

NEW ZEALAND BUSINESS ROUNDTABLE

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SUBMISSION ON THE WELFARE WORKING GROUP PAPER  
*REDUCING LONG-TERM BENEFIT DEPENDENCY: THE  
OPTIONS*

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December 2010

## 1. Preamble

- 1.1 This submission on the Welfare Working Group's paper *Reducing Long-Term Benefit Dependency: The Options* (the Options Paper) is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.
- 1.2 We see the issue of welfare dependency and welfare costs as hugely important – economically, fiscally and socially. The WWG's work should be seen in the context of the precarious current economic situation, with an anaemic GDP growth outlook and dangerous external vulnerabilities due to very high foreign indebtedness. Within a short period of time demographic trends will add to fiscal pressures with the prospect of higher government spending on superannuation, health and welfare. Policy reforms in all these areas are essential if the government is to have any chance of achieving its goal of income parity with Australia by 2025. The 2025 Taskforce advised that “ambitious welfare reform measures should be undertaken as a matter of priority to reduce the very large number of people of working age currently receiving benefits.”
- 1.3 The Business Roundtable made a submission on the WWG's earlier Issues Paper. We are attaching it to this submission as its commentary and suggested options remain relevant.
- 1.4 Subsequent to the Issues Paper, Aboriginal leader Noel Pearson delivered the Business Roundtable's 2010 Sir Ronald Trotter Lecture on the subject of *Pathways to Prosperity for Indigenous People*. Among the points made in it were:
  - welfare dependency is not an ethnic issue (although its incidence may be concentrated in particular ethnic groups)
  - ‘sticks’ as well as ‘carrots’ are needed to move people from welfare to work
  - the welfare system may need to require people to move locations to find jobs

- there is no government ‘forklift’ to raise people out of dependency; they have to rise by their own efforts, one step at a time; and
- welfare recipients have to accept that they may initially be worse off before becoming better off.

A copy of Noel Pearson’s lecture is attached to this submission.

## 2 General comments

2.1 The main thrust of our submission on the Issues Paper was summarised in its final paragraph:

The key perspectives that should inform the WWG’s future work can be summarised as follows:

- No amount of tightening benefit rules or expenditure on ‘activation’ strategies for getting beneficiaries into work will achieve much if labour market barriers (especially for those on benefits) are high.
- No amount of changes to those barriers to achieve greater labour market flexibility will achieve much if the benefit system is not changed to provide stronger incentives to seek and accept work.

Welfare reform and labour market reform must go hand in hand.

2.2 The treatment of labour market obstacles to employment in the Options Paper is very weak. Little heed has been taken of submissions on the Issues Paper by employer and business organisations. As a result we suspect few will take the trouble to submit on the Options Paper. As one informed person wrote to us, “I have not made submissions because it appears to be no more than a political exercise to ask for them.” If the WWG’s final report is to be credible in the eyes of employers, it will need to give much more consideration to labour market issues. (We comment further on reform options below.)

2.3 Relative to the Issues Paper, we think the Options Paper goes in many of the right directions. In particular, we note:

- there is a sound general theme that work rather than welfare should be the norm for most people, and that the numbers of people unable to do any work are low

- the paper correctly recognises that benefit dependency is affected by overall economic performance and policies (although it lacks an emphasis on labour market flexibility)
- the paper recognises that the unemployment benefit area is a real problem. This was under-played in the Issues Paper
- there is a good discussion of sole parent issues. This is the major problem area from the point of view of corrosive social effects and child poverty. The paper makes a useful start in identifying criteria for making decisions on Domestic Purposes Benefit (DPB) rules
- there is a good preliminary discussion of issues around teen parenthood
- a start has been made on identifying strategies for moving people on sickness and invalid's benefits into work, and these need further development, and
- similarly, issues of crime associated with welfare dependency, fraud and abuse, and drug and alcohol problems are noted but touched on only lightly. More data and recommendations on all these issues should be presented in the final report.

