



Welfare state design: Architecture and outcomes - the New Zealand benefit system in comparative perspective

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Outline

- Nature and limitations of the approach
- The design of benefit systems
- Targeting, progressivity and redistribution
- How New Zealand compares – particularly to Australia
- Summary and some conclusions
 - Sources and additional material

Caveats and limitations

- Approach is descriptive and based on statistical calculations.
- Most analysis is static.
- The counterfactual effectively assumes that the welfare state has had no incentive effects, or at least is the same in all countries.
- Some welfare state features treated as if they are produced by market mechanisms (e.g. minimum wages).
- Does not include non-cash benefits (health care, education, social housing, child care); indirect taxes – VAT, employer social security contributions also not included.
- Employer social security contributions are paid by businesses direct to government and do not pass through the household sector. Particularly problematic as they are one of main sources of funding for the welfare state.
- Employer provided fringe benefits not included.
- The distribution of wealth, including owner-occupied housing makes a difference.

A framework for assessing social protection

- Many analyses focus only on government provided social protection, but this needs to be seen within a broad framework
- In addition to government cash benefits, assistance can be provided through allowances or concessions in the tax system or through direct service provision. (e.g. child care).
- The tax system can also offset or reinforce the objectives of social protection.
- Occupational social welfare can be provided on a voluntary or mandatory basis.
- In New Zealand and Australia, labour force regulation has a long history – since the 19th century.
- Private social welfare can be provided by churches, NGOs, family and friends or purchased in the market (insurance).

Social security design

- The New Zealand and the Australian social security systems differ from those in most other countries
- In Europe, the United States and Japan, most government benefits are financed by contributions from employers and insured employees, and benefits are often related to past earnings, so that higher income workers receive higher absolute levels of benefits if they become unemployed or incapacitated or when they retire.
- In contrast, in New Zealand and Australia, most government benefits are flat-rate entitlements financed from general government revenue, and there are no explicit social security taxes.
- In addition, in both countries – but more so in Australia – most benefits are income-tested or asset-tested, so that entitlements reduce as resources increase.
- Because these systems are not contributory, eligibility is based on residence and coverage of the population is broad.
- Duration of payment receipt is not time limited, with income support payments being paid indefinitely subject to the continued meeting of eligibility criteria.

Social security design

- Because the New Zealand and Australian systems are income-tested and not contributory, there is a tendency for overseas commentators to see them as residual, rather like vast forms of social assistance. This view is mistaken.
- Benefits are legal entitlements and there is very limited discretion in the system, and recipients have the right to appeal to administrative and judicial tribunals in case of disagreements about administrative decisions.
- The social security system is also a national system, with entitlements and conditions being uniform across the country. While income support payments are means-tested, these assets tests are much more generous than those typically applying in social assistance schemes in other countries.
- In a sense, the New Zealand and Australian systems are hybrids falling between a social insurance system and a social assistance system, being less “generous” than some social insurance systems, but more “generous” than most social assistance systems.

Who benefits under different welfare states?

- A “pure” social insurance system is status maintaining – contributors get out what they have put in, and you have to be a contributor to benefit.
- On average, social insurance systems are more expensive and therefore appear more “generous”, but this can be generosity to the middle classes and the well-off.
- Universal and income-tested schemes are therefore likely to be relatively more generous to the lifetime poor and to those who have not contributed or been able to contribute to social insurance schemes, particularly young people, women and migrants.
- However, one of the central issues in the literature is that more encompassing welfare states provide higher levels of benefits because the middle class have a stake in the system.
- Does targeting undercut political support for generosity to the poor?

Incentives – general considerations

- Different forms of assistance and financing have different implications for incentives:
 - Contributory systems may enhance incentives to participate in the labour market
 - Paid maternity/parental leave with right to return to work promotes labour force attachment, but if parental leave is too long (> 6 months) may be associated with loss of earnings potential.
 - Child care support encourages employment, particularly if targeted to employed families or those looking for work;
 - Family allowances likely to have a small income effect, discouraging employment;
 - More generous, joint income-tested payments for the low paid likely to have stronger work disincentives;
 - Family-based taxation likely to discourage employment of second earners;
 - Practically all OECD countries have income-tested payments for low income families, which dominate the effects of the tax unit.
 - Generous income support for the non-employed may act as work disincentive, unless associated with active job search requirements;
 - Generosity needs to take account of ease of access and potential duration of benefits, not just benefit levels.
 - **Specific eligibility conditions are important, e.g. Early retirement provisions**
 - **Expectations are likely to be important.**

Types of redistribution in social security systems

- The design features of social protection differ in important respects - two of the most important features relate to the *funding* – i.e. the different ways in which programmes are financed – and *structure* of benefits – i.e. the relationship between benefits received and the past or current income of beneficiaries.
- Redistribution can be between rich and poor (Robin Hood) or across the lifecycle (the piggy bank) – risk insurance (against unemployment, disability, sickness etc.), savings (for retirement).
- All welfare states are a mix of the two, but the mix varies.
- Other types of redistribution – notably between men and women and also across regions.
- Behavioural effects may undercut redistribution; private provision also redistributes across the lifecycle.
- Point in time, static analysis implicitly treats all measured redistribution as if it were between rich and poor.
- Taking account of redistribution across the life course, the level of redistribution between rich and poor is less than it appears, but is still strongly associated with progressivity of benefit structure.

Targeting, progressivity and redistribution

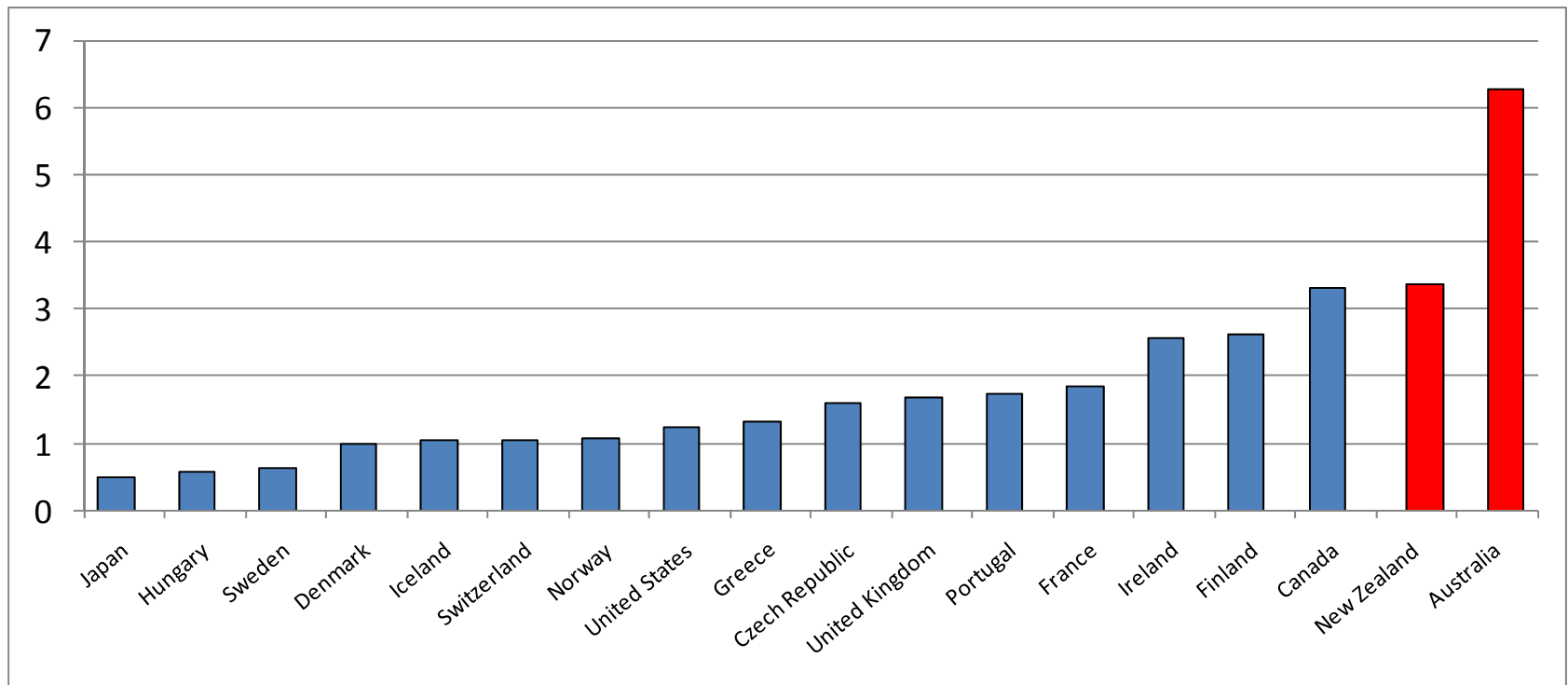
- *Targeting* is a means of determining either eligibility for benefits or the level of entitlements for those eligible. In a sense, all benefit systems – apart from a universal “basic income” or “guaranteed minimum income” scheme – are targeted to specific categories of people, such as the unemployed, people with disabilities or those over retirement age. Income and asset-testing is a further form of targeting that can be applied once people satisfy categorical eligibility criteria.
- *Progressivity* refers to the profile of benefits when compared to market or disposable incomes – how large a share of benefits is received by different income groups – e.g. do the poor receive more than the rich from the transfer system?
- *Redistribution* refers to the outcomes of different tax and benefit systems – how much does the benefit system actually *change* the distribution of household income?
- *Effectiveness* measured by how much redistribution is achieved; *efficiency* by the resources used to achieve this redistribution.

New Zealand's distinctive tax/benefit system

- Total NZ spending on social protection (cash benefits, health care, social services) at 18.5% of GDP in 2005 was about 90% of the OECD average – but this is mainly due to lower than average spending on age pensions; health and disability spending are a little higher than average and cash benefits for people of working age about 20% higher; spending on non-health services about 2/3rds of average. (Australia spent 17.1% of GDP.)
- Direct taxation paid by benefit recipients is higher than average, but indirect taxation of benefits is a little lower – in Australia direct and indirect taxes on benefits are amongst the lowest in the OECD .
- NZ tax expenditures are very low. Australian pension tax expenditures are the highest in the OECD, but other tax expenditures below average.
- Mandatory private social benefits are very low in New Zealand, but in Australia (sick pay and superannuation) they are amongst highest.
- Thus, net expenditure – after direct and indirect taxes paid on benefits – is even closer to average – and tax expenditures and mandatory private social expenditure increase Australia's ranking but reduce New Zealand's ranking.
- Net total social expenditure is 16.4% of GDP in New Zealand, but 19.3% of GDP in Australia – the rankings are reversed (in addition, Denmark falls from 26.9% of GDP to 21.6%, while USA rises from 15.9 to 25.3% of GDP).
- To assess distributional impacts it is necessary to look at all components of the system together – ideally.

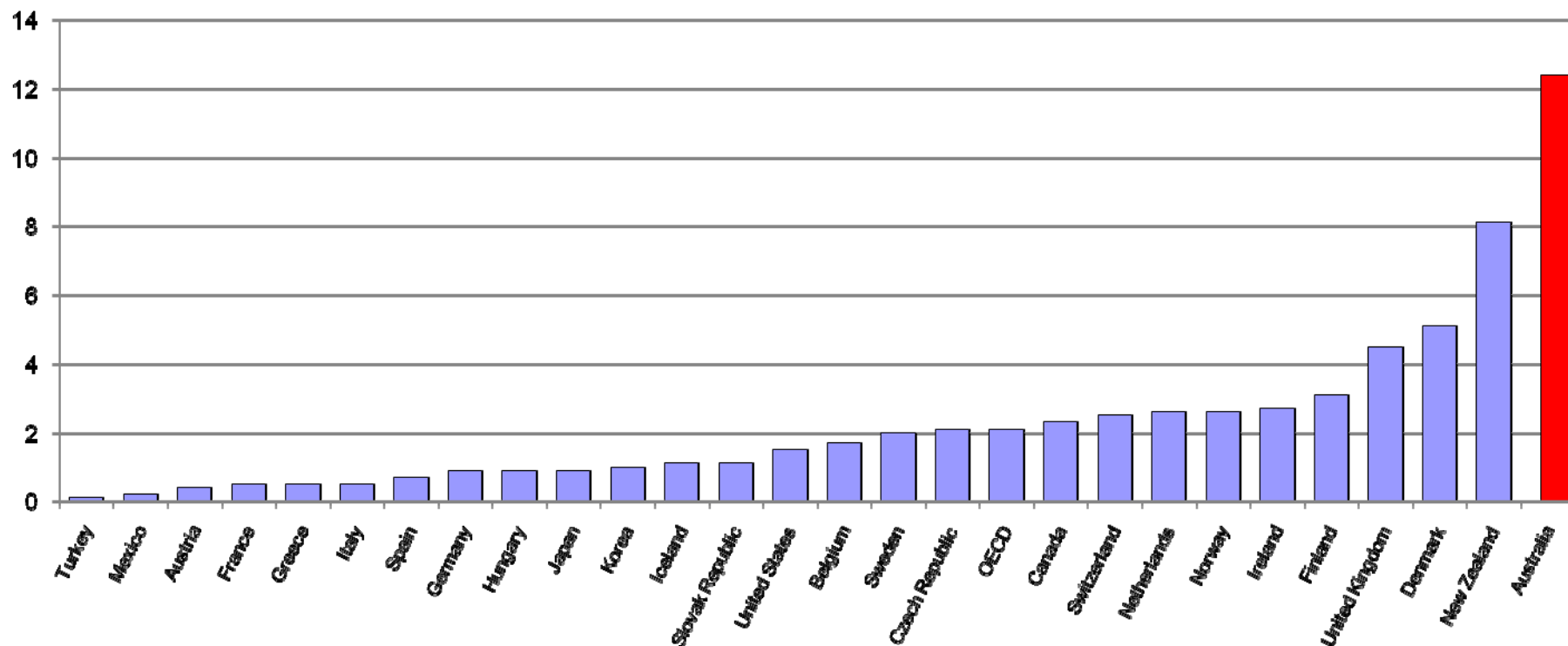
Australia and New Zealand rely on income-testing more than any other OECD countries

