

## CHAPTER THREE

# Social Policy

## INTRODUCTION

### Social Well-being

The well-being of society and the people in it is a multi-dimensional concept. The elements involved include material matters, emotions, and cultural and spiritual values.

At a most basic level the fundamental requirements for well-being include food and shelter, without which life cannot continue. All people need a reasonable degree of safety from various physical dangers. This means that the maintenance of law and order is essential to social well-being. People need to be in good health so that they are not suffering from unnecessary pain or discomfort and are able to lead their lives to the full. People need to learn about the world around them so that they can participate in society and contribute productive effort to help improve their situation and that of others. People need to be able to participate in social networks including their family or tribe and need to be able to rely on various forms of community support. The ability to relax and take part in recreational activities is important to the maintenance of well-being. Similarly the opportunity to find and develop a cultural identity is critical and spiritual aspects of life are central to the well-being of many people.

Essentially social well-being is about what people do and what people are. The enjoyment of life and its pleasures are affected by all aspects of economic and social activity.

An example of the interdependency and linkages involved in social well-being can be seen in the need to maintain social networks. Central to this is communication. A basic element in communication is language and therefore learning of language is a critical aspect of welfare. Further the ability to write, access to postal services, the use of the telephone, and the availability of radio and television are all central to communication and the maintenance of the role of individuals and groups within their social context. Another aspect of the maintenance of social networks is mobility. In a modern society the use of the motor car has become critically important. Similarly access to public bus or train services is significant, as is the price of petrol, the availability of vehicle insurance and safety on the roads.

These examples give an idea of the sweep of elements involved in the overall well-being of society. An examination of these activities demonstrates that they are mostly matters which result from private actions by individuals and people in voluntary social networks. The voluntary exchange of goods, the natural cohesion of families and the spontaneous growth of social organisations are all basic to our social well-being.

If social well-being is essentially the result of private activities and interactions, what is the role of the state? That same question can be applied to all aspects of government policies. The purpose of policy analysis is to identify social improvements which the state can promote by use of its unique powers. Though voluntary exchange can be generally expected to promote the well-being of those involved, the coercive powers of the state can sometimes be used to achieve particular ends which could not otherwise have been realised.

Before examining those areas of activity that are generally regarded as social policy it is important to realise that the main means available for the state to support social well-being is through the promotion of sound economic management.

Balanced and consistent economic policies can be used to control inflation; until inflation is controlled it is difficult for investment to be directed into efficient activities and for savers to receive a reasonable and predictable return on their investments. In a stable economic environment with a reasonable return on investment it is likely that productive activity will be encouraged and employment can expand. Paid employment provides the cash income that gives households the freedom to access many of the material goods and services that are critical to their well-being.

The extent of utility that the household may derive from their employment income is affected by the amount of tax which must be paid on either income or expenditure. The greater the tax burden the less the household is able to direct their own resources towards the pursuit of particular goals. Provided the taxes are spent efficiently on services that are of value to the household then this tax burden is balanced by a social wage. However, given the lack of direct control over

publicly provided goods it is likely that for many households the value of such goods may be lower than the amount of taxes given up to pay for them.

In the examples of social well-being identified above, attempts to meet the communication and mobility aspirations of people in society through subsidised state provision of postal and telecommunication services or urban transport may lead to inefficient processes, and services that are not directly responsive to the needs of their users. A subsidised free service may therefore not generate gains equivalent to the value of the taxes used in the subsidy. This is likely to be especially so if the service is provided by a loss making trading enterprise rather than by means of an explicit subsidy.

Similarly regulation of the society and economy may place restrictions on the investment and expenditure choices of households which can reduce their ability to achieve their own aims. On the other hand, well designed regulation can clarify the rights of individuals and households and enable fruitful exchange and development to proceed.

All aspects of economic management are therefore of considerable significance in the overall well-being of society and in the particular position of individuals and households.

A major concern of the Government is the maintenance of a fair society. This relates not just to the promotion of some overall level of well-being but also its distribution across the members of society. The degree of disadvantage, restricted opportunity or poverty are all relevant. Any bias which is inherent in the operation of society and which leaves individuals or groups at a significant disadvantage calls into question the overall justice of our social order. Though the efficiency cost of complete equality would be prohibitively expensive, the Crown does have a central role as the provider of justice. If any given social order can be seen to be unjust then the state may take a hand to correct that injustice. The complication, however, is that policies to promote social justice or equity are not without cost. Like any other thing of value there is an opportunity cost to the pursuit of an equitable set of social outcomes. Excessive attempts to impose a predetermined concept of justice might be very stultifying of economic activity and can act as a powerful disincentive to private and voluntary activities which could promote social well-being.

## Values and Rights

For the purposes of this briefing we take it as understood that the redistribution of resources towards those in the community who are disadvantaged, is a worthwhile aim. Such disadvantage may take the form of low income or the presence of

factors which make it difficult for individuals to attend to their own well-being. In either case equity suggests that the individual could be assisted to achieve an acceptable level.

It is assumed through this discussion that this equity judgement is derived from a basic value judgement that all people are equally precious and that their well-being is important to everyone. This does not mean that all people should receive the same income or that equality must always be pursued. Rather it means that the criteria to be used when considering the position of any individual should be uniform across people. Government policy which is based on such a premise would aim to promote a reasonable level of well-being for all people and would pay particular attention to those with the least access to resources. This aim should be pursued by whatever means are the most successful, taking into account the cost of resources and the costs to others in society.

Chapter 1 identifies a series of issues to be considered when selecting the best means of achieving social goals. Obviously a range of possibilities are available and the acceptance of some government responsibility for equity could suggest that such responsibility should be discharged by direct government activity and provision of services for those who need them. However, a more careful examination is needed to explore the possible options. Several issues can be identified in such an examination.

The first is that if policy is aimed at meeting the needs of people then it is relevant to realise that needs are subjective and that individuals have their own value of various aspects of well-being. Some critical information is therefore held by individuals rather than the state or any other agency, such as the family, the school or the tribe.

Another consideration is that in most contexts the person with the strongest incentive to attend to the needs of an individual, is that individual. Others may have an altruistic concern, and some individuals may be self-destructive or nihilistic some of the time, but as a general rule individuals have a strong incentive to attend to their own interests. Some people suffer reduced capacity to attend to their own needs, and in such a case an agent is needed to attend to the interests of the individual.

A third factor relates to issues of uncertainty. The factors influencing the well-being of any individual or groups in society are very complex. Social processes are therefore very difficult to predict. This difficulty does not relate to the information problems of any given individual, but is a general problem. The state has no better ability to predict in this area than in any other institution.

Given this set of constraints on the pursuit of well-being, it seems likely that an appropriate role for the state in many areas is to define a clear set of rights for people and to permit individuals to voluntarily transact between one another in order to pursue their own well-being. The definition of rights is obviously critical

in this process, and in doing that the state needs to be mindful both of the need to establish an environment within which transactions can easily take place but also one which gives a fair chance for all.

The definition of rights cannot be based solely on promoting the free flow of efficient exchange, it also relates to equity. If the rights are defined in a way which supposedly permits exchange, but an individual is unable to use the opportunities offered then there would seem to be inequity of opportunity and probably inequity of outcome. In other words, equity relates to both the initial allocations of rights and resources that an individual holds, and the fairness of the processes through which people may develop their interests. In addition, when the outcomes of transactions seem to be unfair that raises a question as to the equity of initial allocations and process. In this context rights should be understood to include rights to the use of resources. That is, the definition of rights to income and income transfers are an important aspect of the Government's role.

## Social Policy

Having discussed in very general terms the wide range of means by which the state might attempt to promote social well-being it is necessary to focus more closely on social policies. Any attempt to arrive at a robust definition of social policy can be very frustrating. Social policies can be characterised as being particularly involved with people and with equity considerations but this is equally true of economic policy in general. They might also be claimed to be involved with the provision of certain services (usually at a low or zero cost to the user) or with the redistribution of incomes. For the purposes of this discussion it is suggested that social policy should be regarded as that list of activities which are normally deemed to be social policies. It is true that areas such as education, health, housing, welfare services and income distribution are dominated by equity considerations. However, equity considerations are neither the sole matter of concern for these (and other) social policies nor the exclusive preserve of social policies.

Social policies can then be seen to cover a list of activities which the Government has entered into over many years for various reasons. Some of them have been taken on because the Government seemed to be the most efficient institution to carry out a particular activity. Others have been taken on in order to permit the direction of economic and social services towards disadvantaged groups. Others might involve the protection of rights and freedoms. These kinds of reasons are all to be found in the criteria for government involvement that are listed in

Chapter 1. The concepts that are explored there are as applicable in social policy as they are in every other area of government activity.

Social policies include the provision of various services (education, health, housing assistance, welfare services) to various people. All of these services are things over which people could exercise some choice. They are things that people derive benefit from. They are things which carry a cost and which must be paid for. They are things which involve the use of resources in their production and therefore someone must be accountable for such resources. For a straightforward exchange of goods and services the choice in the application of resources is usually left to the person who will benefit from them and who also must pay. In that context the question of the accountability for the use of resources is solved by internalising the issue, that is, those directly involved make the relevant decisions. A central characteristic of government intervention in social policy areas is that there is a separation of the processes of choosing, deriving benefit, paying, and accountability. The would-be beneficiary of education may have little effective choice in the use of education. The organisation paying for health care may have very little choice in the control of the use of pharmaceuticals or pathology tests. Though there are huge assets tied up in the delivery of health, education, and housing assistance the accountability for their use is uncertain and there are few incentives for the managers of those resources to control them efficiently.

The need to harmonise systems for choice, payment, benefit and accountability arises from the existence of the constraints on the achievement of social goals that are identified in Chapter 1. These constraints include scarcity, uncertainty, information costs, interdependence and incentives. The fact that these constraints are manifest in social policy areas underlines the need to analyse issues carefully to determine which institution, regulation, subsidy or benefit payment will be the preferred means of meeting social goals. The disjuncture of choice, payment, benefit and accountability means that social policy should always be scrutinised closely to ensure that social goals are achieved as fairly and efficiently as possible. The size of resources involved is sufficient to demand a close review. In terms of annual outlay through the Government, a total of over \$12 billion per annum is now involved in social policy. We have little knowledge of the value of the assets tied up in schools, universities and other social facilities, but clearly the total amount is enormous. Labour force statistics show that the total number of people employed in social and community services is around 250,000. In addition to these formal measures of the size of resources devoted to social policy, it should be remembered that these activities exist alongside the daily efforts of all people to attend to their own welfare. The successful integration of state activities with private initiative is critical. Any activities of this size are obviously of great significance to our economic performance and our social well-being. Any small

increase in their success in terms of efficiency or greater achievement of equity could be of considerable value to our overall success as a society.

A further reason for reviewing social policy at present is the growing public interest in social policy issues. The establishment of the Royal Commission on Social Policy, combined with statements from all political parties, suggest that change in social policy is due and therefore careful analysis is appropriate. This part of the brief does not aim to present a comprehensive review of social policies. Rather it offers some introductory insights and outlines some areas for priority attention. The part includes sections on multicultural issues, education, health, housing and income redistribution. It concludes with a short discussion of targeting versus universality, which is an issue at the heart of many social policy debates.

## SOCIAL POLICY IN A MULTICULTURAL SOCIETY

### The Establishment of Rights

Chapter 1 explored the role of the Government in establishing rights to facilitate the processes of voluntary interaction and to achieve goals including equity and efficiency. The introduction to this chapter explored some of the values underlying policy, and concluded that the protection of a fair society with a reasonable access to resources and equitable processes of exchange was an important goal for the state.

An important role for the Government is therefore to use democratic processes to arrive at defined sets of rights which will put in place an appropriate environment within which people are comfortable and secure, and within which they can enter into voluntary interactions. These interactions do not simply include the exchange of economic goods and services, but would include social contracts such as marriage and the less formal sets of mutual obligations that are involved in voluntary societies or friendships.

So long as the Government takes account of the interests of all people in society then the steady evolution of rights is likely to take account of the interests of various people. The rights are formed in a democratic process through the political trades that are made between the representatives of coalitions of interests. Political theory suggests that the fact that different coalitions can form, and that therefore today's minority may become tomorrow's majority, will tend to reduce the risk of an insensitive majority imposing inappropriate rights structures onto minorities. The assumption therefore may be that, with a democratic system, rights structures will tend to evolve which will permit a successful development of the voluntary pursuit of well-being for all people.

This evolution of rights should not be seen simply in terms of the formal definition of rights by the government. Many rights or standards of social well-being evolve through continued voluntary exchange and interaction. So long as there is a general understanding of the values behind exchange and a widespread acceptance of an implicit set of priorities then the rights structures that evolve through private transactions and those derived from the state will tend to provide an environment within which all people can achieve a reasonable living standard without any systematic bias.

However, in a multicultural society with a substantial cultural minority or minorities this assumption may not be borne out. Where there is a minority with cultural values sufficiently distinctive from the majority that it is difficult to arrive at a consensus of values, then the costs involved in the formal and informal processes of establishing agreed rights become significant. Where the values of the minority are sufficiently different from the majority that it is difficult for the minority group to join any potential majority coalition then the interests of the minority may not be fully reflected in the sets of rights that are established. In such a case it can be difficult for the minority to function on an even basis with members of the majority group. The rights and understandings behind social and economic exchange can tend to place the minority at a disadvantage.

This relative disadvantage, is likely to be self limiting. The disadvantage arises because in the processes of making the political, social and economic deals that generate rights it suits the members of the majority coalition to deal with each other; they find it emotionally less 'costly' to interact with each other than to make deals or trades with people from the minority culture who they dislike or do not understand. However, this 'cost' or inhibition on striking deals is not infinite, because the split between the cultures is never absolute. Where members of a minority group are suffering a substantial disadvantage then eventually it is in the interests of some of the majority to change their position. In a political context this could take the form of some members of the majority culture leaving the ruling coalition of interests to form a new coalition with the minority; this new coalition would involve a set of reciprocal trade-offs which would imply lower concessions by the members of the new coalition than they needed to make in the old coalition. At a more day-to-day level, some employers may find that workers from the disadvantaged minority are cheaper and more tractable (simply because their negotiating position is weaker) than other workers. There comes a point when the attractions of this more profitable labour outweighs the cultural prejudice. Generally it can be expected that this point will be fairly close to the prevailing wage because competition among employers means that expensive prejudices cannot be afforded. In the rental market, where landlords are often not operating as commercial profit makers, the disparity may remain more severe.