2.4 On the other hand, we think the Options Paper has numerous features in addition to those noted above which require strengthening. In particular:

- the paper is very unbalanced in respect of the interests of beneficiaries and measures to support them. It is extraordinary that the words 'taxpayer' or 'taxpayers' only appear 10 times in a 125-page document 'Personal responsibility' is mentioned only a few times. The role of the family is barely discussed. The family should be the first port of call in an emergency or straitened circumstances (as it is, for example, in many Asian countries).
- the deleterious effects of welfare are under-played. The paper contains a relevant quotation on p2:

Long-term benefit dependency for the able-bodied is very destructive at every level: it destroys initiative and drive, cripples the future opportunities of children, encourages family breakdown, fuels intergenerational dependency and the growth of the underclass, and is an enormous cost burden on society that the country cannot afford.

However, there is little further analysis of these points, which are an important motivation for welfare reform. The final report should present data on the links between welfare and child abuse and welfare and crime

- the paper focuses mainly on approaches to people currently on benefits. This emphasis is misplaced. A significant proportion of beneficiaries exit the benefit system after relatively short periods. The more important issue quantitatively is the inflow into the system. This should be the main focus of the WWG's advice on how to reduce dependency, including long-term benefit dependency. It means that changes in incentives are more important than so-called 'activation' measures to facilitate moves of current beneficiaries from welfare to work
- the paper puts forward as serious options a Guaranteed Minimum Income and European-style social insurance. These are unrealistic and unaffordable.
- we doubt the merits of a single benefit option. There are three main ways a single benefit could be set. First, some benefits are levelled upwards (which is unaffordable) or secondly downwards (which is contrary to the government's stated intentions and which we would not support). The third option is to set a single benefit at a relatively low level and then apply top-ups depending on the circumstances of the beneficiary. This option would in practice be little different from the present system. The last government explored the single benefit option and eventually ruled it out. That is not to say that the issue of migration between benefit categories should not be addressed
- many of the options are frustratingly vague. To cite one of many examples: Option 1 under 'Regions' (p6) reads:

Work and Income engaging more intensively in supporting regional economic and social results. Development of local model with specific funding and engagement with key agencies and people.

We do not know what this is supposed to mean. We hope that final recommendations will be concrete, clear, fully costed and capable of being implemented

- like Noel Pearson, we doubt whether ethnic distinctions should come into welfare policy. The WWG risks being accused of 'Maori bashing'. We

think individuals in all ethnic groups respond in broadly similar ways to welfare incentives and disincentives, even though different ethnicities may have differing cultural values that create different incentives and responses. In respect of *delivery* of welfare assistance, we are open to consideration of options such as Whanau Ora but we think practical issues of administration and accountability need to be explored very carefully. Ongoing cases of fraud and abuse (a recent serious one was reported in Porirua) illustrate the pitfalls and are demoralising in the context of Maori advancement. We struggle to understand the idea and merit of the Memorandum of Understanding proposal in the 'Maori and benefits' chapter. In order to be properly evaluated the proposal needs to be spelled out in concrete form and should not be recommended unless the WWG is satisfied it would be beneficial and work well in practice

- the paper at various points refers to experience under ACC. In general, ACC is not a successful model: the scheme has been plagued with problems since its inception. Private insurers demonstrated that they can do a better job in getting accident victims back to work in the brief period when the scheme was partially opened up to competition. The government is currently looking at a similar reform. We think the WWG should draw instead (or as well) on the experience of private insurers or brokers in this area. We suggest, for example, that it would greatly benefit from discussions with Geoff Blampied, the CEO of the insurance broker AON, and Ian McPherson, the CEO of Southern Cross
- there is a sound general theme that work rather than welfare should be the norm for most people, and that the numbers of people unable to do any work are low
- we note the idea of presenting the lifetime costs to the taxpayer of people on benefits. The aim appears to be to justify spending more up-front but unless some real limits are set on benefit receipt it could just add to welfare costs. The idea may have some relevance for the invalids benefit category but we struggle to see its operational relevance for other categories. Numbers and the duration of those in other benefit categories are influenced by many other factors including general economic

conditions, labour market flexibility and changes in welfare rules. These are not matters of administration (the idea behind the proposal), and

