipients will be able to earn up to around \$706 per week before their entitlement to part-rate income support is extinguished. People with disabilities on Newstart Allowance will only be able to earn up to about \$398 a week before their entitlement to income support is extinguished.

This means that income support will cease at a much lower level of earnings for those subject to the new Newstart Allowance test than for those on the existing DSP.

Table 1 Summary of the Newstart Allowance and Disability Support Pension Payments for Single Person Aged 21 to 60, 2006-07^a

	DSP	NSA	Difference
	\$ pw	\$ pw	\$pw
Payment rate	\$257 ^b	\$211 ^b	-\$46
Amount of income that can be earned before payment is reduced	\$64	\$31	-\$33
Withdrawal rate for each \$ of private income above this threshold	40%	50%	+ 10%
Second income test threshold	Na	\$125	
Withdrawal rate for each \$ of private income above this threshold	40%	60%	+20%
Income support cuts out when private income reaches this point (cut-out point)	\$706 ^c	\$398 ^c	-\$308

^a These are the estimated averaged payment rates and thresholds that will apply in 2006-07. The actual payment rates vary at various points throughout the financial year, in line with indexation arrangements. All figures rounded to nearest whole dollar. Both NSA/YA with disabilities and DSP recipients will receive the Pensioner Concession Card, Pharmaceutical Allowance (PA) and Telephone Allowance. NSA/YA recipients with disabilities who are unable to use public transport to undertake job search and take up employment will be able to receive Mobility Allowance of \$50 a week. DSP recipients who cannot use public transport and are undertaking sufficient paid or voluntary work or vocational training or job search activities also receive \$50 a week in Mobility Allowance. Mobility Allowance is not income or asset tested.

^b This includes \$2.90 a week of PA.

^c This includes the effect of the \$2.90 a week of PA.

Source: Specially created version of STINMOD/05A

People with disabilities receiving Newstart Allowance will clearly receive lower payments and face a harsher income test than those on DSP: however there are also other, less obvious, factors that will adversely affect them relative to DSP recipients. One is that DSP is not subject to income tax. In contrast, both Newstart Allowance and Youth Allowance are taxable payments. This means that those with earned or

other private incomes in addition to their income support are adversely affected by being placed on Newstart rather than DSP.

A second issue is the receipt of the Pensioner Concession Card. DSP recipients are automatically entitled to a Pensioner Concession Card, which many organisations use as a 'passport' to a range of concessional prices for such services as property charges and taxes, energy, water, transport, education, health, car registration, housing and recreation services and so on. While such services are often provided by State and local governments, many private sector businesses also use the possession of a Pensioner Concession Card as the trigger for lower prices for such diverse services as movie tickets and shoe repairs. Similarly, doctors may often bulk bill those with Pensioner Concession Cards, so that they do not have to pay any additional co-payment.

The Government has stated that those people with disabilities who are placed on Newstart Allowance under the proposed new arrangements will retain the right to a Pensioner Concession Card. However, as Table 1 makes clear, eligibility for Newstart Allowance for people with disabilities will cease at a much lower level of private income than eligibility for DSP - \$706 vs \$398. As a result, there is a wide range of private income of more than \$300 a week over which those Australians with disabilities who would formerly have qualified for the Pensioner Concession Card will apparently not qualify under the new rules.

It appears that those people with disabilities with private incomes above \$398 a week will not receive a Health Care Card - and thus will lose their right to concessional pharmaceuticals.

Those people receiving Mobility Allowance will still receive a Health Care Card, but some concessions are provided by State and local governments and other organisations *only* to those with Pensioner Concession Cards and not to those with Health Care Cards. In Victoria, for example, Pensioner Concession Card holders (but *not* Health Care Card holders) qualify for an additional municipal rates concession of up to \$160 a year and an additional transport accident charge concession of up to about \$170 a year. Thus, the loss of these three items alone could reduce the effective income of some people with disabilities by some \$6 a week.