% of GDP spent on income-tested benefits, 2005



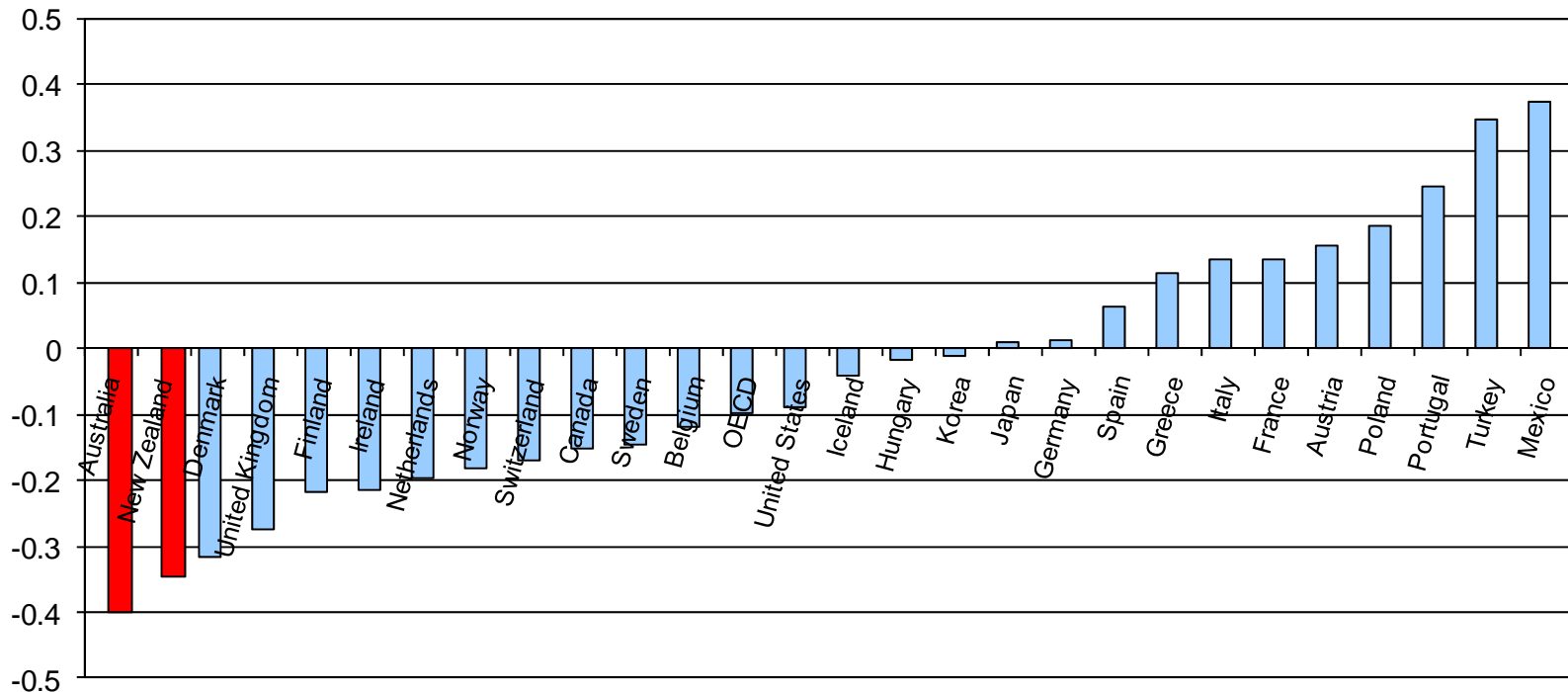
Australia and New Zealand have the most progressive benefit systems in the OECD

Ratio of benefits received by poorest quintile to benefits received by richest quintile, total population, 2005



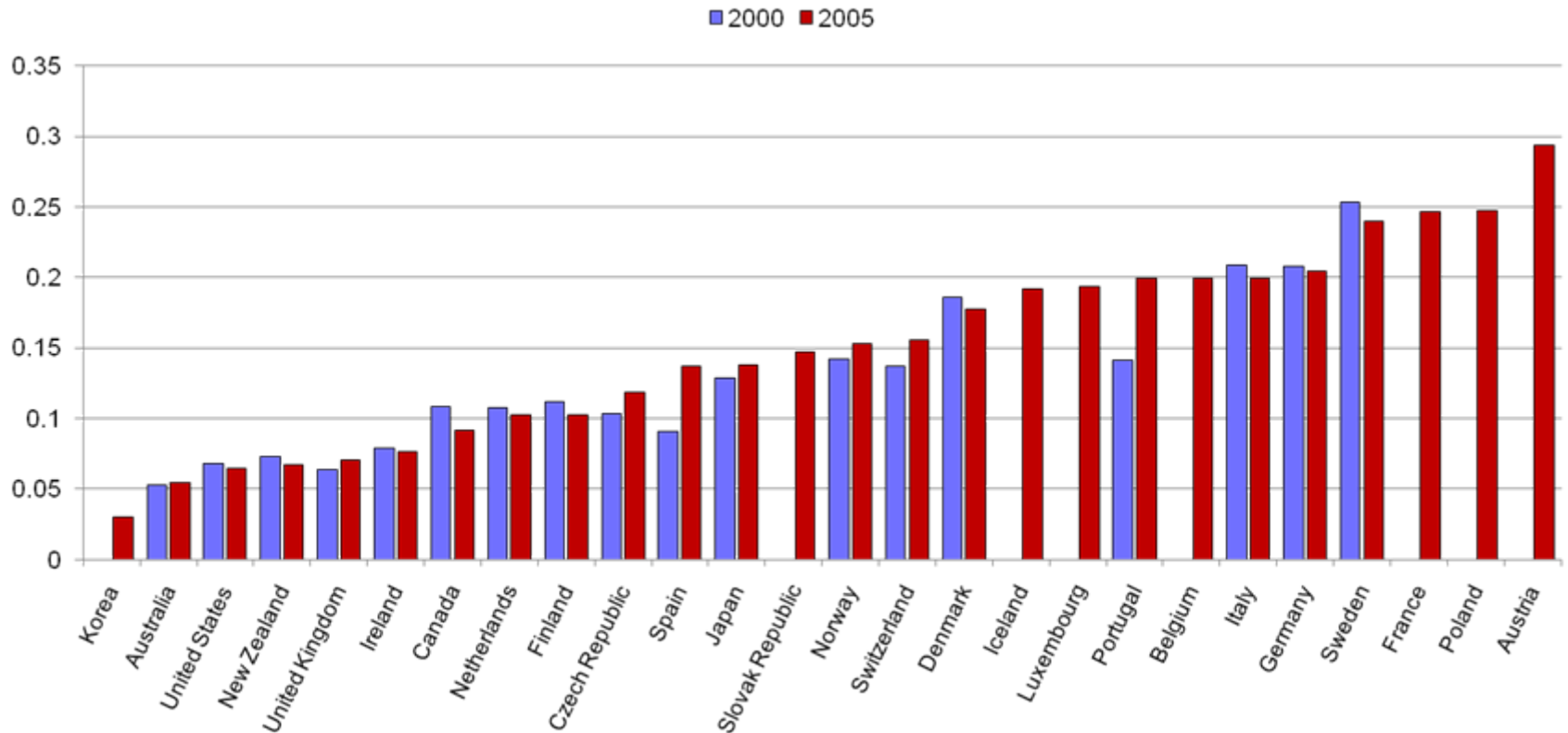
Progressivity of transfers, 2005

Concentration coefficient of transfers



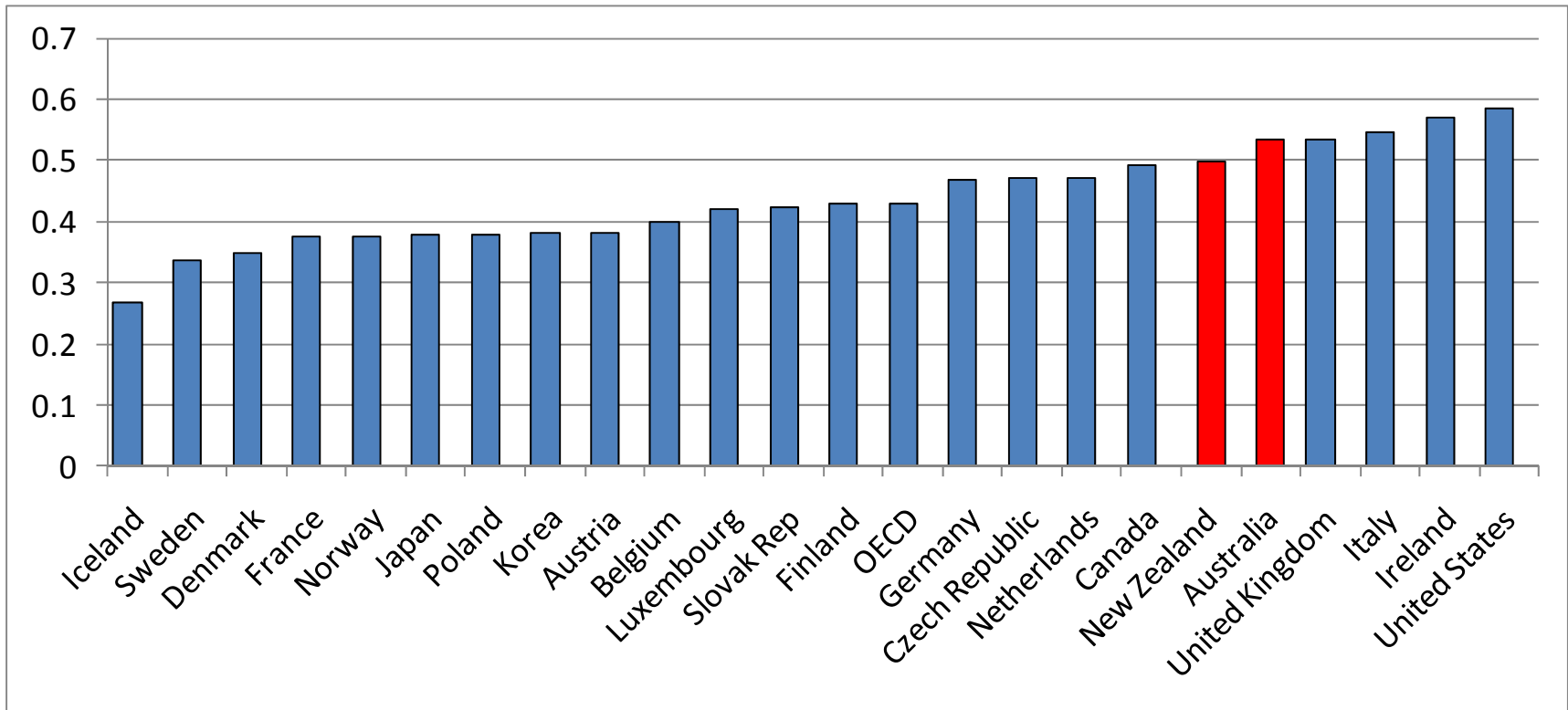
Australia and New Zealand have low levels of churning

Churning as % of equivalent household disposable income



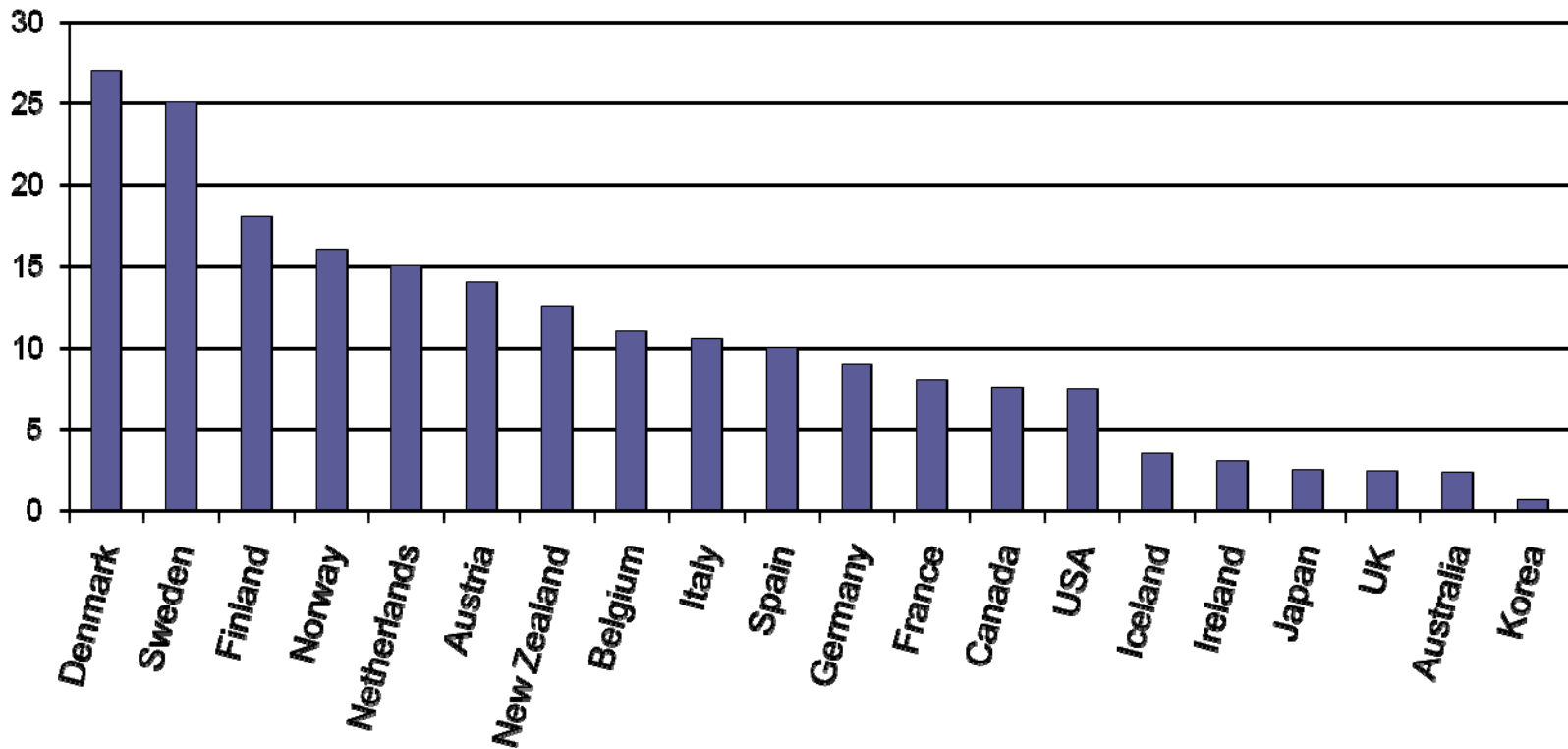
The progressivity of direct taxes is highest in the English speaking countries and lowest in the Nordic countries

