

NOTES ON REFORMING WELFARE IN NEW ZEALAND

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This is not intended as a tightly-argued, heavily referenced, academic paper. Instead, it consists of my broad-brush reflections on some of the issues the Welfare Working Group may wish to consider if they are serious about reforming New Zealand's welfare system.

1. What's the problem?

The number of working-age adults relying on welfare benefits as their main or only source of income has risen dramatically in all western countries over the last 50 years. Although we might expect dependency rates to fall during periods of economic expansion, this no longer happens. During the recent boom, from the early 1990s to 2008, official rates of unemployment fell in countries like UK, Australia and New Zealand, but other categories of claimants (notably single parents and those claiming to be sick or disabled) continued rising. Particularly worrying is the continued rise in the numbers of long-term claimants (i.e. those relying on benefits for more than a year).

In New Zealand (as elsewhere) there are three main categories of claimants:

- The unemployed (currently 60,000)
- Single parents (claiming Domestic Purposes Benefit: currently 110,000)
- The sick and disabled (currently 56,000 on sickness benefit plus 85,000 on invalidity benefit).

Any reform needs to look at all 3 categories. In addition, the government income transfer system also provides:

- Pensions for retired people
- Subsidies for families with children.

Any thorough review of the welfare system should arguably also include both of these categories within its remit.

2. What's caused the increase in dependency?

Several factors have combined to generate the upward trend in welfare dependency among working-age adults:

- The opening up of the *global economy*, combined with the modernisation of China, India and other developing nations, means that a lot of low-skilled work in manufacturing has gone overseas. The effect of this has been exacerbated by rapid *technological change* which has similarly reduced the demand for low-skilled manual labour. These changes have impacted especially strongly on unskilled men (the expansion of services and of state sector employment has tended to shield women from these developments, with the result that male rates of labour force participation have fallen as female rates have risen).

- *Dramatic changes in family life and sexual norms* (what Francis Fukuyama calls ‘the Great Disruption’) have increased the number of women raising children with little or no help or commitment from men. Most single parent families are created by relationship break-ups, but the number of women having children without a partner has been increasing at a faster rate. Many absent fathers fail to provide financial support for their children (many go on to have children with other partners, and significant numbers are on welfare and have little or no independent source of income). Sole parenthood is economically non-viable for most people without substantial state assistance.
- A social and political *momentum towards ever-increasing state dependency* has become established which makes it extremely difficult to reverse this trend. The more people who live on benefits, the more ‘normal’ it becomes to do so (in Britain, one-quarter of the population of Liverpool and Glasgow now live on benefits). The stigma that used to attach to long-term dependency has largely disappeared and been replaced by a ‘rights’ discourse in which people believe others should support them. People’s behaviour changes to take account of the availability of state assistance, and relatively generous benefit levels, combined with high marginal tax rates, undermine the incentive to work. Old distinctions between ‘deserving’ and ‘undeserving’ claimants have been abandoned in a non-judgemental age where moral relativism has displaced shared ethical norms, but reforms to welfare still spark public concerns about harming those who genuinely need help. Vociferous pressure groups trade on this, campaigning against any attempt to roll back welfare, and political parties take the line of least resistance, agreeing to fund increasing levels of dependency rather than risk losing votes. With the exception of the USA, where a Democratic President and a Republican Congress introduced a radical and extremely successful reform in 1996, most attempts at pushing back the tide of welfare have failed.

3. Why does it matter?

We are much wealthier now than in the past, so some people think it doesn’t really matter if welfare spending keeps rising. Some ‘experts’ even favour a right to a basic income with no strings attached. But the growth of welfare dependency is unsustainable and may now have passed its ‘tipping point’:

- *Increased spending is unsustainable.* The more welfare spending grows, the higher the burden on those still paying tax, and the more the revenue base gets squeezed as a result. In New Zealand, welfare benefits for working-age people absorb one-fifth of all government spending (\$13bn out of a budget of \$65bn). This is more than is spent on education or age pensions and is second only to health. This \$13bn represents a transfer from productive to unproductive activity. Alex Robson estimates that each additional dollar raised in tax costs the economy at least \$1.20 as a result of deadweight losses (i.e. work that does not get done because of the higher tax disincentive). Every additional person on welfare therefore not only increases the amount the government has to raise, but it also reduces the revenue base it can dip into. In Australia in the 1960s, there were 22 people in work to support each person on