It also appears that the proposed changes will be particularly harsh for those people with disabilities who are engaged in full-time study as part of their preparation for future workforce participation. They will be ineligible for Newstart while undertaking full-time study and will thus be placed on Austudy. While people with disabilities on DSP receive the Pensioner Education Supplement, currently worth \$31.20 a week, it appears that this will not be payable to people with disabilities placed on Austudy. Thus, it appears that a person with disabilities in full-time study and no private income who is placed on Austudy under the proposed new rules will

face a cut in income of about \$80 a week (relative to the payment they would have received under the current system).

A final issue is that Newstart is much more strictly asset-tested than DSP. In 2006-07, a single homeowner with assets of more than \$157,000 loses their entitlement to any Newstart Allowance. In contrast, a pensioner with assets above this level loses \$3 per fortnight of DSP for every \$1000 by which assets exceed this level. A 50 year old person with disabilities who owns their own flat and who has inherited a \$200,000 house from their parents will thus not be entitled to Newstart Allowance, but would be entitled to DSP and the Pensioner Concession Card under the current system.

3 Impact of proposed changes on disposable incomes

The figures below trace the impact upon the disposable incomes of those with disabilities who would qualify for DSP under the current rules but qualify only for Newstart Allowance under the proposed new rules. Thus, the graphs show the impact upon those people with disabilities who are assessed as being able to work 15 to 29 hours per week and who commence receipt of income support after 1 July 2006. (Note that if suitable work is not available in the area where the person lives, it appears that they will still be put on NSA rather than DSP. Thus, the test is in their *potential ability* to work such hours, not whether such work is actually available.) For simplicity, the figures abstract from the precise point in the year at which recipients become eligible for the payments and simply show the estimated averages for the entire 2006-07 year.

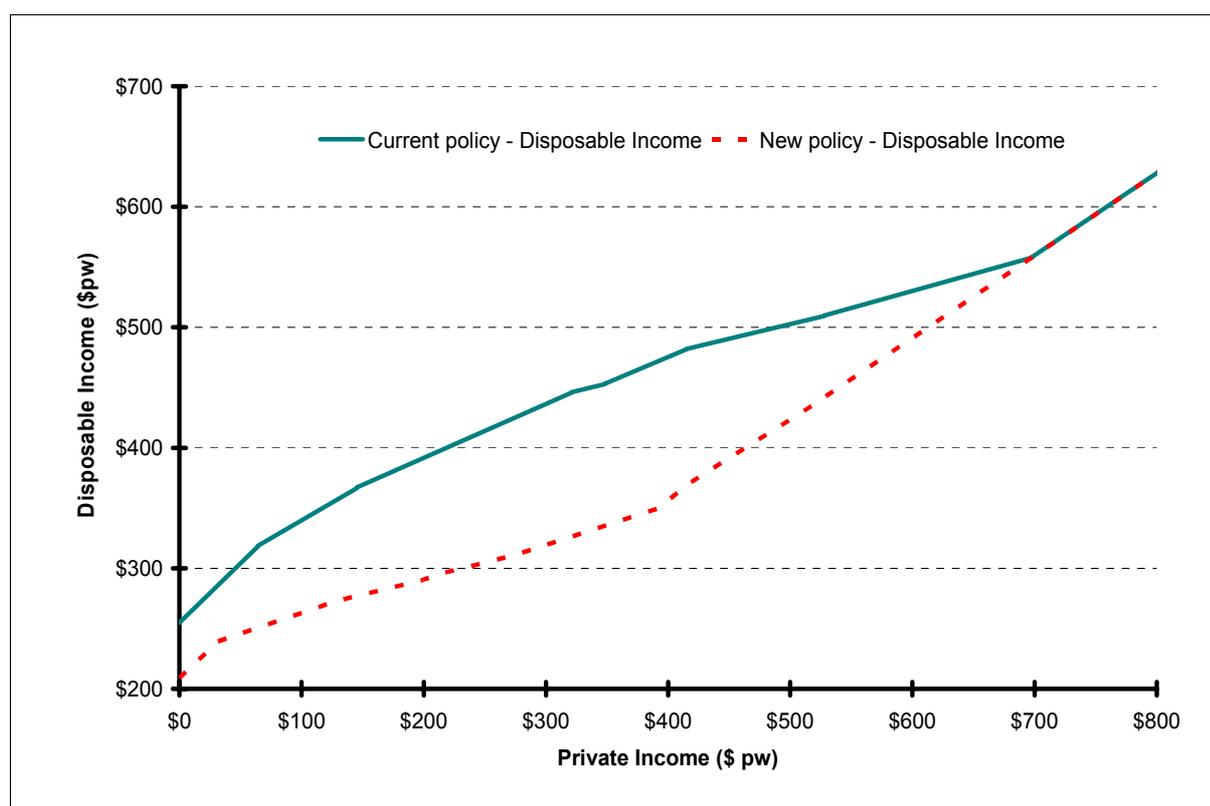
Disposable income means the income that recipients have left in their pockets to spend each week, after the receipt of any income support and/or private income, the payment of income tax and Medicare levy, and the receipt of the various tax allowances such as the beneficiary tax offset and the low income tax rebate. The figures below do not take any account of any possible costs of work or the possible impact of rising private income levels on such factors as consequent increases in public housing rents. The value of the Pensioner Concession Card is also not included.

