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Social Policy, Cold Climates and Economic Recessions

Prediction is extremely difficult when it is about the future

ancient Chinese proverb

Introduction

The aim of this article is to consider what *could* happen to social policy expenditure and parameters in a worst case scenario, if the financial crisis spills over into the goods and services sector. Academics are very good at making *ex post* analyses of why certain events occurred, and extrapolating from this past experience to predict the future, but the future will be different. The starting point will not be the same – people have learnt from the past and have different reactions, the context will vary, and the political players and ideology will have changed. The policy adviser has to be forward thinking, anticipating events. It is in this context that this article is written.

Expenditure on social policy (working-age benefits, pensions, health, education, housing, ACC) accounts for roughly 70% of government expenditure, and is largely financed from general tax revenue. As a consequence, any planned changes in total government spending or tax take are likely to have an impact on the social policy area.

This discussion is set in the post-November 2008 political context of a predominantly National-led government, supported on the (far) right by ACT, and on the left (predominantly) by the Māori Party. The paper concentrates on what *could* happen to social policy, given this political configuration, and varying degrees of recession. The article is thus speculative, and certainly not intended as a blueprint for change.

The context for social policy developments

The options for social policy do not fall into a simple public/private dichotomy, because of the not-for-profit sector, which delivers a wide range of social services under varying types and degrees of cont,acts with government, as well as its own funding. A distinction can also be drawn between funding, provision and decision.

- *Funding* could come from any mix of direct public revenue, user charges and charity/donations.
- *Provision* could be a mix of public, not-for-profit and/or private organisations.
- *Decision* relates to who chooses the quantity and quality of services to be provided, though private decisions may be subject to government regulatory changes.

For instance, not-for-profit organisations could provide services, be financed and contracted by government for specified outputs, or be allowed to choose their own mix of outputs, financed by user charges. Or certain services, such as early childhood education, could be provided by for-profit organisations financed by government-provided supplementable vouchers, with service delivery decisions regulated by government. Each of these parameters, and their mix, could change in a new environment.

In the short term, much social policy spending is demand-driven. The drivers are population age and structure, and trends in numbers entitled to service delivery. The current

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conjuncture for social policy is an ageing population, with the baby boomers hitting pension age from 2010, although the major impact comes a decade or more later. Partly counteracting this, there was a blip in births in the 1990s, and these people will enter the labour market and tertiary education about 2010.[1]

The affordability of the current policy settings is significantly affected by both the proportion of these baby-blippers going into tertiary education and the labour market success of this group. The baby-blippers will have a higher proportion of Māori and Pacific people, whose average labour market skill levels are below those of the population as a whole, with that lower skill level potentially reducing economic growth. As the majority of the elderly population is white, there is a potential for ethnic tension, especially if the current differentials in employment rates, benefit receipts, poverty rates and income distribution are maintained.

Compounding these demographic, demand-driven pressures is the current rise in the number of births. These children will reach pre-school age around 2010 and primary school a couple of years later. To maintain current staff–student ratios in primary school, at least a further 560 classrooms will need to be built, along with a similar number of teachers trained.

In the short term these demographic effects may be a more important driver of social spending than the recession. However, they are likely to increase the imperative on a National-led government to control expenditure growth, even if there was no recession. The National Party made a large number of 2008 election manifesto promises that will increase government expenditure and reduce tax take if implemented, while keeping most of the Labour government's enacted social policy changes. The distrust that the 1991 benefit cuts engendered will reduce the initial willingness of National to move significantly from their manifesto position.

Recessions and cold climates

Scenarios differ about the extent of the recession, with the range going from short and mild through to global and severe economic meltdown. For the purpose of this analysis, all that is needed is three alternative scenarios, for each of which one may take a crystal ball and guess at the changing political strengths and ideologies within a coalition government to see a possible social policy impact.

The economic scenarios are:

- a mild recession, of short duration, leading to unemployment of up to 5%;
- a moderate recession, but lasting up to five years, with minimal economic growth and higher unemployment of longer duration; and
- a global depression, with unemployment rising to 15% or more and widespread closures of businesses.