- Ever-expanding welfare also has severe *psychological costs*. By encouraging people to look to government to organise their lives, welfare disempowers them and reinforces a sense of ‘learned helplessness.’ Lawrence Mead notes that fatalism often accompanies a life on welfare (people are ‘dutiful but defeated’, saying they want to be self-reliant but failing to recognise opportunities when they arise). Charles Murray notes how perpetual reliance on others undermines self-respect and leaves people with nothing to do.
- Welfare also generates *social dysfunction*. Defenders of the welfare state often claim it contributes to social cohesion, as everyone takes responsibility for everyone else, but the reverse is more often the case. James Bartholomew notes how the welfare system encourages lying, cheating and mutual suspicion, and how it undermines family responsibility. UK Labour MP Frank Field traces the way unconditional welfare has undermined civility by breaking the link between behaviour and its consequences. State welfare crowds out voluntary self-provision, philanthropy, charity and local-level initiatives by communities to solve their own problems. And state welfare politicises civil society, encouraging rent-seeking behaviour, and encouraging a spiral of expectations and demands (as Anthony de Jasay puts it, ‘The beast must be fed continually’).

4. Can welfare be reformed without increasing ‘poverty’?

Richard Blundell (Institute of Fiscal Studies) identifies 3 contradictory aims of most social security reforms (what he calls the ‘iron triangle’):

- Keep people out of poverty
- Reduce total government expenditure
- Increase workforce participation

Blundell warns that, at best, we can only ever achieve 2 of these. In particular, you cannot increase the incentive to work (raise workforce participation) and reduce state spending if you refuse to countenance any reduction in the living standards of those on benefits. The more generous the benefits, the greater the perverse incentive to rely on welfare rather than work, and there is not much anyone can do to change this (although tighter eligibility rules can help). Any reform which commits itself to ensuring that no claimant will end up any worse off than before is therefore doomed to fail.

What, then, is a minimum ‘adequate’ welfare payment? The ‘poverty industry’ will tell you that an equivalised income below 60% of the median income puts people in poverty, and the last UK government legislated to ensure no family should fall below this level, but this ‘relative’ approach muddles up the issue of ‘poverty’ with the broader question of income inequality. Sensible reforming governments should resist such policies, for all ‘poverty lines’ are arbitrary, income data (especially at the bottom end) are notoriously unreliable, and estimates vary according to which

equivalence scale you happen to use. Targets based on poverty lines inevitably result in increased benefit spending to raise welfare claimants above an imaginary income boundary. They should be avoided.

The basic principle should be that anybody in work is significantly better off than the equivalent person on welfare. If this means some benefits have to be reduced (and/or if some people lose eligibility for benefits altogether), then the impact on income distribution should be openly acknowledged and justified.

5. How should the three main categories of benefits be reformed?

If the number of welfare claimants is to be significantly reduced, changes are needed to all 3 main types of working-age benefit:

a. Unemployment: Most episodes of unemployment are relatively short (less than 6 months). But if somebody remains unemployed for a 6 month period, the likelihood is that they will stay on benefits for substantially longer than that. Whatever compulsory participation conditions are applied to claimants, therefore, they need to kick in, at the latest, after 6 months. For school leavers and for people returning to unemployment after only a short time in the workforce, participation conditions should kick in immediately (i.e. if a job cannot be found for them, they should immediately be directed into work schemes as a condition of receiving benefits).

Training, if offered, should be given early in any period of unemployment. Once people reach the 6 month mark, activity undertaken in return for receipt of benefits should involve work, not ‘training’ (see paragraph 6f, below, on the limits of training). Nobody should receive unemployment benefits for more than 6 months unless they are undertaking regular work activity (in addition to active job search).

