The Cost of Welfare Options and Cost Containment

A BRIEFING PAPER
FOR THE
MINISTER OF SOCIAL WELFARE

OCTOBER 1990

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INTRODUCTION

A contributing source of the present fiscal pressure on Government is the high level of welfare expenditure, which continues to increase. For the years 1986/87, 1987/88 and 1988/89 (the lastest GDP data) welfare expenditure as a percentage of GDP was 11.6%, 12.2% and 12.9%. In terms of dollar amounts, the expenditures were $6.2 billion, $7.2 billion and $8.2 billion respectively. In the last and the current financial years expenditure has been or will be around $9.5 billion.

What follows is a brief outline of the cost of welfare programmes, and short term options for containing those costs.

COSTS OF PROGRAMMES

The Estimates of Annual Appropriations presented to Parliament on 24 July 1990 for the 1990/91 financial year allocated $9.4 billion to the Department of Social Welfare for the purpose of making Payments On Behalf of the Crown (excludes administration costs). This is an estimate of the cost of existing social welfare programmes for which this Department has responsibility.

The following table gives a breakdown of the expenditure into the main programmes.

Table 1. Summary of DSW Programme Costs as Voted for 1990/91

Expenditure Item	Appropriation (1990/91) million	As % of total "POBOC" Appropriation
1. Guaranteed Retirement Income (GRI)	5,048.3	53.4
2. Domestic Purposes	1,264.6	13.4
3. Unemployment	1,143.7	12.1
4. Invalids	283.1	3.0
5. Sickness	269.4	2.9
6. Widows	118.4	1.3
7. Training	107.7	1.1
8. Tax on Benefits (2 - 7)	603.0	6.4
9. Family	263.7	2.8
10. All War Pension	135.7	1.4
11. Other payments *	213.6	2.3
TOTAL	9,446.2	100.0

* Item 11 covers programmes ranging from smaller benefits (eg Handicapped Childs Allowance $21m) to IHC funding ($44.2m) to Family violence programmes ($4.9m) and some small programme grants.

In addition to these POBOCs, approximately $60m has been allocated towards the "Output cost" for Social Work Services which could be more appropriately considered POBOC expenditure. It relates mainly to the cost of CYP and F Act programmes.

SOME PROGRAMMES UNDERFUNDED

After three months into the 1990/91 financial year it is apparent that expenditure on some programme items will exceed the original allocation if current trends continue and no compensatory changes to programmes are made.

The items which are underfunded are:
a) GRI - likely to exceed allocation by $82m (1.6%)
b) Unemployment Benefit - likely to exceed allocation by $216m (18.9%)
c) Family Benefit - likely to exceed allocation by $20m (7.6%)
d) Sickness Benefit - likely to exceed allocation by $4m (1.5%)

The GRI item arises mainly from the introduction of the Living Alone Payment from 1 October, which was not built into the original costing. The Unemployment item is caused by benefit numbers being higher than forecasted by Treasury.

There may be over funding of some other items - possibly to the order of $26m.

At this stage the Department anticipates requesting an additional appropriation of approximately $322m for POBOC items for the 1990/91 year.

SHORT TERM OPTIONS FOR CONTAINING WELFARE COSTS

The following are possible ways of reducing the real level of welfare expenditure over the next few years. In general, their capacity to achieve cost reductions is their only positive feature.

The set of possibilities described below is intended to be comprehensive, if not in detail at least in pointing to all of the broad approaches which in principle are available to Government to achieve cost reductions. The inclusion of a measure does not imply that it is endorsed or advocated by the Department of Social Welfare.

All of the measures have disadvantages in terms of the pursuit of commonly accepted social policy objectives. However, the nature of the disadvantage differs from one measure to another. To choose between them requires a decision on which types of disadvantages it is most important to avoid.

The main disadvantage of each measure is indicated.

The measures would achieve savings by various means. For example, some would achieve savings by improving the extent to which expenditure is targeted towards those with the greatest need, other measures would achieve savings by reducing the number of persons receiving benefits, and so on. The measures are grouped according to the means by which they would achieve savings.