- there is very little discussion of the role of the voluntary sector. This is a major issue: the voluntary sector, including churches, plays a huge role in respect of welfare services. It has advantages over the public welfare system in that it is less subject to rule-bound administration and can deal with cases on a more personalised basis. This is the essence of welfare needs: no two cases are identical. We think the WWG should explore imaginatively ways of harnessing the resources of civil society to better address difficult welfare issues.

2.5 A final general comment is that the WWG's final report needs to contain solid analysis demonstrating that its recommendations would have a material impact on benefit numbers and fiscal costs. Tinkering with welfare rules over more than 25 years has been largely ineffective in reducing welfare dependency. A very large number of the options in the paper would involve higher, not lower, costs to taxpayers. Any cost-raising recommendations should be accompanied by recommendations that would substantially reduce costs. The experience in the United States was that welfare reform cut rolls by over 50 percent with generally beneficial results. Is there any reason why similar reductions would not be feasible in New Zealand? Successful Asian countries like Hong Kong, Singapore, Japan and Korea have nothing like the welfare problems associated with many of the 'old' OECD welfare states and New Zealand. Trend increases in sickness and disability beneficiaries, for example, have been far lower. The WWG should look to reform experiences and successful models both to motivate and benchmark potential improvements in New Zealand and for policy reform ideas. For this purpose, high quality modelling of expected reform outcomes should be presented in the report in order to assist political decision making and to ensure that the WWG's recommendations are robust and, if adopted, likely to be effective. Modelling the effects of reducing inflows is particularly important.

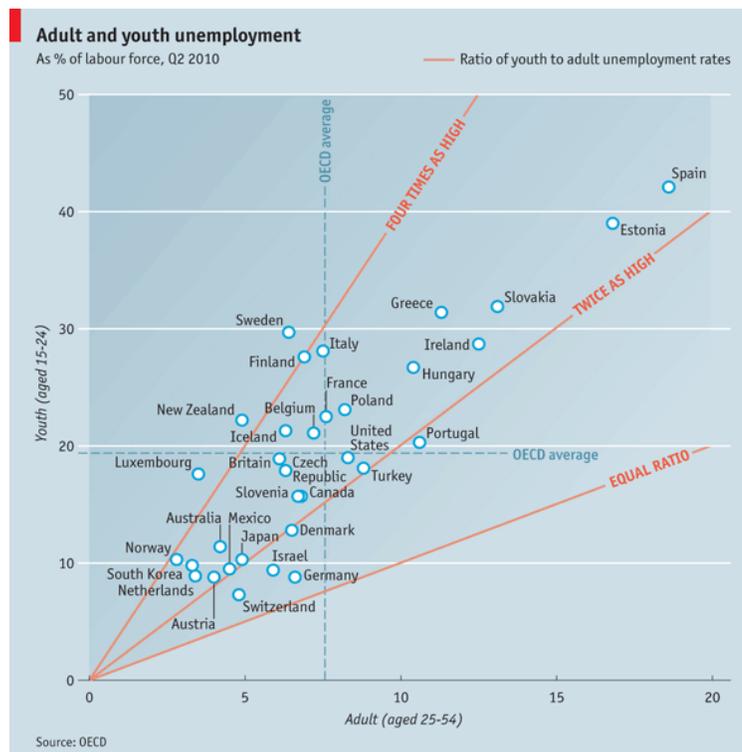
### **3 Specific comments on the Options Paper**