Thinking more strategically, there may be a case for time-limiting unemployment benefits (in the USA, where unemployment insurance expires after 6 months, there is a surge in job uptake towards the end of the period suggesting that time limits encourage people to adjust unrealistic expectations). This might entail a two-tier payment, with transfer to a lower basic welfare rate after 6 months.

It is also worth thinking about the scope for introducing contributory unemployment insurance schemes, or (for those without insurance) loans repayable from earnings once claimants return to work (in the same way as student loans are repaid when students enter employment). For example, insurance or top-up loans might cover the first 6 months of unemployment in, say, any 3 year period, after which claimants would revert to a basic, taxpayer-funded welfare payment. A system like this would strengthen the incentive to return to work and would create a sense of responsibility and self-respect through paying for at least part of one’s own benefits.

b. Domestic Purposes Benefit: Until recently, Britain, Australia, Ireland and New Zealand were the only OECD countries which paid single parents to stay at home until their youngest child reached school leaving age. There is obviously a balance to be struck between parenting and economic participation, but this rule was clearly ill-advised. Some American states require single parents on welfare to look for work when the child is still in infancy, and this may cause harm to the child’s development,

but most European countries expect single parents to return to work by the time their child starts school, and some set the time much earlier (e.g. between the age of 1 and 3 in Scandinavia, where good quality child care is available). Both Australia and the UK now insist on some form of ‘participation’ once the child reaches 7, and NZ is belatedly moving in the same direction. But leaving people on welfare for 7 years still appears unwise.

The case for getting single parents back into the workforce earlier rather than later is compelling, for not only do long periods out of work erode skills and destroy the work habit (making it almost impossible to resurrect a career when the children do eventually reach maturity), but children growing up in households where no adult works have no positive role models, and they are often emotionally as well as materially deprived. ‘Head start’ childcare schemes targeted at welfare-dependent households can improve children’s future prospects while also releasing parents for work (which in turn raises the household’s material living standards), and it makes sense for any money saved in reduced welfare payments to single parents to be used to improve child care provision in the most deprived neighbourhoods.

Insisting on a relatively early return to work minimises the perverse incentive effects of paying welfare to single parents, it helps prevent a subculture of dependency from emerging in communities with large numbers of incomplete families, and it acts as a deterrent to young women who might otherwise believe that a life as a single mother on benefits offers a more attractive prospect than working.

Professor Gregory’s work in Australia seems to indicate that significant numbers of women use their fertility as a means for extending eligibility for Parenting Payments. To counter this, any claimant who has another child while on benefits should not receive additional payments in respect of that child, nor should the new child extend the parent’s period of eligibility for welfare. As for absent fathers, serious attempts must be made to force men to take financial responsibility for their children. Where men have gone on to have further children with new partners, the financial claims of their earlier children should be prioritised, and where fathers are themselves on benefits, a larger portion of their payments must be withheld and directed to their children – even if this leaves the men with only a minimal income. Persistent defaulters should be arrested and, if necessary, given prison terms. It is crucial that the norm be re-established that when people have children, they become responsible for raising and providing for them until they reach adulthood.

c. Sickness/Invalidity: This is the hardest of the three benefit categories to reform. It is now widely acknowledged that many (probably a majority) of those classified today by the welfare system as ‘disabled’ are in principle capable of working, and would in times past have been regarded as ‘unemployed’. All western countries have seen a flood of unemployed claimants into disability/invalidity/sickness benefits since the 1980s, and none has found a solution to this displacement problem.

One obvious response, adopted in both Australia and the UK, is to tighten the eligibility rules. Medical assessments need to be made by people who are not the claimant’s GP and who cannot be put under pressure to record a favourable diagnosis. Some attempt has also to be made to distinguish long-term and debilitating incapacity from shorter-term or less critical conditions, and claimants falling into the latter

category should not simply be left alone (as currently happens), but must be followed-up, periodically reassessed and (where possible) found work that is consistent with their condition. People on invalidity payments who are capable of working should be transferred to unemployment benefits and made subject to the usual participation conditions. There should also be a serious clamp-down on fraud.

