

NEW ZEALAND BUSINESS ROUNDTABLE

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SUBMISSION ON THE WELFARE WORKING GROUP'S PAPER,  
*LONG-TERM BENEFIT DEPENDENCY: THE ISSUES*

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September 2010

## Summary

- This submission on the Welfare Working Group's paper, *Long-Term Benefit Dependency: The Issues* (the Issues 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.
- Welfare dependency is an enormous problem that blights the lives of many people and has wider deleterious social and economic effects. Its roots lie in a welfare system that has eroded the acceptance of personal responsibility, diminished self-reliance and weakened the family as a social institution. What began as a safety net for the truly vulnerable and destitute has become an all-encompassing support system for which many people now feel a strong sense of entitlement.
- While the Issues Paper contains considerable analysis and commentary that we endorse, we think the following deficiencies should be addressed in the Welfare Working Group's future work:
  - The Issues Paper does not come to grips with the enormity of the welfare dependency problem confronting New Zealand.
  - It unduly reflects the perspectives of beneficiaries rather than the wider interests of taxpayers and the community.
  - It makes no reference to the role of families, churches and other voluntary organisations in supporting and assisting people in adverse circumstances.
  - The Issues Paper is not sufficiently rigorous in identifying the underlying causes of welfare dependency such as labour market inflexibility.
  - It contains little discussion on issues involved in reducing the flow of people on to benefits.
  - The Issues Paper largely overlooks difficult policy issues such as minimum wages, family breakdown, substance abuse, the link between benefits and crime, and benefit fraud.
- Labour market flexibility should be a main thrust of the Welfare Working Group's future work. It is impeded by policies such as those relating to dismissal rules,

minimum wages, holidays, health and safety, and ACC. The Welfare Working Group should engage the expertise required to address these matters.

- Family breakdown should be another main focus of the Welfare Working Group.
- As it considers options for reform the Welfare Working Group should examine policies including the following: enhanced work incentives; the introduction of time limits for the receipt of benefits; elimination of incentives that encourage couples with dependent children to separate; the introduction of clear mutual obligations including the application of work tests to the Domestic Purposes, Sickness and Invalid's Benefits; stricter criteria for entry on to these three benefits; the strict enforcement of work tests; work to be given priority over training; outsourcing employment services; emphasis to be given to immediate rehabilitation and an early return to work of people suffering from injuries and illnesses; and strengthened provisions to hold non-custodial parents liable in the case of family breakdown.
- We are not advocating any particular measures at this stage but wish to see options fully explored.

# 1 Introduction

- 1.1 This submission on the Welfare Working Group's *Long-Term Benefit Dependency: The Issues* (the Issues Paper) is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand business firms.<sup>1</sup> The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.
- 1.2 The Business Roundtable welcomes the establishment of the Welfare Working Group (WWG). Welfare dependency is an enormous problem that blights the lives of many people and has wider deleterious social and economic effects. Its roots lie in a welfare system that, despite the admirable intentions of its founders, has over time eroded the acceptance of personal responsibility, diminished self-reliance and weakened the family as a social institution. Impersonal taxpayer-funded support has displaced assistance previously provided by families, churches and other voluntary organisations, and reduced the impact on harmful behaviour of community sanctions.
- 1.3 The Issues Paper outlines the level of the welfare dependency in New Zealand and demonstrates that such dependency has grown substantially. Some 356,000 people of working age (aged 18-64 inclusive) were receiving a main benefit in April 2010. This is almost equivalent to the total population of Manukau City (368,600), the country's third largest city. They account for about 13 percent of the working-age population. In 1960 around 2 percent of the working-age population were on a benefit. The proportion of the working-age population on a benefit has increased more than six-fold since 1960.<sup>2 3</sup>

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<sup>1</sup> Welfare Working Group (1010a), *Long-Term Benefit Dependency: The Issues: Detailed Paper* and Welfare Working Group (1010b), *Long-Term Benefit Dependency: The Issues: Summary Paper*, retrieved 12 August 2010 from <http://ips.ac.nz/WelfareWorkingGroup/Index.html>.

<sup>2</sup> The WWG's analysis does not generally include people who are in receipt of income compensation under the ACC scheme. Some working-age people who were injured in accidents (for instance accidents other than those at work) may have qualified for a benefit before the ACC scheme started in April 1974. Thus the growth in welfare dependency since 1960 may be understated.