#### ***Labour market issues***

- 3.1 The final report should respond with competent analysis to the claim: 'but there are no jobs for beneficiaries to go to'. The WWG will be well aware that this is a fallacy: the wants of any society are infinite but the resources, including labour, to satisfy them are finite. There is work to be done everywhere: on farms, in factories, in health and education, in the hospitality sector, in tourism operations and so forth. Many of these activities do not require high entry-level skills. The economic problem consists of fully employing available resources in their most valued uses. Given labour market flexibility, there is no reason why labour force participation could not be far higher in New Zealand than it is, and unemployment far lower. At one point in the early 1950s there were only two registered unemployed people in New Zealand (although there were some government work schemes). The welfare dependency problem is not like a plague of unknown origin: it is the result of changes in incentives created by changing laws, policies and social attitudes over the past two generations. For a fuller exposition of these issues, we commend the report by Professor Judith Sloan that formed part of our submission on the Issues Paper.
- 3.2 The Options Paper's treatment of employment and employer issues, especially in the private sector, is very limited. We suspect commercial realities are not well understood by the authors. For example, Option 1 under 'Prevention and early intervention' on p11 reads "Provide information to employers about the financial benefits of promoting wellness in workplaces". We have no doubt that these benefits are well known to the vast majority of employers, and elementary contact with representative employers (for example, the Progressive supermarket chain) would demonstrate the lengths to which many firms go to promote wellness in their staff. Apart from anything else, they have strong commercial incentives to do so. There is little point in talking about 'encouraging' employers to do this or that, as the Options Paper does in many places. Employers respond to incentives like everyone else. As WWG members would know, if you want to change behaviour you must change incentives. This reality should be borne firmly in mind by the WWG as it proceeds to develop its recommendations.

3.3 There are many disincentives to employment in New Zealand's labour market arrangements and we think the WWG should explore them thoroughly, drawing on additional expertise where necessary. For the purposes of illustration we focus on only a small number:

- Minimum wage regulation. New Zealand's adult minimum wage level is now the highest or close to the highest in the world relative to median wages. This alone should call it into question. We have no doubt that increases in the last decade have cost jobs, especially among marginal, low-skill workers such as many beneficiaries. Most would be better off in work – the gap between benefits and minimum wages is considerable. The WWG should not ignore this problem. We note that the Irish government is cutting minimum wages by 12 percent.
- Youth rates. A particular problem is the abolition of youth rates by the last government. Rough estimates by Eric Crampton of the University of Canterbury suggest this has resulted in the loss of 9000 jobs or more – a huge number. The chart below shows that New Zealand's current youth unemployment rates are an outlier relative to other OECD countries.



The further north a country is, measured on the perpendicular from the 'four times as high' line, the worse youth unemployment is relative to adult unemployment. Only Sweden and Luxembourg have worse youth unemployment outcomes than New Zealand relative to adult rates.

The productivity of some young workers will be such as to warrant adult minimum wages but that of others will not, and employers simply won't employ them. To do so would mean they would incur financial losses. In our view youth rates should be restored in some form, as the 2025 Taskforce has recommended. There are a number of ways of approaching the issue, and the suggestions made to the WWG by McDonald's, such as tiered training wages, deserve consideration.

- Personal grievances. Taking on beneficiaries will be risky to employers in many cases because of issues of skills and attitude. The 90-day trial period will not be an adequate protection. Some employers have told us they would take on marginal long-term beneficiaries (the hardest to employ) only on a no-fault dismissal basis. We suggest that such a rule should be recommended for long-term beneficiaries (say those on a benefit for more than 6 months or a year) and we believe motivated beneficiaries would readily accept it. It would of course be open to employers and such employees to voluntarily agree to a different rule.

A related point under this heading is the ability of a dismissed worker to avoid a stand-down period if they lodge a personal grievance claim. This is a perverse incentive and is costly to employers. Australia does not allow this practice and we recommend that it be changed here.

