

Working Towards Self-reliance: Three Lessons for Disability Pension Reform

Jessica Brown

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Working Towards Self-reliance: Three Lessons for Disability Pension Reform

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Executive Summary

More than 800,000 Australians rely on Disability Support Pension (DSP). The program costs taxpayers more than \$13 billion a year, a figure that is projected to increase.

There is clear bipartisan support for the idea that growth in DSP must be reduced. Both the Howard and Rudd/Gillard governments have attempted to reduce the number of people on the pension, but it has continued to inexorably grow. Since 2002, the proportion of the working-age population on DSP has remained fairly stable, but at the same time the proportion of people relying on other major working-age welfare payments has fallen substantially.

In the future, there will be an even greater emphasis on getting more people with disabilities off welfare and into work. Attitudes about the role that people with disabilities can play in the labour market and society are changing. Population ageing and slower workforce growth have led to a growing focus on increasing labour force participation.

Australian policymakers have been remarkably successful in reforming much of our welfare system over the past decade and a half. Many thousands have moved from unemployment to the workforce as a result of these reforms. Sole parents are much more likely to be in the workforce now, compared to just a decade ago.

Yet DSP remains the big unsolved problem. If we are to be successful in increasing the number of people with disabilities in the workforce, we must apply the lessons learned from reforms of other income support payments to DSP.

Lesson 1: Better categorisation equals better results

We should clearly differentiate which disability pensioners may be able to work, now or in the future, with the appropriate treatment and support. This group should face a different set of rules to those disability pensioners who are clearly unable to work.

Lesson 2: Create rules, and ensure recipients stick to them

New and existing disability pensioners with some ability to work should be required to engage with employment services, and to develop with caseworkers an individually tailored plan to help them move towards employment. Those who don't follow their plan should face benefit sanctions.

Lesson 3: Economic incentives matter

Broader reform of the income support system is required to reduce the incentive to transfer from unemployment benefits to a disability pension. People with an assessed level of disability should be allowed to retain their Pensioner Concession Card indefinitely, even if they return to the workforce.

The success of welfare reforms over the past few decades in Australia and overseas has been based on a combination of strict conditions and mutual obligations, providing appropriate help to jobseekers to find work and creating strong financial incentives to move from welfare into work. Only by applying these tools will government be able to successfully increase the number of people with disabilities in work.

Introduction

The last three decades have seen huge growth in the number of people claiming disability pensions in Australia. In the mid-1980s there were about 250,000 people on DSP, accounting for 2.5% of the working-age population. Now there are more than 800,000 disability pensioners—around 5% of the working-age population.¹ At a time when overall reliance on welfare has fallen, disability support pension continues to climb. The program now costs more than \$13 billion a year and is projected to grow, making it one of the single largest items of government expenditure.²

Disability pension will come under increasing pressure in the future. Until recently, the largest category of disability pensioners have been people nearing retirement age with musculoskeletal conditions (including the fabled ‘bad backs’). In the future the largest category will be people with mental illness, who are on average younger.³ If the current low exit rates from DSP continue (around 1% re-enter the workforce each year), in the decades to come we can expect to see people—who joined DSP in their 20s or 30s—staying on the pension for even longer than the current 12-year average. Unless we find a better way to keep people with mental illness in the workforce, the number of people on DSP will balloon.

The ageing of the population will also put pressure on the disability pension. In 2009, 13% of Australians were over 65. By 2050 this proportion will have increased to more than 20%, regardless of our fertility rate and migration policy.⁴ Disability is strongly correlated with age. As our population gets older and the pension age increases, there will be increasing numbers of Australians in their 60s claiming DSP. The fastest growing group of disability pensioners is older women, who would have once been on (now-defunct) payments such as the Widow’s Pension or received the Aged Pension at 60.

There is growing agreement that many people with disabilities currently on DSP can and should be engaged in the workforce.

At the same time, there is growing agreement that many people with disabilities currently on DSP can and should be engaged in the workforce. This is partly driven by economic factors: Looming skills shortages mean an increased focus on workforce participation.⁵ There is also a growing recognition that a wealthy and inclusive society like Australia should be able to offer more than just a life on welfare for people with disabilities, and that people with disabilities have much to contribute to society and the economy.

Reforms to other working-age welfare payments such as Newstart Allowance (unemployment benefits) and Parenting Payment (for single parents) have been remarkably successful in getting large numbers of recipients off welfare and into work. But attempts to reform DSP have been much less successful. This report will focus on how DSP can be redesigned to ensure that all those people who have disabilities but can join the workforce are given the opportunities to do so.

There are three important lessons from other welfare reforms that can be applied to DSP. Recipients should be divided into clearly demarcated categories, based on whether they are able to work or might be able to work in the future. Those DSP recipients who do have some capacity to work should face tailored and appropriate mutual obligation requirements. Finally, all recipients should face better incentives to move into the workforce.

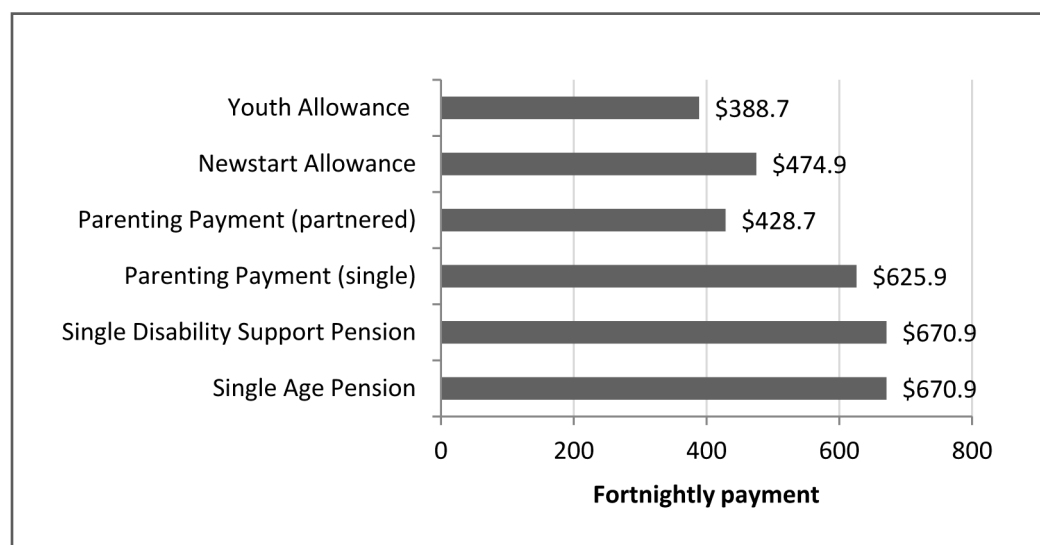
Australia’s welfare system

Australia has a unique income support system. Most developed countries in Europe and North America have ‘social insurance’ funds to which workers are required to contribute. If they leave the workforce because of unemployment, ill health, old age, or caring responsibilities, they can make a claim based on their previous contributions. In contrast, Australia pays all income support out of consolidated revenue, even to people who do not have a history of work. Benefits are tightly income tested and asset tested so the poorest households benefit the most, making Australia’s system among the most redistributive in the OECD.⁶