Concentration coefficient for direct taxes around 2005



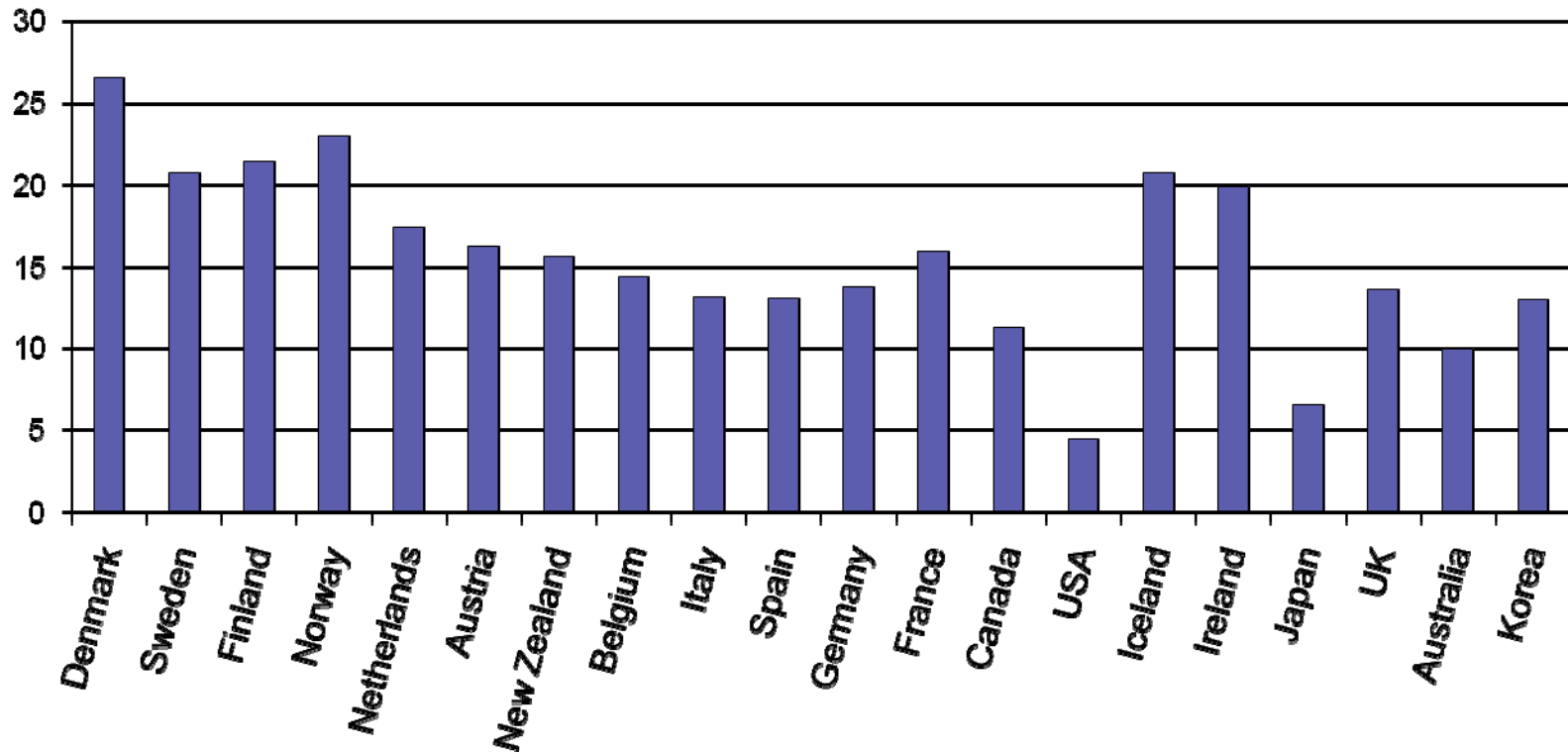
Direct taxes on public transfers

% of public social benefits paid in direct taxes



Indirect taxes on public transfers

Implicit average indirect tax rate (%)