However though the degree of disadvantage may be self limiting it is still present. The goal of equity must be to find an effective means of reducing the disparity without imposing further social costs. Clearly this is not easy since the disadvantage arises from the preferences of the majority. Attempts, for example, to require equal pay may simply mean that the self limiting process is prevented and there is increased unemployment among the minority group.

## Maori and Pacific Island People in New Zealand

In New Zealand there is a clear disparity in the income and wealth of the Maori and Pacific Island communities on one hand and the Pakeha community on the other. This disadvantage is such that our overall success in promoting the well-being of all people must be questioned. There are many factors that might contribute to the disparity between the races. On average the Maori population (and to a lesser extent the Pacific Island population) is younger than the Pakeha population. The labour force is composed of younger people, who could expect lower incomes than older workers, and who are more likely to be unemployed. The Maori and Pacific Island labour force is less well educated, and the Maori population tends to be concentrated in regions of high unemployment. Further, Maori households tend to be newer on average than Pakeha households and this might explain some of the disparities in home ownership. However even when age, household function, education and location are taken into account these factors do not explain the wide disparity in unemployment, income and housing between Maori and Pacific Island people on one hand, and Pakeha on the other. This suggests that the current means, both formal and informal, of defining equitable and efficient rights are unsuccessful and we should therefore search for more successful approaches. The first step in such an analysis is an understanding of the causes of disadvantage.

One factor in the disadvantaged position of Maori and Pacific Island people is discrimination by Pakeha. Discrimination can be seen as a means by which individuals cope with some uncertainty and information costs, and also as a form of opportunism. A landlord or employer, needing to choose a potential employee or tenant, must adopt some criterion for selection. The information costs of determining which person is best for the job or tenancy can be high. The risks of a bad choice can be serious in terms of investment losses for the firm or the landlord. A cheap approach for such people is to adopt some broad screening device to eliminate all those who are clearly unsatisfactory. One common method is to eliminate all those who are unlike the landlord or employer and focus more closely on those who are more similar and whose particular attributes are therefore more easy to assess. A more simple form of a similar issue is that landlords and

employers have personal likes and dislikes. In a market environment without perfect information or zero costs of transacting, some local market leverage can develop. Landlords or employers may then take opportunistic advantage of that leverage by refusing to deal with people they do not like.

Whether the emphasis is on similarity as a basis for screening, or personal likes as a method of choice these are both expressions of different cultural values which affect the rights of the minority, and the result can quickly become discrimination against those from different cultural or racial groups. As pointed out above this discrimination is likely to be self limiting because it is worthwhile for some landlords or employers to trade because the benefits can outweigh any prevailing value they might hold. The problem is that disadvantage is suffered even if it is self limiting.

Evidence of discrimination is most clear in the housing market. Studies in Auckland have shown that many landlords actively discriminate on racial grounds. This discrimination may be one of the reasons for the generally lower standard of housing for Maori and Pacific Island households and the higher incidence of over crowding in those groups. It is more difficult to observe discrimination decisions in the employment market, but the fact that Maori and Pacific Island workers are over-represented among the unemployed and heavily concentrated into low income and status occupations is striking.

There are other possible explanations for these concentrations of Maori and Pacific Island groups. There may be a degree of cultural preference within the group which would favour outcomes which seem less satisfactory to Pakeha people. A preference for communal living means that one person's over crowding might be another's lifestyle choice. While this might explain some extended family households, it clearly is not a satisfactory explanation for households living in a high degree of discomfort.

It is also possible that cultural preferences may apply in the employment market. Where group cohesion is valued highly, then the social sacrifice needed for personal success in the employment market may be difficult. It can be very hard work to maintain community obligations within an extended family while pursuing a career and developing complex obligations to an employer.

A further possible explanation relates to the school system. At that level there may be some institutional failure as the school offers a culture which is foreign to the child. The values of the school may seem hostile to the child and the child's response might seem inappropriate to the teacher. What ever the cause of this educational breakdown the results are tragic. The number of young Maori and Pacific Island pupils leaving school with a low level of education is very high, and their academic results are spectacularly less successful than their Pakeha counterparts. This has serious implications for the Maori and Pacific Island communities and for all New Zealand.

The significance to New Zealand society is made more clear when the demographics of the Maori community are examined. The Maori population is very young and growing fast. This means that in 20 years the labour force will include a very much higher percentage of Maori workers than at present. The population of Pacific Island people shows a similar demographic structure.

This insight into the future suggests that if we are unable to improve the success of Maori and Pacific Island children at school then the long term consequences could be very severe both in terms of the aspiration of Maori and Pacific Island people and the productivity of the economy. Clearly there is an issue; the question is to find the best means of addressing it.

Another important factor is the Treaty of Waitangi. The ceding of sovereignty to the Crown in exchange for the protection of various significant rights for Maori tribes is of great importance. It imposes obligations and establishes rights for both the Government and tribes. Recent decisions by the Waitangi Tribunal, the High Court and the Court of Appeal have all contributed to a developing understanding of the rights under the Treaty. These rights may prove to be significant in many areas, but the land area alone is already of considerable importance. This growing significance of the Treaty means that relations between Maori tribes and the Government will be one of the major developing issues facing the Government.

## Policy Directions

Whether issues are viewed in terms of the Treaty, or are identified in the light of the state's obligation to those who are disadvantaged, there is a major need to develop appropriate methods of addressing the needs of Maori and Pacific Island people. Many initiatives are currently underway in various government departments and agencies to improve the performance of social policy in the Maori and Pacific Island communities. A heightened awareness of such issues has led to an increased emphasis on cultural sensitivity among public servants responsible for the delivery of government provided social services. However, the more significant initiative, of particular importance for the Maori community, is devolution. The decision early this year to devolve the activities of the Department of Maori Affairs to tribal authorities represents a major initiative. This initiative will need to be carried through carefully and sensitively if it is to be successful.

The process of devolution must be constructed on a mutual understanding by the Government and the iwi of the obligations, interests and rights of both parties. It needs to be understood that the purpose of devolution is to find a means of discharging the state's interests and responsibilities as effectively and

efficiently as possible. It does not in itself represent a major new financial initiative with substantial new commitments for the state. Rather it involves the agreement that an iwi will act as the Crown's partner and agent in delivering social assistance in a way that is more efficient than other approaches have proved.

Devolution and pluralism may take many forms. As well as the Department of Maori Affairs programmes, other initiatives include Te Kohanga Reo, Access, and Mana Enterprises. Each case is different, and each needs to evolve in its own institutional structure.

The adoption of a policy of devolution is not an indication of a basic different value premise for government policy. It is still evolved from the same overall equity objectives that underlie other social policies but represents an example of the variety of means that can be used to pursue those objectives. As such it represents a substantial initiative but it does not change the fundamental nature of the problems faced by the Maori community. As explained throughout these papers the Government cannot hope to address all the difficulties of any community, and it is important that devolution be seen as only one of the means that Maori people may use to improve their own position.

## EDUCATION

### Introduction

The state education system in New Zealand is one of the country's largest enterprises with an annual expenditure of about \$3 billion (or nearly \$1,000 for every man, woman and child). One New Zealander in every three is involved as a part-time or full-time student. Some 71,000 work as teaching or non-teaching staff. The formal educational system in New Zealand is predominantly a state system, with the direct provision of educational services as the dominant form of state intervention. It is free or virtually free to the consumers and their parents. It is, for those aged 6 to 15, compulsory. There is a high degree of centralisation of control and a unified workforce with national terms and conditions of service and so on.

Education fulfills various functions: fulfilment (of the individual), integration (of the individual with the community and wider society), economic (preparation for economic role, whether paid or unpaid), and custodial (for or from the parent as agent of the individual being educated). Different and conflicting interpretations of these functions may occur, leading to different educational agendas. Different elements of any particular agenda may be provided by different sources: the home, formal education, television, peer group, and so on.

The benefits and costs of education may accrue to different groups:

- the individual being educated;
- the parent or agent of the individual being educated;
- the community or society as a whole (including the economy);
- the providers of institutional education: teachers, administrators and support staff.

These benefits and costs can take monetary or other form and may take effect immediately (consumption) or in the future (investment). Different educational agendas will imply different weightings to particular benefits and costs and different distributions of them. For example, a child may be concerned with immediate personal fulfillment and integration with his or her peer group, an employer with the dedication, presentation and skills of potential employees. Decision making by any particular member of the group or any particular group may not maximise the net benefits to other members or to other groups.

For the individual being educated or parent or agent, different levels of benefits and costs may occur in relation to a particular educational source because of differences in access to, process by, or output from that source. Differences in output may arise for three reasons—differences in what is sought by the individual or parent, differences in what is brought by the individual to education, and differences in what is offered by the educational source.

Education is never free as there is always an opportunity cost to the provider. Those who provide the inputs to formal education naturally seek to defend and develop their own interests. Hence, formal education is unavoidably part of the market economy and the Government can afford to be no less concerned with the effectiveness and 'profitability' of its expenditure on education, in relation to the state's aims, than private providers would be in relation to their own.

To overcome problems arising from scarcity, interdependence, bounded rationality, information, opportunism and incentives, an individual or parent seeking private educational provision will enter into a contract with a provider. The contract will aim to be mutual, binding, bounded and based on the resources and information available. However, significant difficulties may arise with the elements bundled together in such a private contract. For these reasons private contracting may not be able to give socially acceptable or efficient outcomes to formal education and hence they explain why governments intervene in education. The four issues are:

- i who pays: (equity concerns arising from scarcity) not all individuals or parents are equally able to purchase suitable education and hence the net benefits that society and individuals draw from education are not fairly distributed to all;
- ii who chooses: (the agency problem arising from bounded rationality and information problems) many of those being educated are not

- adults and are not in a position to make strategic decisions about their future or have the consequences enforced upon them; they are exposed to agency failure if their parents do not act in their best interests;
- iii who benefits: (arising from interdependence) societal costs and benefits may not be fully captured by the individuals being educated or their agents;
  - iv who is accountable: (efficiency concerns arising from the potential for opportunism and uncertainty in relation to the provider) for example the risk of institutional failure.

The long-term investment nature of many of the benefits of education, as against the predominantly short term costs, means that the feedback loop on educational decisions is weak whatever party is the decision maker, hence the difficulties associated with the four issues are reinforced.

Potentially, state intervention can redistribute educational and consequent life chances in society in favour of the disadvantaged, assist parents in their role and safeguard children against parental failure, ensure that net benefits to society are maximised and ensure efficiency in the institutionalised educational sector. There still seems to be a high degree of optimism in New Zealand as to the potential of formal education to contribute to both economic growth and equity. However, in other OECD countries there is increasing doubt about the role of state education in delivering these benefits which has resulted in contracting public education budgets.

In intervening to counter problems with one or more of the elements outlined above, the Government necessarily enters into implicit or explicit contracts with providers and users of education. Hence, in its own role, the Government is liable to face the same four issues as do private contractors. These give rise to the general costs of government intervention. Thus, on benefits, the Government has greater difficulty measuring the benefits of education than the individual or family. As a result inputs tend to be used as measures of success instead, leading to the misapprehension that more is necessarily better, and to problems with determining the goals and parameters for intervention. On accountability, consumers will share a common interest in reducing the direct cost of education to themselves. Providers will enjoy greater job security and improved career paths as state support increases. If decisions are made centrally by the government, both consumers and providers will seek representation and rights at the centre, rather than contracting with each other. Hence, providers cease to be accountable to consumers and accountability becomes lost in the bureaucracy. On choice, some state interventions will run against others or against privately held agendas in their effects. Thus the Government's choice displaces others. Finally, there are the opportunity costs of state intervention.

The above are general difficulties with the Government's role. Further, each of the four possible reasons for intervention suffers its own problems. On equity, there is evidence that institutionalised education makes very little, if any, difference to the relative position or life chances of most groups. Some interventions, however well intentioned, may increase inequity. On agency issues, state intervention may reduce parental responsibility and hence increase dependence on subsidised institutional provision, thus furthering the agency problem. On interdependence, state intervention runs the risk that the benefits will in fact be captured by particular groups of individuals/providers, that is, the cost becomes public but the benefits remain private. On efficiency, the inefficiencies of central bureaucracy may be substituted for individual freedom of choice, reducing the ability of individuals to hold anybody to account. In sum, state intervention for each of the four reasons listed has significant potential to achieve the opposite effect.

The net effects of state activity in education are complex and are assessed in greater depth in Volume 2. The focus in government intervention in education that would be expected to flow from any (and thus all) of the four possible reasons for such intervention appears in practice to be blurred or lacking. Hence, the costs to intervention may have come to dominate the benefits and government intervention may be significantly ineffective, possibly counter-effective. The following summarises the main concerns for each sector.

## Early Childhood Services

The first few years in a child's life are crucial for their subsequent development. The main issue arising with early childhood and early school education is the balance between institutionalised provision and family care and the consequences of that balance for development of the child as against the benefits to parents.

There is evidence that children from disadvantaged homes may benefit from suitable institutional provision of education at this age level, which builds on the role of the parents. Therefore, there is a case for government intervention to enable such benefits to be achieved where the parents would not otherwise be able to afford early childhood care. Because the immediate customer (the child) is little able to report back on childcare services, the parent may find it difficult to act on the child's behalf to achieve improvements. This might be a basis for government intervention to regulate the provision of childcare services if it can be shown that the Government can regulate the area more efficiently.

The Government influences decision making in relation to early childhood services, by virtue of the tax regime. Because the state does not tax the internal

provision of household services but does tax the external provision of the equivalent of such services, the state is effectively encouraging the family to provide its own early childhood services rather than to utilise external providers. As women in most households take on much of the burden of childcare, this has implications for equity of opportunity outside the home for females. On the other hand, the increased labour force participation by workers brings private benefits to them and it is not evident that the state should assume the associated costs.

The forms of government financial assistance in early childhood are quite varied at present and have the advantage of diversity and lack of direct central control. No early childhood services are provided directly by the state, but nearly all are funded in whole or in part. However, the diverse arrangements, depending in large part on local initiative, may mean that state funding has become substantially captured by more advantaged groups, with the possible exception of the Kohanga Reo movement. In consequence there is likely to be significant variance in equity of outcome.

Government funding of early childhood services has expanded significantly, largely reflecting increases in workforce participation rates of mothers. Along with this has gone a trend to professionalisation, notably with the recent announcement of three year pre-service training for early childhood workers, and centralising tendencies. This is in spite of both the limited evidence in the field suggesting that such extended pre-service training may be of very little additional benefit and the successes hitherto of local initiatives not run from the centre.