Income support payments in Australia are divided into two broad categories: pensions and allowances. Pensions are relatively more generous: they are designed as long-term payments for people who are unable to re-enter the workforce. Allowances are relatively less generous: they are designed as short-term payments for people temporarily outside the workforce. Allowance recipients face a number of conditions, such as a requirement to look for work, and they can have their benefit suspended or reduced if they do not meet these conditions. The main income support payments in Australia are:

- **Aged Pension**—paid to people aged 65 and over who are no longer in the workforce and whose income and assets fall below a threshold.
- **Disability Support Pension**—paid to people aged 16 and over who are unable to work at least 15 hours a week for two years or more due to disability or ill health.
- **Parenting Payment**—paid to sole parents with children below school age (Parenting Payment Single) or parents of below school-age children where one partner is not working because of unemployment or ill health (Parenting Payment Partnered).
- **Newstart Allowance**—paid to people who are over 21, unemployed, and willing to look for work. Recipients face benefits sanctions if they do not fulfil mutual obligation requirements such as looking for work. This includes some people with disabilities able to work 15 hours or more a week and parents of school-age children who face part-time work requirements.
- **Youth Allowance**—paid to full-time students and apprentices under 25 and unemployed people under 21. Young unemployed people are required to look for work or engage in study to retain eligibility.⁷

Figure 1: Value of income support payments



Source: Centrelink.gov.au

Disability Support Pension

One year after introducing the ‘old-age pension’ in 1910, the Commonwealth government introduced the Invalid Pension. Both were non-contributory and means-tested payments, partly modelled on similar schemes in New Zealand. Few changes were made to the

Invalid Pension until it was revamped as the Disability Support Pension in 1991.⁸ DSP is now available to working-age people who are ‘unable to work for 2 years because of illness, injury or disability, or ... are permanently blind.’⁹ Changes to the payment over the past decade have shifted the emphasis from recipients’ medical condition to their ability to work.

To be granted DSP, applicants must have both an ‘**impairment rating**’ of at least 20 points and a ‘**continuing inability to work**.’

To obtain a 20-point impairment rating, applicants must have a physical, intellectual or psychiatric disability or be permanently blind. Their disability must be permanent, diagnosed, treated and stabilised. Applicants are assessed against a series of ‘empirically agreed set of criteria for assessing the severity of functional limitations for work related tasks.’¹⁰ For example, applicants will score 20 points on the ‘Spinal function impairment table’ if they are unable to ‘perform any overhead activities, turn their head or bend their neck without moving their trunk, bend forward to pick up a light object from a desk or table, or remain seated for at least ten minutes.’¹¹ Those who score 20 points on a *single* impairment table are considered to have a ‘severe’ impairment.¹² Those who score fewer than 20 points are not considered for DSP.

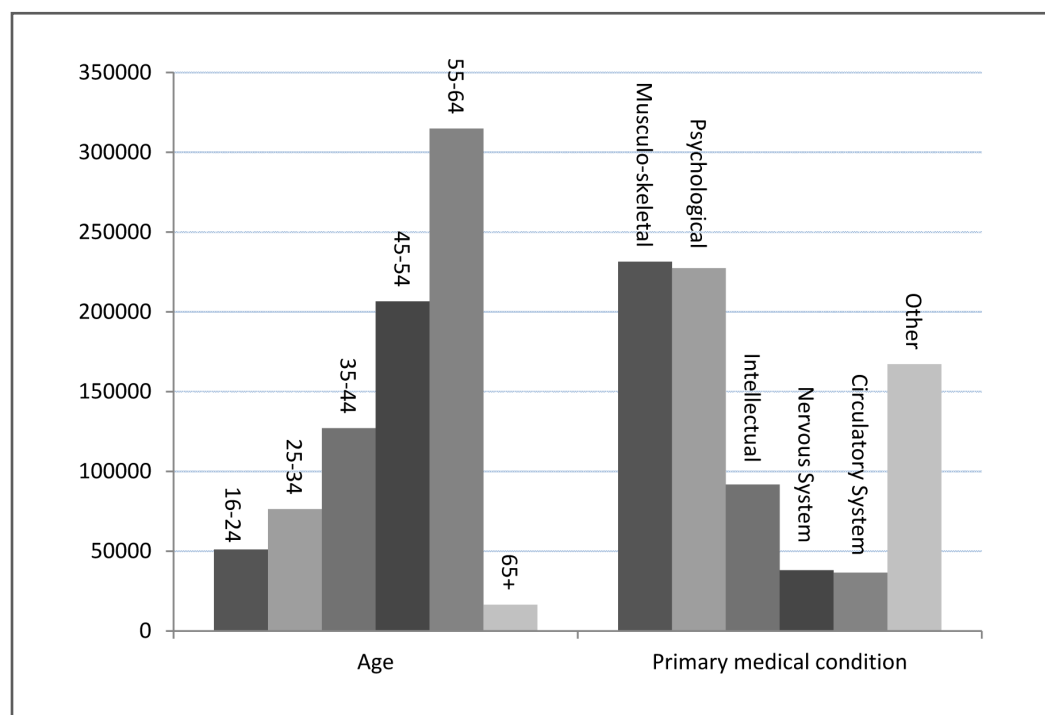
To have a continuing inability to work (CITW) applicants must be unable to work independently, or undertake training to help them move into work, for 15 hours a week for the next two years (or 30 hours a week for those who joined DSP before 2006). Job Capacity Assessors look at factors such as a person’s ability to understand and follow instructions, communicate with others, move around at work, travel to work, and attend to personal care needs at work. Factors such as the availability of work or a person’s preferences for a certain type of work are not taken into account. Applicants rejected on the basis that their condition is likely to improve within two years may become eligible for DSP if they have undertaken suitable training but have not seen a functional improvement in their work capacity during this time. People participating in the ‘supported wage system,’ a government program that provides employment to people whose productivity is severely reduced because of their disability, are considered to have a continuing inability to work.¹³

DSP continues to be means-tested, so anyone with a household income over a certain level is excluded.¹⁴ At current levels, single disability pensioners are allowed to earn \$150 per fortnight before their pension begins to be gradually withdrawn, and up to \$1608.60 per fortnight before it cuts out altogether.¹⁵

DSP is overwhelmingly a long-term payment. More than half of all recipients have been on income support for more than 10 years.

Who is on DSP?

There are now around 800,000 disability pensioners in Australia; around 91,000 new grants were made between July 2009 and June 2010. Fifty-five per cent of all disability pensioners are men. However, the proportion of women is steadily increasing, as other welfare payments such as the Widow’s Pension are being phased out. DSP is overwhelmingly a long-term payment. More than half of all recipients have been on income support for more than 10 years.¹⁶ Only around 1% of DSP recipients leave the payment for the workforce each year; most leave DSP when they move on to the Aged Pension or die.¹⁷

Figure 2: Characteristics of disability support pensioners, 2010

Source: FaHCSIA¹⁸

Even though an estimated two-thirds of disability pensioners have moderate or mild limitations, very few of them are working.