As Figure 1 shows clearly, the disposable incomes of single people with disabilities are very much lower under the proposed new system than under the current system over a broad range of private income. The losses sustained by Australians with disabilities amount to more than \$100 a week when earnings are between about \$196 and \$448. The peak loss of \$122 a week is experienced by disabled people with

private incomes of \$393 a week. As shown in Table 2, for example, the proposed new reforms reduce the 'take-home' incomes of Australians with disabilities and private incomes of \$200 a week from \$391 under the current system to \$290 under the proposed new system – a cut of \$101 a week. This effectively represents a 26 per cent cut in the living standards of these people with disabilities.

At low levels of private income, there is a \$46 a week difference between the proposed new and existing systems, due to the difference between the maximum rates of pension and allowance for single people. At the other end of the spectrum, above around \$700 a week, there is no difference in the incomes of people with disabilities under the proposed new and current systems because, beyond this point, they are not receiving any income support. Between these points, the disposable incomes of people with disabilities are lower under the new system than under the current system, primarily because of the stricter income test and lower payment rates applying to Newstart Allowance.

Figure 1 Disposable income of single person with disabilities under current and proposed systems, 2006-07



Source: Specially created version of STINMOD/05A. PA excluded from all calculations (see footnote to Table 2)

Table 2 Impact of proposed new system on disposable incomes and EMTRs of single disabled people with various levels of private income, 2006-07

Private Income	Disposable Income			Effective Marginal Tax Rates		
	Current System	New System	Change	Current System	New System	Change
	\$ pw	\$ pw	\$ pw	%	%	Percentage point
\$0	254	208	-46	0	0	0
\$50	304	245	-58	0	65	65
\$100	339	263	-77	40	65	25
\$150	369	278	-91	55	75	20
\$200	391	290	-101	55	73	18
\$300	436	319	-117	55	67	12
\$400	475	356	-119	57	17	-40
\$500	503	423	-79	76	36	-40
\$600	530	491	-39	72	32	-40

Note: Averaged 2006-07 payment levels have been used. All dollar figures rounded to nearest dollar. All EMTRs rounded to nearest one per cent. Note that we have been unable to simulate the receipt by single disabled Newstart Allowees of PA within the time frame allowed for this project. PA has a particularly complicated income test and is also non-taxable. To make a fair comparison between the current and proposed systems, we have excluded PA from the calculations in both the current and proposed new world. However, this exclusion makes little difference, as the payment is only worth \$2.90 a week and is received by disabled people in both the current and proposed new systems if they are in receipt of income support. Thus, the *difference* between the two systems is in most cases not affected by this exclusion.