<sup>3</sup> The prime minister indicated that the number of beneficiaries of working age had increased to 377,000 (see "Drive to Stem Generations of Welfare Dependency", *New Zealand Herald*, 10 August 2010). This number and that cited by the WWG include partners of beneficiaries. The Ministry of Social Development's "National Benefit Factsheet June 2010" puts the number on benefits excluding partners at June 2010 at 333,000. The data cited are taken from the Welfare Working Group (1010a), *op cit*, p 18 and the Ministry of Social Development (2010a), "National Benefit Factsheet June 2010", retrieved 30 August 2010 from <http://www.msd.govt.nz/about-msd-and-our-work/publications-resources/statistics/benefit/2010-national-benefit-factsheets.html>.

- 1.4 The growth in long-term dependency is of particular concern. Some 170,000 people receiving a main benefit in June 2009 (about 1 out of every 2 beneficiaries) had been on a benefit for 5 or more years. People who are on benefits other than for a short period are more likely than other beneficiaries to stay in long-term benefit dependency. As the prime minister commented, long-term dependency "imprisons people in a life of low income and limited choices."<sup>4</sup>
4. A disproportionate number of people harmed by, or at risk of, welfare dependency are young, hold limited or no educational or vocational qualifications, and/or are Maori and, to a lesser extent, Pacific people. Maori make up 32.1 percent of all beneficiaries of working age (27 percent of the total Maori population) compared with 8.3 percent of Pacific people (15 percent of the total Pacific population).<sup>5</sup>
- 1.5 As noted in the Issues Paper, some people will never be able to support themselves because of the nature and severity of their illness or injuries. The number of people of working-age in this group, though unquantified, is understood to be small. They account for no more than a tiny proportion of all beneficiaries and little of the growth in the number of beneficiaries, despite policy changes that provide for the care of people with high levels of disability in the community rather than in institutions. If it were not for the attraction of the benefit system to those who could be self-supporting, such people could be provided with a more generous level of assistance. This group will remain dependent on benefits. The policies outlined below do not generally apply to them. Part-time work with job subsidies on a continuing basis, for instance, may well be appropriate for people who will never be able to support themselves.
- 1.6 Long-term welfare dependency should be addressed in the interests of those whose lives are, or would be, directly affected (such as present and potential future beneficiaries and their children) and taxpayers who are required to fund the benefit system. There are also wider economic and social grounds for addressing the problem. The deadweight costs of the taxes required to fund the benefit system and the adverse incentive effects of the benefit system itself (for instance, in discouraging work as benefits are abated) reduce aggregate output and income and make general alleviation of poverty harder. Anti-social behaviour associated with dependency impacts on the wider society.

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<sup>4</sup> "PM's Presser - Welfare Working Group", retrieved 1 September 2010 from <http://www.scoop.co.nz>.  
<sup>5</sup> Ministry of Social Development (2010a), *op cit*.

- 1.7 The prime minister commented on the release of the Issues Paper that the WWG was "intended to be free thinking and would examine a wide range of ideas." <sup>6</sup> This submission has been prepared with that mandate in mind.
- 1.8 The balance of this submission is presented in 4 sections. The next section (section 2) presents our general comments on the Issues Paper. Section 3 focuses on the future work of the WWG. Some specific policies that the WWG should examine are outlined in section 4. Our conclusions are presented in section 5.

## **2 Comments on the Issues Paper**

- 2.1 The Issues Paper provides considerable helpful commentary and data on benefit trends. It notes that participation in paid work is important to a person's health, and to social and economic well-being. Increased reliance on benefits, the growth in long-term benefit dependency and the migration of beneficiaries from the Unemployment Benefit to Sickness and Invalid's Benefits that are not subject to similar expectations of work are acknowledged. The Issues Paper also recognises that higher minimum standards of educational achievement would assist in addressing long-term benefit dependency.
- 2.2 We endorse the above views and the observations in the summary of the Issues Paper which emphasise the wider economic context of the WWG's work. The Issues Paper comments that strategies to reduce long-term benefit dependency can only succeed within a broader focus on raising living standards, by improving productivity and economic growth. It notes that a growing dynamic economy, with flexible labour markets generating high levels of employment, "is an essential foundation of successful social policies."<sup>7</sup> The Issues Paper comments that policies to encourage workforce participation "are central to a programme to lift living standards. Up-skilling and, where necessary, retraining must go hand in hand with job creation so that people are not shut out from well paying jobs".<sup>8</sup>
- 2.3 The comments below relate to matters that were not addressed (or not adequately examined) in the Issues Paper and which should be a high priority for the WWG's future work:

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<sup>6</sup> " Invalids May Have to Defend Benefit", *New Zealand Herald*, 9 August 2010.

