

Bryce Wilkinson

# Budget 2015

## the government's welfare policy, a positive view

### Introduction

Nearly four years ago, Prime Minister John Key announced a major reform of the welfare system. He defined the problem with the existing system in the following terms:

The stand-out feature of New Zealand's benefit system is how passive it is. For the most part it simply hands over benefits and leaves people to their own devices. Most beneficiaries are not expected to be available for work, or to take up work if it is offered to them. Naturally, many don't.

The benefit system also lacks a focus on intervening early. We know, for example, that the longer people stay on a Sickness Benefit the more it gets entrenched. (Key, 2011)

He reported that around 328,000 people of working age (one in eight) were receiving a benefit. More than 170,000 had been on a benefit for at least five out of the last ten years. Two hundred and twenty thousand children were living in benefit-dependent households. He summed up the problem as being one of 'poor outcomes for beneficiaries, for their children, for society and for taxpayers', outcomes not intended by the architects of the welfare state.

Key's remedy was not to abolish the welfare state. To the contrary, he observed:

I've often said that you measure a society by how it looks after its most vulnerable. But you also measure a society by how many vulnerable people it creates. At the moment it is creating too many vulnerable people and trapping them in a life of limited income and limited choices.

His remedy was instead to turn it from a passive to an active state that does not treat people as passive recipients of welfare, focuses on what they can

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achieve, and challenges them to achieve it while providing support, training and opportunities to return to work sooner rather than later.

Budget 2015 continues to implement this direction.

#### **The short-term political side show: the first real benefit increase since 1972**

The Budget increases base benefits for the first time since 1972. According to the Budget speech by the minister of finance, Bill English, benefit payments will increase from 1 April 2016 for 'around 110,000 families, with 190,000 children' (English, 2015a). The potential increase is \$25 per week after tax, or \$1,300 a year. To put that in perspective, \$25 a week is 8.4% of the \$300.98 net of tax payable weekly from 1 April 2015 to someone on the sole parent benefit with an 'M' tax code;<sup>1</sup> better than nothing for those families, of course, but not a game changer.

The Budget also increases fiscal assistance for low-income working families. 'Working families earning \$36,350 a year or less before tax will get \$12.50 extra a week from Working for Families, and some very low-income families will get \$24.50 extra.' Qualifying working families earning more than \$36,350 a year will get less than \$12.50 a week. 'Around 200,000 working families will benefit from these changes, with about 50,000 of them being families earning \$36,350 or less' (see English, 2015b). The combined total of 310,000 families represents 27% of the nation's Statistics New Zealand estimated 1,136,397 families.

Budget 2015 also increases child care assistance to make it easier for parents to move from welfare to work and to lower the cost of child care for around 40,000 low-income working families. The Budget speech put the total cost of the package at around \$240 million in each full year. Spread over 310,000 families, it would average out at \$774 per family. It notes that this is on top of Budget 2014's pre-election \$500 million children and families package, which included free doctors' visits and prescriptions for all children under 13.

Politically, the additional spending on low-income and beneficiary families makes it harder for the Labour and

Green parties to get traction. Even so, the additional amounts per household are small relative to the potential annual variability in household expenses. No significant and enduring change in circumstances in aggregate will result from this measure. Work and work skills remain critical to escaping hardship.

#### **The government's real welfare goal: securing better outcomes**

The government's real programme for alleviating hardship is now unfolding. Its focus is commendably far-reaching and long term. It is aimed at addressing

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root causes. It is aimed at getting better outcomes rather than merely increasing funding for inputs or outputs. It recognises that getting better outcomes is hard. Many of the problems are close to intractable.

#### *Desired outcomes*

In a presentation to church leaders in May 2015, the minister of finance summarised the government's desired outcomes as including:

- Reduce the numbers on a working age benefit for a year or more;
- increase participation in early childhood education;
- increase infant immunisation and reduce rheumatic fever;
- reduce the number of assaults on children; and
- increase the proportion of 18-year-olds with NCEA 2. (English, 2015c).

#### *Means: more stringent work testing*

English observed in his Budget press release the same month that '[t]wo-thirds of New Zealand children in more severe hardship have a parent on a benefit, with nine out of 10 being sole parents.'

He concluded that '[t]he best thing we can do for those children is to get their parents into sustainable, full-time work, where that is possible' (English, 2015b). Accordingly, the Budget proposes to make eligibility for base benefits dependent on more stringent work tests. Even so, Treasury's Budget 2015 projections do not appear to be anticipating a material reduction in benefit numbers as a result. For example, Treasury's December 2014 half-year update projected that there would be 65,000 sole-parent beneficiaries in fiscal year 2019; so did Budget 2015.

#### *Means: better information*

Securing better outcomes for those the welfare state should be helping requires a better understanding of what their situation is and of what works and what doesn't. The government has found that state information systems have been lacking in revealing both the real nature and extent of the problems being faced by those experiencing material hardship and the efficacy of existing programmes. It has made the collection of better information a priority.