Source: Specially created version of STINMOD/05A

4 Impact of proposed changes on EMTRs

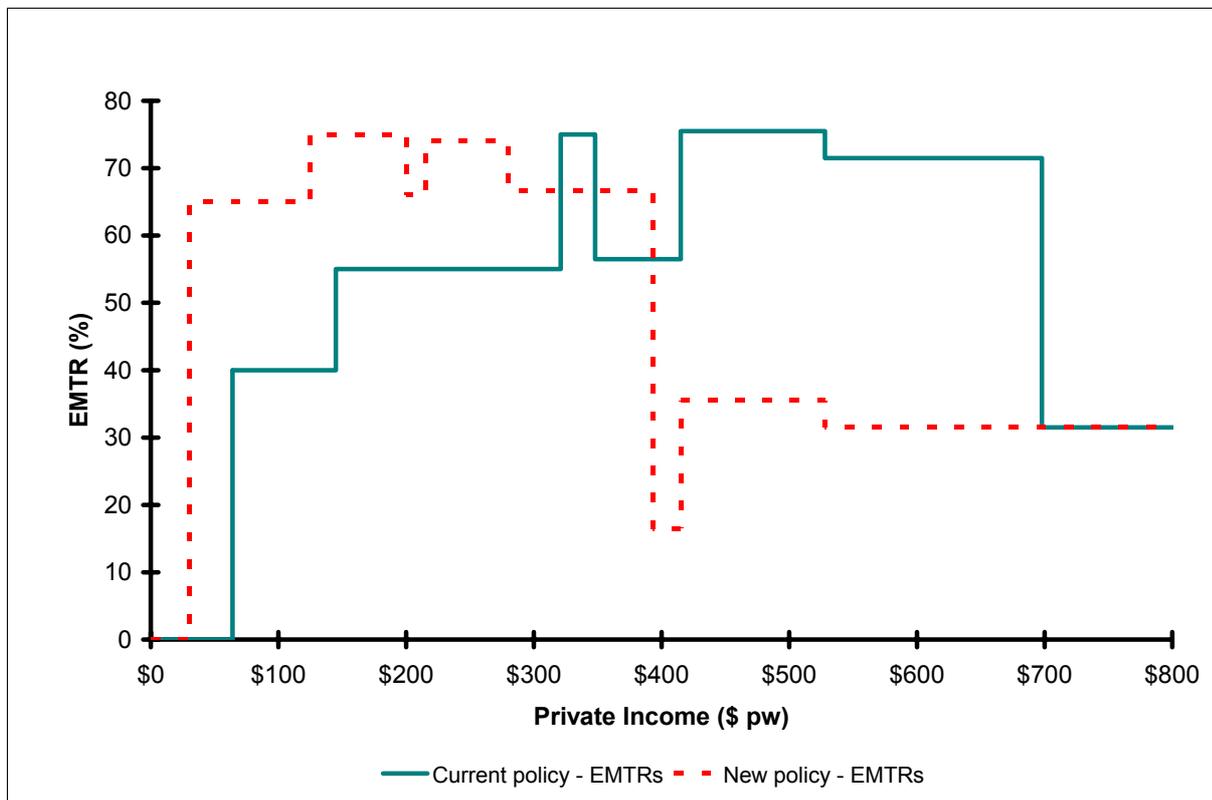
One of the factors affecting the workforce incentives of Australians with disabilities is the effective marginal tax rate that they face. An effective marginal tax rate (EMTR) measures how much of an additional dollar of earnings people actually keep, after taking account of the various income tests associated with social security and family payments, the payment of income tax and the receipt of various tax allowances and rebates. An EMTR of 70 per cent means that the 'disposable' or 'take-home' income of a person will increase by only 30 cents when earnings increase by \$1.

The EMTR graph shown below takes no account of the possible *increased costs* associated with rising earnings, such as increased transport or clothing costs. They also take no account of possible 'knock on' effects to programs or services not

administered by the Federal Government, such as rent payments for public housing tenants or State and local government concessions. As a result, the EMTRs shown below can probably be regarded as being somewhat lower than those that will face many people with disabilities in the real world.

For single people with disabilities, the EMTRs faced at lower levels of private income (that is, earnings) are generally higher under the new system than under the existing system. People with disabilities with weekly private incomes between around \$31 and \$64 a week face an EMTR of 65 per cent under the new system, compared with a zero EMTR under the current system. That is, for each additional dollar of earnings in this range, people with disabilities will keep only 35 cents under the new system, compared with 100 cents under the existing system.