<sup>7</sup> Welfare Working Group (2010b), *op cit*, p 1

<sup>8</sup> *Ibid.*

- The Issues Paper does not come to grips with the enormity of the welfare dependency problem confronting New Zealand. In addition to the high level of welfare dependency, especially long-term dependency, welfare dependency affects second or later generations of some families. Welfare benefits are a main source of personal income in some towns and communities. The benefit system has encouraged socially harmful behaviour as leaders such as Sir Apirana Ngata feared it would. The predatory behaviour associated with the Christchurch earthquake would have been inconceivable a generation or two ago.
- The issue of how to change the entitlement mentality that appears to pervade New Zealand's benefit system is not addressed in the Issues Paper.
- The Issues Paper does not generally look beyond OECD member countries for comparisons and insights. Most of the OECD has significant welfare problems, such as high unemployment. The dynamic developing countries of Asia, which are increasingly important to New Zealand, and Japan are not experiencing similar welfare problems. Korea and Japan, for instance, do not have comparable levels of sickness and invalid beneficiaries.
- The Issues Paper unduly reflects the perspectives of beneficiaries rather than the wider interests of taxpayers and the community, including those people who will stay in welfare dependency if the problem is not resolved. There is an inconsistency between what beneficiary groups claim, such as the reported desire of beneficiaries to engage in paid employment, and the preferences revealed by the choices that beneficiaries make.<sup>9</sup> Only a small proportion of beneficiaries engage in paid work and those who do so generally work few hours a week.

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<sup>9</sup> Only 13.2 percent of beneficiaries on a main benefit (excluding partners) at 30 June 2010 declared that they earned income compared with 17.7 percent in June 2005. See Ministry of Social Development (2010a), *op cit*.

- Removing barriers to employment alone will not work for beneficiaries who prefer to be on benefits or are better off on benefits.<sup>10</sup>
- The Issues Paper is not sufficiently rigorous in identifying the underlying or real causes of welfare dependency:
  - Many beneficiaries are receiving the Unemployment Benefit. Some other unemployed people are receiving the Sickness, Invalid's or Domestic Purposes Benefits. Unemployment is given insufficient weight in the Issues Paper and its general discussion of the labour market is weak. The Issues Paper does not examine the key role that poor labour market regulation plays in generating unemployment. A more flexible labour market is essential if the level of unemployment is to be reduced permanently. The view that there are no jobs (or no good jobs) available for beneficiaries and that an economic upturn is required to address unemployment is misconceived (see below). Full-time, full-year employment rather than part-time or part-year work is required to overcome welfare dependency and should be the objective for all people of working age who are able to work. The main exceptions are those with significant disabilities, or people who are responsible for the care of young children or those who are incapacitated.
  - The causes of family breakdown are not examined. Patricia Morgan reported, "the family is now in a worse state in New Zealand than almost anywhere else".<sup>11</sup> Family breakdown is a main reason why sole parents receive the Domestic Purposes Benefit. The responsibility of non-custodial parents for the support of their children and their children's caregiver is not examined in the Issues Paper.

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<sup>10</sup> Connie Raiwhara, who runs a community house in Papakura, told the *New Zealand Herald*, "A lot of our solo parents get well in the \$700s. They are not going to go from \$700 to \$400 ... Even if you're in a fulltime job on \$400-\$500 a week [after tax], childcare is \$240 a week. You're working to pay for someone else to look after your child. Maybe they should put the wages up and maybe that would give people the incentive to go back to work." See Collins, Simon (2010), "Changing social norms could take generations", retrieved 15 September 2010 from [http://www.nzherald.co.nz/nz/news/article.cfm?c\\_id=1&objectid=10664828](http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10664828).

<sup>11</sup> Morgan, Patricia (2004), *Family Matters: Family Breakdown and its Consequences*, New Zealand Business Roundtable, Wellington, p 3. The Issues Paper tends to support Morgan's assessment. Figure 4.5 shows that New Zealand has the fourth highest proportion of children in sole parent households in the OECD after the United States, the United Kingdom and Canada. See Welfare Working Group (2010a), p 27.



