

SUMMARY – HISTORY OF THE WELFARE STATE IN NEW ZEALAND

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The report draws heavily on the much more detailed papers prepared by Michael Belgrave, Bernard Cadogan, and Brian Easton. However, the report presents the author's views and all errors and omissions are his responsibility. In particular, this report does not purport to represent the views of the Treasury.

Introduction

This paper briefly summarises the history of New Zealand's social welfare system, and compares New Zealand's experience with other similar societies. It also touches on the major demographic changes that have already occurred and that will continue into the foreseeable future. The main issue it attempts to resolve is the capability of our institutions, broadly defined, to cope with the challenges that our changing demographics pose. Our ageing population is ageing, and its structure is changing quickly.

The conclusions it reaches are;

- 1) New Zealand has successfully dealt with major challenges over its history to date, and there seems to be no reason why it cannot deal with the challenge posed by demographic changes; and
- 2) Major change in the economy and in society will remain a constant.

New Zealand's History

Economics is ultimately about how choices are made. This paper sets out to provide an account of the choices New Zealand has made over time. The term "welfare state" is assumed to cover health, education and welfare. Although the major focus on social welfare in the last few decades has been on income maintenance, similar issues arise in all three areas. The amounts spent on health and education were much higher than the amounts spent on income support and maintenance till comparatively recently.

1850s-1890s

From the 1850s to the 1890s, New Zealand developed as a colony of Great Britain, but with a society that was deliberately more egalitarian than Great Britain's was. Although its underlying philosophy was based on the then current ideas of individual responsibility and capitalism, the Government itself deliberately played a major role in economic and social development. Institutions such as the Government Life Insurance Department were created to mobilise local savings and to provide income support later in life. Land was seized from major landholders and broken up into smaller holdings for more intensive farming. The Government borrowed heavily to fund the construction of railways and other infrastructure, a policy which eventually ran into serious financial difficulties, partly as a result of the collapse of the City Bank of Glasgow.

This period also saw serious conflict between Māori and Pakeha settlers, especially over land ownership and control. The results of this conflict are still very much a subject of political interest and decision now.

1898 saw the creation of the first publicly provided pension for "persons of good character" aged 65 and over. Although the pension was means-tested and income-tested, additional income from insurance products from the likes of Government was allowed. It was seen at the time as a better and fairer alternative than the existing "civil list", which relied heavily on grace and favour. Comparatively few were expected to receive the pension, and the take-up

rate amongst the target group was reported to be less than 40%. One of the other reasons advanced for this reform was to recognise the service by those who participated in the land wars – both Pakeha and Māori. The pension itself was well below average incomes. It was administered through the Courts and the Post Office. The local Magistrate decided if an applicant qualified, and the Post Office handled the payments.

Over this colonial period, Health and Education were generally delivered at provincial levels, and often through the private sector, religious organisations and NGOs. The roles for central Government were limited to oversight and funding of the existing private or provincial systems. The initial Health Ministry was actually the Department of Public Health, and local Education Boards ran the public school system.

For Māori, whanau remained the traditional means of support for the elderly. While the 1898 pension was available to Māori, in practice few Māori received it, partly due to difficulties in proving their age and income. Those Māori who did receive the pension often received it at a lower rate than their Pakeha counterparts.

1900s-1940s

From the 1900s to the 1940s, New Zealand endured the same cataclysms as the rest of the developed world – World War 1, the Spanish flu (a major public health disaster), and the Great Depression of the 1930s. The central Government's roles in Health and Education grew in scope, from merely Public Health to all Health, and from central support to the provision of schooling. Income support continued to be based on the thought of mutual obligation. In particular, receipt of the unemployment benefit required the recipient to be available for work. This included Public Works in the early to mid 1930s, the so-called Sugar Bag years.

The reforms of 1935 to 1938 started to reduce the conditionality of benefit payments, in an attempt to soften the impact on families and individuals of the existing systems. A wide range of new income support programmes were also introduced. These included the creation of a two-tier pension regime. The first tier was the Old Age Benefit, which started at age 60. This was means and/or income tested, and was intended to recognise those who had worked in difficult work since leaving school, often at age 13. The second tier was Universal Superannuation, which was not means or income tested and was available to all New Zealanders at 65. Universal Superannuation started at a lower payment rate than the Age Benefit, but this gradually increased till parity was reached. It was intended that a tax surcharge of 5% of income (actually one shilling in the pound, later rising to 1/6 in the pound) would fund most of these changes.