## Early Childhood Services: Suggestions

The challenge in the earlier childhood field is to develop the diversity of arrangements that exist, so as to ensure greater equity in access, process and outcome and to ensure that the system remains focussed on the needs of parents and children and is reasonably resistant to provider capture and centripetal tendencies. The Kohanga Reo movement demonstrates what can be done outside familiar institutional forms when flexibility is permitted. It remains to develop a co-ordinated policy which will enable a beneficial balance to be struck between family care and institutional or community based care for disadvantaged families, which will not prevent suitable provision being bought in by more affluent families, and which promotes a contestable system for the delivery of early childhood services.

## Primary Education

As at the pre-school level, we suggest that the quality of the partnership between the home and educational institutions at the primary level is highly important. At both levels, the investment benefits are particularly long-term whilst the direct customer, the child, has a very short-term view. Thus, there are equity and agency grounds for state intervention in ensuring that the foundations for long-term benefits are laid. The principal equity concern at primary level must be that all individuals capable of it are enabled to achieve a minimum education level which will permit them to lead their lives at a reasonable level. (That minimum involves more than the three Rs.) This involves setting minimum standards of educational provision and, more problematically, of education attainment. This requires ensuring equity in access and process to the requisite educational level and equity in what is offered by the educational sources concerned for individuals in moving to the requisite level. Typically, such equity has been pursued by the free provision of public education to all, together with a controlled core curriculum—though these are not the only possible means.

State intervention to deal with the agency problem may occur where what is sought from education by the agent is not what should be sought in terms of the core curriculum etc. State intervention to counter agency concerns may help to remove problems in relation to educational sources external to the family, for example by moving or reducing cost barriers or clarifying or reducing options as to choice of external sources. To the extent that activity within the family is itself a source of educational problem (anything from a lack of reading material in the home to domestic violence), intervention to deal with the issues that are external to the family does not tackle the internal problem. Any failure on the part of the parents threatens to undermine the vital partnership between the educational source and the family.

Government intervention to ensure realisation of societal benefits will depend on the nature of the benefits anticipated. Where the societal benefits exceed those to the individual—for example learning to value others' dignity may help reduce crime—then the parent, in maximising the child's benefit, may invest less than necessary to maximise the net social benefit. There thus may be a case for government intervention to increase the purchase of education and to ensure that its contents include aspects of civic values.

Against these factors, there are three significant inefficiencies to general provision of 'free' education by the state:

- i the transfer costs of removing monies from families so that the government can spend it largely on their behalf;

- ii the inefficiencies of the state as a spender of other people's money in comparison with their own efficiency;
- iii the disparities between the likely state education agenda and those of families, and the difficulty of resisting centripetal and provider pressures once the family is not in direct control.

Universal provision fails to target aid where it is most needed, fails to address the possible weaknesses of the home as an educational source and fails to build a potentially powerful partnership between home and school. It may remove responsibility from families and create dependency.

## Primary Education: Suggestions

Rather than being the all-purpose and authoritative source of primary education, the school may be seen as an integrating mechanism between the various possible sources and a specialist source for core skills. In all these areas, the school would work in partnership with the family. State intervention to meet agency concerns may be achieved by developing flows of information to parents on:

- i the state system as educational source, to enable parents to make informed choices and contributions to the development of that system; and
- ii acting as an educational source themselves and in partnership with the state system.

State intervention to realise social benefits may be achieved by setting minimum output standards in the three Rs and other core areas, including any necessary civic values. This would leave the school committee or equivalent free to determine how the minimum output standard would be achieved—the opposite of present practice where syllabuses tend to be prescribed but the outputs are not. The efficiency costs of state intervention may be minimised by:

- i maximising consumer choice and information;
- ii maximising provider flexibility and responsiveness to consumer demands;
- iii ensuring that management, accountability, and incentive structures cohere and are performance and target related; and
- iv minimising the extent of in-kind provision by the state, in a contestable environment.

In schooling, as with any other service, there can be no presumption that monopoly state provision is either equatable or efficient in meeting the diverse needs of children. More contestability in provision would tend to make it easier to exert greater pressure on schools to reach the high standards that families want.

To the extent that free in-kind provision is generally available, it should be focused on the core curriculum areas where the state has most legitimate concern and the displacement effects are minimal.

Given the inherent limitations of primary schools as an educational source, the state cannot deliver if the partnership between school and family is not good. By capturing virtually all available state intervention for itself, the institutional sector is ensuring that the potential of the family resource is in many cases not fully realised, particularly among the disadvantaged.

## Secondary Education

In broad distinction to primary education, the key to success at the secondary level is not so much the quality of the partnership between informal education in the home and institutional education outside it but the quality of the partnership between the individual being educated and the educational source, with the home—though still important—becoming increasingly a junior partner.

As at the primary level, the Government may intervene to ensure that every individual is given the opportunity to achieve a minimum standard of competency in core subjects so as to be able to operate effectively in society and the economy. Hence, the levels are set by society and the economy. However, formal school education is not necessarily the best source for some important skills and individuals may be capable of identifying and using the best source for themselves, for example private driving schools.

The Government may also intervene to ensure equality of opportunity in access to higher educational levels and the life chances flowing from them. However, the process of formal education may itself act inequitably, discouraging those from disadvantaged backgrounds who leave school early thereby reinforcing their disadvantage. Formal education thus has the task not only of providing opportunities for learning relevant to the wider world but also demonstrating that it is relevant to the individuals concerned at a time when they may be reacting against conventional values.

The school, if it treats the individual as the customer looking for immediate benefits from its services, will create a relationship that disprepares individuals. At the same time, if the individual sees the school as irrelevant to them, they will create better uses for their time, for example in peer group socialising at school. Either way the danger is that formal education will produce individuals who are streetwise but job stupid. Thus the task is to create a mutual relationship between school and individual to enable the exploration of those areas of long-term benefit

to the individual. This requires discipline on both sides, and hence the **joint** development and maintenance of strict standards for and by schools.

The OECD has commented that, in spite of greatly increased government expenditures on formal education around the world, educational inequalities may have been widening and that the declared aim of greater equality appears sometimes to have been a pretext for attracting bigger resources. To discharge its purpose, the school system has to enable the disadvantaged rather than disable the advantaged—to level up not down. The OECD terms it an ‘iron law’ of educational development that privileged groups and social strata constantly seek to maintain their privilege. Attempts to disable the advantaged by disbursing exam credentials more freely, and restricting choice will lead to counter moves, such as takeover of the public school agenda, and hence to an expensive game played out largely with public money and probably leaving the advantaged no less so at the end—no equity gains but a high efficiency cost.

Thus, unless secondary schools can respond to what is brought to and sought from formal education by individuals and offer a well signposted way to the valuable social and economic skills, additional expenditure on schools is more likely to fuel than counter inequity. Similarly, on the agency concern, the state may intervene to act *in loco parentis* for the individual who is in transition from childhood to adulthood but this can only be effective if a mutual contract can be established between school and individual.

Increases in the level of education, and hence in educational qualifications, may bring productivity gains for the economy but, unless employers and employees have to take into account the full cost of the qualifications concerned, will also lead to credentialism (that is, increasing levels of credentials are required for entry to the same job). This imposes efficiency losses from the net cost of over-qualification and equity losses for those with the lower levels of qualification which consequently become devalued. Such educational inflation can turn post-compulsory education into a trial by ordeal, which those who hold values least orientated to those of formal education will find hardest to bear. By OECD standards, New Zealand has very low retention rates at senior secondary school. The recent changes to School Certificate may help in raising retention. However increased retention rates at school are not a good thing in themselves; only if good use is made of the time and resources.

## Secondary Education: Suggestions

As with primary education, there are significant costs to universal provision by the Government. Means of minimising costs were outlined among the suggestions for

primary education. What secondary education can achieve is limited and its task is probably becoming more difficult. Its strengths lie in signposting and providing the skills and attitudes that young people will need in the world beyond education. Research has demonstrated the dramatic differences in attainment level between the best and worst schools, including those dealing with disadvantaged populations. Focus on 'what works' in education can enormously improve outcomes if there is sufficient pressure on schools to attain the highest possible standards. Emphasis at school either on educational values or individual values as ends in themselves will be disastrous for those either who do not already possess the set of values which orients them to the longer-term benefits of education in the outside world or who do not intend to stay on in the educational field as adults. Hence, secondary schooling needs to be outward bound.

Similarly, to make passage in the outside world, individuals need realistic information about their skills and abilities and in a form that is communicable to potential employers. Hence, the need for assessment which hands out neither 'success' nor 'failure' levels, but can command the confidence of all parties for the objectivity and relevance of the information they contain. The recent revision to School Certificate offers the potential for a substantial step forward.

Zoning and limited subsidy of private schools are disabling tactics, restricting choice. The ever changing explanations given of why zoning is necessary (from elitism to egalitarianism) have not recognised the underlying principle: as with any monopolist practice, it restricts choice and hence competition. At present, many individuals and parents are 'rationally ignorant' about education—the cost of obtaining information is so high and the area of choice so small that there is little point bothering. Those who are irrationally knowledgeable tend to become highly frustrated! The individual will benefit from greater choice and the pressure this exerts for attainment of the standards achieved by the best schools, including those dealing with disadvantaged populations. Individuals will become well informed when it is worthwhile for them to be so. This will be most securely achieved by giving choice as far as possible at the individual/family level rather than through committee at the school level, where provider or pressure group capture is liable to occur.

The inflexibilities of the present system prevent both human and other resources being used effectively. By OECD standards, New Zealand appears to have relatively well paid teachers giving below average teaching hours (though not necessarily working hours) in a system of low flexibility. Given the quality of personnel and commitment that good wages should have purchased, there is a strong case for greater flexibility so that those skills can be deployed effectively, matched with greater accountability—through the customer and through incentives for achievement.

## Tertiary Education

In distinction to the secondary level, the individual at tertiary level may be taken as generally not needing substantial further assistance in developing their personality or basic attitudes or skills. Educational institutions are more straightforwardly meeting the demands of their customers.

Individuals may be seeking general or specific skills, for career purposes, for personal fulfilment, or for some mix of purposes. The investment benefits to the individual will be more evident and for some courses more immediate and more short-term than at primary or secondary levels. The benefits from discharge of the other educational functions are liable to be captured by the individual being educated or their educational peer group; those who will benefit from more informed, more culturally appreciative etc. individuals are precisely those who are more informed etc. Employers will benefit from the economic function of education as it will reduce the transaction cost in hiring staff and may enable them to externalise training costs. Other benefits of the economic function are likely to be mopped up by the individual or employer (depending on the balance of power at the work place).

Tertiary institutes carry out work which goes beyond purely educational functions. They may act as the repository of knowledge and culture for the community as a whole and they may engage in the research and independent pursuit of new knowledge. These two non-educational functions may be discharged by other institutes also.

The Government may intervene at tertiary level for equity purposes to ensure equity in access and process. To the extent that access is determined by previous educational outcomes or job held, intervention may focus on these determining factors rather than tertiary education per se. The provision of second chances to those who missed out first time around would be of particular importance. To the extent that individuals' attitudes to education present a barrier to entry, equity in formal barriers may achieve little and attitudinal changes by the individual, atmosphere changes by the institution, or the development of outreach or support facilities may be more pertinent. Monetary barriers to access are, therefore, only part of the equity problem. The state may act to remove or reduce such monetary problems by subsidising in whole or in part the costs, including the opportunity costs, of study for disadvantaged students.

Because the outputs from attending tertiary education are so varied, as are the demands placed on individuals, equality of outcome is even less of a viable goal in the tertiary sector than in the school sector. The Government may intervene to meet agency concerns where young people lack the knowledge and resources to pursue the optimal educational path and their parents are unable or unwilling to

help. However, in the absence of government intervention, information and financial facilities would develop such that, notably, a student could borrow against future expected income streams. Hence, the case for government intervention boils down to the equity concern—assisting those who would be disadvantaged in such a market for information and financial facilities.

On the non-educational functions, to the extent that the Government is a direct customer of such services it should pay for them. Where other identifiable groups are the beneficiary they should pay. This includes high risk research as there is no reason the taxpayer should assume the risks that the immediate beneficiaries are not prepared to. Research with no clearly identifiable users that is potentially of social benefit may be funded by the Government to an appropriate level, possibly as part of its overall approach to public goods research.

Government intervention to achieve social benefits not captured by the individual or groups is liable to be limited overall and focus on the non-educational, rather than the educational, functions of tertiary education. As with secondary education, tertiary education is likely to lead to both productivity gains and credentialism.

The tertiary sector appears to be atypical of the OECD. As far as comparisons allow, it appears that in the early 1980s, New Zealand was near the bottom among comparable countries for enrolment of 17 and 18 year olds in formal education, but about mid-way if non-vocational secondary education was excluded, and near the top in terms of university enrolment for this age group and for participation in tertiary education by the population as a whole. Thus, it appears that schools in New Zealand operate exceptionally finely as a filtering device for first chances at the tertiary level—with accompanying tertiary benefits for those surviving the process—but the tertiary sector has developed programmes to give those deselected at school a second chance. Data on social economic status (SES) of students' fathers confirms this pattern.

## Tertiary Education: Suggestions

As long as private returns to tertiary education exceed public returns, the demand for tertiary education, if fully met, is liable to produce educational inflation, increasing costs in the economy and disadvantaging those who do not join or succeed in the paper chase. Hence, for the generality of students, only limited government subsidy to reflect general social benefits not captured by the individuals concerned can be justified as possibly effective and not grossly inequitable. Beyond that, targeted assistance for those disadvantaged in borrowing money on the capital markets may help meet equity and agency concerns. Intervention at

lower levels than tertiary and intervention to assist the overcoming of attitudinal barriers are likely to be more important.

By virtue of current government intervention, price signals as to the cost of various courses are removed or weakened for the (often inexperienced) student decision maker. In so far as under the proposed approach students from high income households would have to face a higher proportion of the actual cost of their education by funding themselves to some extent through the capital market, there would be a greater incentive and ability for optimal use of the resources involved. Employers will be faced with graduates necessarily more aware of the real costs of their education and, legitimately, seeking to recover them. The Government, as a price setter for many graduates' wages, is at present subsidising its own employment of graduates through its subsidy of tertiary education, thus reducing the pressure on the public sector to utilise graduate resources efficiently.

On the supply side, rigidities in funding and in wage scales as well as the limited contestability of provision are slowing the tertiary sector's responsiveness to the increasingly rapidly changing and complex patterns of demand.