'Cold climates' refers to the attitudes that those in political power take towards the welfare state. Successive Labour-led administrations had developed a Third Way approach, based on social development and social investment supported by integrated and co-ordinated policy development across social policy agencies to address complex social problems.

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A social development framework was initiated because many of those on social security benefits were there not because of being work-shy or facing adverse labour market conditions, but due to a range of other social conditions – domestic violence, psychiatric conditions, substance abuse, absence of labour market skills, or physical disability. The source of these problems needed to be addressed first through social investment from a range of service delivery agencies, before individuals were enabled to enter the workforce. Nevertheless, the policy was 'work first', to provide a long-term solution to poverty through a mix of both incentives through the in work benefit and the use of case management to direct beneficiaries into work, training or caring streams. The aim was to reduce the social problems that stem from poverty, rather than using the benefit system as a short-term palliative.

The National Party's election manifesto specifically rejected this social development approach, advocating a return to 'welfare'. This change in philosophy is designed to ensure that beneficiaries will receive the existing 'safety net' level of benefits, but will fail to address the reasons why people are on benefits in the first place. The 'work first' approach will remain, but by forcing people into quasi-work via a 'work-for-the-dole' or 'community wage' scheme and requiring them to accept any job offer that comes along. My concern is to highlight the return to the 20th century's approach to welfare policy, which has been shown by several Ministry of Social Development evaluations on the community wage scheme to have had no significant beneficial impact on long-term employment outcomes.

Scenario 1: a mild recession

Here the expected 'climate change' is that of a chilly day, not a roaring Wellington southerly. The economic recession is mild, and of relatively short duration, successfully addressed by Keynesian stimulatory fiscal policy combined with monetary policy of lower interest rates and bank guarantees. Current policy settings and expectations from Treasury in their pre-election fiscal and economic update forecasts seem to be based on that scenario, though there is increasing recognition that the clouds in the south are a portent of deteriorating conditions, as shown in budget economic forecast update. Even with the Ministry of Social Development's more pessimistic forecasts, economic growth reappears late in 2010, resulting in some, but not large, increases in numbers on each of the working age benefits. The biggest impact would be on second- and third-tier benefits such as the accommodation supplement, special needs grants and temporary additional support. Expenditure on health and education would probably be maintained.

In the mild recession case the National Party can probably maintain its policy manifesto, though with frost causing some fraying around the edges due to the combined impact of the Māori Party and ACT. Both ACT and the Māori Party want a reduced role for government in social policy, but for different reasons. Māori want, for their own people, service provision and delivery to be devolved to hapu or iwi, so that services can be provided in a culturally appropriate way, although funding will still be from central government. ACT also wants to minimise the role and functions of government, but by devolving spending decisions to individuals, from their own pockets or through private insurance. An initial ACT move may be for government-financed vouchers that can be supplemented by individual contributions, to enable choice in private sector service provision. An alliance between ACT and the Māori Party may result in greater devolution of social service delivery.

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There are strong indications of greater user pays, largely from not increasing or indexing existing social policy programmes, as well as increasing private provision. With early childhood education, while National is committed to maintaining existing subsidy levels, the 'free' aspect will be removed and greater flexibility for private providers introduced, with the latter able to obtain the fee subsidy. In tertiary education, cuts in funding are likely, as the student fee cap will remain, but the government will not increase funding to the universities, with an impact on teaching and research quality.

National has already signed up for the Working for Families package's indexation of benefit levels by the CPI (though there is an ominous sign that similar indexation will be used for New Zealand Superannuation despite the government accepting the current level at 66% of average earnings). Both the New Zealand Super Fund and KiwiSaver will be kept. There will be major changes to the direction of investment of the fund into infrastructure, where the return on investment will be problematic, reducing the ability to keep current tax arrangements for future funding of New Zealand Superannuation, exacerbated by using the fund to finance the expected budget deficit. Altering the required level of individual savings and employer contributions to KiwiSaver could lower savings (and investment), and future standards of living for tomorrow's elderly.