The medical conditions of disability pensioners are often quite strongly related to their age. In the past, musculoskeletal conditions comprised the largest category, but they are being overtaken by psychological and psychiatric conditions. Recipients with musculoskeletal conditions are overwhelmingly 45 and over, with most being over 55. Recipients with psychological or psychiatric conditions are more evenly spread across the age groups. Recipients with intellectual or learning disabilities tend to be younger—most are under 35. People on DSP also have much lower rates of employment than other people with a disability. While fewer than 9% of disability pensioners earn income from work, 13% of Australians with a profound disability, 33% of Australians with a severe disability, and 45% of Australians with a moderate or mild disability are employed.¹⁹ Even though an estimated two-thirds of disability pensioners have moderate or mild limitations, very few of them are working.²⁰

Fifteen years of welfare reform

Since the mid-1990s, Australia has been at the forefront of a global revolution in the way income support payments are designed.

The Keating government's 1994 Working Nation package was aimed at getting the unemployed back into work, and the Howard government introduced even more sweeping changes in 1997. Unemployed people were required to meet a number of conditions, called 'mutual obligations,' in return for their benefit. Most were made to keep job search diaries, apply for a minimum number of jobs, or spend a minimum amount of time looking for work. Some were required to enrol in part-time Work for the Dole programs, or attend training courses to get them work ready.²¹ At the same time, a network of private for-profit and not-for-profit employment service providers was established to assist jobseekers look for work. Jobseekers were required to register with one of these Job Network organisations, who were paid by the government according to the number of unemployed people they placed

in jobs. Concurrently, a Disability Employment Network was established to specialise in placing people with disabilities in work.²²

In 2006, the Howard government extended these ‘mutual obligation’ policies to some sole parents and some people with disabilities. Sole parents had previously been eligible to receive a pension until their youngest child turned 16.²³ As a result, Australia had one of the lowest rates of employment among single parents in the developed world.²⁴ Now, they were required to look for part-time work once their children reached school age. Parents not meeting these conditions faced benefit sanctions. Those already on income support when the changes were introduced were allowed to stay on Parenting Payment while they looked for work. However, new entrants after 2006 were transferred to Newstart Allowance when their children began attending school, and also faced job search requirements. New DSP applicants assessed as being able to work 15 hours a week or more were no longer awarded the pension, and were instead transferred to Newstart Allowance. They also faced part-time job search requirements.

Although critical of many of these policies in opposition, the Labor Party retained the bulk of them when it won government in 2007. ‘Mutual obligation’ for the unemployed now has bipartisan support; indeed, it is the bedrock of welfare policies across the developed world. Since coming to office, the Labor government under both Kevin Rudd and Julia Gillard have introduced a number of changes to DSP. Since July 2010, Senior Job Capacity Assessors have assessed DSP applications using new clearer guidelines.²⁵

From September 2011 new applicants who score 20 points across *multiple* impairment tables, but do not score 20 points on a *single* impairment table (for example, 10 points on the ‘brain functions’ table and 10 points on the ‘mental health functions’ table), will be required to participate in a support program designed to get them into work or improve their prospects for work for 18 months (within a 36-month period). If they have not found employment after 36 months, they can reapply for DSP. During this period, they may be eligible to receive another income support payment, usually Newstart Allowance. Applicants who score 20 points on a single impairment table are considered to have a ‘severe’ impediment and are exempt from this requirement.²⁶

‘Mutual obligation’ for the unemployed now has bipartisan support; indeed, it is the bedrock of welfare policies across the developed world.

From July 2012, new and existing DSP recipients under 35 years of age and assessed as being able to work at least eight hours per week will be required to attend a quarterly ‘participation interview.’²⁷ Existing DSP recipients subject to the ‘15-hour rule’ will be allowed to work for up to 30 hours each week and still retain a part-pension to encourage existing recipients back into the workforce.

Employment services

After coming to power in 2007, the Labor government undertook an extensive review of the Job Network in response to criticisms that it had become overly bureaucratic, and that providers had a financial incentive to help easy to place jobseekers (‘creaming’) while paying relatively little attention to difficult cases (‘parking’). In 2010, the Job Network became Job Services, and the Disability Employment Network became Disability Employment Services (DES).

DES provides customised assistance to disabled jobseekers and incentives to employers to hire them. Each jobseeker can access up to 18 months of assistance, as well as ongoing assistance in the workplace if needed. Places in the program are uncapped, so all eligible jobseekers can get immediate support. DES places can be tailored to assist people who have a short-term or minor condition, through to those who have more severe conditions and require intensive support. Extra ongoing support can be given, for example, to people with episodic mental illness conditions who may be able to work independently for some time before requiring in-work support again.

DES providers develop an individually tailored Employment Pathway Plan (EPP) with each jobseeker to create 'the best combination of rehabilitation services, skills development, work experience or other assistance to help the job seeker overcome or manage barriers to employment. Services will also include work trials, job search skills and assistance.'²⁸

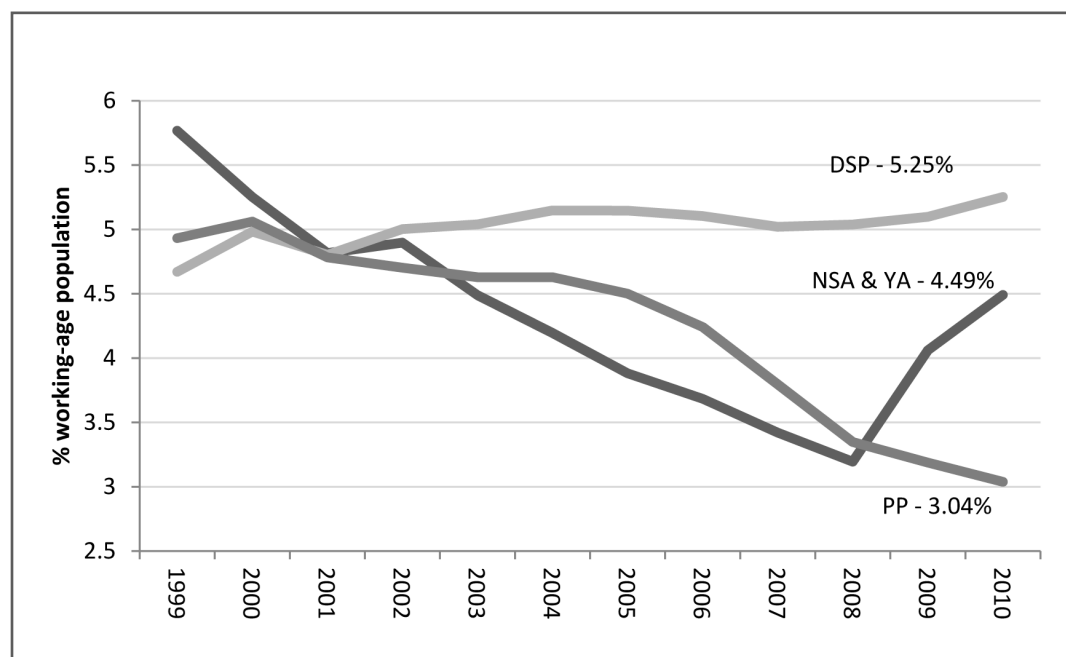
Uneven success

Since the beginning of welfare reform in the mid-1990s, the proportion of working-age Australians relying on income support has fallen markedly from 25% in 1996 to 17.5% in 2007.²⁹ However, success has not been uniform.