Maintenance of the status quo, where both demand and supply are removed from exposure or response to market forces, is not, in practice, an option. The status quo is breaking down, as private institutes move to fill gaps in the market and universities and other tertiary institutes seek to exploit such room for manoeuvre as they have. The exploitation of commercial markets in the margin of the wider state sector will tend to draw away scarce teaching and other resources from the pure state sector, increasingly leaving those in that sector with a second class education. Nor is increased regulation, in an attempt to control developments on the margin, a realistic option. In the unlikely event of success, the economy would pay a heavy price in loss of flexibility. However, developments in freeing either the demand side or supply side in tertiary education in isolation from the other will produce significant efficiency or equity costs or both.

If the supply side is freed up but the demand side is not then all three-year university courses, for example, will cost much the same to the student and hence students will be attracted to 'commercial' courses away from 'non-commercial ones' and differentials in academic salaries will grow wide. The result: inefficiency, over-response to changes in the labour market (because of no feedback through course costs) and a narrowing of study to areas perceived to be commercial. If, on the other hand, the demand side is freed up but the supply side is not, the consequent extreme shortages in the supply of some courses will be resolved by non-price rationing methods or by greatly bidding the price up. The result: inefficiency and inequity. By contrast, if both demand and supply sides are freed up, those courses offering the best job prospects and other advantages will tend to be bid up slightly in price counterbalanced by a reduction in demand. Hidden cross subsidisation between commercial and non-commercial courses will be

removed. Differentials in academic salaries will be less than in the first case (though still present, due to the outside labour market) and rates of return for students taking different courses will even up, particularly when aspects such as personal enjoyment are taken into account. Hence efficiency and equity are liable to be improved.

Such a system implies minimal central planning, though the Government could influence demand by selective subsidies as could the tertiary institutes by selective cross-subsidy. The recommendations of the recent working party (the Probyn and Fargher report—The Management, Funding and Organisation of Continuing Education and Training) go some way to freeing up the supply side but their effectiveness is greatly reduced because the same proposed central body would represent, co-ordinate and plan both the demand and supply side and retains at the centre considerable powers over the detailed allocations of resources with all the consequent efficiency and equity costs and encouragement of pressure group politics. Rather than adopt such a central body it seems preferable to permit the provision of tertiary education on a more commercial, contestable basis. The Access scheme is an example of the purchase of targeted education and training on a contestable basis. There seems no good reason why the concepts it embodies could not be applied to all tertiary education.

To ensure flexibility and contestability within and without the tertiary sector, the educational and non-educational functions need to be distinguished and funded separately according to separate criteria.

## Maori Education

Since the middle of this century there have been increasing Departmental efforts to teach Maori language and culture at all levels of the education system. At the same time the attainment gap between Maori and non-Maori students has remained wide and in some ways has widened whilst the commanding heights of the educational system have remained predominantly in Pakeha hands.

In looking at pre-primary and primary education, we have developed a concept of partnership between the family and formal educational source; in secondary education, the concept of partnership between the formal educational source and the individual being educated. At tertiary level we referred to the individual as customer. In the case of Maori individuals the implications are rather different than for Europeans. For Maori people, the family that is in partnership at the primary and pre-primary stage is likely to be a different unit than the European concept of family. The individual in partnership or acting as customer of education at the secondary and tertiary stages may, for Maori people, wish to act more

in a group or family context. Thus the institutional framework of state provision that enables a European, will not necessarily be an ideal institutional framework for a Maori individual. In moving to a state system that can be more enabling and more responsive to the demands of families and individuals, the needs of Maori people may need to be reflected by specific institutional devices to ensure that Maori aspirations are not filtered out by inappropriate European institutional frameworks.

Policy initiatives for Maori education may proceed on three broad fronts. First, the Maori community's development and revitalisation of their own language: this is, of course, largely a matter for the Maori community but, to the extent that the formal educational system is seen as a device for cultural strengthening and affirmation, Maori people may expect to utilise some part of it for their own ends. Second, enabling the rest of the community to acquire a more appreciative attitude and understanding of the Maori heritage. This may be fulfilled by the *taha Maori* approach. The third front is to enable Maori individuals to have access to the skills, knowledge, and attitudes that enable success in the wider society, either as members of the wider community or as representatives of the specific Maori interests within that community.

## Private Overseas Student Policy

The international demand for education is very large. Educational services may be exported, principally by the admission to New Zealand state and private educational and training institutions of full-cost paying, non-quota foreign students. As for other 'products', the level of demand for education depends on price and quality.

The removal of disincentives to the export of educational services is necessary. Hence, to achieve international competitiveness, it will be essential to tackle institutional factors that have significant cost effects. Once the demand and supply for tertiary education is freed-up, there should be little objection or disadvantage to the export of educational services and minimal danger of New Zealand students being crowded out; rather they are likely to benefit. The potential advantages are considerable not only in terms of generating export and employment opportunities but also in making the tertiary sector more internationally competitive and helping overcome the limitations of scale that are imposed by the small domestic population in New Zealand. Equity concerns point to the need to make a clear distinction between admission of foreign students on a quota and subsidised basis for aid reasons and admission on a non-quota, full cost basis for commercial reasons.

## Conclusions

Our analysis suggests that there are substantial inequities and inefficiencies arising from current state intervention in education. Public expenditure on education can be regarded as at the expense of New Zealand's public debt, hence the rising generation will eventually have to pay the costs of their own education through inherited public debt. If the investment proves poor it will impose a net cost on them; increased expenditure will increase that burden.

Our analysis shows that the formal education system cannot *in itself* hope to achieve well educated adults or good or even productive citizens. These are largely a function of the success of society and the economy. Formal education can assist in this process by building a partnership with the family and individual. A system which enables choice and control by parents and families is more likely to lead to positive identification with the education process, particularly by disadvantaged individuals and groups, and is more likely to achieve equity and efficiency goals.

## HEALTH

Health is basic to the enjoyment of life. It is a critical factor in the welfare of all people; the 1978 Alma Ata Convention of the World Health Organisation defined 'health' as the physical, mental and social well-being of the individual. Like other aspects of life, the main influences on health arise from private voluntary actions of individuals and groups, and the environment which they live in.

One of the influences on the health status of the individual is lifestyle. Diet is increasingly recognised as a major factor in cancer, and heart disease. Alcohol and other drugs are strongly linked to many ailments, and are a factor in many accidents. Smoking is a proven killer. Exercise can assist in preventing the onset of illness. Stress is linked to blood pressure, ulcers and heart problems. Social pressures can lead to psychiatric illness.

Some of the lifestyle factors listed above are more controllable than others. Sometimes it can be difficult to avoid stress, and the social environment of the individual may effectively limit personal control over diet. Further there are many conditions which are entirely beyond the control of anyone. For example hereditary disorders are a fact of life from birth. Similarly normal human frailty suggests that many aging people will tend to 'wear out'; nobody has succeeded in finding a lifestyle which prevents aging. However, the relevant point for policy analysis is that most of the matters that can influence the health of individuals are beyond the control or effective influence of the Government. The Government cannot

forbid excessive consumption of fats and sugars, and the Government's influence over levels of stress is minimal. These are matters which are best understood as being within the area of private choice. They arise from the continuing arrangements that people fall into in their social interactions and the most that the Government or any other institution could achieve is to increase awareness of health risks through public education.

Any policy goal in the health area must take account of the fact that health status can be significantly influenced by private processes and must grapple with the need to encourage people to make lifestyle choices which take account of future health risks. This is a proposition that would generally be regarded as uncontentious, but which is not found at the heart of our health policies. One reason for this is that most health policy is actually concerned with the provision of care and the treatment of illness rather than the maintenance of good health.

The subsidies for visits to the doctor and pharmaceuticals, and the funding of hospitals account for most of the state's spending on health. The state is closely involved in the regulation of doctors, pharmacists, nurses, dentists and other health professionals. The state owns most of the hospitals and controls them through a combination of local bodies and Health Department regulation. These interventions predominantly relate to illness rather than health, and to care and treatment rather than prevention.

The traditional explanation of the state's role is that health, or health care, is different. At times of illness the need of the patient is so great, and their ignorance so profound, that any real choice and control is lost. It is suggested by many that it is best in such a context to rely on the state and the health professional to make the necessary arrangements for the care of the sufferer. Thus health policy is seen as a special case where the role for the state is to provide medical care for the ill, and public health measures which promote a healthy environment.

Before accepting that there is something different about health it is worth attempting an analysis of health issues in terms of the concepts established in Chapter 1. The main constraints on the achievement of social goals were there identified as scarcity, interdependence, uncertainty, information costs and opportunism (which is the basis of the need for incentives). These factors are present in varying degree in any social or economic activity, including health care. Various means of achieving health goals can be examined in the light of these problems so that appropriate policies may be identified. A key consideration is the effect of the different sets of interventions in the entire range of activities that contribute to health.

## Uncertainty

A fundamental characteristic of health issues is that illness strikes unpredictably and that health outcomes are uncertain. Even the most careful person may catch an illness by droplet infection, or suffer an accident requiring intensive care. At a personal level the suffering and discomfort of ill health is a major concern. Medical treatment is wanted to control and repair the problem or long term care is needed for a dependent patient. However medical care is expensive, so there is also a financial dimension to the issue. Most household budgets would be severely strained by the cost of treatment following a heart attack. This cost can be particularly hard to cope with if earnings have been disrupted by the illness.

The logical response to a problem of uncertainty is insurance. By paying in advance people may spread risk over time or across a community so that the cost of health care may be paid in easy instalments while earnings are available.

Insurance can take many forms. It can be by way of a private insurance market or through government funding of medical care and treatment as exists in New Zealand at present. In order to examine the appropriate role for the Government in protecting people against medical risk it is useful to explore the possible effects of private insurance, in order to establish a comparison.

Private medical insurance is common around the world and is rapidly growing in New Zealand (partly as a result of its favourable treatment under the fringe benefits tax). Experience demonstrates that insurance can offer many benefits but it also has limitations as a means of addressing health problems. It is difficult to assess the effects of medical insurance as in many cases an apparent feature of insurance results from the legal and tax environment surrounding the insurance contract rather than being central to insurance itself. With that caveat in mind the potential of insurance markets may be explored.

There are a number of reasons why voluntary insurance is said to be preferable to public finance of health care. First, private markets may be more responsive to consumers' preferences than the Government. The Government almost by necessity has to cater to an average New Zealander, while in the private sector a variety of niche markets may arise that respond to minority demands, including different ethnic communities. Second, people have different attitudes to risk and different abilities to deal with risks. This means that people may desire a wide variety of insurance policies, but the Government, by the nature of the political process, tends to offer a uniform cover to all New Zealanders.

Last, competition between insurance funds may create better incentives for controlling costs than are possible for a government funding agency. Many cost containment measures presently being discussed for adoption in the public sector were first developed by private insurance. These include part-charges, admission

reviews (where the need for treatment is double-checked by independent experts), preferred provider organisations (which offer cut-price deals with selected doctors) and Health Maintenance Organisations (HMO). Under the HMO concept the insurance company, instead of guaranteeing financial reimbursement, undertakes to provide medical services 'in-kind'. This way it has greater control over the services supplied to the individual and their cost.

However, numerous concerns also exist about the workings of the insurance markets. As American experience demonstrates, a substantial proportion of the population is likely to remain with low levels of cover in voluntary markets. A 1977 survey in the US of those not entitled to either Medicare or Medicaid public programmes showed that while people with the worst coverage tended to be between the ages 19 and 24 (who can generally be expected to be relatively healthy although accident prone), other age groups were also significantly represented. In fact, the extent of coverage was not strongly linked to people's health (to the extent that it was linked, the healthy tended to have more insurance), but was directly related to their income, with low income people less likely to carry insurance. Whatever the reason, clearly significant numbers of people may carry insurance cover which is inadequate to provide for major loss.

In the process of controlling risk, insurance companies must set a premium to cover the average expected cost of their clients. Though the company may attempt to assess the risk of each policy-holder it can be expected that many individuals will be aware of information that affects their likely health cost. Those with higher than average likely costs will take up the policy, while those with a lesser risk are more likely to reject it. As a result, the company may face increasing costs and a significant number of people may be partially insured.

Insurance of some form, whether administered and funded privately or by the state, clearly has some role in health care to address the problem of uncertainty. However, if the state has a goal of ensuring that everyone is protected against medical risk, voluntary medical insurance without state assistance is likely to be unsatisfactory. Attempts to overcome this by regulation or subsidy may prove complex, and create difficult incentive problems.

## Information

Medicine is an area where information problems are generally acknowledged. Some of the information difficulties of insurance have already been touched on. In addition, there are particular problems in the area of medical knowledge. Doctors study for many years to acquire the knowledge and experience to diagnose and treat a wide range of conditions. Though patients can successfully self-diagnose

many recurring minor ailments, most people cannot afford to make the investment necessary to arrive at an informed opinion on serious medical issues. As a result much of the advice of the doctor tends to be taken on faith. Partly this is a problem intrinsic to the nature of medicine, but it partly arises from the way that medicine is presently supplied on a relatively uncompetitive basis.

This difficulty in appraising medical advice suggests that it may be difficult for a patient to assess whether a doctor or other health professional is competent to provide care. This is an issue which can arise whenever a specialist service like legal advice or car repair is offered. However, in medicine it is seen to have particular force because the consequences of wrong advice can be tragic. These problems of the ignorance of consumers are often cited as a justification for the regulation of medical professions.

As in most countries, health markets in New Zealand are characterised by a range of rules and regulations governing the entry and professional behaviour of service providers with the aim of controlling the quality of health care. The controls include, most importantly, registration carried out by statutory bodies and linked to training and education standards, and strict disciplinary rules enforced by those bodies.

There are a variety of constraints. For example, while, on the face of it, the Medical Practitioners Act 1968 provides a relatively liberal system of certification (which allows unregistered persons to practise medicine or surgery as long as they do not employ the style or title of a physician, surgeon, doctor or medical practitioner or any other description implying qualification to practise medicine), the medical practitioners' monopoly is enforced through a series of privileges relating to the role of general practitioners as 'gatekeepers' to the rest of the health care and the social welfare systems.

At present, access to prescription pharmaceutical products, to a variety of tests and to specialist advice is possible only on referral from a general practitioner. Moreover, general practitioners have a monopoly right to certify access to the Accident Compensation Corporation (ACC), sickness and invalids' benefits and to sick pay. Legislation also specifies that certain appointments may only be held by registered medical practitioners.

Other professional legislation is more direct in creating a closed shop for the profession. The Dental Act 1963, with some exceptions, prevents anyone other than a registered dentist from practising dentistry irrespective of the style or title they assume for themselves.

Minimum education and character requirements as well as pervasive professional ethical codes are justified, for the most part, on the grounds that they assist the public:

- by providing an external benchmark when the quality of the particular service, or even its outcome, are difficult to determine;

- by reducing the costs of searching for an appropriate provider when the consumer has little information or little opportunity to test his or her choices.