- Fixed-term contracts. Another way for employers to protect themselves against employment risks is to write contracts for a fixed term. This is not possible under New Zealand law unless there is a special justification (eg employment is for a project of limited duration). In Australia, on the other hand, employers can use fixed-term contracts for any reason. We suggest the WWG should recommend accordingly.
- Human Rights Act. This Act makes discrimination unlawful on a variety of grounds. A Maori employer, for example, could not advertise for a mature, Maori, woman – that would be in breach of the Act on three

separate grounds. This seems absurd. Older beneficiaries may find it difficult to get employment because employers may feel they face the risk that the person's work capacity may decline and they are not able to contract for a set retirement age. In the case of beneficiaries with significant disabilities, employers may be prevented by the Act from setting wages which reflect their limited capabilities. A related issue is the move by the previous government to require workers in what were previously known as 'sheltered workshops' to be paid minimum wages, with only limited exceptions. This has simply eliminated work opportunities for many people with disabilities. Anti-discrimination legislation may be promoted with the best of intentions but, like much other government regulation, it often acts against the interests of those it is intended to protect. We suggest the WWG should advocate its relaxation, at least in the case of long-term beneficiaries.

### ***Welfare issues***

- 3.4 Requirements to accept job offers. When it comes to welfare, the overriding rule that the WWG should promote is that beneficiaries should be required to accept a job opportunity if offered one, other than in exceptional circumstances. It should not be regarded as acceptable for a job offer to be turned down on the grounds that it does not pay more than the relevant benefit (having regard to transport costs and the like) or is simply not appealing. Taxpayers should be entitled to expect no less – if someone can be self-supporting, they should not be a burden on others. We are aware that Work and Income New Zealand has some rules along these lines but they are not rigorously enforced. We think the WWG should make it plain that they should be.
- 3.5 Abatement regime. A related point is that if someone is offered a job they should not expect to face a lenient benefit abatement regime. They should accept the position even if they face a relatively high effective marginal tax rate over an initial income range. This is in part a moral point again: people should be self-supporting if they can. It also recognises the fact that tinkering with the abatement regime over the last 25 years has done little to ease welfare dependency problems. We do think the WWG should review abatement rules and we favour a 'short high fence' approach, including abatement from the first dollar of market income. Most people do not stay on low wages for long – they move up the income ladder (and at some point face standard statutory marginal

tax rates). Further ways around the high EMTR problem include reducing tax rates further with stronger spending discipline. However, the key point we would make is that administrative rules should generally require beneficiaries to take jobs offered to them, regardless of the immediate financial benefits. The WWG is rightly emphasising the multiple social benefits of work.