There are some positive proposed improvements. Included in these are a slight easing of the threshold before benefit abatement starts, extending the in-work benefit, and maintaining the maximum accommodation supplement for those who become unemployed as a result of redundancy for 16 weeks. However, these policies may fundamentally change the nature of benefit provision. There will now be two tiers of benefits, with more going to those made redundant for 16 weeks than to other unemployed, or people on other benefits. Employers may be more willing to make workers redundant, or to reduce redundancy payments, knowing that the state will pick up some of the expense. This will be similar to an earnings-related benefit, where past standard of living is a determinant of benefit level, rather than need. It would be a shorter step to a social insurance model, which is a form of user pays, with a safety net social assistance scheme underpinning it.

Other policy announcements will make a more fundamental difference to the nature of the welfare state, and the presence of ACT in government is likely to accelerate changes towards greater private insurance in both health care and accident compensation. In health, the plan is to make greater use of public–private partnerships, especially for elective surgery, in order to reduce waiting lists. Unless there is a significant increase in the size of the medical profession (the supposed efficiency gains are usually illusory), all that this two-tier medical system will do is transfer resources from the public to the private health system, resulting in rationing by ability to pay rather than by severity of medical condition and waiting lists. Private health insurance will be too costly for the elderly (due to experience-rated premiums) and for most on low incomes, leading to the public hospitals becoming residual providers.

Although there has been limited detail concerning National's policies on ACC, already funded on a social insurance basis, there is no doubt that they plan to privatise at least some of the seven ACC accounts, a return to the brief 1999 experience. The most likely to be privatised are the employer and self-employed accounts, though the motor vehicle account could also be covered. This is despite a PricewaterhouseCoopers report that said 'there is a moderately strong view that government monopoly is the best mechanism for operating the employer account', and Blue Lotus research showing that private insurers were more reluctant to approve claims, were late in paying, and placed pressure on employees not to lodge claims. The employers account is only 12% of ACC revenue, so ACC direct savings will be relatively small, with the cost falling on employees and profits going to Australian-owned insurance companies.

Thus, with a mild recession the bulk of the current welfare state is likely to remain intact, but with greater reliance on user charges and vouchers, some privatisation to insurance companies, and a return to a work-for-the-dole scheme. The policies are those of the last century, based on a philosophy of 'welfare' or passive payment of benefits combined with an enforcement of work, rather than an approach that attempts to enable people to achieve their potential. Devolution of social policy delivery to not-for-profit organisations under contract to the government may also occur, depending upon a confluence of pressures from ACT and the Māori Party. The adverse changes will be made stealthily and gradually, in order to avoid a political backlash, and tied in with 'good news' announcements.

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Scenario 2: a moderate-to-severe recession of long duration

Because of the relatively severe and long duration of the recession, this scenario looks at a political situation in a second term, where ACT, with a clear political objective, will have a greater policy influence, with the Māori party sidelined.[2] The simplest case here is for the existing policy direction to continue, but more so. However, a move to a flatter tax system, with lower tax rates, is likely to significantly lower tax revenue, and lead to a vigorous call for government expenditure cuts in order to avoid a growing budget deficit. In both 1984 and 1999 a less severe fiscal and economic crisis was used to introduce radical change to the prior policy parameters, and the same could all too easily happen again. Keynesian economics may be foregone for monetarist and new-classical economic policy prescriptions.

The speculation here is that there will be cuts to most programmes through: financially-constrained or targeted vouchers; reliance upon market provision; privatisation of social services; increasing degree of user pays; devolution to not-for-profit providers and iwi/hapu, where contracts will be financially tight, requiring donations or charitable support if existing services are to be provided; local government severely restricted to provision of local services; and even tighter targeting on the basis of need for the residual government provision. The welfare state will become truly residual, providing a bare minimum safety net, with many in even low-paid employment effectively targeted out of government provision. The incidence and severity of poverty will rise, living standards will fall, especially over a period as assets are run down, inequality will rise, and inter-generational transference of a lack of social inheritance will have an impact on social and economic development for decades.