The rate of DSP receipt has remained fairly steady at about 5% of the working-age population since 2002.

The number of people relying on Newstart Allowance has closely mirrored the unemployment rate. In 1996, when unemployment was 8.5%, more than 7% of the working-age population relied on Newstart. By 2007, with unemployment at 4.1%, the proportion of working-age Australians on Newstart had fallen to 3.5%.³⁰ As the global financial crisis hit in 2008, both the unemployment rate and Newstart claims began to rise. While it seems certain that the introduction of mutual obligation made some difference to reliance on Newstart, it is difficult to separate the effects of changed economic conditions.

Figure 3: Mixed success in welfare reform (1999–2010)



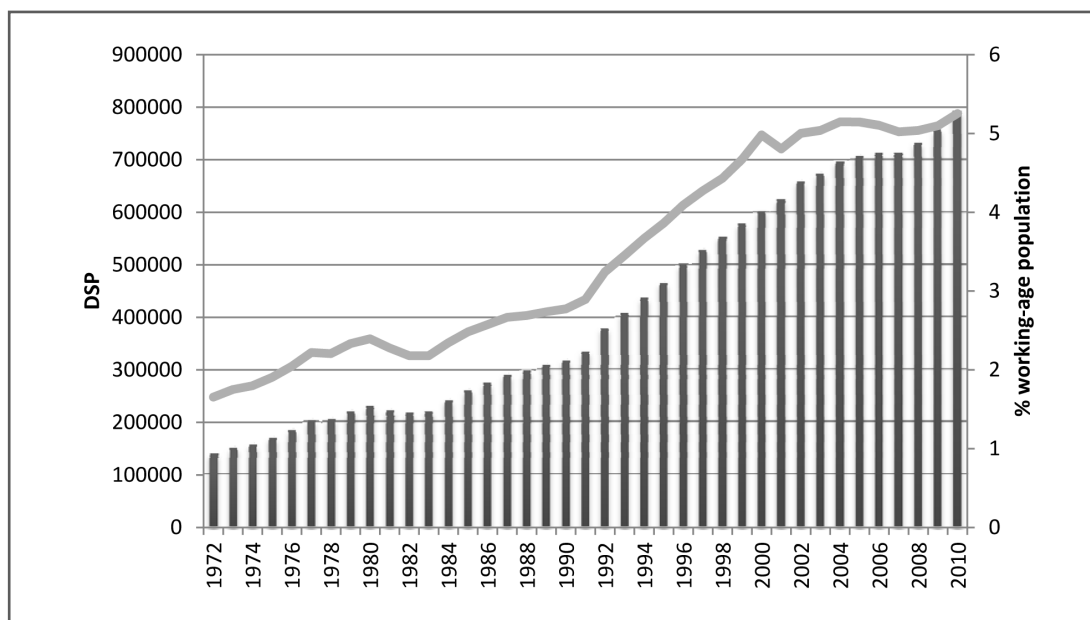
Source: FaHCSIA, DEEWR, ABS³¹

Changes to Parenting Payment have been very successful. Two years after the 2006 reforms, 20% fewer people were on Parenting Payment. Numbers have continued to fall. This change occurred while unemployment was falling and women's workforce participation increasing, suggesting that former recipients did not become unemployed but instead moved off income support altogether.³² The reforms were so successful that there are now calls across the political spectrum to require single parents to face some work requirements when their children are younger still.

Changes to DSP were not as successful: the rate of DSP receipt has remained fairly steady at about 5% of the working-age population since 2002. Growth in the payment did slow for two years after the 2006 reforms were introduced. But total numbers did not fall, and soon began

to increase again.³³ A federal government evaluation found that ‘no significant change in the number of people who commenced Disability Support Pension occurred during 2006–07,’ concluding that the effects of the reform were minor.³⁴ It is too early to tell what effect the most recent changes to DSP will have, although there has been a fall in the proportion of applicants granted a disability pension from 63.3% in June 2010 to 56.8% in May 2011.³⁵

Figure 4: Growth of Disability Support Pension (1972–2010)



Source: FaHCSIA, ABS³⁶

Along with most other working-age income support payments, DSP has been the focus of considerable reform by government. However, reforms to DSP have not had the same success in reducing numbers that they have had in other areas. If DSP numbers are to be successfully reduced, the lessons learned from reforming other welfare payments must be applied.

Three lessons of welfare reform

There are good reasons to believe that, despite their disabilities, there are many people on DSP who—given the right help, conditions and incentives—can work. There will always be people with severe and profound disabilities who can't realistically be expected to work independently. The welfare system should support them, not make their lives more difficult. However, survey data show that one-third of DSP recipients do not assess themselves as having a disability.³⁷ A large group of disability pensioners fall into a 'grey area.' Their disabilities do not necessarily prevent them from working. Many say they want to work too.

Straightforward rules work well for unemployed people, because most cases are fairly black and white: A person is either unemployed or not. DSP is far more complicated. Some people clearly do not have a disability and should not qualify for a disability pension. Others have a profound disability that prohibits them from working at all. But there is also a large group in the middle for whom work *may* be possible given the right circumstances. Technology, the availability of medical treatment or support, transport, assistance employer and community attitudes, labour market opportunities, and motivation can all affect a person's capacity to work³⁸—to the point where two people suffering the same disability can have markedly different experiences in the labour market. This group is

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undoubtedly extremely difficult to define. Nevertheless, important lessons from the success of other welfare reforms can be applied to DSP.

Lesson 1: Better categorisation equals better results

Once a person has proven their eligibility for DSP, there is little incentive and no compulsion for them to rejoin the workforce.

Despite the evidence that many disability pensioners can work, and want to work, disability benefits have been largely designed as if all recipients are manifestly unable to work. Once a person has proven their eligibility for DSP, there is little incentive and no compulsion for them to rejoin the workforce.

Reforms since 2006 have tried to overcome this problem by streaming people with disabilities into different categories based on their ability to work. The 15-hour rule, introduced as part of the 2006 'welfare to work' changes, differentiates between people who can work relatively long part-time hours and those who cannot. New requirements for DSP applicants to test their work ability before being granted the pension and changes that will see some disability pensioners attending work-focused interviews help distinguish differing levels of work ability.