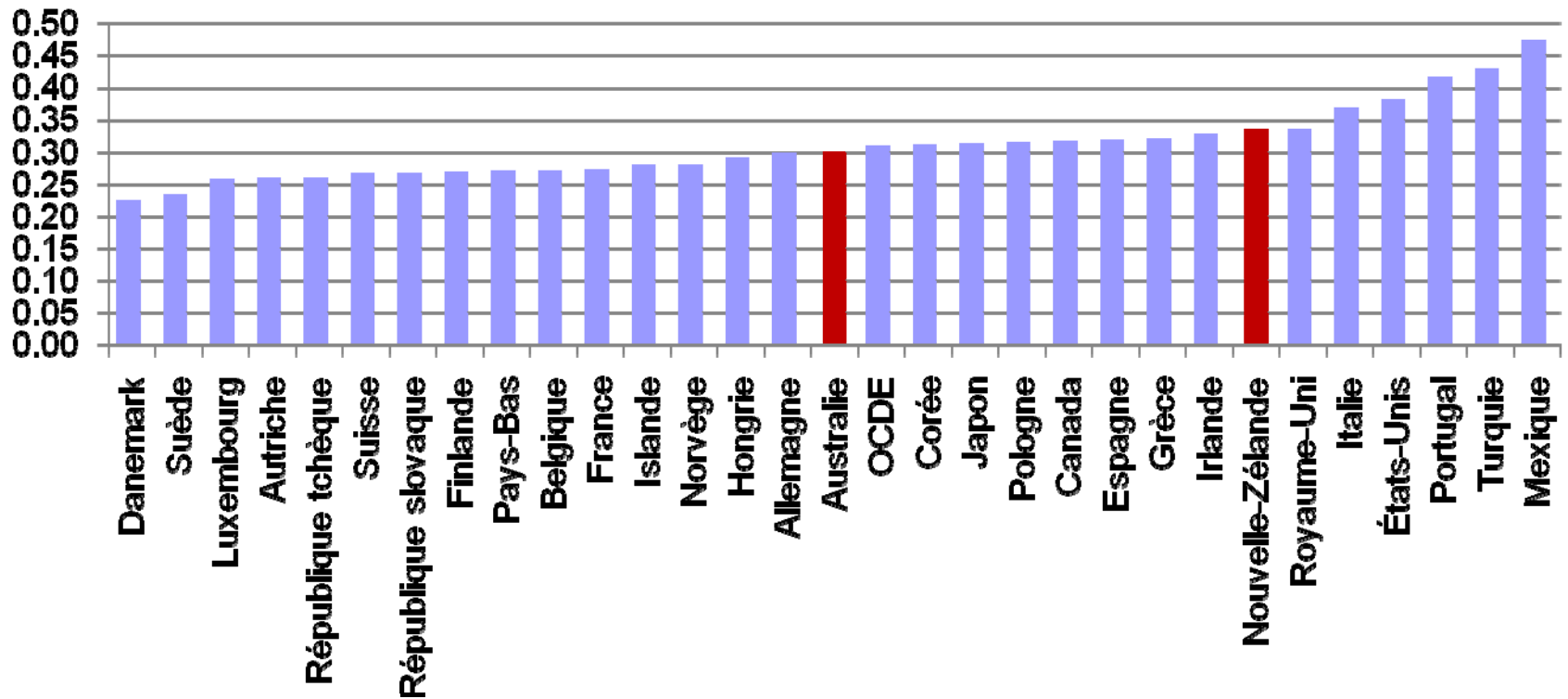




OUTCOMES

Levels of inequality, OECD countries, 2005

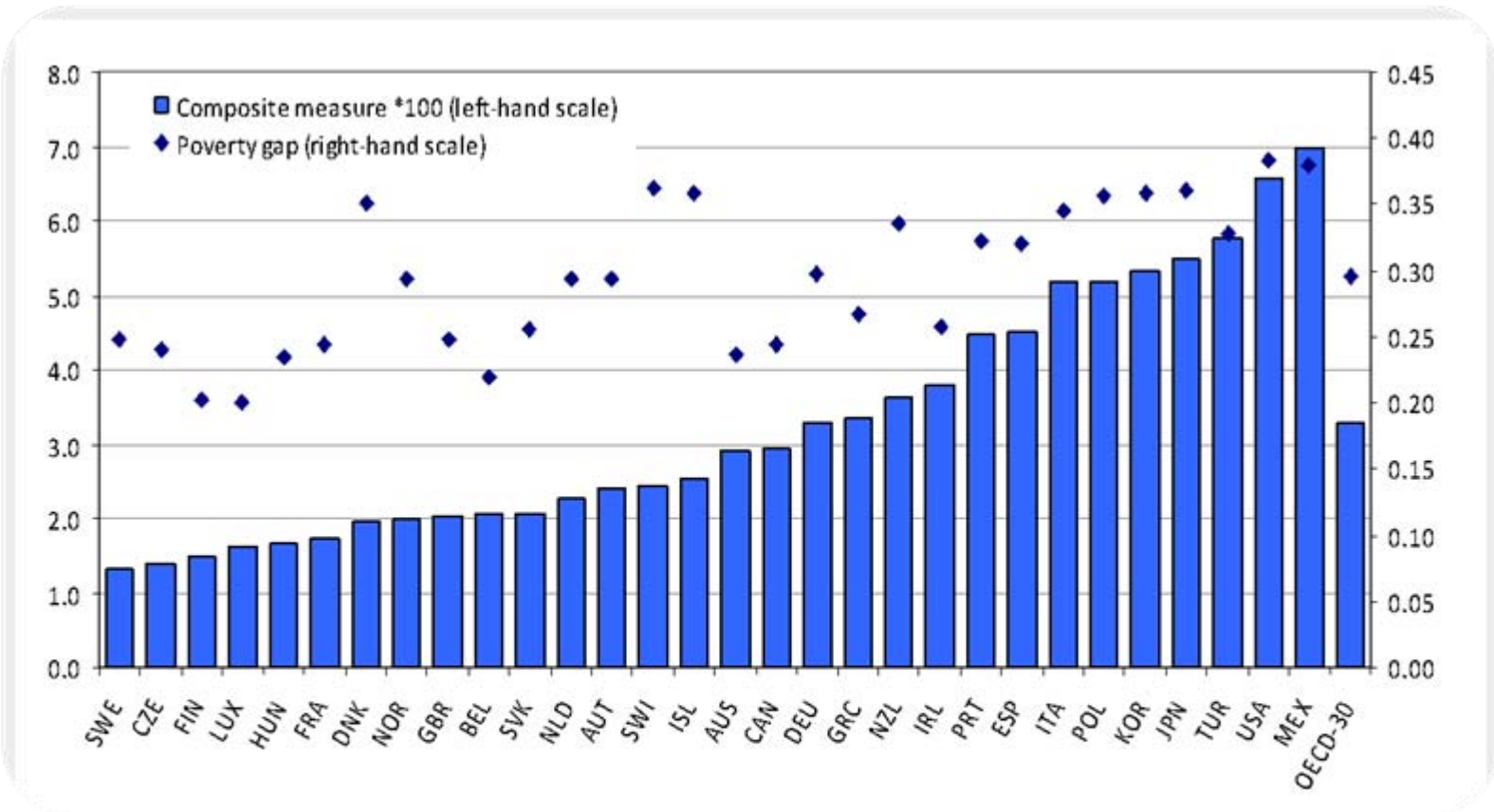
Gini coefficient for disposable income



Income poverty rates and poverty gaps

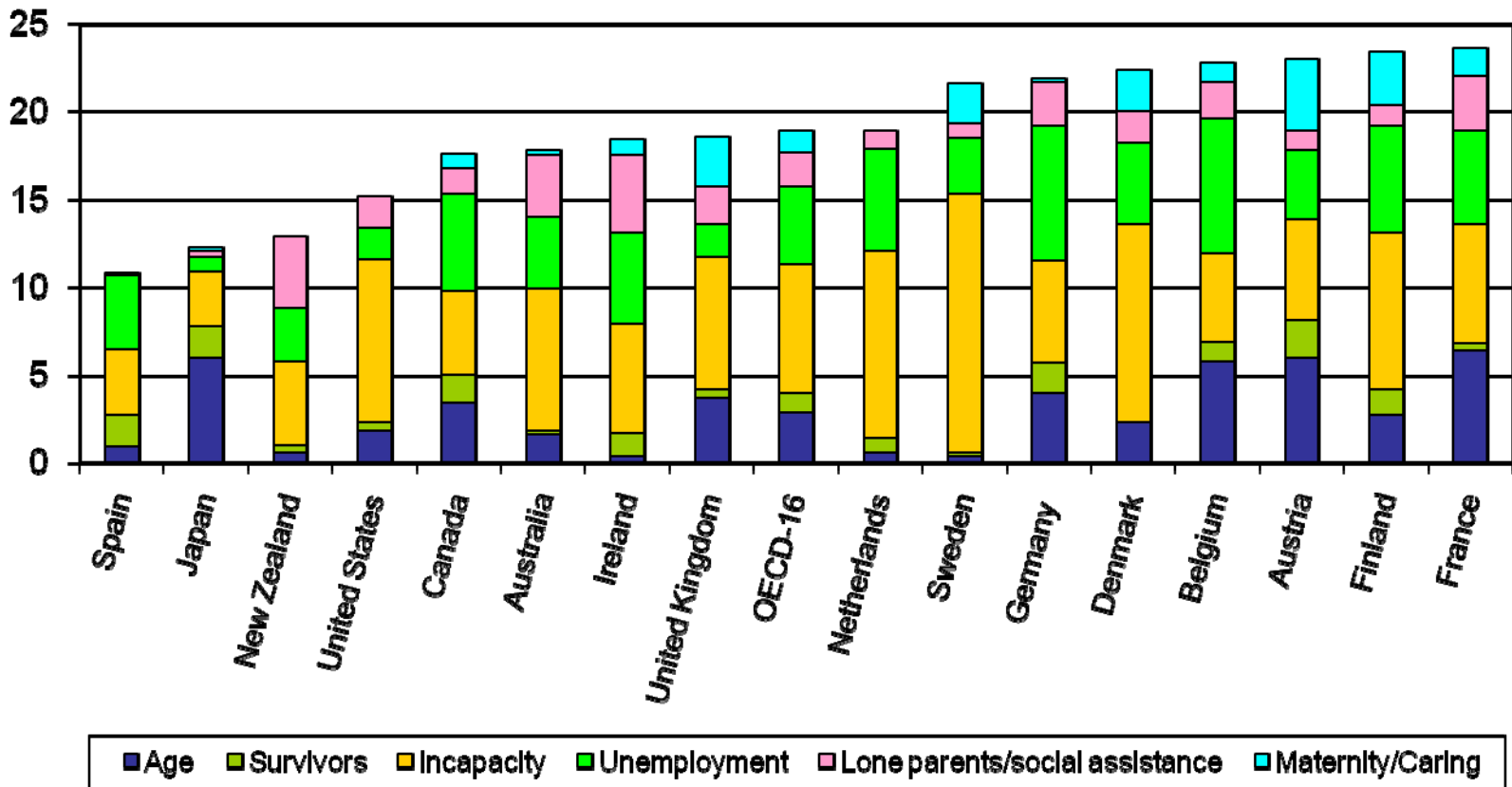
- In most international comparisons, income poverty is measured by reference to median household income “after” taxes and benefits, adjusted by household size (either 40, 50 or 60%).
- The poverty rate or headcount is the % of the population with incomes below the benchmark; the poverty gap is the difference between the average income of the poor and the benchmark – a measure of distance (and possibly exclusion?).
- Household surveys do not include many of the most disadvantaged – people who are homeless, in nursing homes, boarding houses or in prison (about 2% of the Australian population).
- Measured at 50% of median income, New Zealand is almost exactly at the OECD average, with the equal lowest poverty rate among the population aged 65 years and over in the OECD (2%). Poverty among the working age population is a little higher than average (11% compared to 9%), and child poverty is higher (15% compared to 12%)
- Australia has more people between 40% and 50% of median income than any other OECD country. Using a 50% of median income poverty line, the poverty gap is the 6th lowest in the OECD and a little lower than in Denmark. So Australia has a relatively high share of the population in poverty, but close to the poverty line.
- New Zealand has more households between 50% and 60% of median income than any other OECD country. At 60% of median income, New Zealand has the fifth highest poverty rate in the OECD. The poverty gap is the 8th highest in the OECD.

Poverty gap and composite measure of income poverty, mid-2000s



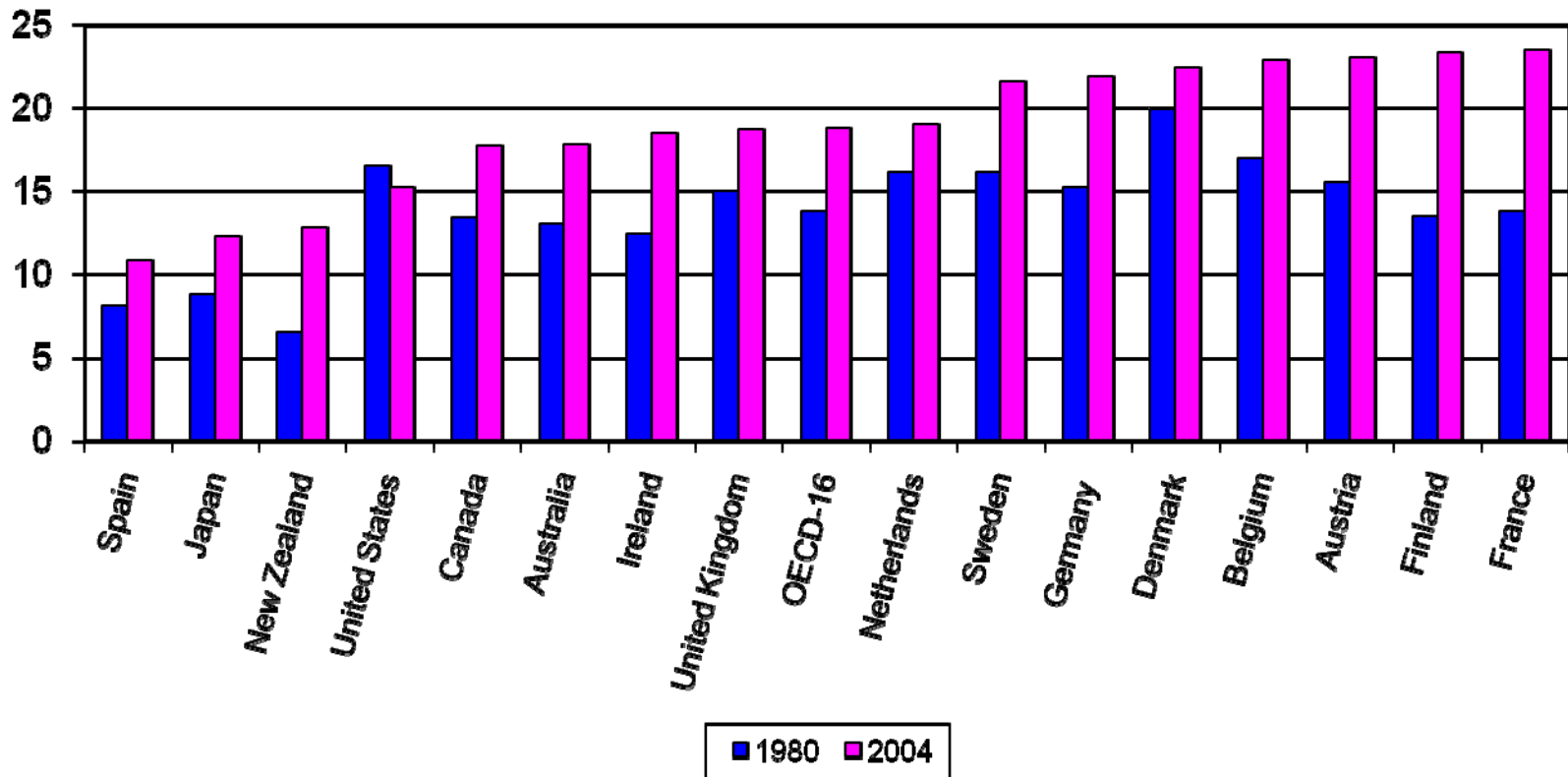
Benefit recipiency in New Zealand is below average

% of working age population in receipt of income replacement benefits, full-time equivalents, 2004

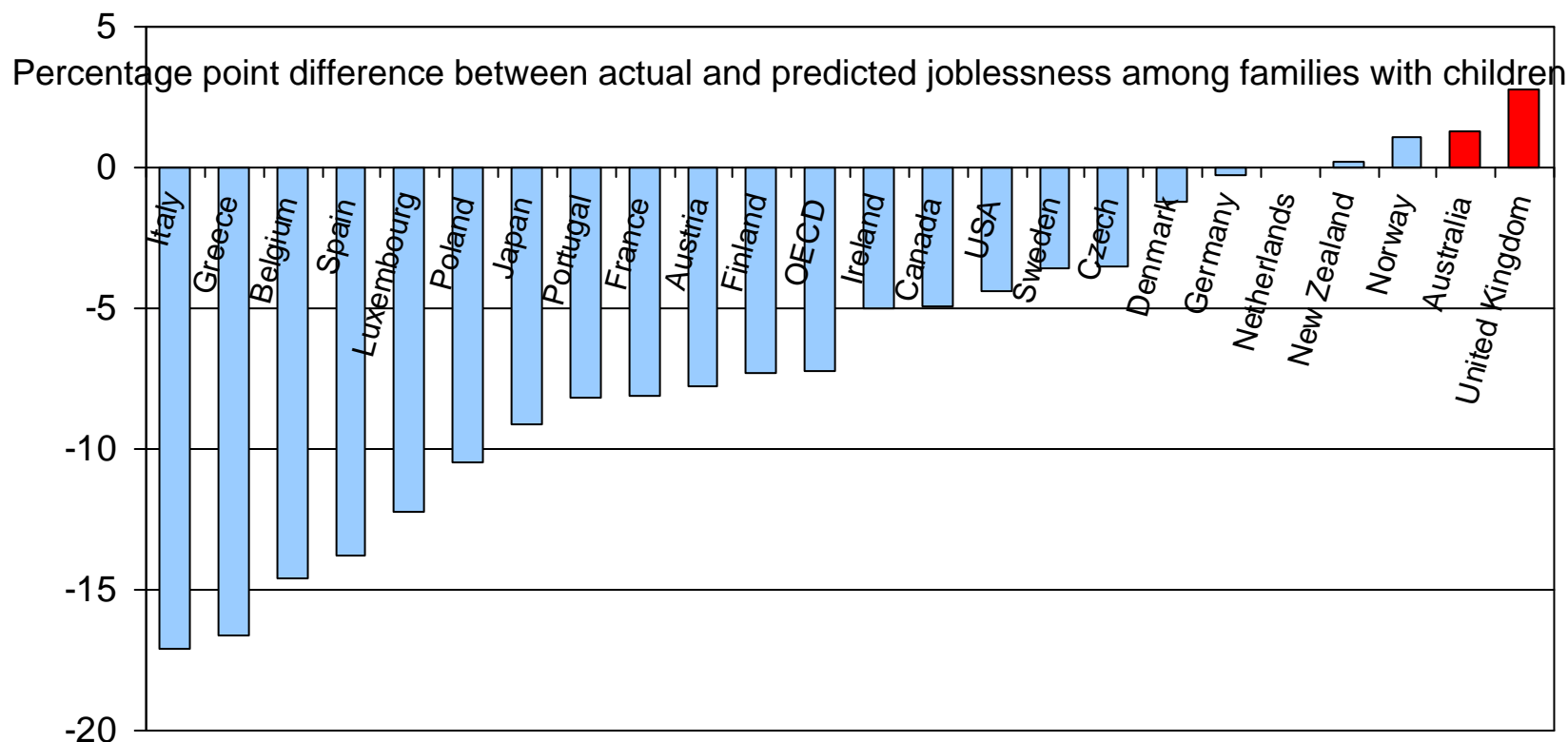


Reliance on benefits has increased, most rapidly in New Zealand (from a low base)

% of working age population in receipt of income replacement benefits, full-time equivalents, 1980 and 2004

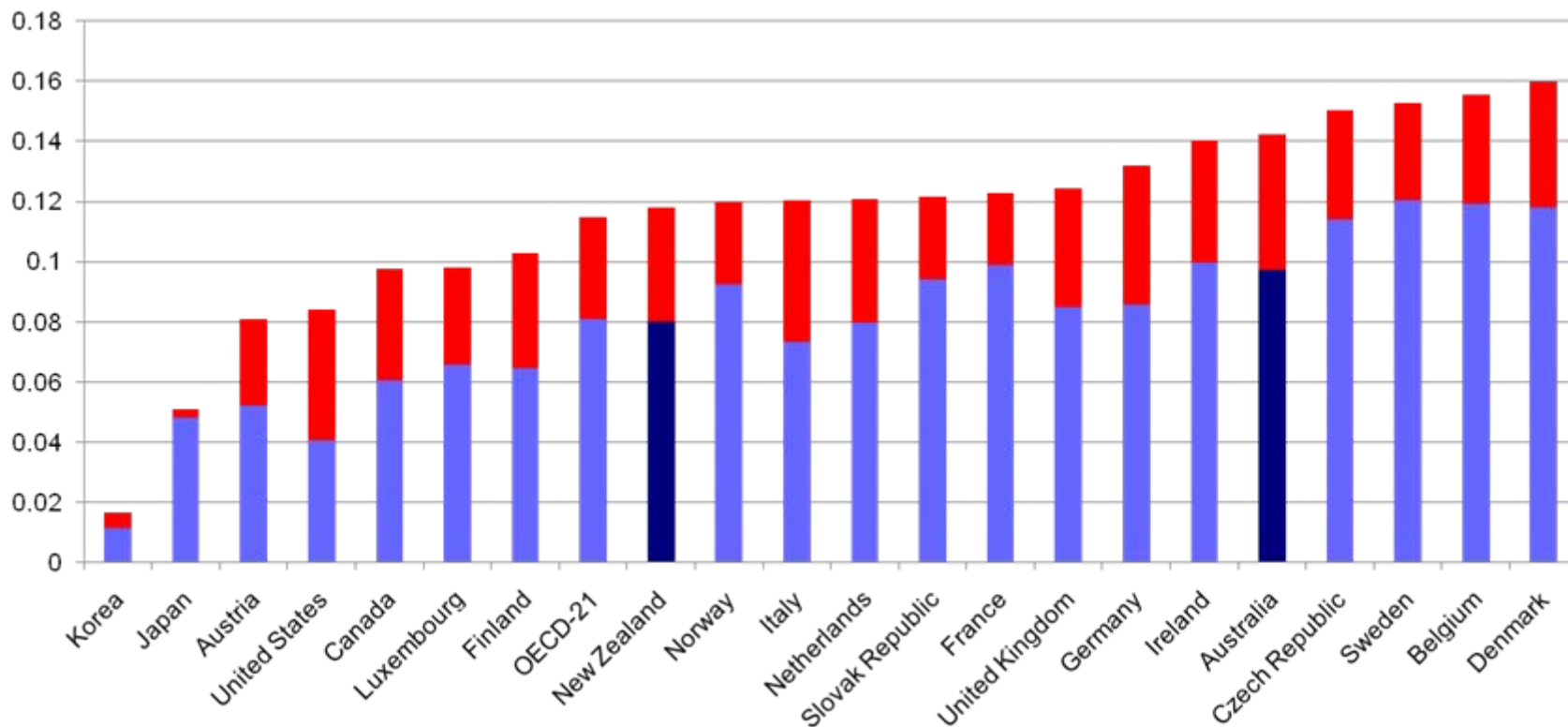


Relative to their high overall employment, the UK and Australia do worst for joblessness among families with children – with New Zealand not far behind