- The reasons why such a large proportion of the working population should be deemed to be unable to work because of illness or injury are insufficiently analysed. Further analysis of the ability to work of people with psychiatric or psychological conditions such as stress should be undertaken.<sup>12</sup>
- The incentive effects of the benefit system are hardly discussed in the Issues Paper and are largely dismissed as too difficult. They are, however, vital and are within the explicit terms of reference of the WWG. Particular attention needs to be given to the replacement ratio (the level of benefit income relative to that of market income) taking account of main benefits and supplementary assistance on the one hand, and the level of market income for people with equivalent qualifications and experience on the other hand. The return from an extra hour of work, net of tax and the abatement of income-related assistance, should also be examined.
- There is very little discussion in the Issues Paper on the issues involved in reducing the flow on to benefits. The emphasis in the Issues Paper is on returning beneficiaries to work, through greater work testing, job placement and training. While that objective is desirable, the suggested approach is limited and unlikely to make a difference of the magnitude required. There have been many previous attempts at addressing this end of the problem. The long-term solution to welfare dependency should focus on the other end of the problem: reducing the flow of people on to benefits. This requires the following:
  - better overall economic performance
  - more efficient labour market regulation and better incentives to engage in paid work

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<sup>12</sup> Psychiatric or psychological reasons accounted for about 41 percent and 29 percent of the people of working age who, at June 2010, were on the Sickness Benefit and Invalid's Benefit respectively. See Ministry of Social Development (2010b), "National Benefit Factsheet – Sickness Benefit" and Ministry of Social Development (2010c), "National Benefit Factsheet – Invalid's Benefit" retrieved 15 September 2010 from <http://www.msd.govt.nz/about-msd-and-our-work/publications-resources/statistics/benefit/2010-national-benefit-factsheets.html>. The Issues Paper notes that being jobless and on a benefit can also produce stress. See Welfare Working Group (2010a), p 25.

- improved educational outcomes for children who fall behind at school (at least from the first year at primary school), have behavioural problems or become disaffected
  - stricter entry criteria and mutual obligations for Sickness, Invalid's and Domestic Purposes benefits
  - a reduction in family breakdown, crime and substance abuse, and
  - changed societal expectations. In some communities being on welfare is the norm.
- Difficult policy issues such as minimum wages, family breakdown, substance abuse and the link between benefits and crime are largely overlooked. Poor educational participation and attainment, however, are acknowledged. The discussion of funding alternatives focuses on ACC, which is a mandatory scheme. Voluntary insurance arrangements for income loss through injury or illness, which could be alternatives to welfare in some circumstances, are not examined.

### **3 Future work**

- 3.1 The development of broader economic policies aimed at lifting the rate of growth and raising living standards are the focus of the 2025 Taskforce. The WWG should, however, continue to emphasise the importance of such policies in addressing welfare dependency.
- 3.2 Labour market flexibility is central to the WWG's task and should be a main thrust of its future work. The material living standards and financial independence of almost all people of working age depend on participation in paid employment by one or more members of a family (or a household) on a full-time, full-year basis. Persistent unemployment (or shortages of labour) points to inflexible labour markets because it is their role to match the supply of, and demand for, all categories of labour. Unemployment (and the absence of it) is not primarily related to an economy's level of or growth in income. Both low-growth economies (like Switzerland) and high-growth economies (like Hong Kong) have maintained generally low levels of unemployment because of their flexible labour markets (and supportive welfare policies).

- 3.3 Judith Sloan's report, *Towards Full Employment In New Zealand*, outlines the policies that are necessary to achieve full employment. Although it was written in 1994 in response to a discussion document, the report is highly relevant to the task of the WWG (a copy is attached).<sup>13</sup> Sloan observes, "The causes of unemployment are well understood, with labour market inflexibilities and perverse welfare incentives being the main culprits."<sup>14</sup> She argues that unemployment is "essentially a political choice"<sup>15</sup>, that is, policy makers can achieve full employment (as defined in the report<sup>16</sup>) if they are genuinely committed to attaining that goal.
- 3.4 Sloan's report outlines the direction of policy that is necessary to achieve full employment. A return to full employment is the only effective solution to a major part of the country's welfare dependency problem. Labour market flexibility is impeded by regulations relating to the following matters (among others) which should be addressed: dismissal rules, fixed term contracts, minimum wages for adults and youth, holidays and parental leave, health and safety in employment, ACC, the KiwiSaver scheme, and occupational licensing, together with tax legislation, the Human Rights Act 1993 and the New Zealand Bill of Rights Act 1990. A range of possible reforms should be presented in the Options Paper. On dismissal rules, for example, these could range from the government's present trial period proposals, to a no-fault dismissal regime or the abolition of relevant mandatory personal grievance laws, to options in between.
- 3.5 The level of minimum wages, especially for those under 20 years of age, has increased substantially since 2000. It is likely that this has contributed to the unconscionable level of unemployment among young Maori and Pacific people, and other youth with no or few educational qualifications. The impact on employment of the increases in minimum wages should be quantified.
- 3.6 The WWG's secretariat may not have the expertise to address labour market issues in depth. We suggest that the WWG engage the expertise required to examine labour market flexibility. We would be happy to suggest suitable consultants.