Figure 2 EMTRs faced by single person with disabilities under current and proposed systems, 2006-07



Australians with disabilities with private incomes between \$64 a week and \$125 a week will also face substantially higher EMTRs under the proposed new system – 65 per cent under the new system compared with only 40 per cent under the current system. That is, each additional dollar of earnings in this range nets 25 cents less under the new system than under the existing system.

This effect is due to ‘income test stacking’, with recipients facing a 50 per cent EMTR due to the allowance income test plus a 15 per cent EMTR due to a combination of the effective withdrawal of the ‘allowance tax offset’ and the payment of income tax. This tax treatment contrasts with the much more favourable tax treatment given to those on DSP, with DSP being non-taxable. Thus, one of the less obvious implications for people with disabilities of the proposed changes is that they will be subject to the harsher allowance tax offset under the new system rather than the more generous DSP tax provisions which apply under the current system.

Private incomes between \$125 a week and \$200 a week are again subject to much higher EMTRs under the proposed new system – 75 per cent under the new system compared with only 40 or 55 per cent under the existing system. The Medicare levy shade-in range ends at \$280 a week of private income, at which point the EMTRs faced by people with disabilities under NSA fall to 66.6 per cent, where they remain until eligibility for NSA ceases at around \$393 a week.

What do the higher EMTRs facing people with disabilities under the proposed new regime mean in practical terms? Those receiving Newstart Allowance with private incomes ranging between \$31 a week and about \$393 a week face EMTRs of 65 per cent or more. This is substantially higher than the top marginal income tax rate of 48.5 per cent (including Medicare levy) paid by the most affluent taxpayers in 2006-07 – that is, those whose taxable incomes exceed \$125,000 a year. As shown below, the impact of these high EMTRs is to ensure that the financial benefits from work are very low for those people with disabilities receiving Newstart Allowance.

The recently announced minimum wage is \$484 for a 38 hour week, or \$12.74 an hour. It is difficult to predict what a likely minimum wage will be in 2006-07, given the proposed changes in industrial relations legislation. But suppose we follow the example recently given by Minister Kevin Andrews and look at the outcomes for a person working 15 hours a week at \$12.75 an hour, with a total pay of \$191 (Andrews, 2005). Under the current system a DSP recipient would keep \$133 of this \$191, thus substantially increasing the amount of income they have to support themselves after moving from no paid work to the 15 hours of paid work.² Under

² Under the current system their disposable income increases from \$254 a week when they have no paid work to \$387 a week when they work 15 hours for \$191 of pay (excluding PA in both cases).

the proposed new system, this NSA recipient with disabilities will experience only an \$80 a week increase in their take-home income.³

In effect, the Federal government will be the major beneficiary of this NSA recipient being required to undertake 15 hours of paid work a week. Thus, while the person with disabilities will keep \$80 a week of their \$191 a week of earnings, the government will take the other \$111, via reduced Newstart Allowance and increased income tax payments.

The Government has argued that those on Newstart Allowance and working 15 hours a week will be better off than those on pension who have no earned income (Andrews, 2005). Table 3 shows that those on NSA earning \$191 a week will have total incomes that are only \$34 a week higher than they receive under the current system when they undertake no paid work at all (\$288 minus \$254). And this \$34 a week gain assumes that the costs of work are zero and that there are no knock-on effects to other programs, such as public housing rent increases. It also assumes that the value of time is zero, as the relevant income support recipients have exchanged zero hours of work for 15 hours of work plus additional likely travel time.

While DSP is indexed to movements in average weekly earnings, Newstart Allowance is indexed to movements in the consumer price index – which usually increases more slowly. As a result, the relative losses for people with disabilities placed on Newstart Allowance rather than DSP will be higher in future years. The bottom panel of Table 3 presents some illustrative figures for 2009-10, given current estimates of likely trends in earnings and prices over the next few years. Leaving the wage rate unchanged for illustrative purposes, by 2009-10 a Newstart Allowee earning \$191 a week is only \$12 a week better off than a DSP recipient who is not working at all (\$304 minus \$292).

³ Under the proposed new system, their disposable income increases from \$208 a week when they have no paid work to \$288 a week when they work 15 hours a week for \$191 of pay (excluding PA in both cases).