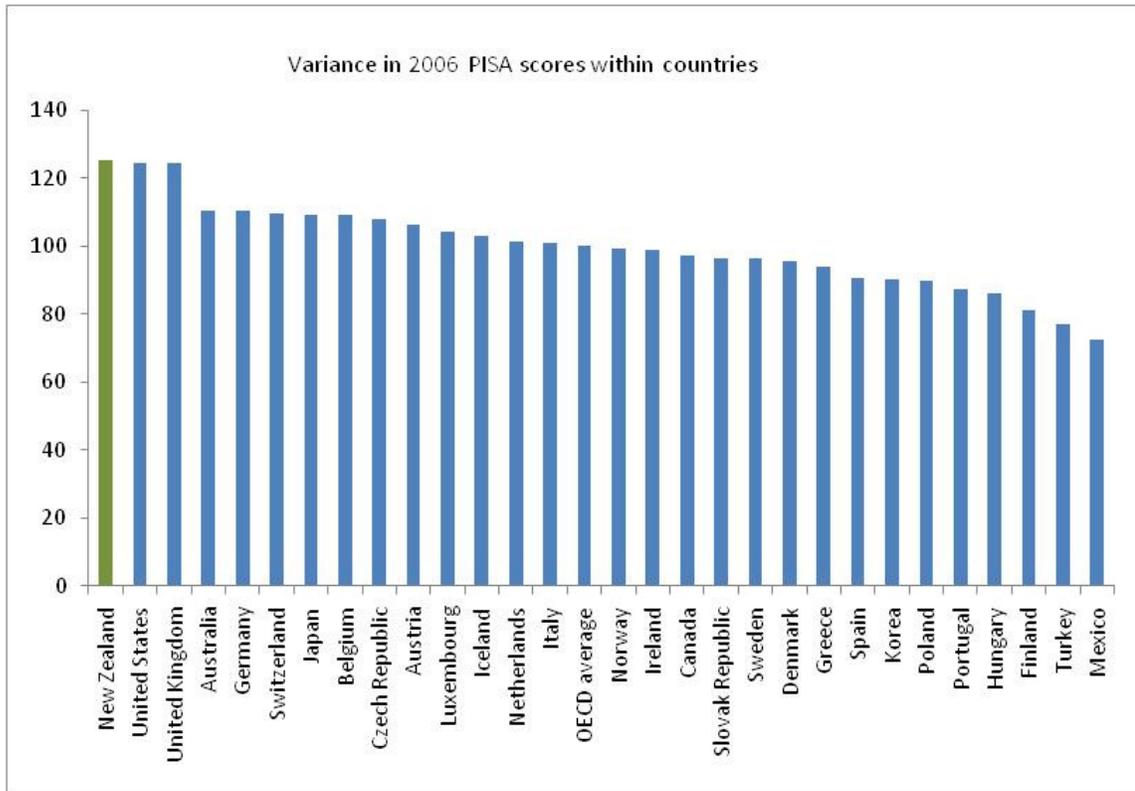
- 3.6 Communities with few job opportunities. Another related issue flagged in the Options Paper is the situation of beneficiaries in communities where few jobs are available. We think the starting (moral) point is that taxpayers should not be expected to fund welfare benefits to people in such situations indefinitely. The focus of the Labour government's Jobs Jolt scheme was to prevent people on the unemployment benefit moving to areas where few jobs were available. Such a policy should be applied to other beneficiaries capable of being self-supporting. But the other side of the coin is beneficiaries already in welfare-dependent communities. The only two solutions are for beneficiaries to move to where jobs are available or for jobs to be created in the relevant community. We think welfare rules should require the first solution, subject to reasonable exceptions, and we would be open to concrete proposals related to the second solution.
- 3.7 Sole parents. The Domestic Purposes Benefit, for all its merits, has clearly been a factor in family breakdown, child poverty and an increased welfare burden. The WWG's terms of reference require it to "consider the structure of the benefit system [which includes the DPB] ... and its contribution to long-term benefit dependency." This has not yet been done. We support options to bring forward the point (the age of the youngest child) at which DPB recipients are required to re-enter the workforce, to a level consistent with the patterns of partnered and unpartnered working parents. Many parents (including those raising children on their own) manage to work full-time, part-time or job share (once their children are beyond infancy), and there is no reason why single parents on welfare should not be required to do likewise.

An element that is largely missing in the Options Paper is the responsibility of the non-custodial or sharing parent. This responsibility should come before the responsibility of taxpayers. We think the WWG should give serious consideration to this issue independently of the review of Child Support by the Inland Revenue Department. Variations to current rules, such as redirecting payments to IRD to the custodial parent instead, should be considered. The amount of unpaid obligations should be regarded as unacceptable to taxpayers.

In addition, more rigorous measures would change incentives to risk becoming a dependent sole parent.