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<sup>13</sup> Sloan, Judith (1994), *Towards Full Employment In New Zealand: A Response to Employment: The Issues: A Report of the Prime Ministerial Task Force on Employment*, New Zealand Business Roundtable, Wellington.

<sup>14</sup> *Ibid*, p 1.

<sup>15</sup> *Ibid*.

<sup>16</sup> *Ibid*, p 17.

- 3.7 Another main focus of the WWG should be family breakdown and matters relating to children at risk. Along with unemployment, they are a key reason for long-term benefit dependency. Problems relating to dysfunctional families, child abuse and poor educational achievement contribute to problems in later life that lead to welfare dependency.
- 3.8 The Issues Paper effectively ducks the issue of family structure but implies that policy may contribute to the prevalence of sole parent families:

Family formation is inherently a personal decision and an individual's decisions about their needs in regard to family formation and partnering will depend on the circumstances that they face. A benefit system should not promote certain family types over others. There is limited evidence in this area. Nevertheless, a key question is whether New Zealand's high rate of sole parenthood compared to other OECD countries is entirely driven by broader social trends.<sup>17</sup>

The benefit system promotes certain family types by subsidising them, for instance additional welfare assistance may be available if families break up and, in the case of the Domestic Purposes Benefit, by providing unconditional support.

- 3.9 Morgan's analysis, which refers to a substantial body of research, reports that the traditional two parent family is generally best for raising children.<sup>18</sup> This does not mean that some sole parents do not do an excellent job or that the continuation of a violent or other problematic relationship is necessarily better for children than separation. The public policy question is what works best on average and over time.
- 3.10 The Issues Paper does not attempt to answer the key question noted above or examine whether the benefit system encourages family breakdown and hence sole parent families. The WWG should, in our view, examine the reasons for family breakdown more deeply and reassert the role of the family. Options for

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<sup>17</sup> Welfare Working Group (2010a), *op cit*, p 26.

<sup>18</sup> Morgan (2004), *op cit*, especially chapters 7-11. An OECD report, *Doing Better for Children*, concludes that the causal effect on child outcomes of being brought up in a single parent family is small or even zero. The OECD warns that care should be taken in drawing firm conclusions because the literature is immature (see OECD (2009), *Doing Better for Children*, OECD, Paris, chapter 5). David Popenoe takes a firmer view consistent with Morgan. His view is reported in Roger Kerr's "Foreword" in Morgan (2004), *op cit*, p viii. As Nobel laureate Gary Becker observes, "common sense and most academic findings suggest that having a father present during the raising of children generally has a positive effect on the development of non-cognitive traits of children. These include a general respect for authority and reduced rebelliousness in school, and the avoidance of gangs and other criminal activities. It also appears that the absence of fathers has a greater effect on the non-cognitive traits of sons than daughters, although that is a less well-established finding". See Becker, Gary (2010), "The Effects on Children of the Decline in Marriage-Becker", retrieved 5 April 2010 from <http://www.becker-posner-blog.com>.

'strengthening families', to invoke the name of a policy of the last National-led government, should be presented in the Options Paper.

- 3.11 There are substantial concerns about dysfunctional and disadvantaged families, and the effect of how they are raised on the development of children, and their transition to adulthood.<sup>19</sup> These issues may be related to family structure or they may be independent of it. In either case, they are important in reducing the flow of young people on to benefits and are central to the responsibilities of the Ministry of Social Development. They should influence the direction of policy on welfare benefits.<sup>20</sup>

#### **4 Specific policies to examine**

- 4.1 We think the WWG's main effort to reduce welfare dependency, especially long-term dependency, should focus on labour market flexibility and measures to reduce family breakdown. Those broad approaches, together with policies to lift the rate of economic growth, should be supported by specific changes to present benefit arrangements, such as those listed below. The policies identified are not necessarily advocated at this stage. They should, however, be examined in the Options Paper.

- Improved work incentives. Paid employment, especially on a full-time full-year basis, must be financially attractive relative to being on benefits, taking account of supplementary assistance and the skills and experience of beneficiaries and potential beneficiaries. Wage rates are set in the market. Welfare support must be set at a level that makes employment worthwhile. This means that any adjustment that is required must be to benefit arrangements such as the levels of main benefits, supplementary assistance and employment subsidies (see below), and assistance available to beneficiary and non-beneficiary families.
- Introduce time limits for the receipt of benefits. Such limits might be useful in reducing long-term benefit dependency. They might be applied to some

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<sup>19</sup> See, for example, Peter Gluckman's interim report, Gluckman, Peter (2010), *Improving the Transition: Reducing Social and Psychological Morbidity During Adolescence*, Office of The Prime Minister's Science Advisory Committee, Wellington.