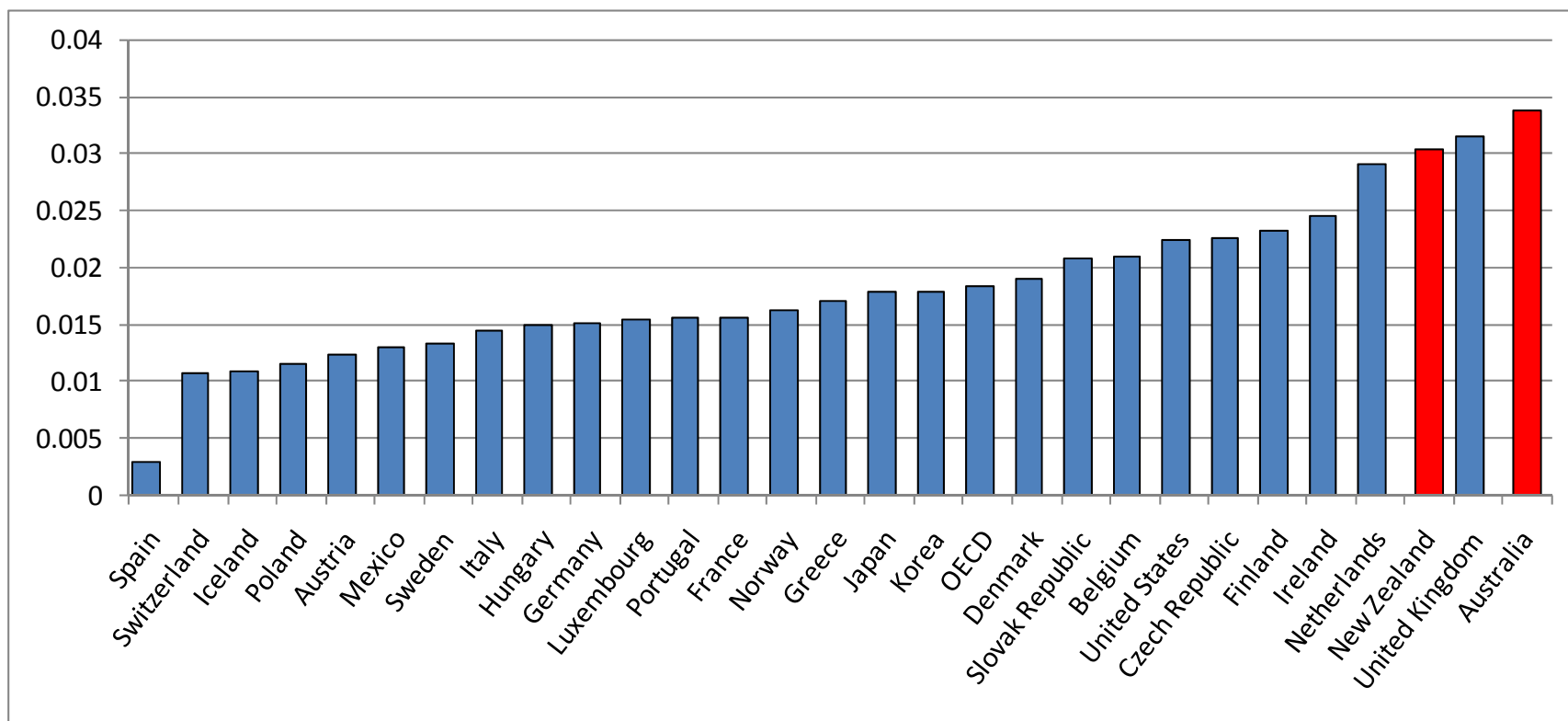
Reduction in inequality due to public cash transfers and household taxes

Point reduction in the concentration coefficient



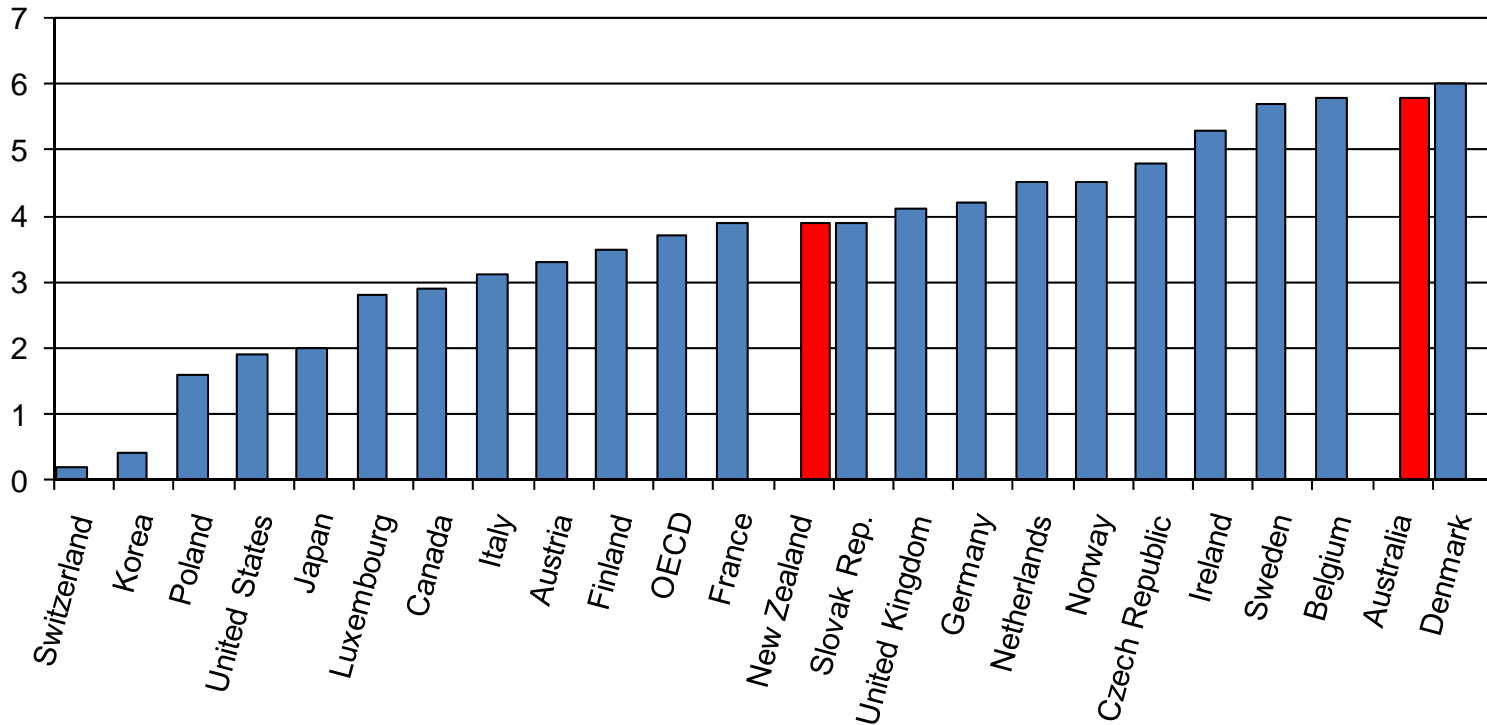
Australia is the most efficient country in the OECD in reducing poverty

Point change in mean poverty gap per unit of transfer spending



Net redistribution to the poor

Net transfers received by poorest quintile as % of household disposable income



Summary

- New Zealand relies on income testing more than any other OECD country except Australia, and has one of the most progressive structure of benefits of all OECD countries.
- New Zealand has lower churning than most other OECD countries, and the third highest level of transfer *efficiency* in reducing poverty.
- Australia (and Ireland) prove to be nearly as *effective* in reducing inequality as the Nordic countries, while New Zealand is above average in reducing inequality.
- But these are measures of programme efficiency, not economic efficiency.
- Efficiency is a means to an end – the goal is more effectiveness.

Conclusions

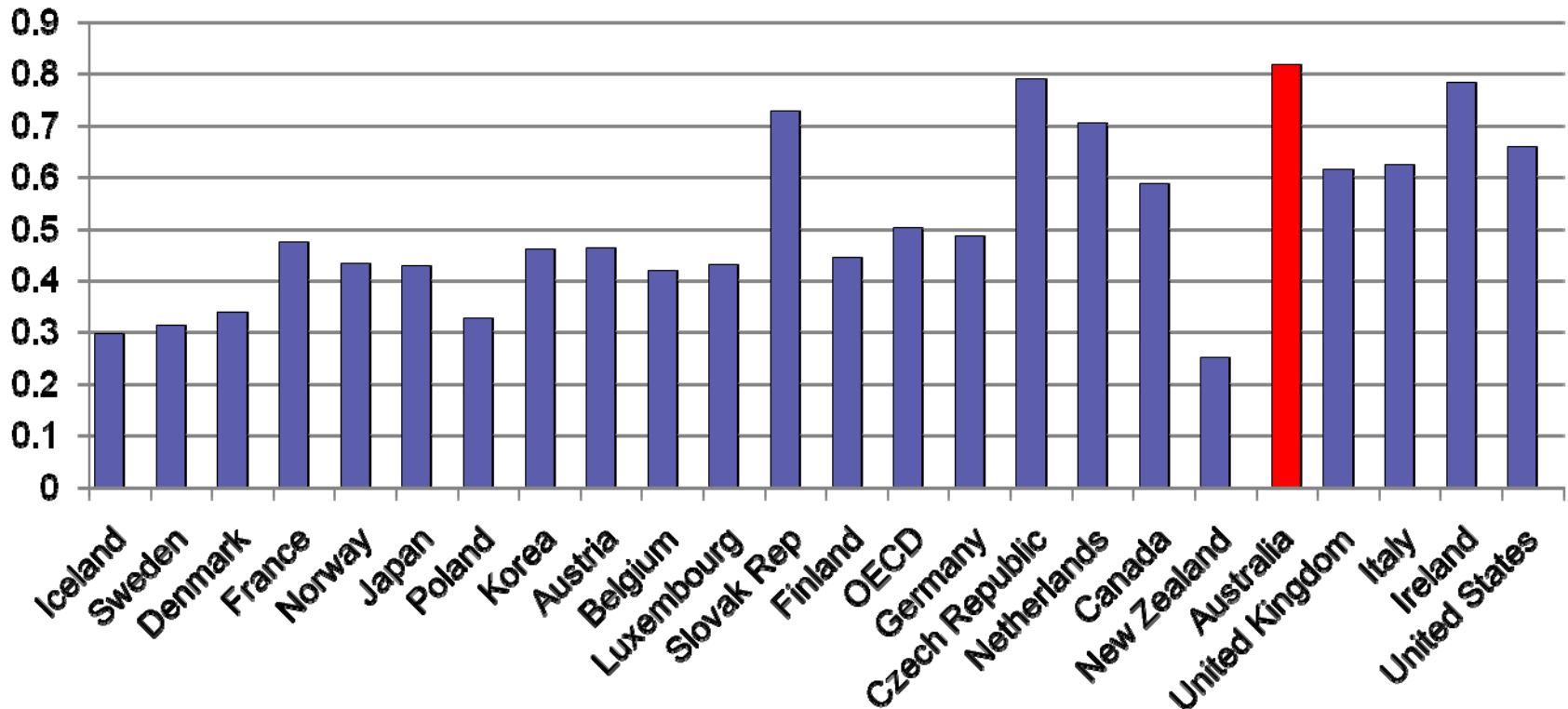
- The broad architecture of the New Zealand system has considerable strengths.
- Broadly speaking, in looking at reform options you can consider refurbishment and modernisation, or demolition and rebuilding.
- Despite impressive design features of tax and transfer systems, disposable income inequality in New Zealand is above the OECD average; this means that income inequality before taxes and transfers is higher than in most countries with better inequality outcomes.
- If New Zealand wants to be more effective it could either increase its high level of progressivity, or tax and spend more while at least maintaining effective progressivity, or identify the factors associated with its relatively high level of market income inequality and address these problems more directly.