It would be a mistake to see the 1930s reforms as simply being about income support. There was also a strong emphasis on employment and economic development. There were major changes in the trade and labour markets, with increasingly tight quantitative controls on imports alongside a much more centralised wage fixing regime. Together, these aimed at improving the ability of income from employment to provide adequate income for the working man and his family – “welfare by other means” – as well as fostering the growth of the industrial sectors.

These changes, alongside falls in export receipts, contributed to serious difficulties in raising debt in London capital markets in 1938 and 1939.

1942 was notable for the United Kingdom's Beveridge report, which provided a solid support for the growth of the welfare state after World War 2 in the United Kingdom and by extension, in New Zealand. In some ways, Beveridge followed New Zealand's lead. This was amongst the first reports suggesting that the state had an obligation to support its citizens in coping with serious problems – at the time perhaps as a form of quid pro quo for the efforts of all classes in successive wars. It also suggested relying on insurance principles to fund newer programmes. In other words, funded schemes were favoured over the alternative of pay-as-you-go. In the event, most governments have favoured pay-as-you-go schemes for pension payments, but funded schemes where insurance principles are appropriate (as for ACC now in New Zealand).

1950s-1970s

The 1950s to the 1970s were a very different world for New Zealand. Full employment was probably the highest priority for successive governments. New Zealand was comparatively undamaged by World War 2, and incomes remained relatively high. The post-war baby boom led to growth in housing and education spending, and the preferential access to the UK markets provided solid support for rising incomes. It is also notable that although there were generous welfare pensions for returning veterans, relatively few used them. The same is true for unemployment. Gaining the unemployment benefit required registration, and surprisingly few did so. There was normal churn in the labour market, but most seemed to find other employment without looking to Government support. There is an anecdote from the time that in one particular month, there were two registered unemployed in Auckland, and the Minister of Labour knew both of them.

At the end of 1972, New Zealand was a net creditor nation, and its GDP per head was about the same as that of Australia. The 1972 Royal Commission on Social Welfare recommended that the welfare system should ensure that “everyone is able to enjoy a standard of living much like the rest of the community, and is thus able to feel a sense of participation in and belonging to the community.” This is a substantially different idea to the thinking behind the initial 1898 pension system.

Major welfare innovations over this period were the introduction of ACC, and the Domestic Purposes Benefit. Both had limited aims, but their coverage and impact has been substantially greater than the architects may have assumed. At the end of 1975, New Zealand voted for the choice of the relatively generous pay-as-you-go (60% at 60) National Superannuation scheme, instead of the option of a very recently introduced funded personalised superannuation scheme.

The 1970s saw the start of a major increase in working age benefit receipt: from around 2% in the early 1970s and peaking at close to 16% in the 1990s.

1980s-2010

From the mid-1980s, New Zealand faced the triple challenge of absorbing the effects of the UK's entry into Europe, the resulting need to move towards more main-stream OECD-style economic policies and the need to react to changing oil prices. Major reforms were carried out in many sectors, from the operation of monetary policy to the ways in which the Government itself was organised. “Welfare by other means” was dismantled as labour market institutions and objectives changed, and as family structures changed. The qualifying age for National

Superannuation was progressively raised over a number of years to stand at 65, which had the effect of lowering the relative living standards of those who might have previously retired at age 60 and met the income and means test for the Age Benefit. The defined benefit public sector superannuation schemes, such as the Government Superannuation Fund, were closed to new members as the long term cost of the scheme became apparent. It was replaced by the State Sector Retirement Savings Scheme, which was in turn replaced by KiwiSaver.

Other major changes included in the 1980s included the expansion of the Waitangi Tribunal's initially modest remit into an expansive mandate to examine historic Treaty of Waitangi claims. By the end of the period, some major iwi had used their settlements to become substantial players in the domestic and export economies, and had also played a substantial role in funding education for their tamariki and mokopuna. On the other hand, Māori are still substantially over-represented in the poorer groups of society.

In the latter years of this period, New Zealand introduced some pre-funding of future retirement income provision through the establishment of the New Zealand Superannuation Fund and through the creation of KiwiSaver. This represented an initial movement to pre-fund some of the future cost of state pensions, and to re-introduce insurance principles to the provision of private retirement income provision, as had been briefly attempted in the 1970s and recommended by Lord Beveridge in 1942.

This period also saw substantial change in the respective societal roles of women and men. As noted above, the 1930's paradigm was based on the idea of sufficient income for a working man to support his wife and children. Family structures are now often much more complex. Women have sought and gained the ability to participate in the work force on equal terms with men (although there may still be some way to go before equality is fully reached). As far as pensions are concerned, women still live longer than men on average.