<sup>20</sup> The Issues Paper notes that around 5,700 enter the benefit system as 16-17 year olds and 4,700 enter the benefit system on their 18th birthday. It is not known what proportion of the latter come off their parent's benefit. See Welfare Working Group (2010a), p 12.

or all categories of benefits. The level of assistance available if the limits were exceeded and the conditions that would apply should be examined.

- Apply work tests to people receiving the Domestic Purposes, Sickness and Invalid's Benefits:
  - In respect of the Domestic Purposes Benefit, the relevant issues are when work tests should be applied, including whether additional children born while on the Domestic Purposes Benefit should be taken into account, and the extent of work that should be required. The Future Focus policy, which will generally require part-time work when the youngest child is 6 years or older, implies that women, especially those with more than one child, may be out of the workforce for a considerable time and is more lenient than comparable arrangements in many other countries. Furthermore, some beneficiaries may be encouraged to have additional children to defer the test. Many women who care for children and who are not on a benefit engage in work. The recent Henry tax review in Australia concluded that the primary carer should be required to look for part-time work once their youngest child reaches four years of age.
  - The WWG should proceed in our view by examining principles and research which should inform decisions on work tests. A body of opinion suggests that a reasonable point at which sole carers should be required to look for part-time work is when the child reaches the age of one. The reasoning behind this is threefold: in terms of the development of their cognitive ability and ability to socialise, children can benefit from being in child care from around the age of one year; a sole carer starts to lose the skills and motivation to work after about seven months of being disengaged from the workforce; and around three quarters of working women return to work within 18 months of their child's birth.
  - Some people who are unemployed rather than ill or incapacitated are understood to be receiving Sickness or Invalid's Benefits that are not subject to work tests. While it would be uneconomic to apply a work

test on a regular basis to all invalids, work tests should generally be applied to most recipients of Sickness and Invalid's Benefits.

- Strictly enforce work tests for all classes of beneficiaries.
  - Sanctions should be applied when beneficiaries turn down jobs, decline to apply for jobs on offer that they are capable of performing (even if the job is perceived to be unappealing) or take steps designed to thwart a job offer. Similar provisions apply in respect of the Unemployment Benefit now but we understand that they are not rigorously enforced.
  - Examine whether existing processes and procedures for assessing the capacity of applicants for Sickness and Invalid's Benefits are fair to taxpayers and whether additional steps should be taken to establish the veracity of illnesses and injuries of a type commonly claimed by malingerers.
  - Apply sanctions in respect of self-inflicted incapacity for work such as substance abuse and gambling addiction. These could include compulsory participation in rehabilitation programmes, with penalties for non-participation, and in-kind assistance or other forms of income management (see below). Comprehensive health checks for those with suspected self-inflicted incapacity could be made mandatory.
- Give priority to employment over job training. Only people who lack the most basic skills and personal attributes to enter the labour market (for instance elementary literacy and numeracy) should be offered training rather than work. The recycling of beneficiaries through training courses that lead nowhere is to be avoided.
- Emphasise immediate rehabilitation and an early return to work (where possible) for people suffering from injuries and illness.
- Reassert the role of the family and strengthen provisions to hold non-custodial parents liable when family breakdown occurs.
  - Review all policies that encourage family breakdown.

- The first responsibility for supporting children should rest firmly with their parents. Shared parenting and support should be encouraged.<sup>21</sup> The ability for parents to split custody of children and both receive the Domestic Purposes Benefit should be reviewed at the very least.
- Greater effort should be made to identify and hold non-custodial parents liable for the support of their children through to adulthood, and the custodial parent at least to the age at which work is required, by those who are on the Domestic Purposes Benefit. Consider using private firms to locate non-custodial parents, including those resident overseas. Apply sanctions to non-custodial parents who evade their responsibilities by living overseas similar to the collection of unpaid fines by those exiting the country. Other methods of obtaining payment should also be explored (for instance, declining to renew passports for evaders until satisfactory arrangements for future payments are agreed). We would expect to see a range of possible strategies put forward for consideration in the Options Paper.
- Entry provisions to the Domestic Purposes Benefit should include measures to encourage non-custodial parents to play a constructive role in their child's life, in addition to financial support.
- Review the administration of the child support scheme. For instance, the Inland Revenue Department is reported not to follow up on non-payment until large overdue amounts are accumulated. The debt that has accrued arises substantially from penalties for late or non-payment. The level of penalties and the possibility of an amnesty, as well as other aspects of the administration of the scheme, might be investigated.
- Re-examine the Child, Youth and Family Service's promotion of the Domestic Purposes Benefit rather than adoption where the child's mother is a teenager. The 'home for life' scheme, whereby foster

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<sup>21</sup> The minister of revenue has released a discussion document, *Supporting Children*, which examines whether better recognition should be given to shared care in computing the level of child support. The discussion paper mainly focuses on possible modifications to the present child support scheme rather than the principles raised in this submission. See Dunne, Peter (2010), *Supporting Children*, retrieved 3 September 2010 from <http://taxpolicy.ird.govt.nz/>.



parents are encouraged to take in children permanently, is a good policy and should be more widely promoted.