Despite these changes some fundamental problems remain:

- There is a clear incentive for recipients to understate their ability to work so as to qualify for DSP instead of the much less generous unemployment benefits (addressed in detail later).³⁹
- While periodic reassessments do take place, in practice DSP is often granted for life. Cai, Vu and Wilkins found that fewer than 3% of DSP recipients move off welfare each year, and only 1.2% of recipients leave the pension for the workforce.⁴⁰ While a lifelong payment is appropriate for some people with profound and lasting conditions, it is inappropriate for others who may see some improvement or fluctuation in their condition in the future. Sufferers of mental illness, for example, may experience long periods (often years) where they are unable to work, followed by equally long periods where they can function relatively well. Other disability pensioners may be able to return to the workforce after a period of treatment or after the introduction of a new type of medication.
- Many disability pensioners have not been subject to recent changes. Those who joined the payment prior to 2006 had been assessed according to the old 30-hour rule, so they do not face activity requirements even if they have the capacity to work long part-time hours. Given that three-quarters of all DSP recipients in 2008 had been on income support (including DSP and other payments) for more than five years,⁴¹ it is likely that several hundred thousand DSP recipients remain exempt from the tougher new requirements. This group faces a clear disincentive to test their ability to work, fearing they will be reassessed under new more restrictive rules. In clear recognition of this, the Gillard government announced in the 2011 Budget that existing disability pensioners will now be allowed to work 30 hours per week without losing their pension, subject to normal income tests.⁴² This is a sensible, pragmatic move designed to improve work incentives. However, it further entrenches a two-tier system whereby recipients on DSP prior to 2006 are treated much more generously than new recipients.

Solution: Divide recipients into clearly demarcated groups based on their work ability.

The Henry Review of the tax-transfer system, presented to government in 2009, recommends streamlining all income support payments into three categories: pensions, a participation category, and students. Under this model:

- Those who are elderly or have a disability that clearly and permanently prevents them from working would receive a pension. This would be a permanent payment, and recipients would not face any work requirements.
- Those with *any* capacity to work would receive a participation payment, regardless of whether they are unemployed, have a disability, or have some caring requirements. This group would be paid at a lower level than pensioners, and would face varying work requirements depending on their work ability. Those with the capacity to work part-time, including people with disabilities, would only face part-time work requirements. People with a disability in this category might qualify for a more generous withdrawal of benefits as they earn private income or an in-work supplement to encourage them to work part-time.⁴³
- Students would receive a less generous benefit that they could top up with part-time work.

A similar approach has already been implemented in Britain. The Employment and Support Allowance (ESA), introduced in 2008 to replace the Incapacity Benefit, attempts to differentiate recipients based on their ability to work. ESA recipients with some capacity to work are required to attend ‘participation’ interviews, while those whose disability clearly prevents them from working are exempt. The new requirements are gradually being applied to existing Incapacity Benefit recipients as well as new applicants (but this will take several years to complete).⁴⁴ The ESA streams applicants into one of three groups, based on their assessed capacity for work:

- Those who are deemed ‘fit for work’ are moved to unemployment benefits.
- Those with some capacity to work now or in the future are moved into the Work Related Activity Group, where they are required to engage with the Pathways to Work program but do not face the same job search requirements as the unemployed. This group qualifies for a higher benefit rate than the unemployed on the condition that they meet these mutual obligation requirements.
- Those who are manifestly and permanently unable to work are moved into the Support Group, where they also qualify for a higher benefit level and do not face any work requirements or conditions.

Under the old Incapacity Benefits system, about one-third of new applicants were assessed as being able to work, whereas more than two-thirds have been assessed as being able to work under the new structure.⁴⁵ Between October 2008 and August 2010, 6% of new claims were referred to the Support Group, 16% were referred to the Work Related Activity Group, 39% were assessed as fit to work, and 36% of claims were closed before the assessment was complete⁴⁶; however, some applicants assessed as fit to work have successfully appealed against this determination.⁴⁷

ESA is still relatively new, and the United Kingdom’s labour market has deteriorated rapidly since the new policy was implemented due to the global financial crisis. It is difficult to assess exactly what the effect of the change has been. However, both the ESA and the Henry Review’s recommendations point in the same direction. In an era when policymakers are trying to encourage more people into the workforce, it no longer makes sense to design disability benefits with the implicit assumption that all people with disabilities cannot—and should not—be required to work.

Changes to DSP introduced in September 2011 that require applicants with less severe disabilities to engage with a job-focused support program before being granted the pension go a long way towards categorising new applicants based on their ability to work. Almost half

It no longer makes sense to design disability benefits with the implicit assumption that all people with disabilities cannot—and should not—be required to work.

of all new applicants have not previously participated in rehabilitation or used an employment service, suggesting that many could be diverted away from DSP and into work, given the right assistance.⁴⁸ But the changes do not apply to the more than 800,000 existing DSP recipients. Existing recipients should be reassessed under similar guidelines, and those considered able to work with ongoing support moved into a participation stream and given access to adequate support.

This would not necessarily be easy. Assessors vary greatly in their competence. National Disability Services, the peak body that represents disability employment service providers, has expressed concern that providers could be forced to expend scarce resources on people whose disability renders them unable to work independently, or who purposely sabotage their rehabilitation to prove their eligibility for DSP.⁴⁹ But these difficulties do not mean more comprehensive categorisation should not be attempted. Both the ESA in the United Kingdom and the DSP in Australia have shifted their focus from a system designed to measure incapacity to one designed to find out what work people with a disability can do. While it makes no sense to impose pointless work requirements on those people with profound or severe disabilities who truly cannot work, it also makes no sense to absolve those who can work from the responsibility—and deny them the assistance—to do so.

Lesson 2: Create rules, and require that new and existing recipients stick to them

There are two big differences in the way we have treated disability pensioners compared with single parents and the unemployed. First, changes to Parenting Payment and Newstart Allowance have generally been applied to existing as well as new recipients. Second, those with some capacity to work (all unemployed people and parents whose children have reached school age) have been given compulsory mutual obligation requirements.⁵⁰

Programs designed to help people into work are only effective if they are backed up by compulsion.

In contrast, changes to DSP have only focused on new applicants. Neither the Howard government's 2006 changes nor (until recently) the subsequent changes introduced by the Rudd/Gillard governments after 2008 have targeted the existing cohort of disability pensioners. While new applicants assessed as able to work 15 hours a week or more have been referred to Newstart Allowance and must meet part-time work requirements,

no disability pensioners have been given mutual obligation requirements even if they have some capacity to work. According to the OECD, 'this is unfortunate because it traps current recipients on long-term benefits and means missing out on opportunities.'⁵¹ In the May 2011 Budget, the government announced a policy that goes some way to addressing this problem. From July 2012, new and existing DSP recipients under 35 who are assessed as being able to work at least eight hours per week will be required to attend a quarterly interview.⁵² This is a good first step, which follows international trends. But the Gillard government's change only goes part of the way in realising the lessons of other welfare reforms.