However, the results are not always consistent with these expectations. Lifelong registrations are inappropriate indicators of quality, but in practice the rule appears to be 'once a health professional, always a health professional', unless some grievous violation has been committed. Moreover, registration only measures quality from the professional point of view and yet it is consumer satisfaction that is the ostensible reason for regulation and not the maintenance of professional purity. Quality standards that are artificial and unnecessary represent an arbitrary restriction of services available to a population that may prefer greater access to alternative services. For example, the present system prevents nurses, who are fully competent in their field, from offering routine or simple medical services on their own, since they can not prescribe medicines and do not receive subsidies.

Professional restrictions such as restrictions on advertising are likely to increase, rather than reduce, the costs of acquiring information and searching for appropriate providers. In emphasising the homogeneity of the profession, they obscure for the consumer the very real differences in quality present in the market. This lack of comparative information may also lower consumers' influence over professionals' pricing decisions and lead to higher costs.

Overall, professional controls in place at present tend to protect health providers from the pressures of competitive markets. This may impose additional costs on the consumer and the appropriate approach is to examine alternative systems to see whether more efficient and equitable approaches might be possible.

There are other ways of achieving the same social objectives which do not impose the same *costs*. Voluntary mechanisms for ensuring the quality of service tend to impose fewer costs. These include the establishment of brand names and trademarks and the formation of voluntary trade associations, membership of which requires the continued achievement of certain standards of performance. Such arrangements signal to consumers the quality of the provider and allow them to make informed choice. Examples of such voluntary mechanisms include the Master Builders Association and the Bonded Travel Agents Association. Moreover, such private associations are contestable, so that if their standards and prices are unpopularity high alternative associations may form.

It is possible that some special provisions are necessary in the health area, and that the framework of common law and consumer legislation cannot cope with medical issues. This issue requires close analysis. However, what the above discussion suggests is that scope should be left for private mechanisms, with occupational controls 'plugging the holes' that still exist. This means that such special legislation, if any, should be drafted in a way that does not suppress

voluntary arrangements and which enables individuals as much as possible to seek redress through general consumer and competition law. This would be likely to lead to medical systems which generated more information for consumers and lead to more informed decision making.

## Interdependence

The health of an individual can be influenced by the health and actions of people nearby. For example a child with the measles is very infectious, and other children at school are likely to contract the illness unless they have an immunity. Another example occurs in the area of waste disposal. If rubbish or sewage are not disposed of with care they may become a source of infection for the community.

As with any other case of interdependence, it is theoretically possible for people to voluntarily make arrangements to cope with sources of infection or environmental health risks. The likelihood of private arrangements arising depends on the costs of organising and implementing the deal, compared to the private gains to be made. In the case of measles it is relatively straight-forward to arrange vaccination for one's own child and so avoid the risks of him or her catching the disease, but as with any other service vaccination has a cost in terms of resource use and time spent visiting the doctor. A parent may decide that the costs are too high in terms of the personal benefits. The problem is that such a decision could overlook wider social benefits.

The wider benefits include the reduced risk of infection for other children who, even without being immunised, enjoy an increased protection because of the reduced chance of meeting an infected contact. It is difficult to envisage a voluntary contract that could internalise this wider gain. It would need to involve the parents of unprotected children contracting with others so the other parents will get their children vaccinated (with its attendant risk) to protect the unvaccinated child.

If the costs of private arrangements are too high, and the state is able to offer the social benefit more cheaply, then there are grounds for state intervention. The case for state or private arrangements depends on the detail of the service and parties involved. The fact that something is identified as a public health issue is not necessarily good grounds for the state to provide the service. It may be appropriate for the state to define rights which permit an easier voluntary settlement, or to require an outcome by regulation.

The disposal of waste is a good case in point. In a built-up community, sewage disposal is a matter of great concern to the neighbours. Large numbers of septic tanks or long drops can put excessive pressure on the purity of ground-water with

increased smells and risk of infection. Reticulated sewerage systems are needed to convey waste to a safer form of disposal. To be reasonably effective sewerage schemes require universal participation; it is not acceptable to have a few households in the street still using night cart services. To avoid that outcome it would be possible for a coalition of residents to pay others to connect to the sewer so that all might enjoy the full potential benefit. However the costs of such a process are likely to be severe as the last residents might extract an extra gain from their bargaining position. Such costs could be so high as to prevent the construction of any sewerage scheme. In this case it seems probable that net social gains can be made through laws requiring co-operation in a public scheme.

However, though participation in waste disposal may be made compulsory on public health grounds, the provision of waste disposal services need not necessarily be carried out by the state. It is possible to require the removal of rubbish and rely on private contracting to achieve compliance. Shops and factories which produce substantial volumes of rubbish, and which need to maintain a tidy image to attract customers, can be a good market for a private contractor. In such cases the costs of monitoring and enforcing compliance may be low. Households are a more dispersed market which may be harder to attract to a commercial service, and monitoring compliance may be more difficult. In that case it may be more efficient for the state (local government) to contract for the service.

This discussion demonstrates that, even in the health area, the existence of interdependence is not sufficient to require direct state provision. The appropriate form of response to any issue must be defined in the light of the costs and benefits of different solutions.

Another form of interdependence that arises in health is altruism. The concern here is not that each person's health may be affected by another, but that people feel some concern for the health of others. This is a basis for much of the public concern about health needs that is discussed in the section below on equity.

## Scarcity and Equity

The existence of scarcity has the same implication for health as for any other product, it means that health and health care have a cost. The fact that health care, or healthy lifestyle choices, may have costs is not in itself a major concern. The policy issue arises from the fact that such costs may restrict access to health services and may remove the opportunity for some people to enjoy an acceptable level of health.

Issues of equity do not arise solely from cost. They are also raised by the fact that uncertainty and information costs are not equal for all people. Similarly the possibility of exploitation through opportunistic behaviour raises equity concerns.

The central equity concern is for access to health care. It seems that where a lack of resources prevents access to a quality of health care of a minimum standard in line with that enjoyed by other New Zealanders then questions of social justice arise which are the responsibility of the state. However, even more strongly than that, there would be concern if health care were withheld from people on the grounds that they had neglected to take proper care of themselves.

The prime concern in providing an adequate access to health care is cost. Major illness requires expensive treatment, and long term care for geriatric patients steadily builds up to a substantial cost. Those with few resources may find it difficult to pay for any hospital care, and most people's resources would be strained by the expense of hospital care for an elderly relative. Therefore affordability and income distribution are central to equity concerns about health care. Further to income issues, access to health care might be restricted by time constraints for those on hourly rates of pay, and information difficulties for those who find large institutions an overpowering experience. Similarly the process of taking out insurance can be complex and confusing for some. Any of these incidentals of daily life might restrict access to health care.

In its simplest form, the problem of privately funded health care, even with medical insurance, boils down to the question of affordability and income distribution. If some people do not have adequate income to purchase health care or insurance the Government can provide assistance either through general income support schemes such as Family Support or through some form of targeted voucher. However, the Government may be concerned, particularly in relation to the more expensive treatments, that some individuals who choose not to insure for whatever reason may still require medical care that they cannot afford. However, if the Government pays for the medical care of those who have no private insurance it creates a strong incentive for people not to insure in the first place. As soon as the state intervenes in the supply or purchase of health on equity grounds that dislocates the nexus of choice, benefit, payment and accountability. The central interest in health policy must be to design institutional structures which protect equitable access to quality health care while maintaining incentives to continue self prevention of illness and efficiency of health care delivery.

## Incentives

When illness strikes then there may seem to be little choice but to seek medical care. Alternatively the equity goal of reasonable access to health care may be expressed as an aim to ensure that the use of medical services may be chosen without too much concern at the cost. Either of these approaches would suggest that incentives are, or ought to be, of little relevance in health.

This approach ignores the point that health care imposes costs, and that there are choices in health. Every time that choices are made that take no account of costs then there is a likelihood that resources will be misused. This is so whether the choice is made by the patient who benefits from the treatment, by a doctor making decisions on behalf of the patient or the family choosing appropriate care for an elderly relative. Similarly, once it is noted that many health care decisions are made on an agency basis by professionals acting on behalf of the patient then the accountability of the doctor to the patient becomes relevant.

The health industry involves many people with a strong motivation to provide a good service for their patients. However, they still need to derive income from their work. The way they are paid, and the cost to them of adopting different forms of treatment, must influence their choices for treating a patient. Different forms of treatment cost different amounts. In other environments where a professional has an option between different processes to address a given problem then cost is a relevant consideration in the choice. Either the professional is contracted to achieve a given result at a fixed price, in which case the professional will choose the cheapest effective option, or the professional will advise the client of the options and the costs and the client chooses the appropriate course of action. In many medical areas neither the doctor, nor the patient faces the cost. This means that the funder (a private insurer or the Government) has little control over costs, and often the funder must attempt to constrain costs by restricting choice.

Choices arise between radical and conservative treatment options. Some treatments may involve complex surgery or the use of expensive drugs. Alternative treatment may involve a long period of rest and convalescence. The first might be more appropriate for someone for whom time is very expensive, but another person with a more relaxed lifestyle but less cash may prefer the second option.

Choices arise between institutional treatment or treatment at home or in the community. Some psychiatric care may be better undertaken away from a hospital setting. Some mothers prefer to give birth at home.

Choices arise between preventive care or treating symptoms. A doctor might devote time to offering diet advice, or offering regular checks for cervical cancer. Alternatively the doctor may emphasise the provision of prescription medicines.

All such choices are influenced by the relative cost to the person deciding the form of treatment. There is an incentive to adopt the option that is the cheapest to the people involved in the choice. If the cost of pharmaceuticals is hidden to the doctor and the patient, drugs may be preferred to counselling for emotional problems. If the cost of institutional care is picked up by the state, then hospital treatment or long stay care may be excessively favoured over home care.

In some cases there is little choice, but, wherever there is, incentives matter. This means that state interventions in health care should be designed to avoid favouring particular forms of health care. Ideally policies should not choose between different treatments, but should establish an environment that is conducive to the most efficient form of care in each case, while ensuring that the equity goal of fair access to health care is protected.

## Directions for Policy

The analysis of health issues demonstrates that there are particular problems in the design of health policies. The goal of defending access to health care in a context of difficulties or uncertainty, limited information, high levels of interdependence, substantial costs of health services and confused incentives is a difficult target. However, some directions for the improvement of policy can be identified. They may be discussed in two categories; policies for the supply of health services, and policies for the purchase of services.

The major problems of the hospital sector relate to poor incentives for management. Hospitals are run by hospital or area health boards. The performance of these boards is not contested in the market, and the discipline of local elections is not very strong. The absence of appropriate mechanisms for accountability and the difficulty of measuring performance creates a tendency for the Department of Health and other central authorities to take an active role in directing the actions of hospital management. This results in cumbersome and slow decision-making.

Poor incentives also produce outmoded management structures. At present, all public hospitals are managed by triumvirates consisting of a lay executive, medical superintendent and the chief nurse. There is widespread concern that the absence of a single manager makes co-ordination very difficult and leads to a great number of inefficient work practices.

We believe that tinkering with management structures is not enough. The whole basis of government involvement in the provision of hospital services should be re-examined. Our analysis suggests that the Government should no longer provide hospital and related services directly. In our view, considerable

efficiency gains are possible if public hospitals are organised along more commercial and businesslike lines providing medical services in direct competition with private suppliers.

This move is recommended regardless of the funding system that may be finally decided. The adoption of this proposal does not imply a 'user-pays' system of health. 'User pays' is an issue of funding. Competitive provision still allows services to be purchased on behalf of the population by the Government, in its role as the dominant funder of health services, and provided to customers free of charge or at a subsidised rate. This is already partially done by hospital boards when they contract services, such as hospice beds, cleaning and laundry.

The earlier chapter on public sector management demonstrated that the efficiency and effectiveness of organisations tends to be impaired when they have multiple goals. The current arrangements for hospital and area health boards amalgamates the function of funder of medical care and provider of care, and that poses a management problem to boards and staff. For example, if the funding agency also supplies services through the hospitals it operates it is placed in a dilemma when it comes to making changes. At a time when there is a general move away from institutional care towards community and ambulatory care, should they do the right thing for their customers or should they protect their staff? It is evident that at present hospital and area health boards find it difficult to cope with such questions.

An important issue that requires further analysis is the development of the interface between the Government, as the dominant funder, and enterprises providing care and treatment. If no contestability were introduced, the funding agency could be a near-monopoly purchaser in some of the health markets and therefore its policies would tend to determine the level of competitiveness as well as what services are produced at what price in those markets. On the other hand for many services like coronary care there will often be monopoly suppliers in some locations.

The other main area for change in the supply of medical services relates to barriers to entry into the market. The earlier discussion of occupational licensing, in the section on information, outlines some of the problems with existing systems. The need for reform exists throughout the health industry. For example the present restrictions on chemists offer little benefit to consumers. Some liberalisation in this area might permit more competition between chemists, and also some competition between chemists, nurses and doctors in the prescription of a suitably restricted range of medicines.

It is on the funding side that the greatest problems arise. The critical problem is to achieve comprehensive cover in order to give everyone access to health care, without disrupting incentives.

As a general rule it is preferable to offer assistance for social services on a targeted basis, direct to consumers where possible. This leaves choice as much as possible with the beneficiary of the service. It makes it possible to integrate payment with choice, where affordability is not a problem and equity is not threatened. It also tends to maintain the accountability of the provider to the user as much as possible.

The special characteristics of health lead some to assert that this approach is not possible. They point to the difficulties of information and uncertainty which suggest the equity problem is not just a matter of affordability. The insurance market would seem to offer a means of overcoming such issues, so that the state's role could be to subsidise insurance costs for low income people. However if it is accepted that the state will assist those who fail to insure themselves then many may fail to insure and therefore the efficiency of the system may suffer.

With existing systems it is difficult to see how to offer a targeted cover for expensive health care without creating incentives to rely on the state. In the area of primary health care (general practitioners and similar services), where it is unlikely that any one medical event would be ruinously costly, it might be possible to offer targeted support and leave it to individuals to arrange their own insurance. It could also be possible to arrange a similar system for elective hospital care. For acute hospital care and for long stay care, where it is not acceptable for people to be unable to get care, it has been suggested that a more universal system may be necessary. Such a service could be arranged by area organisations purchasing health care from competing providers.

Such a system would have the advantage of separating the Government funding role from the management of hospitals. So long as the state is a major purchaser of health care there seem to be advantages in separating the purchase of health care from the production of hospital or other services. The present amalgamation of functions causes confusion of roles. Equity goals and efficiency targets are forever entangled.