There is a range of feasible policies that could come in, with their desirability depending on the ideological perspective of the reader. Some of these have been listed above, but others, like the largest ticket item, New Zealand Superannuation, will come under increased scrutiny.[3] There are several options for Super. First, the age of eligibility could be raised to 68 or above. Initially there may be a two-tier system, with a lower pension level for those retiring at 65, but eventually the ages and rates will converge at the lower pension level. Second, the pension level may itself be lowered, maybe to the invalids benefit rate, or more slowly by adjusting the rate with consumer prices rather than average earnings. Third, pensions could be targeted through the use of a surcharge, or other targeting mechanism such as asset testing, though, as in the past, the interaction of the surcharge with occupational pension and investment income will result in significant avoidance behaviour.

Working-age benefits may not always receive cost of living adjustments, or may all be reduced to the unemployment benefit rate, reducing even further their real value. Stricter entitlement rules may appear, cutting the number of people eligible, possibly using past contributions to the tax base through work. Longer stand-down periods may be introduced. An alternative may be a shift to social insurance, and, even though the OECD regards social insurance contributions as a form of tax, they will be off-budget and seen as a form of privatisation of income maintenance.

Student fees will rise as a proportion of a declining funding from government to tertiary institutions, and student loans will return to market interest rates with shorter repayment periods. Vouchers for compulsory education, able to be supplemented with private contributions, will be reintroduced on the basis of parent/child choice, but in essence the better schools will be able to choose their students based on academic record and level of contribution (again a two-tier system). The voucher system may also apply at the pre-school level, with care of children for working parents replacing early childhood education, with the aims of offsetting social inheritance and raising long-term educational standards put into abeyance.

Greater reliance upon health insurance, the removal of subsidies for GPs, and full costing of diagnostic testing are other possibilities. These would switch health expenditure from the government to the private sector, with the higher-health-risk individuals who are less able to afford health insurance facing a residual, poorly funded health system. A return to market rents may have happened under the first scenario, along with an initial sale of state housing. That sale may become complete, with the poor left dependent upon a limited stock of social housing or sub-standard dwellings.

The scenario painted here is dramatic and likely to cause significant hardship and inequality, and potentially social upheaval. The policies described here would eventually ensure a change of government, but while a new, more liberal regime would then be in office, there would be a short-term lack of room to manoeuvre because of the parlous state of the economy and the government's fiscal balance constraints. Only a gradual change could be contemplated.

Scenario 3: a severe recession of long-term duration

This scenario is only likely to occur if the crisis is truly global. New Zealand, with its agricultural base and plentiful water supply, may be better placed to maintain a minimal standard of living compared to many other countries. The impact of a global recession coupled with possible impacts of global climate change may result in inward migration, especially from the Pacific Islands.

In terms of social policy, the changes above would probably be as bad as it might get. Under truly extreme circumstances 'all bets are off'. The climate may be a howling Wellington southerly with horizontal rain, but it might lead to a warmer, more compassionate society, as occurred with the 1938 Social Security Act, depending upon political configurations. A New Right government may effectively abandon the welfare state; a left-of-centre government could try to restore the welfare state, albeit at a lower level of service provision.

From a social democratic perspective, let us hope that none of the above scenarios applies. But most of scenario one is already in train, and may be hard to prevent. The second scenario indicates the imperative of quickly addressing the current financial crisis, and preventing it turning into a more serious crisis in the goods sector. With a mild, or even moderate, crisis there is much that a government could do in a positive light to ensure that New Zealand was in a strong position to take advantage of the technological age, through retraining to offset an adverse social inheritance. The downturn may represent an opportunity as well as a threat.

1 The previous baby-blip entered the labour market and tertiary education in 1988–92, when the economy was also in recession. It took many of those affected a long time to obtain employment and has been a probable cause of inter-generational transmission of adverse outcomes.
2 Under this scenario, the National Party may be less able to form a majority without help from several other parties, or even remain in power. A return to a Labour-led administration would see many of the above policies reversed, as in 1999, but the fiscal constraints would probably limit any significant changes to the above policy settings, though Labour would not venture down the route speculated in this current scenario.
3 Winston Peters will not be in Parliament, so the influence of Grey Power on policy will be less, but the ageing of the population will make them a significant voting block which a government will upset at its peril.