The government's innovative analysis of lifetime welfare costs quantifies some things that should be obvious. The more a child has come to the attention of state corrective agencies by age five, the bleaker that child's future in terms of education, benefit dependency, crime and, no doubt, health. On the government's analysis of children born in 1990, the estimated fiscal cost to age 35 of a child who had not come to the attention of the Department of Corrections, Child, Youth and Family or Work and Income officials by age five was likely to be less than \$50,000 (English, 2015c, p.8). The cost was likely

to be more than three times higher for a child who had come to the attention of just one of those agencies by age five, more than four times higher in the case of attention from two agencies, and over \$250,000 if all three agencies had become involved by age five. In short, the pre-school environment is very important.

An actuarial assessment on behalf of the government by Alan Greenfield, Hugh Miller and Gráinne McGuire (2013) from Australian actuarial firm Taylor Fry also demonstrated that the younger the age at which a person first enters the benefit system, the greater their likely lifetime welfare costs (Greenfield, Miller and McGuire, 2013). English reports that those who enter the benefit system between the ages of 16 and 19 account for 81% of the Crown's assessed actuarial liability in respect of welfare (English, 2015c, p.11).

## In a competitive environment, the need for repeat business provides a powerful incentive to satisfy the needs of the situation.

### *Means: the social investment approach*

The minister of finance has also observed that what state agencies think are priority solutions for the targets of state welfare programmes are not necessarily what the recipients themselves consider to be priorities for improving their circumstances. Innovative solutions are needed, and the state does not have a monopoly on such solutions. In some cases, local solutions to local problems may be better than those imposed from Wellington.

The problems faced by many welfare recipients are complex and diverse. Near-intractable problems don't have easy solutions. Many apparently promising solutions will have disappointing outcomes. So the government is tapping into the ability of the community at large to come up with solutions. English calls this a 'social investment' approach

(English, 2015a). Social investment he describes as a new process that will help the government to:

- get better information about outcomes and services;
- evaluate spending effectiveness and calculate return on investment; and
- buy what works, and reprioritise funding for what doesn't. (English, 2015c)

The European Commission defines social investment as follows:

Social investment is about investing in people. It means policies designed to strengthen people's skills and capacities and support them to participate fully in employment and social life. Key policy areas include education, quality childcare, healthcare, training, job-search assistance and rehabilitation.<sup>2</sup>

explained the concept of social impact bonds (Jeram and Wilkinson, 2015). It reviewed the (limited) overseas experience with them to date and examined their potential application to New Zealand. The essence of a social impact bond is that the government only pays for success.<sup>3</sup> Private investors bear the financial cost of failure. Either way, all observers learn from the experience. The need is to find what works.

### *Opposition to the social investment approach*

It would be a churlish person indeed who did not want to see better outcomes for welfare beneficiaries, in the short and long terms. Yet for existing providers of social services the government's social investment approach is both a threat and an opportunity. Strong opposition to alternative arrangements, even very small pilot projects, can be expected from those who see it as a threat to their established positions. Even the information provided by a failed pilot programme could be a threat to some and an opportunity for others.

Privately provided programmes are a potential threat to publicly provided programmes. One concern is that for-profit providers' incentives might be less well aligned with recipients' needs than not-for-profit incentives. However, how well or poorly incentives are aligned depends heavily on degrees of transparency, contestability and contractual quality, including recipient empowerment. In a competitive environment, the need for repeat business provides a powerful incentive to satisfy the needs of the situation. A surgeon working for a profit does not want a malpractice suit; nor does a teacher or social service provider want to get paid less or to face a charge of child abuse or elderly neglect. Milton Friedman once pointed out that incentive alignment is most problematic when someone is spending the money of strangers for the benefit of other strangers (Kharkof, 2011). That problem bedevils much government spending, regardless of whether actual provision is bureaucratic, for-profit or not-for-profit. By harnessing competition for delivery and ideas, increasing contractual clarity and improving the information

The government's existing programmes that involve private parties with an outcome focus include its children's teams, social sector trials, public-private partnership programme (e.g. Wiri prison), its social housing programme, Whānau Ora, partnership schools and its pilot social impact bond programme. Budget 2015 provided a further \$50 million over four years for Whānau Ora. On 1 June the government announced that it would be proceeding with four pilot social bonds as part of its social investment approach. It revealed that Budget 2015 had set aside \$29 million for this purpose. The first social bond will provide employment services to people with mental health conditions (see Davidson, 2015). That looks like a worthwhile but challenging task.

A 2015 report by Jenesa Jeram and the author for The New Zealand Initiative

base, social bonds can hope to improve incentive alignment.

Another argument, most to be expected from those associated with publicly provided programmes, is that involving private providers undermines the public sector ethos. The knee-jerk 'privatisation' bogey is also likely to be invoked in this context. However, public providers don't have a monopoly on compassion, or competence. Voluntary charitable organisations have existed for a lot longer than the welfare state. The government's focus is rightly on finding what works. As Deng Xiaoping reportedly said, 'It doesn't matter if a cat is black or white, so long as it catches the mouse.'<sup>4</sup>

One argument that potentially concerns opponents and supporters alike is that a social investment may fail to improve outcomes, and perhaps even worsen them. Judging this on a case-by-case basis requires an assessment of the deficiencies in both the existing and proposed programmes. Keen debate which focuses on robust assessments is a desirable thing. Obviously, the hope is that political processes will favour adopting a programme with real potential for success.