MEASURES WHICH RELY ON GREATER TARGETING OF EXPENDITURE TOWARDS PERSONS IN NEED

1. <u>Strengthening the targeting provisions of Family Benefit</u>

Existing plans to restructure family assistance provisions which reinforce the emphasis on targeted over universal assistance could be modified to increase the degree of targeting even further. If the constraint was imposed that the worst off families should not suffer any income reduction, increased targeting could produce an annual saving of up to $125 million. This degree of targeting would result in many families getting less family assistance than at present, and a substantial number getting no assistance (ie the universal Family Benefit would be abolished).

Main disadvantage: the measure would worsen the financial position of many families whose present position is only marginal; it also could generate widespread public resentment, partly because of the reaction of women's organisations convinced about the importance of non-working mothers having a source of money other than their partners, and partly because it would run counter to a widespread feeling that equity is served by the state making some payment to all parents in recognition of their expenses in supporting their children; in the longer term, the measure could lower general public commitment to a comprehensive system of income support.

2. <u>Introduction of a "sharing" rate for income tested benefits</u>

If a decision were taken to delay, or not proceed with, the Universal Benefit, there would be one expenditure-saving feature of it which still could be introduced. Payment of single beneficiaries in shared accommodated at half the married rate (rather than a single rate of 20% more than half the married rate) would result in less expenditure than continuation of the present married-single rate structure. It is envisaged that if the alternative rate structure were to be adopted, beneficiaries who live alone (thus not having the economies of scale which result from shared living arrangements, with consequent higher living costs) would receive a living alone allowance. For income tested benefits, this structure of a common core rate for both married and single persons, together with a living alone allowance, would give a continuing annual saving of the order of $145 million.

Main disadvantage: the measure would result in some hardship (mainly amongst persons receiving Sickness, Invalids, Widows and Domestic Purposes Benefits), although not to the extent of an across-the-board reduction in all benefits, being a measure which increases the degree of targeting of expenditure. The impact would be most severe on Maori and Pacific Island families, where extended family situations are more common than in Pakeha families.

3. <u>Introduction of a "sharing" rate for GRI</u>

If the above structure were to be applied to GRI (with single "sharers" receiving only half the married couple rate but with the GRI living alone allowance being increased to make it sufficient to compensate for the higher living costs resulting from living alone) there would be a continuing annual saving of the order of $120 million.

Main disadvantage: further unheralded restructuring of the provisions for the elderly would increase anxiety amongst the elderly and cause hardship to some; it also would increase uncertainty amongst people in the working population about the personal provision they should make for their retirement.

4. <u>Tightening the income test applying to GRI</u>

Savings could be made in GRI by tightening the tax surcharge provisions, which provide a much less severe income test than that applying to the standard income tested social security benefits. The upper limit for a saving by this means could be around $1 billion annually, that being the saving which would result if the social security test were to be applied to GRI. A less severe option would be to tighten surcharge provisions for only those under 65 years. The saving would be around a third of that produced by a general tightening. Relaxation of the current test would have the reverse effect of <u>increasing</u> expenditure, and its abolition would boost annual expenditure by about $250 million.

Main disadvantage: same as for item 3.

MEASURES WHICH REDUCE THE NUMBER OF PERSONS WHO ARE IN RECEIPT OF BENEFITS

5. <u>Limitation of the period for which unemployment benefit can be received</u>

A limit could be placed on the period for which an unemployed person is eligible to receive a benefit. (There is currently no time limit.) For example, a beneficiary might cease to be eligible after a period of a year, and may remain ineligible for the subsequent three months, or six months. Such limits are found in some European countries. However, the scope for achieving a significant saving through this approach is probably limited. Measures currently being developed, such as the mandatory "work focus" interview, are likely to substantially reduce the number of persons receiving the benefit of a long period, and those persons are currently a minority of beneficiaries. Overseas experience is that in the absence of an expansion of the labour market such measures tend to produce "churning" of unemployment; that is to say that they produce a turnover in which persons at any particular time are unemployed but do not produce much reduction in the aggregate number of unemployed.

Main disadvantage: if the measure produced a significant saving (which it might fail to do) it would be at the expense of creating financial hardship; furthermore, it would be seen by unemployed persons, and some of the general public, as unfair.