In these Centrelink interviews, young disability pensioners will develop their own individual 'participation plans' aimed at getting them into work, or at least getting them ready for work. These plans 'could involve working with employment services to improve job readiness, searching for employment, undertaking training, volunteering or rehabilitation.' DSP recipients who are required to attend these interviews will face penalties, such as benefits sanctions, if they do not attend. However, according to Minister Jenny Macklin, 'participation in activities will be on a voluntary basis.'⁵³

While some motivated people will undoubtedly embrace the plans enthusiastically, experience tells us that many will not. The extensive body of international literature on 'active labour market programs' shows that programs designed to help people into work are only effective if they are backed up by compulsion, and ultimately, sanctions for non-compliance.⁵⁴ This principle has been used extensively—and remarkably successfully—in Australia for unemployed people since the mid-1990s. Unemployed people are required to look for work and participate in 'mutual obligation' activities. If they refuse a job, or don't

participate as required, they risk having their benefit suspended.⁵⁵ The same rules do not apply to disability pensioners, even if they have some capacity to work.

Solution: Impose appropriate mutual obligation requirements on those disability pensioners assessed as able to work

Rather than just requiring that young DSP recipients with some ability to work attend interviews, they should be required to adhere to their personal participation plan. Like other jobseekers, including those with disabilities on Newstart Allowance, if they don't meet these requirements, they could have their benefit suspended, reduced or even cancelled. The government has already announced plans to require *new* DSP recipients with less severe impairments to test their ability to work by engaging with the DES, mainstream employment services, or some other job search program.⁵⁶ A similar requirement could be extended to those existing DSP recipients under 35 who will soon be required to attend Centrelink interviews.

A major OECD study into moving disability benefit recipients into work found that several developed countries have begun placing mutual obligations requirements on disability pensioners with a partial work capacity:

- Denmark, Austria, Germany and Hungary require new applicants to undertake rehabilitation before they are granted a disability benefit.
- Swiss legislation introduced in 2008 sets out an explicit list of obligations that disability benefit recipients must undertake to assist them to reintegrate into the workplace, as well as sanctions for non-compliance.
- In Luxembourg, 'people with partial work capacity are now obliged to enrol in training and reintegration measures.'⁵⁷

In Australia, the introduction of mutual obligation requirements has successfully moved large groups of jobseekers and single parents into the workforce. However, these programs have been less successful in moving the very long-term unemployed or highly disadvantaged jobseekers into work.⁵⁸ While mutual obligation can play an important role in reducing DSP numbers, a 'work-first' approach that encourages employment service providers to place jobseekers in work as quickly as possible might not be suitable for all disability pensioners.

However, 'individual placement and support' programs that are 'highly work focused and [view] work as part of an individual's broader recovery and reintegration into society'⁵⁹ have had some success in integrating severely disadvantaged jobseekers (including those with mental illness and other disabilities) into the workforce in the United States and Europe. Tailored case-management can take into account the differing levels of impairment and work capacity of individual disability pensioners. Flexibility can be built into the system to ensure that disabled jobseekers are not unfairly penalised simply because the circumstances of their disability have changed.

DES programs are designed to provide tailored and flexible job search assistance to people with disabilities, but the number of people who are on DES is very small compared with the total number of people on DSP. According to DEEW's 2010 Annual Report, in the first four months after the launch of DES in March 2010, fewer than 30,000 jobseekers—less than 4% of disability pensioners—took up places. Around 9,000 of these secured employment.⁶⁰

One reason for this relatively low take-up may be that there is no requirement for any DSP recipient to use employment services. By contrast, Newstart recipients, including those assessed as having a part-time work capacity due to disability, are usually required to look for a job, attend Centrelink and/or Employment Services interviews, and undertake other 'activity requirements' such as job search training or Work for the Dole. If they do not meet these requirements, they face sanctions such as suspended or reduced benefit.⁶¹

'Individual placement and support' programs have had some success in integrating severely disadvantaged jobseekers into the workforce.

If older jobseekers with disabilities assessed as being able to work 15 hours per week can face job search requirements and sanctions for non-compliance, it seems only fair that younger people assessed as being able to work eight hours a week face similar—if less onerous—conditions. The ‘carrot’ of helping disability pensioners look for jobs will not be effective unless it is backed up by a requirement to use it.

The government is right to target young disability pensioners under 35, at least initially. Scarce resources should be directed at those most likely to gain employment. Targeting older disability pensions and those with less capacity to work will yield diminishing returns.

We must also be realistic about the capacity of the existing DES to place large numbers of disability pensioners into ongoing employment. The success of DES providers has been extremely patchy. Less than one-quarter of participants continue to be employed three months after leaving the program.⁶² Providers are susceptible to the same problems of ‘parking’ difficult customers while ‘creaming’ easy to place customers that mainstream employment services experience. Some disability organisations allege that DES providers focus more on meeting government-set performance indicators than providing ongoing and tailored assistance to their customers.⁶³

If we are serious about getting disability pensioners into jobs, carrots alone will not work.

Rigorous evaluation must be undertaken to ensure the program is effective before being extended to DSP recipients more widely. Small, niche services may have trouble scaling up. DES must be adequately funded: more resources are needed to place more severely disabled jobseekers. An alternative might be to create a new ‘stream 5’ within mainstream employment services providers, who currently stream jobseekers into one of four categories based on their readiness for work,⁶⁴ allowing disability pensioners greater choice of providers. Many of these organisations already have the capacity to work with hard-to-place jobseekers. Alternatively, a separate ‘pension eligible’ stream could be created within DES to ensure extra resources are available for providers specialising in hard-to-place disability pensioners and need extra ongoing support.

Much work is needed to ensure the employment services system can efficiently and effectively handle the extra load. An expensive, punitive program is pointless if it does not work. But if we are serious about getting disability pensioners into jobs, carrots alone will not work. We will need—carefully—to also use some stick.

Lesson 3: Economic incentives matter #1: Unemployment and DSP

A key reason many people who can work are on DSP is that there is a big incentive for unemployed people with a disability to apply for the pension—even if they have worked recently and think they can work again. While there are many highly skilled and highly educated people with a disability in the workforce, people with disabilities have—on average—lower levels of education and less work experience than the wider population. About half have not completed secondary school,⁶⁵ and many are clustered in low-skilled and low-paid jobs.⁶⁶ While many people with disabilities hold high-skilled and well-paid jobs, there is a large group clustered at the low-skilled end of the market. When a downturn hits, these people are often the first to be laid off.

In purely economic terms, it’s always better to be working than on DSP. The minimum full-time wage is about \$570 a week, while the disability pension is about \$364. Disability pensioners can also combine part-time work with a part-pension. But if the choice is between unemployment benefits and DSP, you would take DSP every time. Newstart Allowance is paid at about \$235 a week—almost \$130 a week less than DSP.⁶⁷ What’s more, the different ways in which these payments are indexed—with DSP being linked to average weekly earnings and Newstart to CPI—means that the difference between the payments will continue to grow.⁶⁸ The incentive for unemployed people to move to DSP, where possible, will grow too. Treasury estimates that by 2040, a single disability pensioner will be paid twice as much as someone on Newstart Allowance.⁶⁹

The justification for paying DSP at a higher rate than unemployment benefits has always been that DSP is a permanent payment, whereas Newstart should be lean and mean to encourage people back into workforce.⁷⁰ But in many ways this is the problem. Across the political spectrum, there is broad agreement that there are many people on DSP who should not have been granted a permanent exemption from the workforce in the first place.