However, though a system such as that sketched in the above paragraphs would offer some hope of addressing some of the current efficiency problems, it would still involve major difficulties. It was explained in the section on incentives that it is preferable to avoid policies which discriminate between forms of health care. Clearly a system with high subsidies for hospital care could be expected to encourage hospital use. Hospital managers would be likely to favour institutionalisation for many problems, such as psychiatric care, where it is not necessarily the best approach.

Work in this area is presently being done in the context of the Task Force on Hospital and Related Services, which is expected to report at the end of this year. However, the problems of ensuring equitable outcomes in the private insurance market, coupled with the possible need for the Government to fund long-term

psychiatric and geriatric care (which currently accounts for about 25 percent of total public sector hospital expenditure), may be difficult to surmount. It may be that a general government funded scheme, which includes both accident and sickness treatments, would work better at present. Any such scheme should attempt to identify appropriate opportunities to fund patients rather than institutions, so minimising any bias to institutionalisation.

In the longer term it is important to explore the possibilities of integrating targeted assistance for all forms of health care on a neutral basis.

## HOUSING ASSISTANCE

### Constraints in Housing Markets

In New Zealand the state has long offered various forms of housing assistance. Like most industrialised countries with advanced forms of welfare assistance housing subsidies are provided for home purchase and for rental relief. A variety of other housing programmes have also been developed. Housing is commonly seen as a high priority for government action.

Housing is a major factor in determining quality of life, providing not simply shelter but also fulfilling people's desires for security, privacy, social interaction, and a base from which work and leisure activities may be pursued. Owning a home is also an important source of financial security, and as such a symbol of status and, potentially, provision for retirement.

Social policy in the housing area has all these values to take into account. These values in turn must be viewed in the context that people choose among them in deciding upon their own housing priorities, and will balance them against other priorities in the consumption of goods and services. Problems arise if policy is formulated on the basis of only one or some of the attributes of the goods and services in question. The dangers of viewing consumption goods in terms of a limited range of attributes was well illustrated in the case of milk subsidies, where focus on nutritional value lead to inequities, waste and inefficiencies which extended as far as influencing investment decisions in the dairy industry. In housing, policy has been strongly influenced by identifying 'a house' with specific attributes, such as security—hence lending programmes which emphasise home ownership, and the provision of rental accommodation with guaranteed tenure through the Housing Corporation. Another example is found in the provisions of the residential tenancies legislation which seek to improve security of tenure for tenants at the expense of reduced flexibility in housing investment and therefore increased the costs or reduced supply of rental housing. The more such limited attributes are pursued, the more other values may be compromised.

Any approach to policy which is based on particular functions of housing is inevitably partial in its basis and is therefore likely to disregard important characteristics of the housing market. An alternative approach is to analyse the operations of the market and other voluntary systems of interaction to see what problems might exist for people and to see whether alternative approaches might reduce those problems. When analysed in terms of the constraints on the achievement of social goals set out in Chapter 1 housing markets can be seen to be relatively straightforward. These constraints include information costs, interdependence, uncertainty, opportunism (leading to the need for incentives) and scarcity.

There are information problems in housing markets. As a general rule the seller or landlord knows more about the accommodation on offer than a buyer or potential tenant. However, this is clearly not a severe problem. Accommodation is usually available for inspection before contracts are signed. Most problems intrinsic to the house are readily apparent to visual inspection. Any problems in the neighbourhood can usually be discovered fairly easily. It may be that the more difficult problem relates to the landlord acquiring information on potential tenants.

In addition, the information problems that can arise in housing markets are addressed by the existence of specialist providers of information. Real Estate agents serve an important function as advisers on prices and opportunities within local markets. They act as brokers to bring potential buyers and sellers together, so reducing the search costs for both parties. Naturally it costs money to use estate agents but that is a reflection of the costs of acquiring and assembling information in an accessible form. Similarly, information on a particular house can be provided by valuers who can inspect the building and appraise it in the light of their local knowledge.

One example where the state provides an information service is in the recording of titles to property. Because the land register defines rights it would be difficult to run this as a contestable service. However, accessing this information for individuals is satisfactorily carried out in the private market by conveyancers.

While informational requirements are manageable for most people it is sometimes suggested that low income and other disadvantaged groups have inherent difficulties in obtaining information, and that centralised systems are therefore necessary for this group. This view appears to be based on an over simplistic assumption that low income is a reflection of poor education, naivety and low social skills. This approach ignores the fact that information on the supply of housing is only one part of the information stream necessary. Central decision-makers face equally difficult information problems in establishing demand factors.

Such information problems as do exist in the housing market are already being addressed by private sector institutions like agents, lawyers, newspaper advertising and the requirement that tenants produce references. It is not apparent that any

public sector solution would be likely to be any more effective than these voluntary arrangements.

Issues of interdependence, or externalities, are often claimed to arise in housing. However, on close examination these turn out to be minor issues. Most issues on the use of property which may affect a neighbour can be resolved on a bilateral basis. There are not usually a large number of potential negotiating partners, and negotiable deals would often be straightforward. Most such cases in fact are now covered by town and country planning provisions, and therefore the need for negotiations between individuals does not generally arise. Either a use is permitted, or it may not be carried on.

The most glaring example of interdependence issues in housing relate to housing which is so unsanitary as to pose a public health risk. This is of course a very rare phenomenon and is hardly grounds for any wholesale intervention. Clearly cases that do emerge need to be dealt with on a case by case basis, and local bodies have the means to do that. However, as a general rule there seem to be no significant interdependence issues which could be alleviated by a generalised government initiative.

There is uncertainty in housing markets, but of no worse degree than in most long run investments. In terms of financial value it is difficult to be certain that the purchase of a house in any given area will prove to be the best possible investment. Similarly it may be difficult to choose the appropriate debt instrument to finance that investment because factors such as future interest rates involve considerable levels of uncertainty. However, there is no mysterious ability that the state has to remove such uncertainty because the employees of the state are also bounded by a limited vision of the future.

Much of the uncertainty in housing relates to personal considerations to do with job prospects or family changes. Clearly these are questions on which the individual concerned is likely to be better informed than any institution. It can be that the landlord may be exposed to substantial risk from the potential behaviour of the tenant. This uncertainty problem can be assisted by the provision of a bond.

Another source of uncertainty is physical risk. Earthquakes, fire, flood or landslide may all severely damage a home and undermine security. These examples of overwhelming acts of God give a salutary reminder that the Government is unable to offer absolute security and certainty to anybody. To the extent that floods or landslides are relatively predictable such information as exists is readily available and valuers or estate agents can supply such advice. Use of insurance can reduce the potential loss that may result from physical risks.

The fourth item on the list is incentives. There would appear to be no special incentive problems in housing markets. The occupier or owner of a house is clearly the person who gains most from any benefits derived from that house. The

classic case that is generally raised under the heading of incentives is the agency problem, that parents may not always pay proper attention to the needs of their children. However, in the case of accommodation even this issue is of limited significance, because parents generally occupy the same accommodation as their children and therefore even the most uncaring parent is likely to take an active interest in the quality of accommodation. Obviously exceptions exist to this rule but they are not frequent. Certainly it seems improbable that any state agency would face clearer incentives to make appropriate choices in the housing area than the occupier or owner of a house.

One argument, which seems to underlie the Housing Commission's view that it is necessary for the Housing Corporation to continue to be subsidised to provide state housing and modest income loans, is that the private sector does not face adequate incentives to supply housing to low income and other disadvantaged groups. No evidence is given to support this view, other than the absence of competitors in this area. However it would be surprising to find any supplier able to contest this market without a subsidy in line with that given to the Corporation.

There is a further view that the state has greater incentives to innovate, which is also open to dispute since it is generally inconsistent with the experience of state organisations elsewhere in the economy. Incentives for increased market share apply in the private market.

The final constraint on the list is scarcity. As in any other market, the scarcity of goods means that housing has a price. This is at the centre of the main problem in the housing market. The cost of a house compared with the income of a low income household is very high. Therefore when rent is charged on a basis which will provide a normal rate of return on the landlord's investment, or when the household aspires to purchase a home, affordability is a major problem.

## Affordability and Discrimination

The above discussion suggests that, viewed individually the constraints of information costs, uncertainty, interdependence and opportunism do not pose substantial problems in the housing market. If that is so it is necessary to consider why problems of homelessness and over crowding occur and why low income and Maori and Pacific Island families seem to feature among those with housing difficulties.

The first reason is that, given the cost of housing, affordability is a major issue for any low or moderate income household. It is true that capital markets exist to spread the cost of buying a house by means of housing loans, and the rental

market exists to provide accommodation services. Both are good examples of the institutional devices which emerge from voluntary exchange to deal with the problems of high costs. However, housing costs can still form a major part of a household's living expenses, and as housing costs rise they can pose serious problems to those on low incomes.

This suggests that the major housing problem can be understood to be an income distribution problem. Low income people find it difficult to purchase housing in the same way that they find it difficult to purchase other necessary' goods and services. The reasons why housing should be singled out as an object for concern are complex. They relate essentially to the long term nature of housing arrangements. If a family is homeless then its condition is strained until their position is resolved on a long term basis. Very few of the aims people pursue in living in a house are met by overnight shelter. Food can be supplied on a daily basis, but housing requires a more complex long term arrangement. However, the basis of the problem is still income assistance.

Another aspect of housing difficulties, which arises out of the complex and long term nature of housing contracts, is discrimination. Discrimination by landlords can be seen as a means of reducing the information costs of selecting a suitable tenant by choosing someone with characteristics similar to the landlord, or as landlord taking opportunistic advantage of potential tenants that they do not like by charging increased rents, or refusing to let the home. Surveys in Auckland for the Office of the Race Relations Conciliator have established that some landlords and a very high proportion of real estate agents do actively discriminate against Maori and Pacific Island tenants.

Since access to housing is an important part of social well-being this suggests that, as well as affordability, the issue of discrimination is one that needs to be addressed if equity is to be achieved.

## Existing Assistance Measures

Current housing assistance policies are dominated by the Housing Corporation. The Government pays the Corporation to offer subsidised home loans for first home buyers. The loans range up to 30 years with the interest rate fixed in relation to the ability of the household to pay, according to an income formula. The other main form of assistance offered by the Housing Corporation is the provision of 60,000 state rental houses which the Corporation administers. The rents for these houses are fixed in line with an income formula. In addition to these two major schemes the Corporation runs a large number of small schemes of

varying complexity which are generally targeted on low or moderate income households.

The Department of Maori Affairs also offers a limited number of house purchase loans for Maori clients each year. The interest rates on these loans are set in line with the formula used by the Housing Corporation.

Another major source of accommodation assistance is the Department of Social Welfare. The Accommodation Benefit is payable to all beneficiaries and low income tenants to assist with rental costs. In addition beneficiaries may receive an accommodation benefit to help with house purchase costs.

Because the Housing Corporation is the dominant provider of housing assistance the rest of this chapter focusses on that institution.

We are concerned that there are major defects in the present system as a redistributive mechanism because current assistance is supplied in a way that does not achieve the goal of adequate housing, gives limited choice to consumers, is poorly targeted and is not neutral between different forms of consumption. We are also concerned that existing arrangements may not meet anti-discrimination goals. In terms of the overall efficiency and equity of the existing policies it is worrying that there is no contestability in delivery and the institutional structures are inappropriate. Each of these points is covered in more detail in the following paragraphs.

The aim of redistributive policies is to improve people's well-being. Given the complexity of issues which go together to make up an individual's well-being it is desirable to leave the decision making on particular consumption items as close to the individual as possible. People are more likely to have the greatest level of information about their own welfare, and are for the most part better able to choose between alternative forms of consumption than public servants acting on their behalf. While assistance via the accommodation benefit allows for consumer choices, albeit restricted to accommodation, Housing Corporation programmes restrict consumption in the rental area to the range of products or houses on offer by the Corporation. Lack of choice in housing also reduces the value which recipients place on the housing provided, which can lead to poor respect for property or even vandalism which raises the costs of provisions through high maintenance bills.

Assistance is tied to housing and thus introduces a bias in favour of accommodation as opposed to other forms of consumption. This bias is likely to reduce the likelihood that social well-being will be maximised. Within housing assistance, there is a further bias in favour of home-ownership which discriminates against renters. Within each tenure, assistance is biased in favour of those obtaining access to accommodation within or funded by the state sector. This is of particular concern in that the majority of low income households are in fact accommodated in the private sector. Data derived from the 1984/85 Household Survey, showed

that only 27 percent of tenant households earning less than \$16,000 are housed by the Corporation and 44 percent of homeowners in the same income category have first mortgages from the Corporation.

Despite recent improvements in targeting much of the assistance delivered by the state is still going to high income households. While the system of income related rentals should lead to tighter targeting for rentals, the maximum interest rates of 17 percent still involves a high level of assistance and cost. The same survey quoted above indicated that nearly 70 percent of households with a first mortgage from the Corporation had incomes in excess of \$20,000 in 1984/85 and over 30 percent had incomes in excess of \$30,000.

In addressing discrimination issues the Housing Corporation has a difficult task. Some recent comments from the Maori community allege that the Corporation can be insensitive in dealing with the needs of Maori clients. In particular it appears that a low number of Maori people purchase houses. This is largely a result of income issues, but appears to be influenced by other factors as well.

Lack of contestability in the provision of housing services to the Corporation's client group, which comprises a significant part of the overall market, raises questions about the efficiency of delivering of assistance. It is difficult to judge whether investment in state houses is efficient as these decisions have to be made in the absence of signals from the final consumers of the accommodation. The restriction on the delivery of assistance to one major institution means that the options available to consumers are limited and the discipline on the Corporation is reduced.

Like any other home occupiers the Corporation's rental clients have many different potential needs that they aim to meet in their accommodation. The choice available to low income people is always relatively restricted. However, the choice offered to a state house tenant is constrained even further. It is not possible for a potential state house tenant to compare the benefits of a state house with the benefits of alternative accommodation on a similar basis because the subsidy is tied to the Housing Corporation. On the other hand loans from the Corporation do not generally pose any particular artificial constraints on purchases, so long as applicants qualify on grounds of income and no previous home ownership.

## Institutional Structures

The Corporation carries out a wide range of functions. It is a major producer of housing services, the Government's advisor on and principal deliverer of housing assistance and regulation. As such, it is subject to the same constraints on efficient operation and effective service as other agencies with combined social, regulatory,

advisory and commercial roles. The concern that has arisen in these cases is that performance is affected by conflicting objectives, inability to identify the true costs of social policies, poor asset management, inappropriate control, incentive and monitoring systems, and limited accountability. These issues are discussed in detail in Chapter 2.

