

Submission to Productivity Commission's Inquiry into the System of Compensation and Rehabilitation for Veterans

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Dear Mr Fitzgerald,

I'm writing regarding the Productivity Commission's Draft Report "A Better Way to Support Veterans". I'm an Associate Professor of Economics at the University of Technology Sydney. Much of my research over the last decade has been on the effects of military service and compensation on veterans' long run outcomes, including health and economic outcomes. I am also on AiHW's Advisory Group for its program of work on veterans' health and welfare.

In brief, I believe that much more emphasis should be placed on the relationship between the design of the compensation/support system and veterans' **work incentives**. I elaborate on this below and make some other observations:

- I think the report does a good job of articulating the issues and challenges of the veterans' support system. I think the broad recommendations are sound.
- Appropriately, the report discusses incentives. In particular, the recommendations for compensation/support costs to be internalised within Defence – this seems eminently sensible.
- However, I think the incentives which veterans' compensation creates for **veterans** should be given far more attention. The section titled "... some discourage wellness" does go into this. But I think these issues should be given far more prominence in any discussion of compensation design. I have similarly been struck by how little attention has been given to such incentives in previous related reviews. To be explicit, I'm

referring to **the relationship between the design of the compensation/support system and the returns to paid employment**. Under the VEA at least (I am less familiar with the subsequent Acts), I think the main issue is that compensation payments are strongly focussed on veterans who are unable to work.

- In this context – I'd like to refer the PC to some of my research and that of my colleagues in this area – funded by the Australian Research Council and The Department of Veterans' Affairs. These papers treat Australia's National Service conscription lotteries as a natural experiment. The national service lotteries were equivalent to a set of randomised controlled trials involving over 800,000 men. They hence provide the most credible evidence on the *causal* effects of military service and veterans' compensation.
- In particular, I refer you to work on the **employment effect** of Vietnam-era service (Siminski, 2013; Siminski and Ville, 2012). This is a particularly **striking case study of how poorly designed compensation can have unintended consequences – namely pushing veterans out of the labour market**. We estimate that by 2006, the effect of deployed service was to **reduce labour force participation by a staggering 39 percentage points**. The effect appears to be relatively recent, emerging during the 1990s and 2000s. This is mirrored by trends in Disability Pension (Special Rate) receipt. We did not find negative effects on the probability of employment or on average earnings in the early 1990s. The **majority** of Vietnam-era veterans attained TPI-status decades after service. This did not happen in the US, despite casualty rates which were twice as high as Australia's. This is **likely due to differences between countries in compensation design**. **A conservative estimate of the present value of the resulting lost earnings is \$9.4bn (AU\$2010), or over \$240,000 per soldier who served in Vietnam** (see Siminski, 2013).
- Johnston et al. (2017) uses the same methodology to estimate the effects of service on a broad range of health measures. It includes an update of the mortality results of Siminski & Ville (2011) – cited in the PC report – and it includes estimates for many other health indicators as well. Given the quasi-experimental methodology and the broad range of health outcomes considered, this is a key paper for understanding the causal effects of military service on health - a topic which the PC report covers.

I emphasise that I am **not** claiming that veterans' compensation is too generous, or that veterans are rorting the system. I believe that Australia's system of veterans' compensation can remain as generous as it currently is (perhaps more generous), even if reforms are made to reduce work disincentives.

I suggest that the PC Inquiry addresses the following issues:

- Veterans (like everyone else) are economic actors. Therefore, they respond to economic incentives. Incentives, in turn, are fundamentally shaped by the compensation system, just as they are shaped by the tax and transfer system. Such incentives can create economic inefficiencies if they distort the returns to paid work. To put this another way, poorly designed compensation (or pension) systems can mean that **work does not pay** for some veterans. This should be avoided if possible. At the very least, such distortions to incentives should be clearly understood.
- Given the complexities of the veterans' compensation system(s), we do not currently have a clear understanding of how the system impacts veterans' work incentives. This should be assessed comprehensively.
- In evaluating the system's impact on work incentives, an important consideration is the distinction between compensation for **impairments** versus compensation for **inability to work**. **The former does not create work disincentives, while the later does.** This is particularly so in the context of a **reverse-criminal standard of proof**.
- **Reforms which reduce or eliminate the central role of employability in setting payment rates for the Disability Pension may be worth considering.**

I would welcome the opportunity to discuss further.

Yours truly,

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References

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