The incentive to switch from Newstart to DSP becomes clearer when the job market deteriorates. As unemployment rose from 4.2% in August 2008 to 5.7% in May 2009, the number of DSP applications grew by 23%.⁷¹ The proportion of applications approved remained steady, suggesting this wasn't just a flurry of ambit claims. In fact, a study by economists Bob Gregory and Lixin Cai found that about 40% of the growth in DSP from the 1970s to the 1990s was due to changes in the unemployment rate.⁷² Around 35% of new DSP recipients come from unemployment benefits.⁷³ However, the link between the jobs market and DSP doesn't go both ways. When unemployment goes up, DSP numbers go up too. But when unemployment goes down, DSP numbers do not go back down with it.

Solution: More closely harmonise Newstart Allowance and DSP

The Henry Review's suggestion of a single working-age 'participation' payment, discussed earlier, addresses the incentive to move from Newstart Allowance to DSP. Only people with severe and profound disabilities that prevent them from working at all would be eligible for a higher pension payment. All income support recipients with some ability to work, regardless of whether they are unemployed, a single parent, or have a disability, would qualify for the same payment, eliminating the incentive to move between payments and the 'lock-in' effect of the DSP.⁷⁴ While there would still be an incentive to be classified as profoundly disabled, applicants would need to pass a much higher threshold.

However, there remains some difficult and unanswered questions about the level at which the payment should be set. With the very low rate of pay for the unemployed, it appears the only viable direction is an increase in Newstart. This could negatively affect incentives for the unemployed, and would be an extremely expensive proposition for a government trying to get back into surplus. The Henry review notes that 'restructuring the income support system will be costly.'⁷⁵

The UK government estimates that its shift towards a single working-age benefit will cost around £3 billion a year.⁷⁶ Undoubtedly, we could expect a similar bill if this type of change were to be implemented in Australia.

Welfare groups such as the Australian Council of Social Services and the Australian Welfare Rights Network call for Newstart to be increased, in part to overcome the incentive problem but mostly because they are concerned about the alleged inadequacy of Newstart payments.⁷⁷ Indeed, it does seem that the growing difference between Newstart and DSP is an issue that will have to be addressed sooner or later, regardless of broader welfare reforms.

A single participation payment could be set at a level somewhere between Newstart and DSP, and ideally designed to be revenue neutral. But political realities suggest that significant payment cuts to existing disability pensioners with some ability to work are unlikely. Simply moving some disability pensioners onto Newstart Allowance will save taxpayers money, but we should not lose sight of the ultimate goal of increasing employment for people with disabilities. Real reform of the income support system is important: it will lead to increased participation. But it is likely to be expensive too.

There are many people on DSP who should not have been granted a permanent exemption from the workforce in the first place.

Solution: Reduce the risk of trying out work

There is a clear incentive to go on DSP and stay on it. The ongoing requirements for unemployed people are so much more onerous than those for disability pensioners that few want to risk a foray into the jobs market that might see them end up back on the dole.

The Howard government's solution was to give disability pensioners the unconditional right to return to the workforce within two years of taking a job.⁷⁸ This was a sensible move, designed to allay recipients' fears that they might end up back on unemployment benefits if their foray into the jobs market did not work out. But the number of people leaving DSP for work has not substantially increased, suggesting the change has had limited success. The Gillard government has also taken a pragmatic approach, allowing DSP recipients to work up to 30 hours a week, in a bid to encourage them to combine their pension with part-time work.⁷⁹ Denmark and Sweden have gone even further, and now allow all existing recipients to return to the pension at *any time* after joining the workforce⁸⁰—a policy that could be adopted in Australia if it was restricted to recipients deemed 'manifestly unable to work,' for whom barriers to participation are highest.

Economic incentives matter #2: The Pensioner Concession Card

The Pensioner Concession Card (PCC) also provides a strong economic incentive to qualify for, or remain on, the DSP. All pensioners, including DSP recipients, are automatically issued with a PCC, which gives them access to a range of transport, utility and medical concessions. These concessions are provided by federal and state government agencies, as well as private companies. Cardholders can obtain discounted PBS medications up to an annual threshold, and then free medication once the threshold is passed. Their annual Medicare Safety Net is increased, meaning they are eligible to receive reduced cost out-of-hospital medical treatments. Doctors generally provide bulk-billed appointments to cardholders, meaning they do not need to bear any out of pocket cost. Cardholders are entitled to public transport concessions, reduced council and water rates, reduced utilities bills, and reduced car registration fees.⁸¹

There is a strong incentive for individuals with low income or high health care costs to qualify for a disability pension so they can retain access to the card.

Pensioners, including those on DSP, report that the PCC makes an important contribution to their standard of living, particularly because they often incur high health care costs due to their disability. One fifth of the written submissions made by DSP recipients to the federal government's 2009 Pension Review (the Harmer Report) reported that health care costs were a major concern, along with around half of all submissions made by disability organisations and carers' organisations. Participants in focus groups held by the review also nominated health services as the most useful way to improve their standard of living.⁸² There is a strong incentive for individuals with low

income or high health care costs to qualify for a disability pension so they can retain access to the card.⁸³

Both the Pension Review and the Henry Review raised concerns about the disincentive effect of the PCC on disability pensioners. Single disability pensioners can earn up to \$150 per fortnight before their pension payment is gradually withdrawn. Above this level, the pension is reduced by 50 cents for each dollar earned, before cutting out altogether when fortnightly earnings reach \$1608.60.⁸⁴ DSP recipients engaging in part-time work face relatively low effective marginal tax rates, so they get to keep most of the extra money they earn after tax and after their benefit is withdrawn. Recipients do not lose their pension until their earnings are well above the full pension level. The system is designed to encourage disability pensioners to combine a part-payment of DSP with part-time work, and to then move off DSP into work.

The PCC severely skews these incentive effects. If a disability pensioner's part-time income increases above \$1,600 per fortnight, they lose eligibility for both the DSP *and* the PCC. If they derive \$50 of value each fortnight from the card, losing eligibility would have the same effect as a \$50 fortnightly tax. Put another way, the Henry Review calculates that recipients deriving \$2,000 in value from the card annually face effective marginal tax rates of over 200,000% on the last dollar of income they earn before losing eligibility for the card.⁸⁵

This is particularly relevant for people who are heavy users of their concession cards or who value their concession card highly because of the insurance it provides. DSP recipients, for instance, may be reluctant to jeopardise the concession they receive for health and disability goods and services by testing their ability to work.⁸⁶

In recognition of this disincentive effect, DSP recipients moving into work are entitled to keep their concession card for one year after they lose eligibility for their pension. If they subsequently leave the workforce, they must requalify for DSP to regain access to the concession card.⁸⁷ However, this provision does not appear to have increased the number of disability pensioners moving into the workforce. Disability groups continue to report that their members are often reluctant to leave the pension for fear of losing their concession card.⁸⁸

In their international study on disability and work, Benitez-Silva, Disney and Jimenez-Martin recommend loosening the link between disability benefits and job status. They argue that policymakers have failed to adequately differentiate between ‘health disability’ (measurable, objective changes in the health of a population) and ‘work disability’ (which fluctuates with changes in the job market, and community and employer attitudes towards people with a disability in the workplace). For Benitez-Silva, Disney and Jimenez-Martin, the answer to why the number of people on disability benefits has continued to grow is clear. Disability benefit programs are largely designed with the assumption that most recipients have a serious disability that will prevent them from working again. But we know that many people who go on to benefits can work again when their medical condition improves, unemployment falls, or social attitudes shift.⁸⁹ The PCC is designed to assist with the costs of *health* disability, but eligibility is determined by a person’s *work* disability.