Table 3 Disposable income under current and proposed system for single person with disabilities, 2006-07 and 2009-10

Year	DSP	DSP	NSA
	no earned income	\$191 earned income	\$191 earned income
	\$ pw	\$ pw	\$ pw
2006-07			
Private income @ \$12.75 per hour * 15 hours	0	191	191
Income support	254	203	121
Tax	0	-7	-24
Total disposable income	254	387	288
2009-10			
Private income @ \$12.75 per hour * 15 hours	0	191	191
Income support	292	243	137
Tax	0	-7	-24
Total disposable income	292	427	304

Note: DSP = Disability Support Pension; NSA = Newstart Allowance. All figures rounded to nearest dollar. In this calculation, PA is assumed to be 0. The minimum wage is now about \$12.75 per hour.

Source: Specially created version of STINMOD/05A

5 Conclusions

The Government's proposed welfare to work reforms will not directly affect the disposable income or effective marginal tax rates (EMTRs) of those Australians who are already in receipt of Disability Support Pension (DSP) on 1 July 2006 and who remain on that payment.

However, those persons with disabilities who begin receiving income support after 1 July 2006 will be placed on Newstart Allowance if they are assessed as being able to work 15 to 29 hours a week at award wages. The Newstart Allowance *maximum payment rate* for single adults in 2006-07 is \$46 a week lower than that of DSP, resulting in an immediate loss of this amount of income for those placed on Newstart Allowance rather than DSP. The gap between DSP and Newstart Allowance will increase further in future years, as DSP is indexed to movements in average weekly earnings, while Newstart Allowance is indexed to the (generally lower) Consumer Price Index. As a result, by 2009-10, for example, the maximum payment rate for

Newstart Allowance for single adults will be about \$224, some \$68 lower than the \$292 payable for DSP (rather than the \$46 a week gap apparent for 2006-07.)

The Newstart Allowance *income test* is also much less generous than the DSP income test, and its payment is also less than that of the DSP. Taken together, these mean that the losses in take-home income can be as high as \$122 a week for single people with disabilities and around \$390 per week of private earnings who are placed on Newstart Allowance rather than DSP. People with disabilities placed on Newstart Allowance are more than \$100 a week worse off when their private incomes range between \$196 and \$448, relative to the payments they receive under the current system. These reductions in income amount to a 25 to 27 per cent cut in income when private incomes range from \$196 to \$400 a week.

It can be argued that all potential job seekers should be treated in the same way and placed on Newstart Allowance. However, this assumes that, for example, a single 34 year old able bodied person with no dependent children has the same capacity to undertake paid work as a 34 year old person with a substantial disability or with two young dependent children. This appears a strong assumption, given the long-term caring responsibilities associated with being a sole parent, and the long-term difficulties encountered by those with substantial disabilities.

In addition, it cannot always be assumed that the problems faced by women with disabilities are the same as those faced by men with disabilities. For example, many would believe that a single 34 year old woman with disabilities, assessed as qualifying for the Newstart Allowance, would have the same capacity to undertake paid work as her male counterpart. However, under current conditions, despite their apparent equal capacities for work, the actual outcomes for women with disabilities are often poorer. For example, in 2003, 47 per cent of women with a disability were participating in the labour force compared with 59 per cent of men with a disability (HREOC, 2005, p. 3). Similarly, while the unemployment rate of men with a disability fell by almost five percentage points between 1998 and 2003, that for women with a disability remained almost unchanged (HREOC, 2005, p. 3).

There is some evidence that the differentials between women and men with disabilities continue even when employment has been found. Women with disabilities are half as likely to find full-time employment and twice as likely to be in part time employment⁴. A recent Senate Committee report concluded that in either case they are affected by the lower wages paid to women relative to men and have a

⁴ Figures supplied by Women With Disabilities Australia, based on disaggregated data commissioned from Australian Bureau of Statistics *Disability, Ageing and Carers: Summary of Findings Australia*, Cat.No.: 4430.0 2003

greater likelihood of being in casual jobs with poor job security (2004, chapter 10). Overall, therefore, these findings suggest that further research is needed to examine the impact which gender differences will have under the new welfare-to-work reforms.

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