6. Requirement for sole parents to make an early return to work

Eligibility for Domestic Purposes Benefit could be restricted to sole parents whose youngest child was below some fairly low age (eg. 5 years, or 7 years, or 10 years). While the demand for labour remains at its current low level, reductions in DPB expenditure would be heavily offset by unemployment benefit payments to sole parents unable to find work. Net savings would depend on how severely DPB eligibility was restricted, and on labour market conditions. The possible level of savings is extremely difficult to estimate. A facilitative approach based on counselling, training and supportive services (eg. to ensure satisfactory child care) would have substantial costs. Initially, at least, the costs could be as great as the reduction in benefit expenditure resulting from an earlier return to work, in which case there would be no net saving.

Main disadvantage: if applied with sufficient rigour to produce a substantial saving, the approach would create hardship amongst sole parent families, and would increase the amount of personal stress within those families; it also would make it more difficult for women with abusive or violent spouses to terminate the relationship, or to use threat of termination to prevent violence.

7. Abolition of the under age spouse option of GRI

Currently where a married person who qualifies for GRI has a spouse who does not qualify, there is an option whereby the married couple rate can be paid, subject to the application of the standard social security income test. Abolition of this under age spouse option would restrict eligibility for GRI and thus produce a saving. It would be partially offset by the cost of paying unemployment benefit to some spouses unable to find work. The annual saving could be around $50 million, but would depend on the proportion who went onto unemployment benefit.

Main disadvantage: same as for item 3.

8. Rapid increase in age of eligibility for GRI

Increasing the age of eligibility for GRI will restrict eligibility, producing potentially big savings. These would be partially offset by unemployment benefit payments to persons over 60 years who were not yet eligible for GRI but unable to find work. If the age of eligibility for GRI were to be increased by one year in each of five successive years, the increased level of savings each year would be up to $180 million. The level of savings escalates each year, and would grow to around $500 million in the fifth year. (These estimates try to take account of offsetting increases in unemployment benefit and reductions in tax and surcharge revenue.) This gives savings of up to $2 billion for the five year phase-in period. Extending the phase-in period would give those close to retirement more time to adjust their expectations and circumstances but would yield correspondingly smaller annual savings.

Main disadvantage: same as for item 3.

MEASURES WHICH RESTRICT THE SUPPLEMENTATION OF BASIC BENEFIT PAYMENTS

9. Further restriction on criteria governing Special Need Grants

Some savings could be achieved by reducing the range of special circumstances in which beneficiaries can receive additional assistance. The most severe move in this direction would be to abolish Special Need Grants. Abolition would produce an annual savings in the range of $20-30 million.

Main disadvantage: the measure would result in financial hardship and could lead to instances of genuine hardship being widely publicised, creating public pressure for an increase in basic rates; it also would cause voluntary welfare organisations which provide financial and material support to be subject to increased demands which they were unable to meet.

10. Further restriction on criteria governing Special Benefits

Special Benefits constitute the main other discretionary provision administered by the Department. The comments made above about Special Need Grants apply. The upper limit for savings is around $35 million, the amount which would be saved if Special Benefit were ti be abolished. Benefit.

Main disadvantage: the same as for item 9.

11. <u>Reduction in levels of supplementary assistance provided to beneficiaries through Accommodation Benefit</u>

It would be possible to reduce amounts of assistance provided to beneficiaries with high accommodation costs by changing the parameters of the Accommodation Benefit. The upper limit of the annual saving which could be achieved is $120 million, the amount which would be saved if Accommodation Benefit were to be abolished.

Main disadvantage: the amount of hardship resulting from this measure would be great, especially in relation to the amount of expenditure saved, because Accommodation Benefit expenditure is already highly targeted towards those in financial need; some of those affected (for example, invalids and intellectually handicapped persons receiving Accommodation Benefit as a boarding supplement) would have little capacity to affect their living circumstances.