It is difficult to get a clear measure of the cost of running the Corporation because of its present structure. The fact that housing supply is combined with assistance delivery makes it impossible to isolate performance on either function. There is no basis to compare the performance of the Corporation with other financial intermediaries or landlords. It is difficult to form an accurate impression of the costs of our housing assistance policies because the real cost is not measured by the funds provided in the Estimates but is related to the cost of maintaining large housing assets with the Corporation. Earlier this year Treasury attempted to value the assets of the Corporation. The current mortgage portfolio was assessed to be worth around \$3,200 million at market interest rates but only about \$1,600 million at the interest rates that the Housing Corporation can charge in line with current government policy. Similarly the state housing stock was assessed to be worth around \$2,900 million at market rents but only around \$660 million at projected rents. From these figures we calculate that there is an annual cost of housing assistance delivered through the Housing Corporation of at least \$500 million. Unless there is a clear segregation of the supply of accommodation from the delivery of assistance it is very difficult to know whether the state is getting good value for money.

It is inappropriate for the Corporation to continue in its present form carrying out all of these functions. The key principle established for improving management is a need for clear objectives and an associated separation of policy advice and operational activity. For the Housing Corporation we see a clear case for the function of policy advice to be separated from other activities.

Similarly there are conflicts in an organisation which is a major provider of rental accommodation, deliverer of assistance to tenants, and regulator of the rental market. These conflicts are not easily resolved and there seems to be little to be gained from continuing to carry out all these functions within the same institution. We would suggest that the administration of regulation should be handled elsewhere within the public service.

The remaining functions of supply and assistance delivery are interrelated as long as assistance is delivered via the Corporation. However we see no reason for funding for assistance to be administered by the Corporation. This should be administered by a separate agency which is responsible to the Minister for the efficient use of these funds. As long as assistance is delivered via the Corporation this agency would be responsible for ensuring that systems for reimbursing the

Corporation are effective. Under alternative delivery options this agency would be responsible for funding delivery via competing producers, or direct to consumers.

Separation of the function of funding delivery results in clarification and identification of the delivery factors which influence the supply function. With these factors identified explicitly the supply function can be considered as a normal commercial operation, on a competitive basis.

In order to meet the redistribution aim there is little need for any state enterprise to provide rental accommodation or lending services. The assistance could be offered instead by means of subsidies to those with affordability problems or as income support and the supply of housing services handled by private sector operators. However discrimination may require a particular institutional response. The discussion of the way that the constraints on the market can permit discrimination by landlords indicates a need for an 'honest landlord'. Such honesty cannot be assumed, but must be encouraged by the incentives that surround the operation of the landlord. At present in the private housing market it is relatively easy for landlords owning one or two houses to follow their prejudices behind the anonymity of smallness. They each let houses sufficiently rarely that it is difficult to prove discrimination. However a large corporate landlord can be observed, and patterns in letting soon become apparent. In addition, a large corporation could suffer significant market embarrassment or loss in the event of enquiry by the Human Rights Commission. Since there is no substantial private corporate presence in the rental market at present there may be a case to establish a corporate landlord to fill the gap.

## Conclusion

Our analysis underlines the view that the purpose of government involvement in housing is primarily to deal with the problem of affordability, and in this respect should be seen as a question of income distribution. Other central issues in housing, notably discrimination, in so far as they are not resolved by income distribution policies should be addressed directly, through policies aimed specifically at those ends. Present policies confuse these different policy objectives. Furthermore, present arrangements for the administration of policy, in the form of the Housing Corporation, give rise to confusion between social and commercial objectives. Incentives for managers are unclear, and efficiency is diminished. It would seem preferable to move towards policies offering assistance better targeted to those on low incomes with affordability problems, and towards structures offering more contestability in the provision of housing assistance. We have not

arrived at a final view of what changes should be made, although we have indicated where we see the directions of change lying.

The need to examine and develop alternative approaches both to housing assistance policies and to the institutional arrangements for delivering housing assistance is amply demonstrated.

## INCOME MAINTENANCE

The previous sections on education, health and housing have explored the issues peculiar to each of those areas of social well-being. A central conclusion of those sections was that much of the problem in each was a question of income. Though there may be some general social benefits from education, some interdependence issues in health, and racial discrimination in housing, the main problem behind government policies in each area is to ensure that low income people have adequate access to those important social services. This means that to a significant degree the provision of state-funded social services is as a form of income redistribution. The problem of adequacy of low incomes has been met in these cases by supplying a subsidised service, rather than direct cash transfers.

For the purpose of this section these wider concepts of income redistribution are peripheral. Here the focus is on direct means of income redistribution. However, the general concepts remain relevant to all forms of social policy, and are discussed in more depth in the following section on targeting versus universality in the supply of social assistance.

Income distribution is a central issue in social policy because the receipt of income is critical to the maintenance of living standards. Policies to redistribute income seek to preserve certain values but it is also necessary to recognise that there are limits to redistribution because of other important considerations which may be compromised if redistribution is taken too far.

Policies for redistribution of income must provide a balance between the sometimes conflicting values of society. The most fundamental value requiring the state to redistribute income is the protection of a basic living standard: as long as people are of value then maintaining life is unquestioned. However, in a society such as New Zealand's, preservation of basic living is not a sufficient standard. Dignity and the ability to participate are values of importance that imply that the state should guarantee more than a minimum income. In modern economies a cash income provides not only the means to meet essential material needs, but is also the key to wider participation in society by providing the individual with the opportunity to exercise choice.

There are other values that could be identified as worthy of protection, but on closer examination there seems little justification for the state to be required to support them. For example, the freedom from loss of income inherent in a value of security might suggest that the state should undertake to guarantee everyone's existing living standard against a potential drop in incomes. However, a responsibility for the state rather than the individual to assume this risk raises the difficult equity question of whether all people, including the poor, should be taxed to maintain the existing living standard of those who are already well off. Another question is whether particular groups of individuals, for example the elderly or parents, should be entitled to support because they have made past contributions or have some intrinsic value to society. On these grounds we may want to 'honour age' or 'honour parenthood' through a universal payment. However, there does not appear to be a strong justification for making a payment simply on the basis of membership of these particular groups. Furthermore, the costs associated with providing such payments are large and therefore may act as a constraint to wider income redistribution objectives.

Two factors which may be undermined by income redistribution policies are the maintenance of incentives for effort and the encouragement of employment and independence. Subordinating these in the interests of higher levels of income redistribution can impose large costs. The individual required to pay tax to fund income redistribution is deprived of enjoying the full value of his or her work effort, and is likely to be discouraged from extending it further. If the disincentives are large enough there can be a net cost to society in terms of output (and therefore income) forgone. Those who have received transfers through the income redistribution process may face a disincentive to participate more fully in the paid workforce. In particular if the income received is close to the level provided from employment, the incentive to achieve greater independence may be undermined.

The costs associated with income redistribution policies suggest that there will be limits to the amount of redistribution that should be undertaken. Determining the appropriate level of redistribution thus involves a difficult trade-off between the equity values of permitting participation in society and the equity value and important efficiency questions of retaining incentives for effort for both beneficiaries and taxpayers.

## The Nature of Poverty

Income maintenance systems have been developed to redistribute income to those unable to generate by their own means sufficient cash income to maintain an adequate living standard. In evaluating the success or failure of a government's

income redistribution policy, attempts are inevitably made to identify and measure the extent of poverty. However, for several reasons, a reliable estimate of the numbers of people with insufficient resources to attain an adequate living standard is very difficult to achieve.

There is considerable disagreement over how or whether an adequate living standard or 'poverty line' should be defined. While there appears to be fairly wide acceptance that poverty should be measured in terms of the average income or resources of members of society, rather than on the basis of a defined minimum income or bundle of goods, establishing how and where the relativity should be set is the subject of much debate, that ends up largely a matter of prevailing values.

Even once a 'poverty line' has been adopted, it is not a simple matter of then saying that all those with incomes below the line are in poverty. An income redistribution policy that guaranteed the same minimum income for all individuals would fail to **recognise** that the majority of households comprise more than one person, with the living arrangement usually being one involving substantial sharing of the responsibility to meet basic living costs and maintain income. Thus when the incomes of individuals are compared with a given 'poverty line', say the benefit level, there appear to be hundreds of thousands of people in poverty. Closer examination reveals that the majority of these people will be sharing the cash income of another person, likely to be their (legal or defacto) spouse. Data from the Household Survey reveals that of the approximately 400,000 people with annual incomes between zero and \$5,000 an estimated 36 percent are non-working spouses. A further 34 percent are in part-time employment, and it is likely that many of these people are also spouses. The 'earnings' of those who care for children at home or do related domestic work are not counted in the Household Survey data. However, these notional earnings may in reality represent considerable value to the household in terms of opportunities for the breadwinner to earn high cash income to be shared jointly.

This reflects a more general problem with the data available on personal income in that they are usually based on a narrow definition of the economic resources available to people for the maintenance of economic well-being. The definition of income takes no account of the future income that a person may receive through ownership of assets, and understates current income to the extent that ownership of assets confers an imputed income through savings on expenditure that would otherwise be incurred—a common example is the imputed income from home ownership, which produces savings on rent. A period of low or even negative income particularly among self-employed people or students may reflect investment in assets that will produce a future income stream and in this context does not necessarily indicate that these people are in poverty. Earnings

from the 'black economy' are also unlikely to be recorded in official data sources but may provide significant supplementary income for some- people.

The data available on the distribution of incomes typically represent a cross-section of incomes at a particular point in time. However, most people can expect to receive a range of incomes over their lifetime. One model suggests that income rises from about 15 years of age as people begin their working career, reaching a plateau through middle age and then falling as retirement approaches. The income profile roughly corresponds with one's expenditure requirements, and it may be assumed that in periods of low income provision for needs in excess of requirements can largely be met from other sources; loans, or support from parents in the case of young people and savings or accumulated wealth for older people. Therefore, while it may be expected that those in the early and later stages of the working lifecycle will be overrepresented among those with low incomes, for most this will be part of a life cycle pattern before or after higher incomes.

When considering the incidence of poverty among households, rather than individuals, it is particularly important to distinguish the size and composition of the household. Smaller households, particularly single-person households, clearly would require less income than larger households. However, in the recent attempt by Waldegrave and Coventry (in their book titled 'Poor New Zealand') to measure the incidence of poverty in New Zealand, this fundamental factor was ignored. That approach compared the purchasing power of low income households with that of the average of all households. This involved adopting an income level below which there are 30 percent of the population and comparing the expenditure pattern of these households with those of the average household. This analysis suggested that because these low income households spend just over half of the amount spent by households with the 'average income on goods and services they can be said to be in poverty. From this basis a figure of 1 million New Zealanders in poverty was arrived at, simply by assuming that the households with the lowest 30 percent of incomes are the same size, on average, as all households, at just over three people.

However, data from the Household Survey suggests that the average size of households with the lowest 30 percent of incomes is under two people. Just over 50 percent of the households with the lowest 30 percent of incomes are single-person households and of these households, just over 70 percent are single national superannuitants. These single people would logically require to spend much less on food and other essentials than the average three-person household. Furthermore, Graph 3.1 shows that of the households with the lowest 10 percent of incomes, 78 percent are single person households. Almost four-fifths of these are single national superannuitants. It can also be seen from Graph 3.1 that, generally as household size increases, so does income, with families being relatively evenly distributed across the top 70 percent of incomes. Therefore not only

does this method of measuring poverty grossly overestimate the number of households in poverty, it incorrectly uses the average household size to arrive at an estimate of 1 million individuals in poverty.

This discussion of the definition and measurement of income does not lead to the conclusion that there is no poverty and therefore no further role for the state to redistribute income. However, it does demonstrate that simplistic approaches to defining and measuring poverty can result in a distorted picture being presented of the extent of the problem—and to calls for the state to greatly extend its role in income maintenance. In the latter part of this section we present our views on the establishment of a minimum income and issues concerning the state's role in providing this income, in the context of current levels of assistance.

## Directions for Change

A number of areas can be identified where the role of the state to provide income support at existing levels does not seem to represent an appropriate balance of the conflicting equity and efficiency considerations described above.

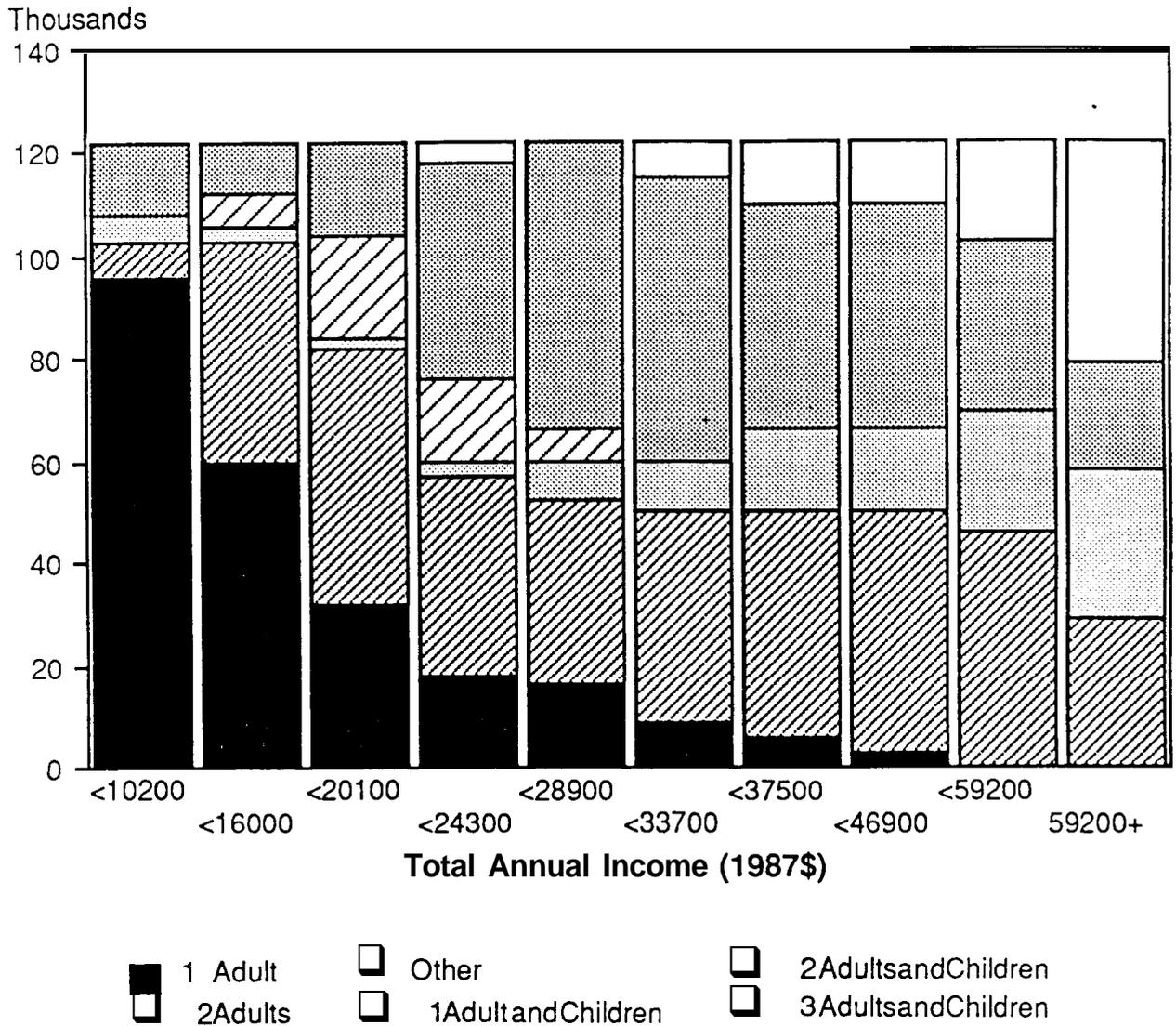
### *National Superannuation*

Three of the equity values identified earlier as being of importance—a basic living standard, dignity and participation—clearly extend to all people, regardless of age. But it does not follow that protection of these values requires that all people over a certain age should receive a universal payment. The values underlying such a payment, in particular 'honouring age', seem to have little firm basis. While security of income may be seen as being of particular importance to the elderly, loss of income on retirement is foreseeable, and thus it seems reasonable to expect that given the appropriate signals, individuals with sufficient resources will be in a position to take responsibility for providing for their retirement.