Life expectancies have continued to rise throughout the last 160 years, at first because of the reductions in death rates for the very young, and more recently because of other lifestyle changes and medical developments. Family structures are also changing, from "horizontal" to "vertical". Great grandparents are becoming more common, while the average number of children per family has reduced substantially.

A lengthy period in retirement is also a relatively recent concept. Qualifying ages for state-provided pensions were usually around or below the average life expectancy of people initially qualifying for them at the time that they were introduced. The notable exception to this is National Superannuation in 1976.

Recent trends in labour force participation for those over 65 suggest there are very good reasons, quite apart from fiscal considerations, for staying involved in the work force. These include physical and mental health benefits, and a stronger sense of belonging and contributing to society – factors which enhance both economic potential and social outcomes.

Finally, state provision of education and health services has become dominant. New Zealand consistently rates well internationally in outcomes in both education and health, with the notable exception of some of the poorest groups in society.

Major themes from all of this are;

- As with most other countries, New Zealand has had to meet and absorb enormous internal and external challenges.
- Major change has been a constant, but institutions have generally proved flexible enough to cope. New institutions have emerged to deal with particular issues.
- Views on the rights and obligations of citizens have substantially changed, in line with changes in the views of the roles of the state. Much of this is reasonably recent – many more in target groups now access state support as a matter of routine, compared with earlier experience.

One way of charting the last 160 years is that New Zealand, along with many other countries, has been searching for an optimal balance between public/state and private provision of important services. New Zealand now has a mature welfare state – the status quo against which challenges will no doubt arise.

The OECD has recently described recent periods as the golden age of pensions for its member countries – low numbers of pensioners compared with those in the work force, and a long period of sustained growth allowing for higher living standards for all citizens, including pensioners. All OECD members face the kind of changing environment that New Zealand does, and some have considerably bigger challenges than New Zealand has.

Questions for the Panel – Does this adequately describe New Zealand’s history? Is the conclusion that New Zealand’s institutions are flexible and robust enough to cope with the challenges of the Long Term Fiscal environment?

International Perspective

Supporting and honouring the elderly has been central in societies and institutions across history and religions. In New Zealand both Pakeha and Māori have strong views about recognising the contributions made by older generations.

It is possible to find the equivalents of income support and transfer payments in much earlier times. Jerusalem maintained food stocks for distribution to inhabitants. In Rome, some basic food items were subsidised. The target groups were initially quite small in number, but over time a much greater proportion of citizens qualified. It is also possible to find evidence that difficulties in funding food subsidies contributed to the decline of Rome. Fiscal consolidation is not a new problem.

More generally, there was a pattern in Roman times that was repeated later across Europe. Settlers following invading armies were given land at very low cost; greater trade and specialisation led to the growth of towns; those who lived in towns tended to have higher incomes than those in villages and those working directly on the land; those who were slaves or servants in towns could become free men, while the same option was rarely available elsewhere. Care of the relatively elderly was the responsibility of their families.

Religions initially emphasised the general benefits of charity and the worth of working with the poor and disadvantaged. Later European thought paralleled the growth in civil society, and

focused more on the duties and obligations of individuals. Over time, mutual obligations became more important. At the same time, the idea of “deserving poor” found some support. Local and central Governments gradually took more responsibility for the organisation and affairs of support for citizens, with religious organisations and other non-government organisations providing less.

Medieval times saw the development of the English justice system over time, through the codification of the existing common law and establishing the principles, if not the practice, of an independent judiciary and the jury system. Earlier conflict between the king and nobles led to the Magna Carta, and later to the development of the concept of habeas corpus. The importance of these steps was not obvious at the time (at least partly because there were relatively few “free men”), but the thinking behind them has contributed significantly to today’s societies, including our own.

The modern welfare state can be traced back to these early foundations, even if the actual systems in many countries differ significantly.

Otto von Bismarck’s Germany was the first to offer widely available public pensions, but the qualifying age for these was slightly above the then life expectancy. It could be said that the pension was more a reward for longevity and military service rather than the provision of retirement income over many years. Bismarck saw the pension as part of an overall strategy to modernise and unite Germany, with a strong lead from the centre.

Following Germany’s lead, a common approach across states was to create pensions to reward those who fought for the state. States also started to provide pensions for those in public service, perhaps to recognise that these people may have found it hard to use private providers such as insurance companies, and perhaps as part of the overall agreement about how the public service should operate (as in New Zealand’s public sector reforms in 1912). The reward for being loyal and discreet serving governments of all colours was a pension that allowed for a modest retirement.