- 3.8 Income management. We are pleased to note that the Options Paper refers to income management, an approach that has been successfully introduced in Australia. We assume the WWG will develop a detailed income management approach. Other complementary strategies should also be considered. We think a further normative starting point is that taxpayers should not be expected to fund drug, alcohol, gambling and similar habits of beneficiaries. The Options Paper recognises this, although mainly in respect of drugs. We think the WWG should advocate strong measures where such problems are identified.
- 3.9 Time limits. Again the Options Paper mentions the possible use of time limits on benefits but detailed proposals are not yet developed. These have been a feature of reforms in the United States and United Kingdom. The starting point here is that assistance for most people in need of state support (after their own resources, such as savings and insurance, and other family or voluntary sector sources of help are exhausted) should be temporary. We suggest benefit category names should be changed to reflect this (cf the Temporary Assistance to Needy Families scheme in the United States). Obviously time limits should not apply to people with severe disabilities in need of long-term support. Specific policy proposals should be worked up for the government's consideration in respect of time limits on spells on a benefit and lifetime assistance. Back-up recourse to hardship grants would be necessary, as the Options Paper notes.
- 3.10 Sanctions. We agree that sanctions are a necessary part of a welfare regime. An essential principle of a welfare system is that it should support those in genuine need of help. But welfare should be conditional: people who are capable of working and looking after themselves and their dependents should be expected to do so, even if the financial rewards are weak. Just as workers lose wages if they fail to turn up to work or carry out the requirements of their job, so if someone is in breach of their welfare conditions without good reason, their benefits should stop. We agree that, where beneficiaries have dependent children, income management schemes should be put in place to ensure that money intended to support their children is spent appropriately.
- 3.11 Education. Inadequate education is a major problem among many welfare recipients. The chart below shows New Zealand scores worst among OECD

countries for the variance in PISA scores within countries – the so-called ‘long tail’ of under-achievers.



Source: PISA 2006

The Options Paper does not tackle this problem. Training programmes for beneficiaries have been found to have limited effectiveness. Other measures discussed are in the nature of ‘ambulance at the bottom of the cliff’ remedies. The problem needs to be addressed at source. We think the most powerful mechanism for improvement would be the introduction of choice and competition into a system which is essentially a state monopoly (along lines implemented in Sweden and now Britain). We favour Option 6.1.1, Reform of funding for secondary education: *Create flexible funding mechanisms for secondary education so that resources clearly follow students*. A voucher approach along these lines was favoured for disadvantaged students (the bottom 20 percent) by an Inter-Party Working Group of parliament in a report earlier this year. The opportunity of greater choice, autonomy and diversity would be attractive to many parents, including to Maori parents, in our view.

We also favour greater use of computer-based learning for disadvantaged students, particularly for remedial literacy and numeracy teaching. There are many such options available locally and internationally which could be offered in schools, after-school care programmes and early childhood education.

3.12 Transition. We see transition issues as relatively straightforward. For the most part, changes in policy should be applied soon after they have been decided and, where necessary, enacted in legislation. In limited cases ‘grandparenting’ of people on existing benefits for a period or permanently might be appropriate. The most obvious example is DPB beneficiaries. It might be reasonable not to change their existing circumstances in the near term, although it would be reasonable to exclude or limit assistance to those who have a further child while on a benefit beyond a transition date.

3.13 Delivery of services. We think much more extensive use should be made of private sector delivery of public welfare services. We support exploration of Option 8.2.4 on p117 – a fully contracted-out contestability model, as in the United Kingdom. Again, a good deal of work by the WWG is needed to develop proposals, and particular attention should be given to issues of contracting, monitoring, enforcement of contracts, and accountability.

## **4 Conclusion**

4.1 We think that from this point on the WWG needs to put most emphasis in its work on the core set of recommendations that would make a real difference to rates of long-term dependency and the fiscal burden. These need to be worked up in concrete form, rather than recommendations that the government does further work on them through its agencies or new taskforces. Recommendations should be capable of speedy implementation if the government accepts them. As noted earlier, we also think the final report should give quantitative estimates of the changes in welfare rolls and fiscal costs that its package of measures would bring about. Ample research is available to inform such modelling.

4.2 A goal of keeping the report as concise as possible should be set. As one commentator put it to us, “Some of the efforts so far seem undisciplined and the work of public servants going through the motions.” A tightly argued final report with clear-cut recommendations (which may include options) will serve the government’s and the country’s interests best.