ADDITIONAL MATERIAL

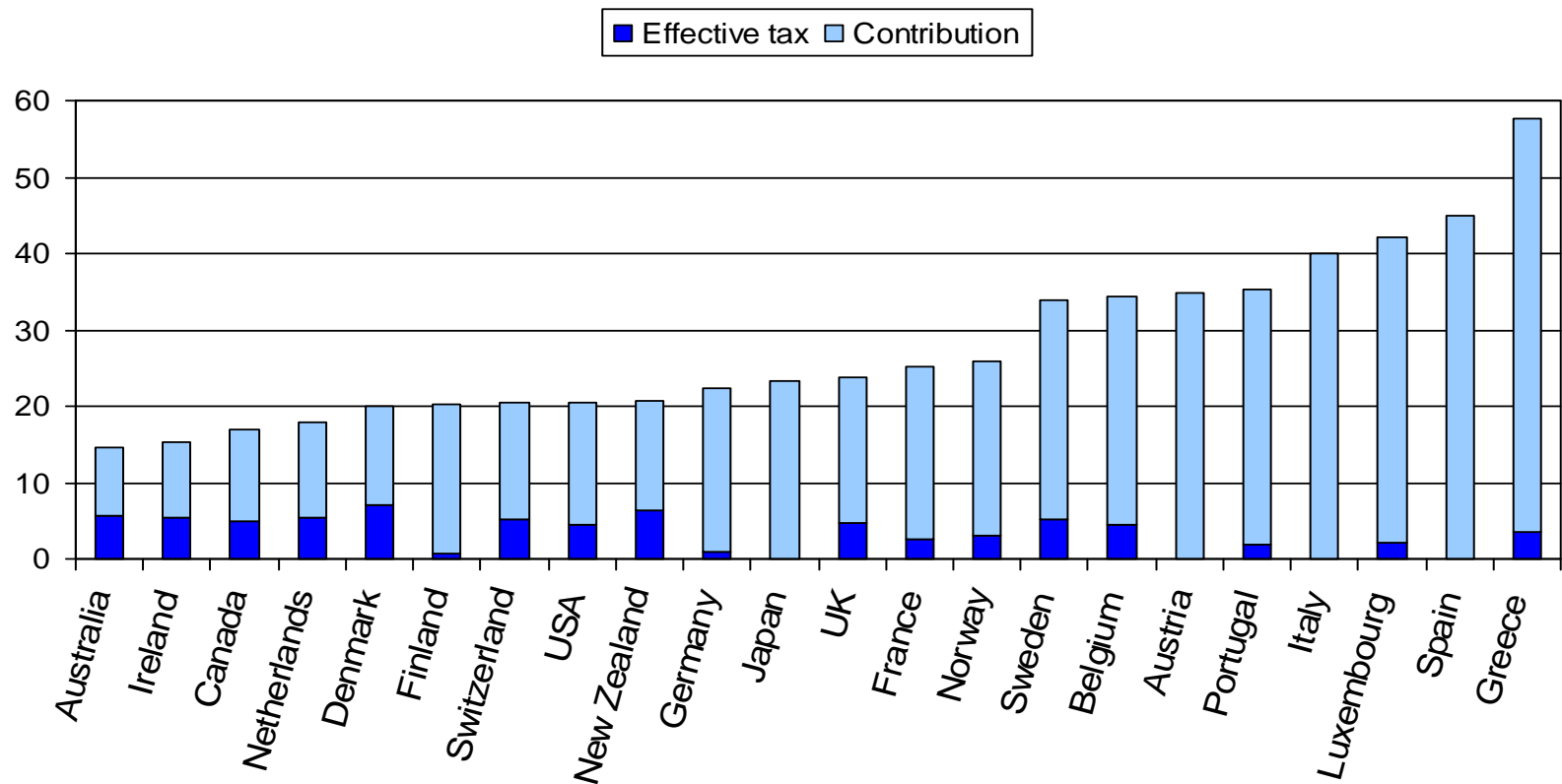
Australia has the most progressive direct taxes on retirement age households – New Zealand the least progressive

Concentration coefficient for direct taxes on retirement age households



Effective contributions to public pensions, redistributive and actuarial components, mid-1990s

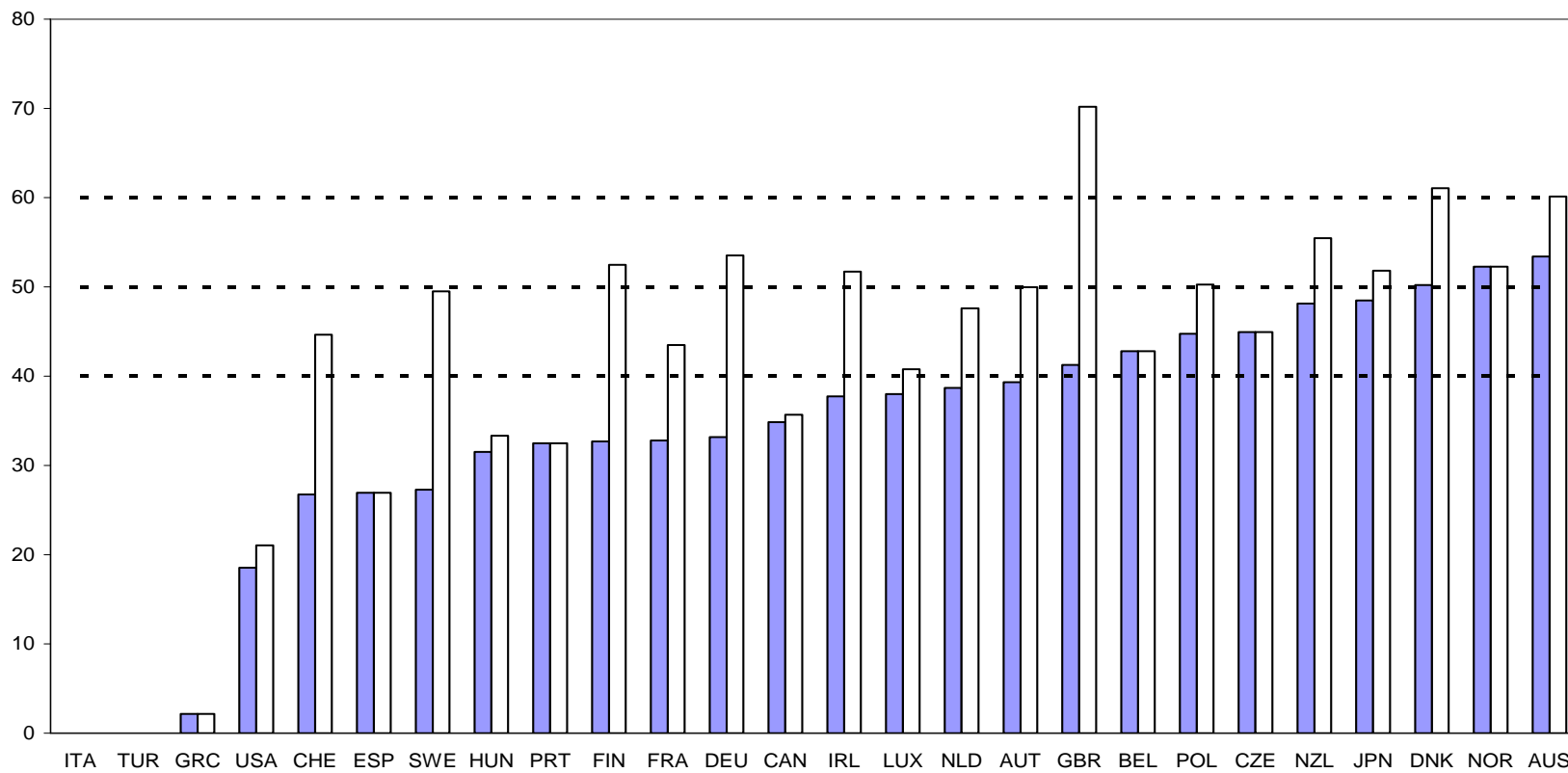
% of wages



Net incomes of social assistance recipients, 2005

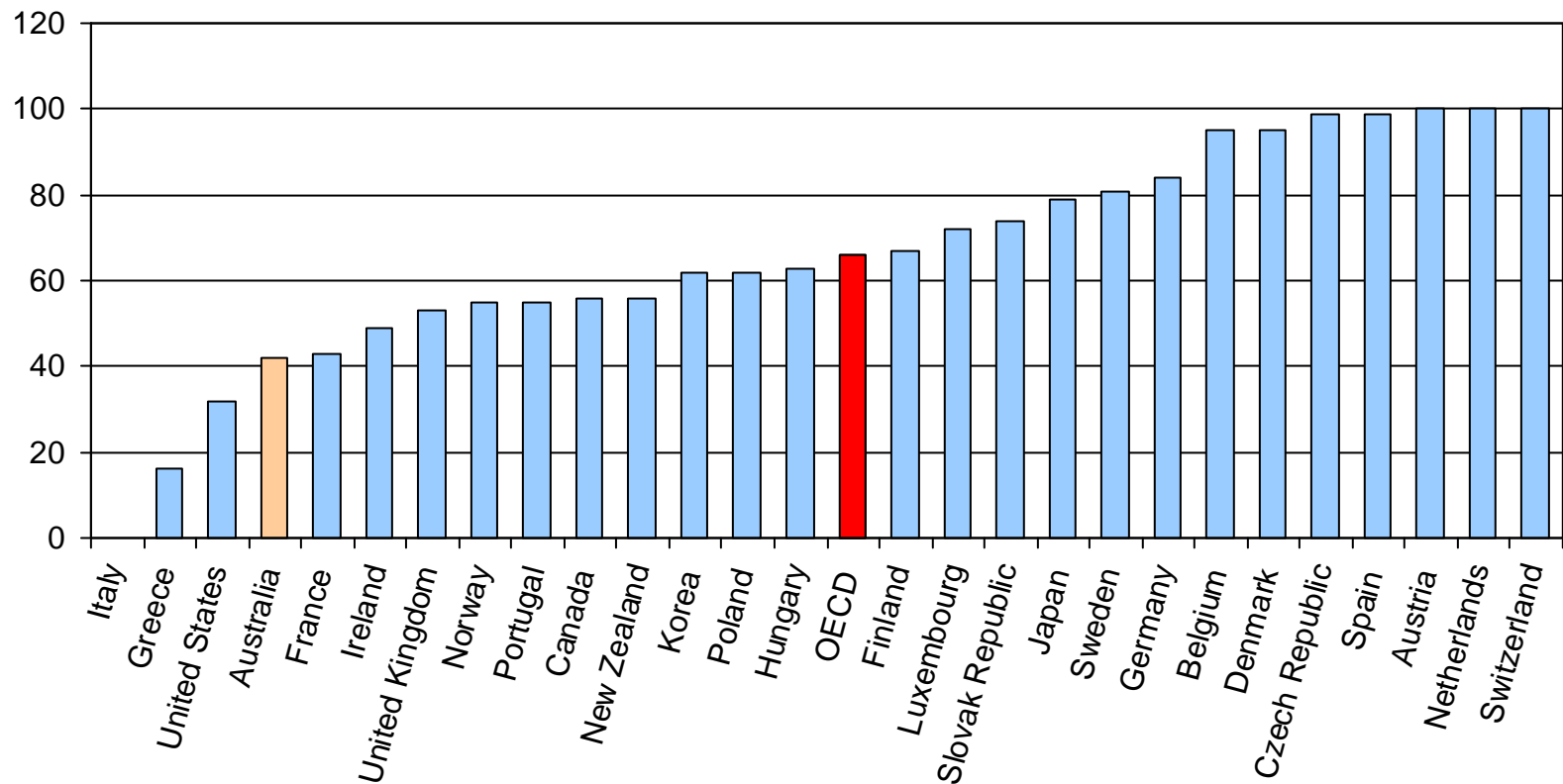
% of median equivalent household income, with and without housing benefits

Lone parent, two children



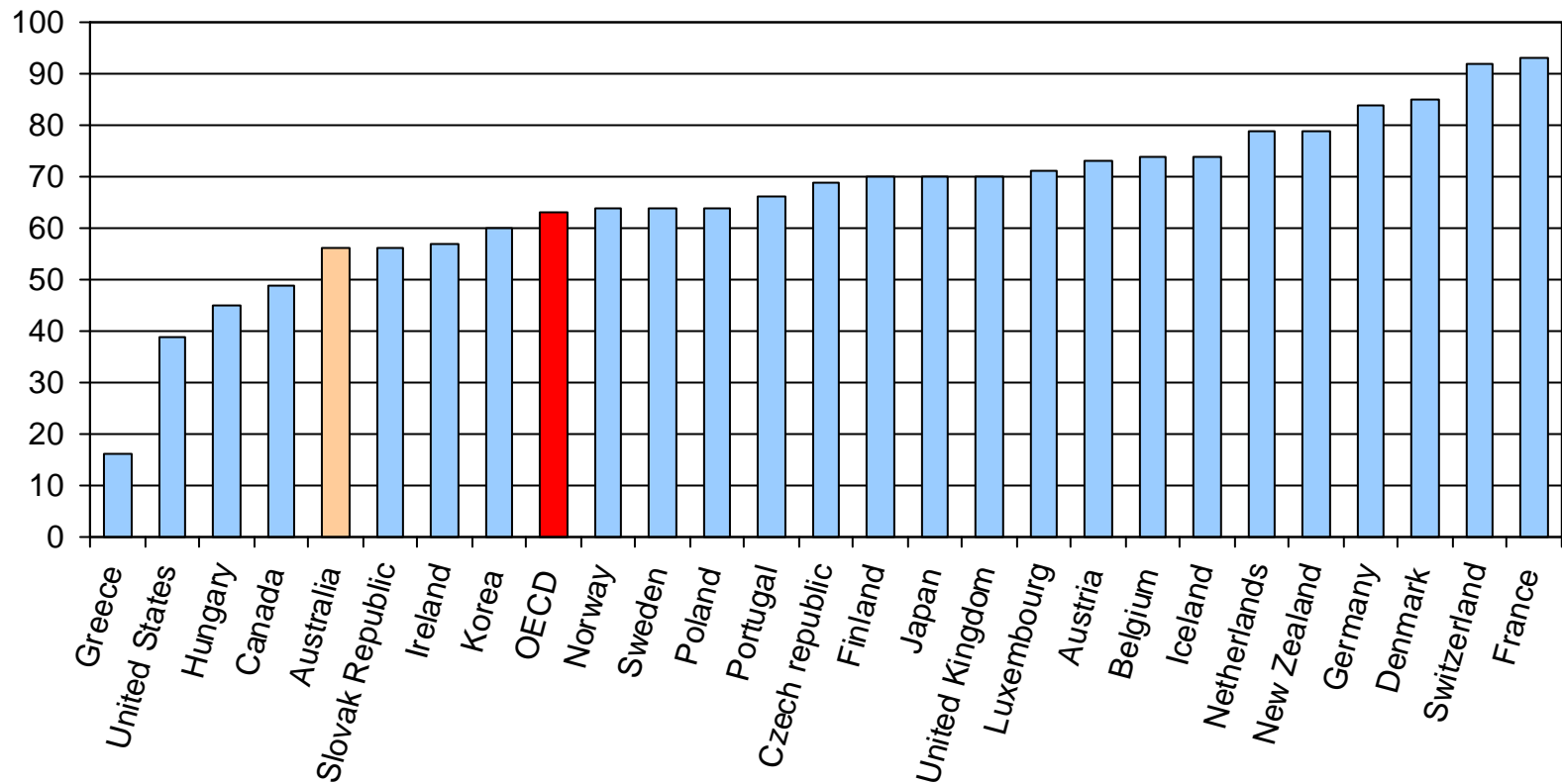
Effective tax rates for parents seeking part-time work are lower in Australia than most other countries