The suspicion remains, however, that, once people with black economy jobs are shaken out of the system, changes to eligibility rules will have only a small net impact on welfare dependency rates. Many people will be transferred from invalidity/sickness to unemployment payments, and this may save some money as unemployment payments are less generous, but the fundamental problem remains that many of these people are low-skilled and only marginally employable. Years ago, people like this were employed in undemanding jobs in the nooks and crannies of the economy, but the drive to greater efficiency in both private and public sectors has reduced the opportunities for them to find work, and globalisation and technological change have destroyed many of the mundane tasks which might once have been available for them.

Government job creation schemes have a poor track record, but in the end, if marginally-employable people currently sheltering in the disability payments system are to be brought back into work, it may be necessary for government to create positions for them itself (e.g. more doormen, bus conductors, park keepers, security guards, night watchmen, road sweepers, school crossing attendants, childcare assistants, etc), or to target subsidies at private sector employers who would otherwise find it unprofitable to employ such people at minimum wages.

6. What are the key organisational changes that need to underpin welfare reform?

New Zealand, Australia, Britain and the USA commonly learn from each other in social policy, and it is notable that the first 3 are all currently going through another period of reform discussion at the moment. The following are some of the major elements in current thinking about the reorganisation of welfare systems:

a. Incentivise employment service providers. The Australian Job Network was a world leader in privatising employment training and placement services and paying providers by results. Britain is now following this lead. The model does encounter problems – clients cannot easily choose their own providers, interference and regulation from the centre tends to increase over time, competition for contracts attenuates over time, the quality of job training may be sacrificed in the rush for immediate results, the hardest cases sometimes get ‘parked’, there are opportunities for fraud, and (perhaps most worrying of all) the third sector runs a risk of being co-opted as a junior partner of government. But most of these problems can be managed, and there is little doubt that in Australia, this model does place more people in jobs than the old state-run system managed to do.

b. Top up low pay for those who move into employment to ensure that ‘work pays’. The US has been operating a simple Earned Income Tax Credit for many years which is designed to top-up workers on low incomes to ensure that ‘work pays’ (it is paid as a lump sum at the end of the tax year). The UK adopted a more complex system in the late 1990s, but this has now lost its way with millions of middle class families

claiming and work incentives eclipsed by the desire to reduce poverty. Tax credits can help boost work incentives without destroying jobs through a big hike in minimum wages, but they encounter two major problems. First, they increase the poverty trap (by tapering payments as wages rise), and this leads to the temptation to push payments higher up the earnings ladder (as happened in Britain). Secondly, they tend to encourage limited work hours (e.g. in UK, claimants are eligible after 16 hours work per week) and can lead to unfair treatment of full-time, low-paid workers.

c. Transitional payments for those moving into employment. Another way of increasing the rewards from working is to increase the ‘earnings disregard’ so welfare claimants can keep a bigger chunk of their benefits when taking a job. This can, however, create inequity between low-paid workers who have never been on benefits and those who take equivalent jobs while in receipt of welfare disregards. It also poses the question of when and how to phase out the disregard.

d. Reduce the complexity of the benefits system by moving to a single payment. In Australia in 2000, the McClure Report recommended moving to a single Participation Payment (with additional elements for claimants with specific needs). The idea was to extend the principle of conditionality (‘mutual obligation’) to everyone, avoiding the need for bureaucratic distinctions to be drawn between different categories of claimants, and enabling greater flexibility in dealing with different kinds of claimants. The new UK government has announced it too wants to move to a single payment which it thinks will help ensure that nobody gets more on benefits than they would in work. However, while a single payment would overcome some of the problems associated with determining eligibility for disability payments, and would simplify calculations of overall payments due to claimants, it would increase official discretion at street level (reducing uniformity of treatment) and might blur the clarity of the conditions attached to receipt of benefit. In the end, it is more important to get the eligibility rules right, and to follow them rigorously, than to collapse the array of different payments into a single benefit.