- Review assistance for child care. As around half of all welfare-dependent single mothers are providing care for only one child, there is enormous child care capacity lying dormant within the population of sole parents on the Domestic Purposes Benefit.
- Provide in-kind assistance (or other forms of income management) rather than cash benefits where families are dysfunctional. Where alcohol or substance abuse, or gambling addiction, are significant factors contributing to dependency, food stamps or other vouchers, or some form of card that restricts beneficiaries' purchases of items such as alcohol, drugs and gambling could be examined. A significant proportion of the total assistance provided to beneficiaries (say, 50 percent) might be provided in this way. The Howard government introduced similar provisions for some aboriginal communities in Australia. They have since been extended. Alternative delivery arrangements (such as Whanau Ora) and the use of the voluntary sector should be examined in extreme cases of highly dysfunctional families. The Options Paper should outline some options in relation to these matters.
- Contract out all employment services. The Ministry of Social Development should focus on the oversight of such contracts and should develop incentives that encourage providers to place long-term beneficiaries in work. The point that this might result in fewer positions in MSD is not a relevant public policy consideration.
- Improve measures to combat benefit fraud such as encouraging reporting of fraud by the public, the use of private investigators, tougher penalties, the loss of future eligibility for benefits, and instituting an anti-fraud advertising campaign and amnesty period.

4.2 Wage subsidies are sometimes promoted as a way of increasing the employment of beneficiaries. With a flexible labour market, wage levels would tend to reflect the prospective productivity of employees, including people coming off a long period on benefits, some of those with disabilities or those recently released from prison. In these circumstances, wage subsidies are not

warranted. The issue of whether the market wage for some classes of labour would provide an adequate income would be addressed through general income transfers (such as the Minimum Family Tax Credit) rather than wage subsidies. An exception might arise, however, in respect of people with high levels of disability.

- 4.3 If minimum wages, unfair dismissal rules or other labour market regulations raise the cost of employment above that justified by the productivity of potential employees, the first-best response is to remove such obstacles to employment. A minimum wage that prices people out of work and forces them on to a benefit that provides an even lower income is inequitable and inefficient. Similarly, dismissal rules that unduly raise the risk of employment and thereby discourage employers from offering jobs to beneficiaries, and other categories of labour that entail a high risk of unsatisfactory performance, should be re-examined. If they cannot be removed entirely, exceptions should be made for high-risk categories of labour. Some employers have told us that no-fault dismissal rules would be necessary for them to take on long-term beneficiaries. The Work and Income policy of not imposing a stand-down period if a dismissed employee takes a personal grievance case should be changed – Centrelink in Australia has no such policy.
- 4.4 If first-best policies cannot be implemented and if other measures (such as those outlined in paragraph 4.1) are not sufficient assistance with job search, child care and transport are likely to be better approaches generally than temporary subsidisation of the wages of former beneficiaries. Similarly, subsidies paid to employers to create additional jobs are undesirable. The recent experience of the United States in attempting to identify additional jobs created as a result of the fiscal stimulus highlights how problematic it is to subsidise so-called job creation. Subsidised jobs displace other jobs. Moreover, subsidising jobs that would have been on offer in any event raises the costs of such programmes and hence the deadweight costs of taxation which itself costs jobs.
- 4.5 Another important issue will be the rate of abatement of welfare assistance. We appreciate that the issue of the level of benefits and their relationship with Working for Families and the tax system are outside the scope of the WWG's work. Nevertheless, tradeoffs among the level of assistance, the rate of abatement and the overall fiscal cost of the programme (and hence the levels of marginal rates of tax imposed on taxpayers generally) need to be recognised.

There is no easy answer. High effective marginal tax rates over wide income bands have a particularly adverse effect on behaviour and are to be avoided if at all possible. People tend to arrange their circumstances to avoid such disincentives. While rules of thumb are necessarily arbitrary, we think effective marginal tax rates in excess of 50-60 percent over broad income bands are generally undesirable. On the other hand, very high effective marginal tax rates over a narrow income band may be appropriate if people can progress beyond the relevant income band. The key principle here is that benefits are a safety net and that people who can work should do so, even if additional rewards are meagre in the first instance.