It is worth noting here that people will always differ about the wisdom of a particular investment because they have different information sets, different interests and different views about how the future is likely to unfold. Such differences are reflected in the enormous variety of private charitable organisations in New Zealand. As explained in The New Zealand Initiative's report, social impact bonds can provide social services entirely independently of government. Private philanthropists or community organisations seeking particular social outcomes can use the social impact bond structure to focus willing social service providers on achieving those outcomes. Those who believe the project will fail don't participate. Non-participation is not possible when government chooses between contending uses of funds. Those who disagree cannot opt out of funding the chosen programme. However, where the government pays only for success, the argument for not proceeding on the grounds of fiscal cost is less convincing.

Another consideration in assessing the likelihood of achieving better outcomes is the degree to which those receiving the social services in question wish to secure the better outcomes for themselves. If they do not, it might be hard to find a social service provider who would be willing to take up the challenge.

Some opposition will be ideological: to what degree should working-age welfare be an entitlement or a privilege? The move to a more stringent work test looks like a shift. Ultimately, the degree is a political decision. But the choice should be informed by evidence as to the effects of the choice. The accumulating evidence of bad outcomes on average for children born into sole-parent, welfare-dependent situations is grim.

much can be expected from that given the weak discipline on spending quality; to its credit the speech made no claim of a material effect. Budget 2015 was notably light on policies to lift economic growth, as Oliver Hartwich, executive director of The New Zealand Initiative, observed at the time (Hartwich, 2015a). He reinforced that message a few weeks later when the OECD released its latest economic survey of New Zealand. Hartwich pointed out that an annex to that survey identified a considerable number of recommended structural measures to lift economic growth and productivity that the government was actioning only in part, and in some cases not at all (Hartwich, 2015b). The latter category included the need to make New Zealand's foreign

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There will be failures. It will be as important to learn from the failures as from the successes. But failures on a small scale are less damaging than system-wide failures. It is the evidence of the latter that is driving the government's programme.

#### **Job creation: economic growth**

Whereas Budget 2015 acknowledges the importance of paid work for alleviating hardship, the government's minimum wage policy works to defeat that purpose. On the OECD's latest statistics, in 2013 New Zealand's minimum wage was 59.5% of the median full-time wage.<sup>5</sup> Only four countries in the 28-country database had a higher ratio. On 1 April 2015 the government increased the minimum wage by 3.5% '[w]hile annual inflation is only 0.8%' (see Woodhouse, 2015).

The Budget speech's section on raising economic growth highlighted increased government spending on education and research and development. Nothing

direct investment screening regime more transparent, to eliminate all remaining tariffs and to raise the age of eligibility for New Zealand superannuation.

#### **Concluding comments**

The Budget speech reported that the number of children in benefit-dependent households has fallen by 42,000 over the past three years. That is plausibly a good thing for those children, but it would be wrong to presume that it was. There is much material deprivation in low-income working families too.

The enduring remedies are higher real wages and less chronic welfare dependency. Securing those goals requires in good part higher labour productivity and/or greater household work effort. Wage earners can raise their productivity by investing in skills. But they can't do much individually about the myriad ways in which governments reduce economic growth, productivity and household real

incomes through ill-justified regulations and wasteful government spending. For example, undue regulatory barriers to jobs and high Auckland house prices relative to incomes are 'made by government' phenomena. Spending on cycleways, the America's Cup and sports stadiums is money not available for household budgets or spending on public goods.

Real action to reduce regulatory costs in respect of Auckland housing in particular has become critical, as the government is painfully aware. The outcome of the recent Northland by-election could be seen as a gift to Auckland property owners and speculators. Prior to that outcome the

government intended to move to reduce the anti-subdivision bias in the Resource Management Act. More generally, MMP can make it hard for an internally-agreed major party in a government coalition to take effective action, other than on a confidence and supply matter. It also makes coalition governments more likely. Parliamentary majorities all too often need to be cobbled together by non-transparent back-room deals on an issue-by-issue basis. No great policy coherence can be expected. Notwithstanding any benefits from MMP, the cost may be high.

Faster productivity growth and greater job creation would be far more effective

in raising living standards in the longer term than any redistributive policy. In summary, the government's welfare policy is incremental; but it does represent a radical change from the earlier failed, relatively passive system. The Budget's growth policy is not so much incremental as lame.

- 1 See <http://www.workandincome.govt.nz/map/deskfile/main-benefits-rates/sole-parent-support-current.html>.
- 2 <http://ec.europa.eu/social/main.jsp?catId=1044>.
- 3 In any particular case the government may choose not to fully transfer the financial risks to private parties.
- 4 [http://www.brainyquote.com/quotes/authors/d/deng\\_xiaoping.html](http://www.brainyquote.com/quotes/authors/d/deng_xiaoping.html).
- 5 <https://stats.oecd.org/Index.aspx?DataSetCode=RMW>.

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