e. Make welfare conditional on behaviour. The idea that you have a right to financial support, irrespective of your behaviour, is a relatively modern one (in the early days of the welfare state, an attempt was made to distinguish the ‘deserving’ from the ‘undeserving’ and to exclude those who disregarded core social norms from eligibility for assistance). There is a case for imposing certain conditions on receipt of benefits, provided this can be done clearly and policed adequately. In Australia, for example, Indigenous leader Noel Pearson pioneered initiatives in Cape York linking receipt of welfare to avoidance of substance abuse, regular school attendance, avoidance of abuse and neglect of family members and observation of tenancy conditions, but this was in a tightly-defined area of just four localities. In the UK, Tony Blair flirted in 2002 with withdrawing the universal Child Benefit from parents whose children persistently truanted from school, but he backed down under pressure from the welfare lobby. An obvious problem with moving to conditionality is that you end up taking money away from some of the most disorganised and dysfunctional households. In cases of alcohol and drug abuse, it may be that some children would benefit by being taken into care.

f. Work, not training. Too often, requirements linking ‘economic participation’ to receipt of benefits have been undermined by accepting ‘training’ as an alternative

activity to working. OECD evidence is clear that government training schemes aimed at jobless welfare claimants generally achieve little. For women returning to employment after raising children, such schemes can be beneficial, for the problem here is rusty skills rather than poor motivation or low intellectual capacity. But for school leavers and the long-term jobless, training rarely achieves anything, and it can be dispiriting for claimants to undergo make-believe courses which everybody knows will not help them get jobs. Although it is unpopular to say so, it has to be remembered that 15% of the population has an IQ under 85. Below this level, people have trouble reading anything other than simple instructions, or working out budgets. Many long-term welfare dependent claimants probably fall into this category. The answer to finding them jobs is not to train them for the 'new technology' economy, but is to find worthwhile but unchallenging tasks in the community for them to discharge. This, I believe, is the biggest challenge facing welfare reform today.

7. A note on family payments and age pensions

To the extent that cost is driving the concern to reform welfare, it is impossible to exclude two other major sets of payments from our overview.

Even when age pension payments are means-tested, as in NZ and Australia, they remain hugely expensive, and with an ageing population there is a clear need both to re-think the retirement age (the UK government would like to index it to average life expectancy, which seems a sensible strategy) and to encourage or require workers to set aside a portion of earnings on their own personal accounts (as in the Australian compulsory superannuation system). Personal savings accounts are potentially an important instrument for increasing people's sense of responsibility for their own welfare, not only when it comes to retirement planning, but also in areas like further education and training, unemployment insurance, short-term sickness cover and health. It would be worth investigating the experience of Singapore, Chile and others with this vehicle.

As for family support, there is a strong argument, based in the principle of horizontal equity, for a universal child payment or (preferably) tax allowance or tax credit. Every individual has a right to retain enough of their earnings to support themselves before the government taxes them, and this is true for dependent children (who rely on their parent to earn money on their behalf) just as for adults. However, in recent years there has been an expansion of family-related spending, much of it linked to subsidies for child care, and this trend needs to be reigned in if overall expenditure reductions are to be achieved.

Further reading:

My *Australia's Welfare Habit – and how to kick it* (Centre for Independent Studies, 2004) reviews many of the key issues regarding the three main categories of benefits. My later CIS monograph, *The Government Giveth, and the Government Taketh Away* (2007) explains how many people now pay tax and receive welfare simultaneously and explores how this churning might be reduced.

More recently, I have published two relevant reports for Policy Exchange in London: *Poverty of Ambition* (October 2009) shows why child poverty targets are a mistake,

and *Reforming the UK Family Tax and Benefits System* (2009) goes into detail on issues of tax credits, work incentives and conditionality. Policy Exchange has also published collections of essays on the privatisation of employment services around the world (*Paying for Success*, 2008, edited by Peter Lilley and Oliver Hartwich) and on conditional welfare initiatives in various countries (*When Hassle Means Help*, 2008, edited by Lawrence Kay and Oliver Hartwich).