MEASURES WHICH PLACE GREATER DEMANDS ON FAMILIES AND INDIVIDUALS TO ASSUME SUPPORT RESPONSIBILITIES

12. <u>Shifting the cost of supporting young adults to their families</u>

More severe parental income tests could be applied to the parents of non-working persons below the age of 20 years. Regimes presupposing a substantial parental obligation could apply not only to students and unemployed young persons, but also to sole mothers under 20 years, with consequent restrictions on the eligibility criteria of the Domestic Purposes Benefit and the rates paid to young sole mothers. The parental income test to apply from 1 April 1991 to under 20 year olds without children will save around $15 million while tightening up on Domestic Purposes entitlements to those under 20 years could generate further savings of up to $10 million. The actual savings would depend on how rigorously the restrictions were applies.

Main disadvantage: a rigorous approach would be difficult to carry out without incurring some extreme cases of hardship or instances of young persons being prevented from escaping from harmful situations (eg. situations involving continuing violence or sexual abuse).

13. <u>Improved collection of child maintenance from liable parents</u>

Significant new measures are currently being planned for improving the collection of child maintenance in relation to both children in the care of beneficiaries and children whose custodial parents are self supporting. These measures involve reform of legislation covering child maintenance and liable parent contributions, together with the establishment of a collection agency within the Inland Revenue Department. Examination has been made of the feasibility of bringing forward the implementation date (July 1992) but experience in Australia in introducing similar reforms suggests this would incur the risk of weaknesses which would undermine projected increases in collection. New initiatives to improve collection will continue to be introduced by the Department of Social Welfare up to the transfer date. They are expected to produce a continuing improvement in maintenance collection, with savings of $24-40 million. It would require administrative resources of $10-16 million to generate these savings.

MEASURES WHICH REQUIRE INDIVIDUALS TO DRAW MORE FULLY ON THEIR OWN FINANCIAL RESOURCES TO MEET THEIR NEEDS

14. Introduction of an asset test on eligibility for GRI

The introduction of an asset test for GRI would restrict eligibility, thus producing savings. The extent of the restriction would depend on the severity of the asset test. A test along the lines of that applying in Australia might reduce annual GRI expenditure by around $500 million, at least initially. (This would be offset by administrative costs of several tens of millions of dollars, an amount which would be high in absolute terms although not as a proportion of the savings achieved.) The savings might decline if (as would be likely) people found it was possible or them to organise their personal finances in ways which enabled the asset test to be avoided.

Main disadvantage: same as for item 3.

A REDUCTION IN THE RELATIVITY BETWEEN BENEFIT RATES AND WAGES

15. Across-the-board reduction in the relativity between benefit rates and wages

The next general benefit adjustment is currently projected to be an increase of about 5%. If the adjustment were to be set at 2% (the level of increase in nominal income to which many paid employees will be limited) there would be a net saving of around $90 million. If the adjustment to GRI also was set at 2%, there would be a further net saving of $120 million. Alternatively, shifting the adjustment from April to July (so that the adjustment period thereafter corresponded to the budget year) would save about $22 million net in income tested benefits and about $30 million net in GRI. Deferral of the next adjustment by six months would produce savings of double those amounts (i.e. $44 million and $60 million). A more severe option would be to freeze nominal rates. This would give a net annual saving of the order of $150 million on income tested benefits and $200 million on GRI. A yet more severe option would be to slightly reduce nominal rates from some future date.

Main disadvantage: the measure would result in hardship. In relation to GRI, the measure would also carry the disadvantages outlined for item 3.

MEASURES WHICH INVOLVE THE DEFERMENT OR ABANDONMENT OF PROJECTED CHANGES WHICH WOULD INCREASE EXPENDITURE

16. Deferment of the shift to individual assessment during the initial period of unemployment or incapacity

A saving could be made by deferment of the projected change to unemployment and incapacity provisions whereby an unemployed married person's entitlement to benefit will not be affected by their spouse's income for the first eight weeks after the person's loss of income to unemployment or incapacity. (That is to say, for the first eight weeks the person will be treated as though single, while subsequent to that being subject to the spouse income test as at present.) This would save about $30 million for each year of deferral. Alternatively, halving the period of individual entitlement from eight weeks to four weeks would produce an annual saving of about $15 million.