Solution: Break the link between health disability and work disability

This disincentive could be addressed in several ways. Concession cards could be abolished altogether, with recipients being compensated by a cash increase of equal value to their pension. However, as both the Harmer and Henry reviews note, this would be extremely difficult to achieve in practice. The value of the card varies greatly between individuals. Moreover, the cost of providing the concessions is spread across federal, state and local government agencies, as well as private businesses. If a standardised compensation package was introduced some pensioners would inevitable lose entitlements, with those pensioners in the greatest need likely to be punished the most. The political consequences alone suggest abolition of the cards unlikely to happen.

The PCC is designed to assist with the costs of health disability, but eligibility is determined by a person’s work disability.

Another possibility is to meet the health costs of people with disabilities through an alternate system, making health concessions effectively redundant. The federal government is considering a National Disability Insurance Scheme (NDIS) to provide individualised funding packages for treatment and support to people with disabilities.⁹⁰ If effective, such a scheme will provide people with disabilities, including disability pensioners, with greater confidence to meet their health care costs. The Productivity Commission argues that an NDIS should not be income tested to ensure that it does not create a disincentive for people with disabilities to work.⁹¹ However, the NDIS will not compensate disability pensioners for the value of non-health related concessions such as transport and utilities concessions, and may not fully compensate them for all health-related concessions (such as GP visits and prescription medicine).

A third possibility is that eligibility for DSP is separated from eligibility for the PCC.

People assessed as having a certain level of health disability could remain eligible for the PCC, even if their work status or income rendered them ineligible for DSP. Cardholders might still face an income test, but this would be set much higher than the DSP to minimise work disincentives. Health concessions could even be separated from utility

and transport concessions. This would inevitably also mean that some people with minor disabilities currently on DSP would no longer qualify for the card. Because we don't know the total cost of providing the concession cards, it would be impossible to accurately calculate in advance what the cost of this change would be.

In the past, disability benefits were awarded on the basis of a person's health status. The process of welfare reform over the past few decades has changed the way we determine eligibility for disability benefits, relying on the ability to work rather than health. A perverse outcome of this is that some people with disabilities have a clear incentive to understate their ability to work to qualify for health-related benefits. Perhaps it is time the link is gently severed.

Towards a new disability benefit

Jenny Macklin, the Minister responsible for disability pensions under both the Rudd and Gillard governments, has introduced a number of welcome changes to DSP. Early indications are that some of her more recent changes will have some success in reducing numbers. But the three lessons above suggest that to make real progress in moving people from DSP into work, more radical reform is needed. In the absence of a broader redesign of the entire income support system, as recommended in the Henry Review, some substantial changes can still be made within DSP itself:

Categorisation

- All disability pensioners should be streamed into two distinct and clearly defined groups:
 - Unable to ever work.
 - Have some work capacity or might be able to work again with the right support.

Rules for those who qualify for each group should be clearly defined, should take into account the severity of a person's disability, and should be made publicly available. Recipients should be made aware of which group they are in, and what their obligations are.

- Existing DSP recipients should be gradually streamed into one of these two groups. Those with the best chance of integrating into the workforce, such as younger or better qualified recipients, should be targeted for re-assessment first.

Mutual obligation

- Recipients in Group 1 (unable to ever work) should be exempt from all mutual obligation requirements but given support to work upon request.
- Recipients in Group 2 (able to work with right support) should face mutual obligation requirements. These should be tailored to suit their individual circumstances; however, all activities should include an eventual return to the workforce as the primary goal.
 - All Group 2 recipients should be required to attend regular Centrelink interviews where they agree on a tailored 'Participation Plan' with their case worker.
 - This could involve engaging with the DES or another employment or support service focused on eventual return to the workforce.
 - Group 2 recipients who do not adhere to their individual participation plan should face appropriate benefit sanctions.

Incentives

- Group 1 should continue to be paid at the pension rate.
- Group 2 should be paid at a lower rate, to reduce the incentive to transfer from Newstart Allowance to DSP, but could qualify for top-up payments if they adhere to the conditions of their personal participation plan.
- Recipients assessed as permanently unable to work (Group 1) should have the right to return to their pension at any time without reassessment if they try to get a job.
- Recipients assessed as having a certain level of disability (perhaps those assessed as having a 'severe' impairment) should remain eligible for a PCC indefinitely, even if they return to the workforce.

Conclusion

Disability pensioners are extremely diverse, with vastly varying capacity for work. However, DSP is designed as if they are a homogenous group. Those who are manifestly unable to work should be subject to quite different rules than those who do have some capacity to work. DSP recipients who might be able to work with the right treatment and support should be required to engage with employment services and adhere to an individually tailored and agreed participation plan that is appropriate to their personal circumstances. Like other welfare recipients, those who do not meet the conditions of their personal plan should be subject to benefit sanctions. These conditions could be applied to all new recipients and gradually extended to exiting DSP recipients, beginning with those who are most likely to successfully integrate into the labour market. Ongoing assessment could ensure that the new rules are not applied unfairly to those recipients who do not have the capacity to work. However, even those assessed as unable to work should be given support to find and retain a job if they request it. The current government is making some headway in this type of reform, but more needs to be done to enforce the conditions.

More can also be done to decrease the incentive to go onto DSP and increase the incentive to leave DSP for work. Many people on unemployment benefits share similar characteristics to those on DSP, but face markedly different rules and benefits. Bringing these two payment types closer together (at least for those disability pensioners with some capacity to work) could help overcome this problem.

Once on DSP, few people ever return to the workforce. If DSP numbers are to be reduced, more needs to be done to encourage existing recipients back into the workforce. Recipients are already allowed to return to the pension at any time within two years after finding work. For existing recipients, this could be increased (or even made indefinite) to encourage them to try their hand at work. Eligibility for the PCC could also be decoupled from eligibility for DSP to ensure that people with disabilities do not lose their health care entitlements when they return to the workforce.

The success of welfare reforms over the past few decades in Australia and overseas has been based on a combination of strict conditions and mutual obligations: providing appropriate help to jobseekers to find work and creating strong financial incentives to move from welfare into work. Using these tools, Australian governments have successfully tackled high rates of unemployment and moved vast numbers of single parents into the labour market. Only by applying the same tools to DSP will government be able to successfully increase the number of people with disabilities in work.

The current government is making some headway of this type of reform, but more needs to be done to enforce the conditions.

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