- 4.6 The policy of permitting beneficiaries to earn market income before the abatement of benefits starts should be abolished. People on the Unemployment, Sickness, Invalid's and Independent Youth Benefits may earn up to \$80 a week before abatement at the rate of 70 cents in the dollar of any additional income applies. This abatement regime will not change under the Future Focus policy. However, from later this month, people on the Domestic Purposes, Invalid's and Widow's Benefits will be able to earn up to \$100 a week (currently \$80) before abatement of 30 cents in the dollar on any additional income starts. The abatement rate will increase to 70 cents in the dollar on any additional income over \$200 a week (currently \$180).
- 4.7 The application of a zero abatement rate on the first increment of market income and a relatively low rate of abatement for a second increment in the case of certain benefits accentuates the problem of providing a worthwhile gap between the level of income in work and on a benefit. The abatement rate beyond the initial income threshold or thresholds must be higher than otherwise if the fiscal cost is held constant. Part-time or part-year work is encouraged whereas exit from benefits is discouraged. A lower abatement rate might be appropriate for those beneficiaries who are not able to work full time because of disability or because they are caring for children or sick people. The problem here is the ability to separate the two groups and the incentive to remain on at least a part benefit for a long time.
- 4.8 The level of the main benefits defines the minimum level of income that society deems to be appropriate for people dependent on welfare. Supplementary assistance is also provided in certain circumstances. Any market income should be abated from the first dollar. This approach may discourage some

beneficiaries from taking up limited work. It may also accentuate the problem of beneficiaries not reporting their earnings but this is understood to be a widespread problem now. These costs might be tolerated, especially as part of a broader policy that puts much greater emphasis on addressing welfare dependency and combating benefit fraud.

- 4.9 Two policy options that may be raised are a guaranteed minimum income for every adult and a single benefit. Neither option is attractive. Several reasons could be advanced. We focus on the main ones. In respect of the first option, it makes no sense to distribute or guarantee income to the entire population to address a problem relating to a small fraction of the population.<sup>22</sup> Tax revenue cannot be collected from a taxpayer and then returned to the same taxpayer without incurring substantial economic costs. Similarly, collecting tax revenue to transfer to a person other than the taxpayer is costly. A guaranteed minimum income would impose much higher marginal tax rates and high deadweight costs on the community and thereby impede economic growth. Guaranteed minimum income or negative income proposals that apply to a large proportion of the population always fail when the details of the scheme are drawn up, the costs are estimated and their incentive effects are properly analysed.
- 4.10 The second option, a single benefit at a flat rate, is also impracticable. It would inflict large income losses on some beneficiaries unless the level of the benefits were set at the highest benefit rate, in which case there would be large additional fiscal costs. Moreover, supplementary assistance would need to be taken into account, otherwise the single benefit would be topped up by such assistance and the concept of a single benefit lost. If a single benefit were to increase the level of assistance provided to beneficiaries, it would encourage welfare dependency rather than reduce it. The Labour-led government announced its intention to examine a single benefit but never published a feasible proposal. Neither option warrants investigation by the WWG.

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<sup>22</sup> As noted above, about 13 percent of the working-age population is on benefits. Around 11 percent of people aged 18 years and over is on benefits (excluding New Zealand Superannuation). The percentage would be reduced if benefit dependency were addressed.

## 5 Conclusions

### 5.1 Our main conclusions are listed below:

- Welfare dependency is a huge problem that blights the lives of many people and has wider deleterious social and economic effects. The Issues Paper does not face up to the enormity of the welfare dependency problem confronting New Zealand.
- The three critical areas for addressing welfare dependency comprise the following:
  - Steps to boost the rate of productivity and economic growth, and thereby raise living standards. While the Working Group should continue to emphasise their importance, the responsibility for the necessary policies lie elsewhere.
  - Enhancing the flexibility of the labour market and thereby returning the country to full employment. The Welfare Working Group should address the many policies that impede flexibility. This should be a key focus of its future work. External expertise should be engaged to assist the Welfare Working Group in this task.
  - Reasserting the role of the family and thereby reduce the level of family breakdown. The child support scheme should also be reviewed. This should also be a key focus of the Welfare Working Group's future work.
- A wide range of measures (such as improved work incentives, time limits, an extension of work tests, stricter enforcement of work tests, measures to reduce the current entitlement mentality, contracting out employment placement services, stricter entry criteria, mutual obligations, and strengthened enforcement of child support arrangements) that could help reduce welfare dependency, especially long-term dependency, should be examined.

### 5.2 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.