Main disadvantage: the measure would perpetuate the existing source of hardship, namely that which can result when two income couples with large financial commitments experience a large and unforeseen drop in income through the job loss of one member. Developments intended to provide better integration between provisions for unemployment, sickness and accident would be set back.

17. Deferment of the implementation of the new incapacity scheme

Some temporary savings could be made by deferment of foreshadowed changes to incapacity provisions which will rationalise assistance currently provided through both social security benefits (Sickness and Invalids Benefits) and Accident Compensation. Alternatively, the new provisions could be modified to lessen the anticipated increase in costs. Note: The changes involve financial responsibility for sickness and invalids benefit clients being transferred from the Department of Social Welfare to the Accident Compensation Corporation (redesignated the "Rehabilitation and Incapacity Corporation) on 1 April 1992.

The cost of this change has been estimated to involve additional expenditure of approximately $250m per year. Funding of this cost has not yet been finalised.

Main disadvantage: The difference in treatment - for income maintenance purposes - of people incapacitated by accident and those incapacitated through illness or birth condition has long been recognised as anomalous. Deferral of the new scheme would further continue the anomaly.

18. Continuation of lower benefit rate for the unemployed

The projected merging of rates - to create a common rate for all beneficiaries, irrespective of the basis of eligibility - could be deferred or abandoned. The result would be that persons receiving income support by reason of inability to find work would continue to receive less than persons eligible because of sickness, invalidity, and so on. Under universal benefit the alignment of rates is planned to occur in tandem with the introduction of the living alone provision, which will provide some off-setting savings. Even so, there will be a net annual cost of the order of $20 million, which therefore is the amount which would be saved by deferring this development.

Main disadvantage: it is indisputably inequitable to pay some beneficiaries at a lower rate than other beneficiaries who are in similar circumstances, solely because the former are unemployed - and expected to look for work - and the latter are not.

19. Deferment of other elements of benefit reform

The total benefit reform package (involving Family Benefit, Universal Benefit and associated youth entitlements) was developed to be "fiscally neutral". However, within the package there are expenditure transfers, which means that some parts of the package produce savings which finance other parts which increase costs.

There are aspects of the package additional to those covered by previous items which could also be deferred, with varying fiscal implications. A separate report on the benefit reform package is included amongst the briefing papers.

REDUCTION OF ABUSE

20. Increased information sharing between agencies to reduce fraud

Increased information sharing between the Department of Social Welfare and some other state agencies (especially the Inland Revenue Department) has the potential to lower operating costs and to reduce fraud through deterrence and improved detection. Short term gains probably would not be sustained as benefit abusers came to substitute different forms of abuse for ones which had become too hazardous. Possibilities are also constrained by the desirability of preserving civil liberties.

Main disadvantage: some forms of increased information sharing would create public anxiety because of their potential for violating civil liberties and personal privacy, and the provision of machinery to prevent such violations would have a cost.

SOME GENERAL COMMENTS ABOUT THE MEASURES

- Social security benefits contribute a large share of the incomes of Maori and Pacific Islander households than Pakeha households. As a consequence most of the measures relating to income tested benefits would have a more severe impact on the living standards of Maori and Pacific Islander households. This is especially the case for the option of replacing the current married-single rate structure with one based on a single core rate and a living alone allowance.

- Options which achieve savings through greater targeting of expenditure create the smallest amount of consequent hardship.

- Any improvement in the uniformity of rates paid by different benefits for people in the same living situations increases the equity of the benefit system. Maintaining or increasing such differences can be rationalised on the grounds of containing expenditure, but not on the grounds of promoting social justice.

- Measures which increase targeting (especially when they involve the use of discretion) require relatively higher expenditures on administration and the control of fraud and abuse.

- While increased targeting by income does direct expenditure most to those in immediate need, the targeting mechanisms employed need to be carefully designed so as to reduce possible disincentives for clients to become self supporting.

- Some of the options would add significantly to the Department's administrative expenditure. The operational implications would have to be considered before the probable gains from some of the options could be accurately gauged.

- Some of the amounts given as potential cost reductions are speculative, having been made in haste and depending on assumptions which could prove to be incorrect.