Most states have greatly increased the coverage of pension and other income maintenance provisions for all their citizens over the last century. It is fair to say, as the OECD has, that many states income maintenance/welfare schemes peaked in the 1970s and 1980s. Since then governments have started to look for other ways to meet their social policy objectives, and to retrench the provision of pensions.

It is possible to categorise countries depending on the kinds of approaches they have followed. The following break-down has been useful;

- 1/ the Bismarckian Welfare State.
- 2/ the Liberal Welfare State.
- 3/ the Social Democrat Welfare State.
- 4/ the Mediterranean Welfare State.

These are reasonably self-explanatory, and provide for useful categorisation for the general directions followed by different states. But it is important to note that countries with similar backgrounds have followed different approaches. Australia’s pension arrangements are quite different to New Zealand’s, and Canada is notable for being a late mover towards income maintenance ideas and an early mover away from them. As far as the UK is concerned, the

centre-piece of its social welfare system is the NHS, rather than income maintenance or pension schemes.

Many states have discovered or rediscovered permanent intergenerational poverty, which provides a critique of the evolution of welfare policies. If one of the original objectives of the modern welfare state was to reach down and provide greater equality of opportunity, freedom from want, and participation in society, then the design and implementation of welfare systems have been at least partially unsuccessful.

The GFC and the more recent problems in Europe have led to a much sharper focus on longer term fiscal obligations. There is now an almost universal move to raise the age of entitlement to pensions to 67 or above amongst the OECD countries.

Finally, it is interesting to note the progress by rapidly developing Asian countries to their own form of welfare state and income maintenance. Although safety nets are spreading and becoming more robust, the rates of support are not high. There also seems to be a strong sense of mutual obligation – in return for this support, citizens are expecting to be looking for ways back into the labour force. Perhaps this is where the main debate for New Zealand will be – what is the nature of mutual obligation we would like to see in our welfare system over the future?

Questions for the Panel – Does this provide enough background of international developments to be useful? Are there issues that need more coverage?

Equity and Fairness

Central to all discussions about income maintenance and pensions are concepts of equity and fairness. To be enduring, policy regimes must have majority support from citizens, and gaining that support requires explicit or implicit agreement of what fairness and equity mean in their society. This is not a trivial point.

There is a separate longer paper on the evolution of thinking about equity and fairness. The following provides a short summary of what economics can say about these considerations.

Economists talk of horizontal and vertical equity. The first means that those facing the same issues should be treated the same. This can be traced back to the Magna Carta, and perhaps to the Gospel. The second means that those with higher incomes can be expected to pay proportionally more taxes than those on lower incomes. This too is relatively uncontroversial.

However, fairness ideas do change with generations and circumstances, as already noted in the discussion about the 1898 pension and the 1972 Royal Commission. Over time, ideas about individual and family responsibility moved to shared responsibility with rest of society, and are now perhaps heading back towards individuals and families.

As far as inter-temporal equity/fairness is concerned, citizens tend to honour the past (war heroes, those who have gone before us) and want better for their children than they may have achieved for themselves.

From first principles, it is possible to argue that individuals owe nothing to the past, since previous generations presumably operated in their own best interests. In turn, this would imply that there is no particular obligation for individuals to care about the future after their own deaths.

There is some support for this from economics. A discount rate of 6%, based on the safest investments available, implies citizens see little value in assets or liabilities becoming due 50 or 60 years hence. Citizens might care about the immediate preceding generation and immediately following generations, but not much more than this.

This has important implications for decisions about “pre-funding” and whether it is possible or desirable to decide now on the details of what might be the final stage of evolution of pension and perhaps health policies.

Pre-funding has two major sources of ideas. The first is from economics, and suggests that it is more efficient to smooth tax rate changes rather than have large discrete changes. The second comes from public finance and suggests that those who benefit from changes should bear some of the costs of those changes. Those who can expect to live for 15 to twenty years longer than their grandparents should be prepared to bear some of the costs involved. The major concern about pre-funding could be the performance of the funds that are built up, and about the fairness of the particular scheme chosen.

As a concrete example of the importance of “fairness”, there seemed to have been a broad consensus in society in 1975 that the generation that had lived through the Great Depression and World War 2 had earned the gratitude of citizens and deserved a higher rate of pension. But life expectancy has changed so much since then that citizens retiring now can expect many more years of “retirement” than those retiring in 1975. It is also noteworthy that today’s retirees experienced nothing as devastating as a world war or a world-wide depression. Does this remain a “fair” bargain?

Question for the Panel – Are these accurate reflections of the way ideas about fairness have played out in various cases?