AETR from zero to 33% APW, 2004



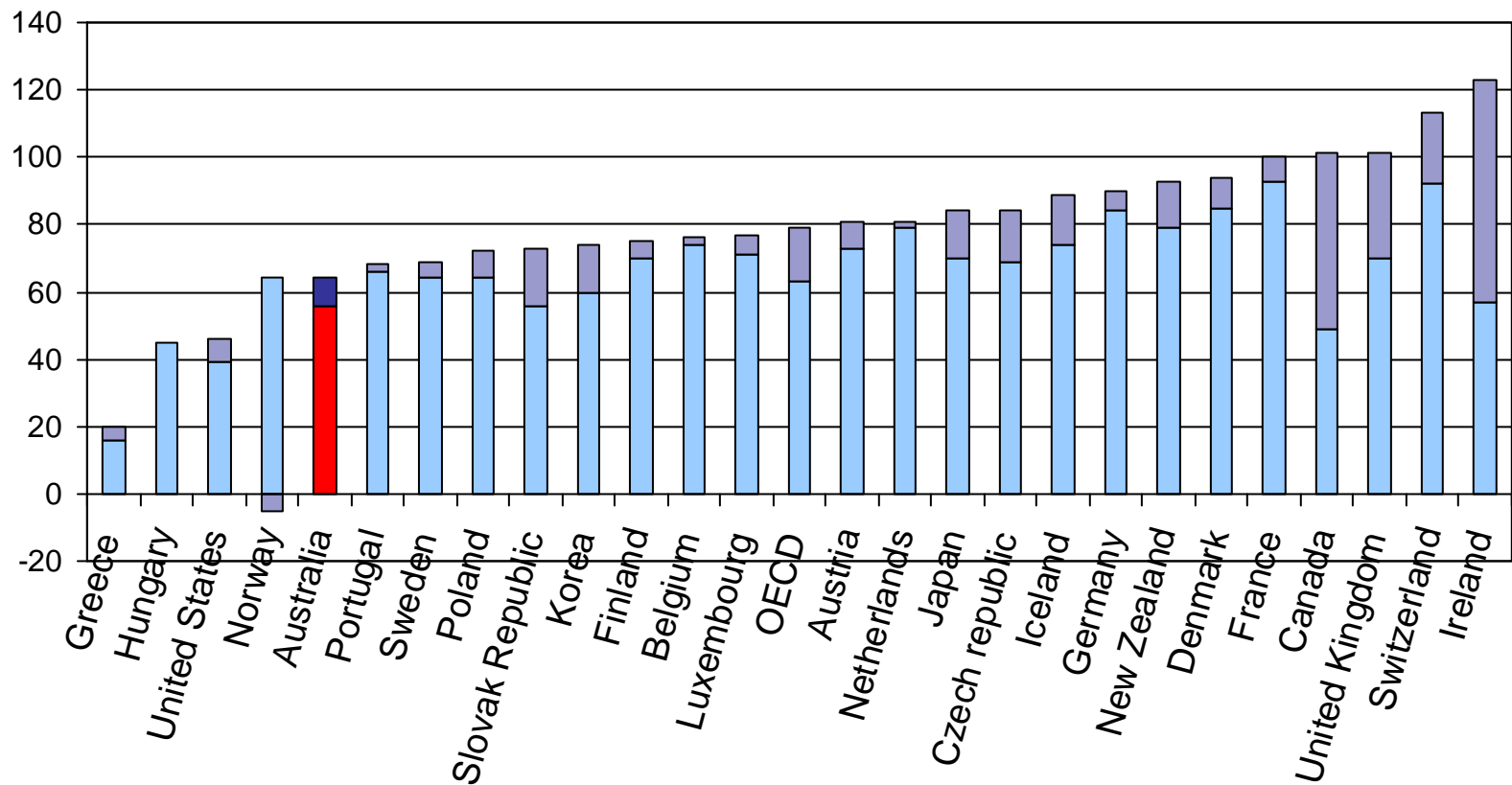
Effective tax rates can be high for parents seeking full-time work, but are lower in Australia than most other countries

AETR from zero to 67% APW, 2004



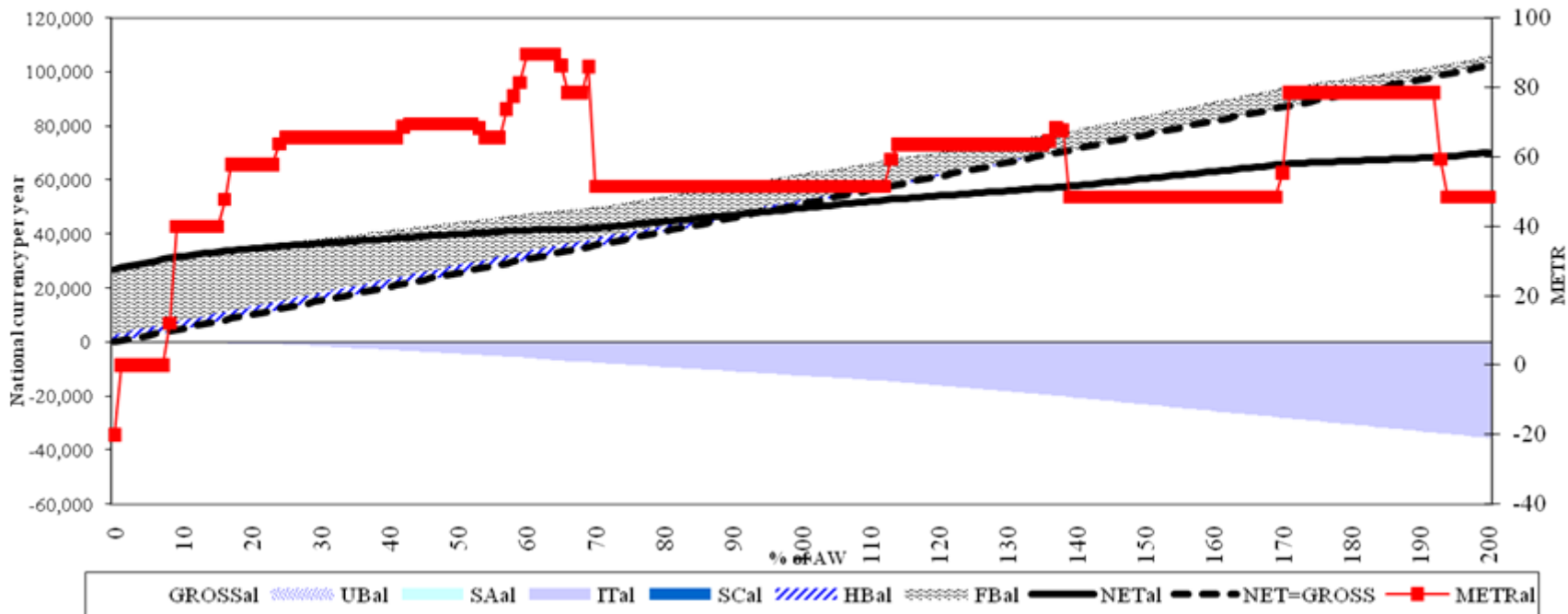
Child care costs can increase effective tax rates

AETR from zero to 67% APW, plus child care costs, 2004



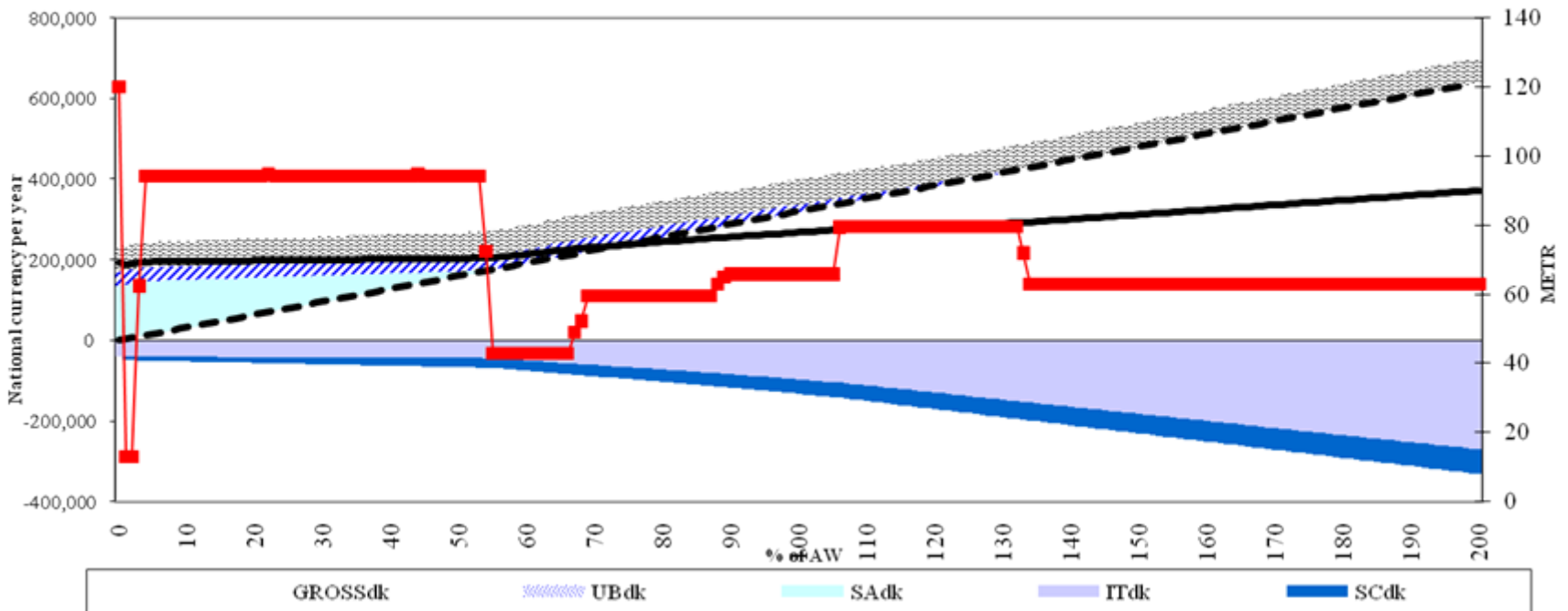
Effective marginal tax rates can be high in Australia but over specific income ranges

Australia 2005
Lone parent with 2 children, not eligible for unemployment insurance benefits



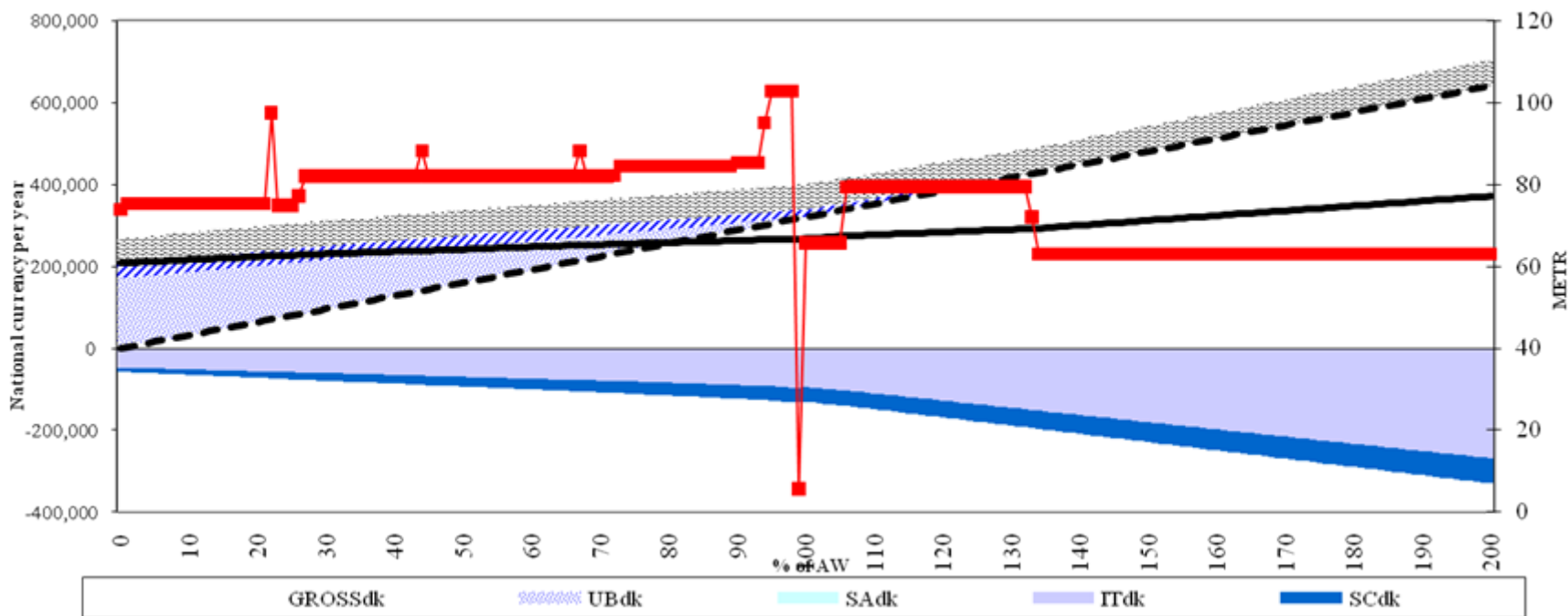
In contrast, the Nordic approach has much higher EMTRs at lower income levels

Denmark 2005
Lone parent with 2 children, not eligible for unemployment insurance benefits



Social insurance does not necessarily reduce EMTRs (for lone parents and single people)

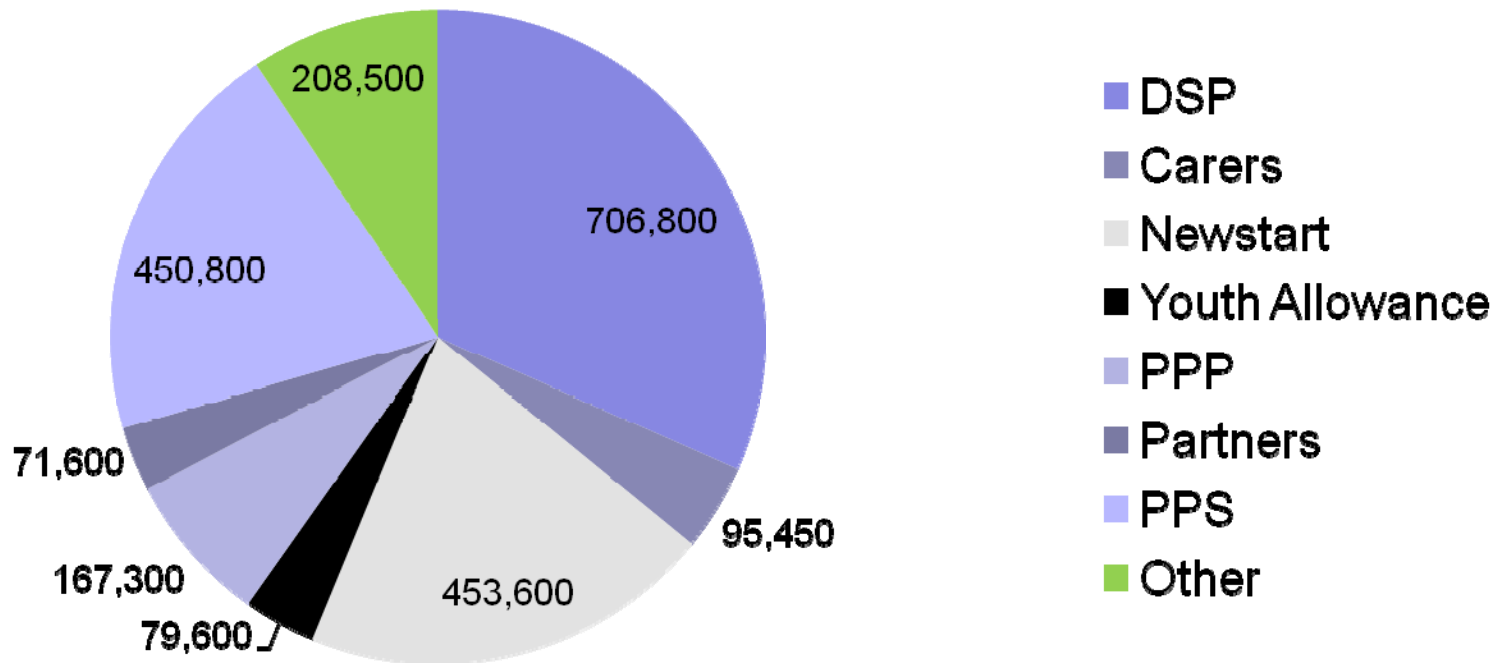
Denmark 2005
Lone parent with 2 children, eligible for unemployment insurance benefits



Why are we interested in the design of benefit systems?

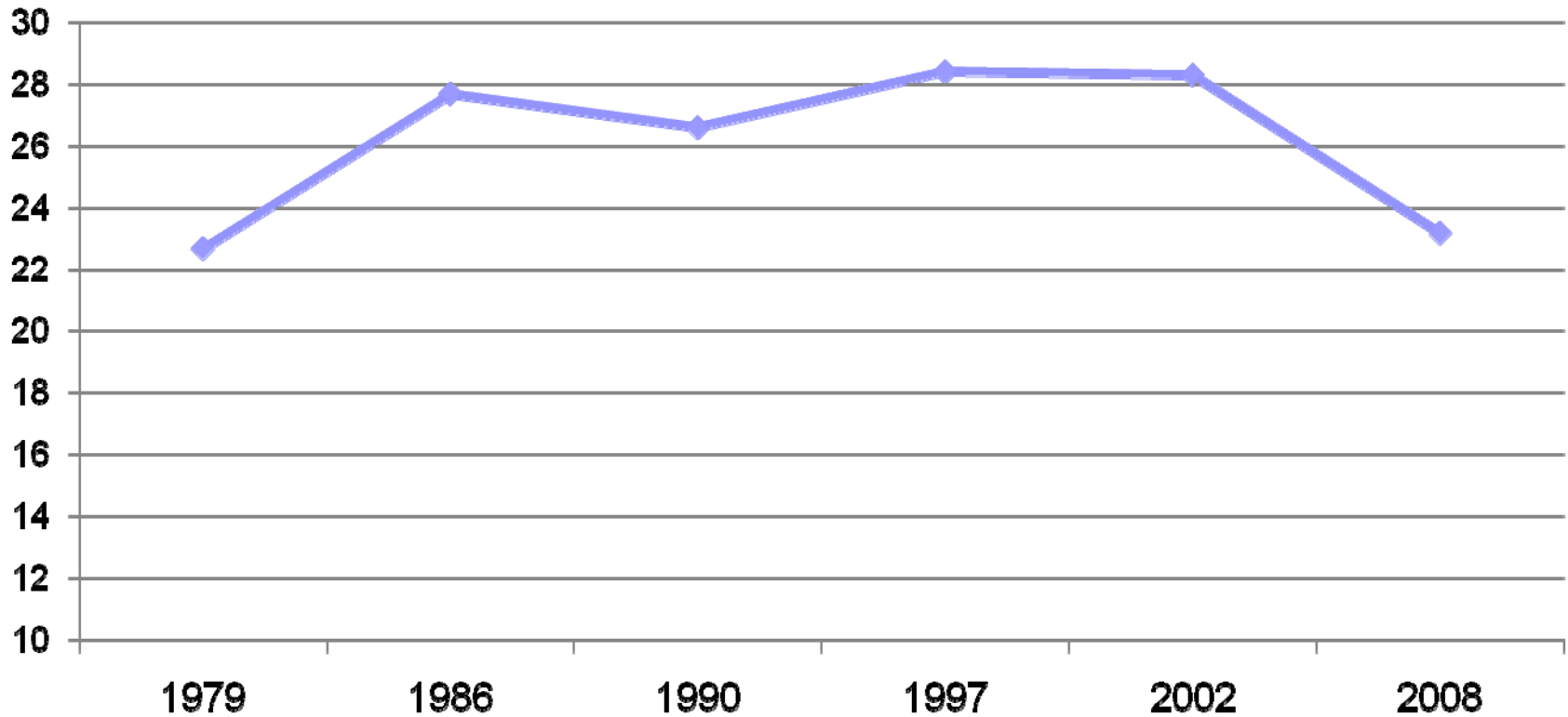
- *“The tax-transfer system is the principal means of expressing societal choices about equity. The tax-transfer system is a reflection of the kind of society we aspire to be.”* Ken Henry, ACOSS National Conference, (2009).

Working-age recipients of selected social security payments, Australia, 2005

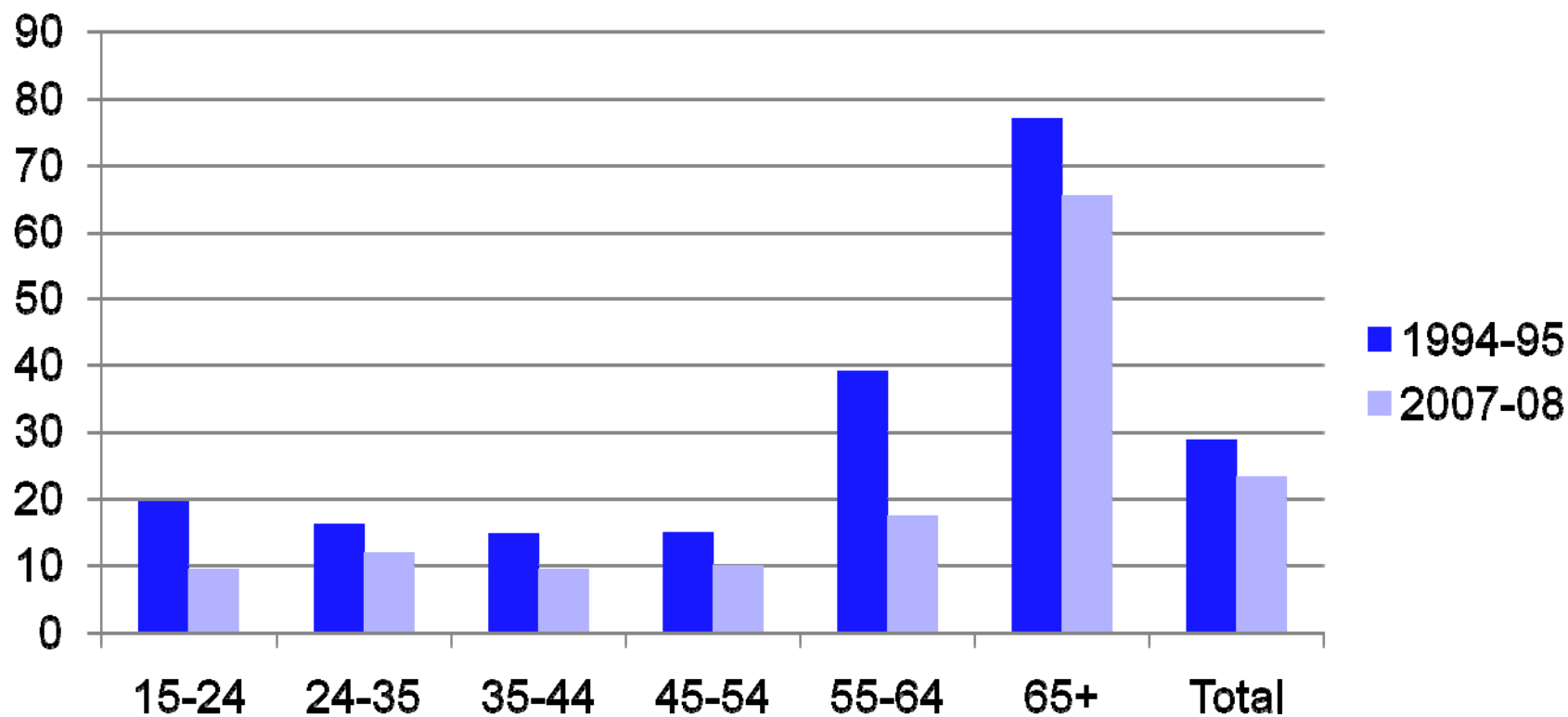


Trends in receipt of government benefits, 1978-79 to 2007-08

% of households whose principal income source is government benefits

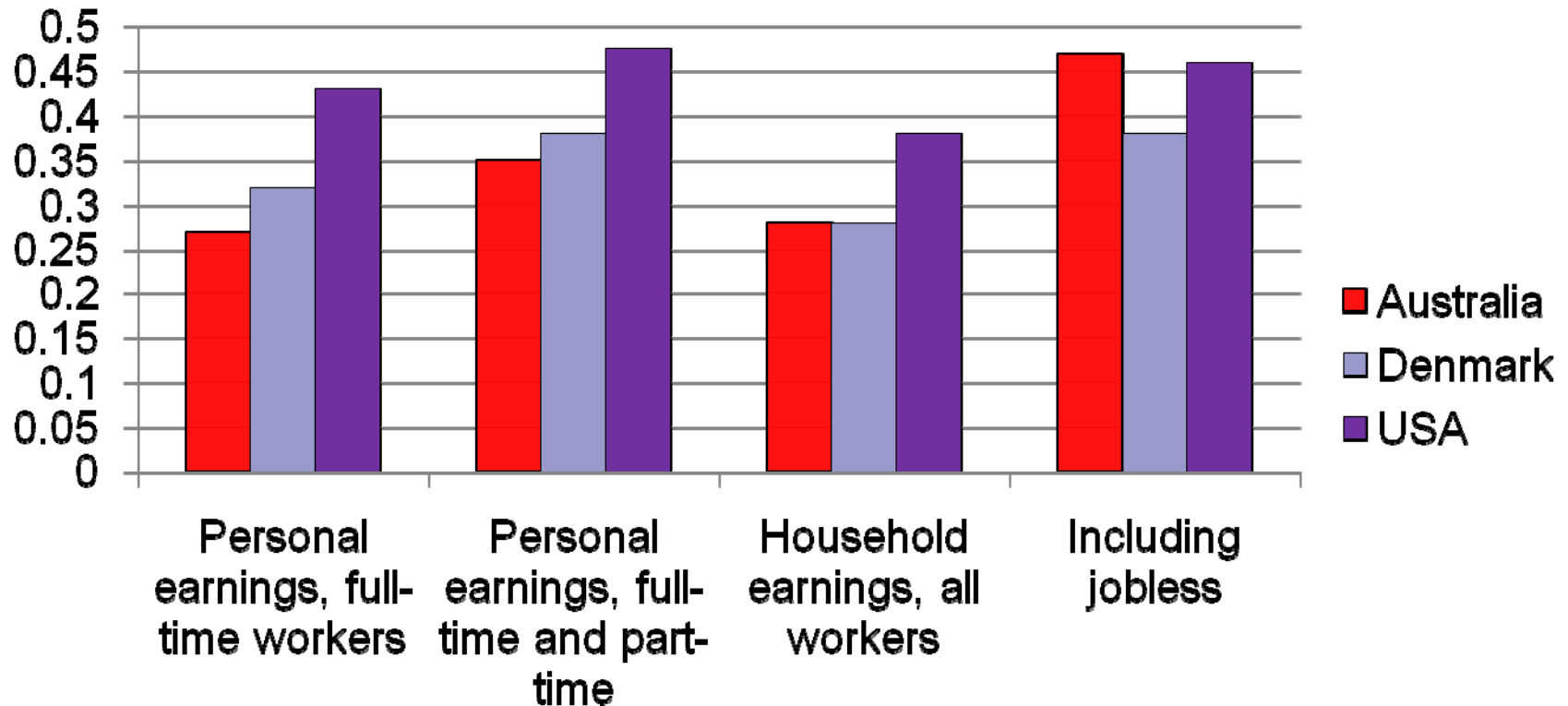


Household reliance on income support, 1994-95 to 2007-08



Inequality of earnings among households of working age, 2005

Gini coefficients for different earnings measures



Sources

- OECD Family database -
www.oecd.org/els/social/family/database
- OECD Social Expenditure database -
http://www.oecd.org/document/2/0,2340,en_2649_33933_31612994_1_1_1_1,00.html
- Net Social Expenditure – Adema and Ladaique (2005) -
http://www.oecd.org/findDocument/0,2350,en_2649_33933_1_119684_1_1_1,00.html
- OECD, Benefits and Wages -
http://www.oecd.org/department/0,2688,en_2649_34633_1_1_1_1,00.html
- OECD study of income distribution (2005) -
<http://www.oecd.org/dataoecd/48/9/34483698.pdf>
- Benefit recipiency - Employment Outlook (2003)
- OECD Social Indicators -
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