The current National Superannuation scheme represents a large intergenerational transfer of income from current taxpayers to those over 60 years of age, estimated to involve a gross cost in excess of \$3.9 billion in 1987/88. At the present time the scheme provides income support to over 90 percent of the eligible over-60s population, or about 14 percent of the total population. The national superannuitant surcharge, which adds a tax rate of 18c in the dollar on married couples with incomes of \$13,000 or more a year (\$7,800 for single people), represents a modest form of targeting, recouping about 4 percent of the gross cost of the scheme.

At the present time, it is estimated that in net terms an average personal tax rate of over 8 percent is required to finance National Superannuation alone (assuming that the scheme is funded entirely from personal income tax), and it is likely that in terms of marginal tax requirements the efficiency costs to finance

**GRAPH 3.1: Deciles of Households by Income By Type of Household**



Income is gross annual income including Social Welfare benefits, Family Support and Guaranteed Minimum Family Income. When a decile of the sample contained less than 10 households of a given type, these were included in Other.

Source: Household Expenditure and Income Survey 1985/86 adjusted to 1987/88 incomes using Treasury estimates.

such a transfer are large. In addition, incentives for private provision such as concessions for pension fund contributions and the tax exempt status for the earnings of pension funds exist which erode the tax base, and may produce further efficiency losses by distorting the neutrality of the tax system.

Furthermore, the situation, if left unchanged, will deteriorate further as a result of demographic trends. In the next ten years the cost of National Superannuation will continue to increase steadily in real terms, (the net cost rising at about 1.2 percent per year). After the turn of the century, if current trends in population and labour force change are maintained, the average tax rate required to finance the current scheme will rise steeply, (almost doubling in the next 60 years) as the labour force declines and the elderly population increases rapidly. This assumes that there is no growth in per capita real incomes but, under the current indexation regime for National Superannuation, real wage growth would simply be reflected in higher benefit levels. Even under a very optimistic set of demographic assumptions, which include long-term net immigration of 30,000 per annum, the net cost of the current National Superannuation scheme will continue to rise in real terms for the next 40 years.

The fiscal outlook and economic costs of retaining the present National Superannuation scheme leads us to conclude that some better form of targeting of assistance to the elderly is required. This would be more in accord with the set of values earlier identified as being important. If a state-funded pension were to be retained as the main form of provision for the foreseeable future, then we should consider options that target assistance more effectively. These include raising the age of eligibility, introducing a variable age of retirement, testing on the basis of employment earnings, income or assets and combining a low universal payment with an income-tested supplement up to a given minimum level. Attempts to cost various hypothetical options suggest that the most effective way of achieving substantial savings is to target superannuation on some income related basis.

A system in which more individuals are expected to provide for their own needs in retirement would reduce efficiency costs by allowing marginal tax rates to fall and would be likely to promote greater intergenerational equity as each individual would be in a position to make the personal trade-off between present and future consumption. Greater targeting of assistance to those with insufficient resources avoids the anomalous present situation whereby taxpayers on low incomes are providing assistance to older people with substantial independent income or assets, while ensuring that those people who have been unable to make their own provision are guaranteed an adequate income in retirement.

However, it also needs to be **recognised** that tighter income testing of superannuation would have unpredictable impacts on the incentive to make personal provision and trends in retirement ages. While state-funded retirement provision in any form is likely to discourage self-provision and encourage people to retire

earlier, the effects of reducing provision will depend on how the gains from acquiring more income from work or saving are weighed up by each individual against the assistance that is lost in doing so. The response would depend on a number of factors, with the basic level of assistance, the rate at which it reduces against other income and what types of income or wealth the benefit is abated against being important. Reduced labour force participation overall by older people would lower output and hence increase the cost per labour force member of supporting the elderly, with increased participation having the opposite effect. A higher age for superannuation entitlement would be more likely to increase labour force participation by the 60 plus age group. In the absence of an assets test on superannuation and comprehensive taxation of wealth, income testing would encourage saving through investment in assets other than interest-bearing investments. Furthermore, if substantial numbers of older people were able to arrange their finances to avoid the income test, the savings from income testing could be considerably reduced.

In considering a change to more targeted income support there are a number of additional considerations that should also be borne in mind. The administrative procedures used to establish eligibility for assistance would need to reflect a concern to preserve the dignity of the client as much as possible. Faced with a requirement to undertake more of the responsibility for their own provision, people facing retirement should be given some time to adjust their saving and spending patterns, and they must be able to trust that options will be available to enable them to meet their requirements. This suggests that consistency and advance announcement of changes in retirement policies and stability in the wider economy should be important objectives. Particular attention will have to be given to ensuring the structure of taxation is consistent with the design of income support policies for the elderly. Finally, differing abilities and preferences across individuals suggest that the financial and labour markets need to be sufficiently flexible to accommodate a range of needs for retirement provision.

While the direction of change for state-funding of retirement income provision seems clear, there are a number of important issues concerning the inter-relationship between state-funded provision, private provision, and the wider economic environment which require further examination before a detailed policy can be specified.

### *Family Assistance*

In the preceding discussion on National Superannuation we suggested that there appear to be few grounds for providing a universal payment to all people once they reach a certain age, and that the responsibility for providing for one's retirement should rest with the individual. While children are clearly not in a position to provide for their own well-being, the provision of a universal Family

Benefit raises again the question about the values which are expressed in making a payment to all families irrespective of their means.

A universal payment may be regarded as recognition of a caring parent's worth to society. However, as we indicated earlier, the state has no basis on which it can justify such a payment to all parents. A payment that truly compensated a parent for the loss of potential income associated with childrearing would be hugely expensive. The current \$6 a week payment is clearly only a token that contributes little to the overall costs of rearing children. However, when summed across all families the benefit amounts to a significant cost to the economy as a whole.

The loss of potential household income suffered as a result of one spouse becoming involved in child-caring and the extra demands made on household income by children are costs that should be borne by the family, being traded-off with the benefits that children bring to their parents. Thus it is generally considered that parents have the responsibility for their children's needs, except where the parents' income is insufficient to adequately cater for these needs. This philosophy underlies the current Family Support scheme, with assistance reduced as income increases to reflect different abilities of parents to cater for their children's needs.

These considerations suggest that the universal payment of Family Benefit should be abolished and that assistance to families should be targeted to those who are unable to meet the full costs of child-rearing themselves. A move that would retain the current level of assistance to low and middle income families would involve merging Family Benefit with Family Support entitlements.

### *Youth Rates*

The current system of financial support for young people conflicts in a number of areas with the wider concerns that have been identified as being of significance for income distribution. A wide variety of rates exist which clearly treat young people in different situations inequitably, and creates a perverse structure of incentives that favour unemployment over training or higher education in the short run.

The main areas of income support include the Unemployment Benefit, other income-tested benefits, the Tertiary Assistance Grant and Access allowances. Thus a 17 year old sickness or invalid beneficiary currently (April 1987 rates) receives \$112.68 a week, a 17 year old unemployed beneficiary \$77.86 a week, and a 17 year old Access trainee \$107.85 a week. By comparison, a 17 year old full-time student at a university, technical institute or other educational institution receives \$78.50 a week if living away from home, and \$41 a week if still at home. A 17 year old still at school receives no assistance, his or her parents receiving Family Support (and Family Benefit) up to \$42 a week if the family income is in the low to middle income range.

Clearly an inequity exists where trainees on Access who take courses in education institutions receive income support substantially greater -than the full-time students they sit alongside. Similarly, young people from wealthy households can receive high levels of support from unemployment or sickness benefit whereas struggling young people from low income households who need to live away from home to train or study receive much lower levels of assistance.

Becoming established in employment is seen as a key to the well-being of young people in the long-term. This, and wider concerns that income redistribution policies should minimise efficiency costs by targeting assistance more effectively and equitably, suggests that the whole system of income support for young people should be radically redesigned.

There are a number of considerations which may guide this redesign:

- Young people's costs of living are generally lower than adults'. This is because most young people have considerably fewer responsibilities than adults.
- The responsibility of parents continues beyond childhood. If their parents can afford it, young people who are making their way in life can legitimately expect some financial support from them and the state should not be expected to take on that role.
- Most young people undergo a transition from being largely dependent on their parents for income support to gradually increasing independence as they get older and find their own means of support. It is unrealistic to focus on just one age as being the difference between youth and adulthood.
- The relationship between state provided income support and possible wage rates is particularly critical for young people because their labour force attachment is weak.
- The employment incomes that are available to young people are generally considerably lower than the average income from work. This is because youth rates exist in many areas (the minimum wage does not take affect until the age of 20) and also because young people tend to take on lower skilled work with lower pay.
- It is important to ensure that there is no discouragement to train. Young people are still acquiring critical skills that are important to their future lives, and education and training are essential to that.

This set of considerations suggest that any regime of income support for young people should make provision for assistance from parents who can afford it and should strike relatively low and uniform rates of support for all young people without other income.

The kind of system that might conform to these principles could involve payment on a family income tested basis (possibly to the family) up- to around 17 or 18 years of age. Beyond that age it might be appropriate to move to a uniform benefit somewhere in line with the Tertiary Assistance Grant until the person is 20. These rates should be the same for people in formal education, training schemes or unemployment.

Whatever system is adopted in this area there is clearly a need for a wholesale change in young people's income support and a rationalisation of the regime. At present the system of payment for young people is under consideration following the publication of a consultative document earlier this year. Until this consultation process is completed our views on the appropriate regime for youth pay and the ideas expressed here are only tentative.

### *Benefit Levels Overall*

In establishing the values of significance to be considered in income redistribution the importance of ensuring participation in society rather than merely protecting minimum living standards has been stressed. This suggests that a minimum level of assistance for those unable to be self-supporting should be defined with respect to other members of society. This reasoning was followed by the 1772 Royal Commission on Social Security. It concluded that the maintenance of an adequate income should be seen as a relative concept and set a benchmark between the married rate of benefit and wages. As well as some specific award rates that are no longer able to be identified, the Royal Commission set a bench mark for the married rate of benefit at 80 percent of the lower quartile of men's wages.

Since that time the relativity has changed because while the real value of benefits has been maintained with regular adjustments in line with the Consumer's Price Index, the distribution of real wages has changed. Using the Household Survey to estimate the current lower quartile of men's wages, the current gross rate of benefit is now 24 percent higher than it would be if the relativity established in 1772 had been retained.

The change in relativity is a cause for concern for **two** reasons. In terms of incentives the maintenance of real benefits has had the effect of increasing replacement rates. These rates measure the net amount an individual would receive on the benefit as a percentage of net earnings in employment or potential employment, with higher rates indicating a greater disincentive to work or save. The increase in replacement rates is reflected in the movement of the married benefit level from two thirds of the average wage in 1772 to three quarters today. As replacement rates rise the gains to a beneficiary from moving into the workforce in terms of an income above that received from benefits become smaller, reducing the incentive to seek employment, and therefore increasing the

likelihood that those in receipt of assistance fall into a 'poverty trap' and dependence. While arguably most people in receipt of assistance will face these incentives at some time, a case may be made that the relativity is more relevant for particular groups of beneficiaries, the unemployed (especially unemployed teenagers) and solo parents with older children, for example, as they are more likely to be in the position of actively seeking employment.

The second concern is the fairness of maintaining the real purchasing power of non-working beneficiaries while their counterparts in the workforce have experienced declining real incomes. It must be recognised that there have been changes in social patterns in the last 15 years that may suggest that using the relativity established in 1772 is no longer appropriate. Increasing labour force participation by women has led to a relative decline in the number of two adult households relying on a single income. At the same time, there has been a rapid increase in the number of single adult families. This may suggest that in order to be able to participate in modern society levels of income assistance should be set in line with family income rather than a single person's wage.

The relatively small numbers of families (about 4,000) currently in receipt of the Guaranteed Minimum Family Income (which at the present time provides full-time wage and salary earners with children an income of about \$14 per week above the equivalent (April 1987) benefit level) may indicate that low income families relying largely on wage income have maintained their incomes. However, more uncertainty surrounds the relative position of people without children.

A problem remains, therefore, of deciding the appropriate basis on which the minimum income should be set. One response would be a much wider extension of the negative household income tax scheme, which is currently embodied in the Guaranteed Minimum Family Income, to cover all low income households or even individuals irrespective of whether they have children. Such a move would recognise that wage levels can no longer be guaranteed to deliver an adequate living income to all people, but would be likely to impose high incentive costs on a much larger number of people, as such schemes usually involve high effective marginal tax rates. While the state is primarily concerned with maintaining household incomes, any move to provide assistance which covers more than the loss of an individual income would create considerable incentive problems by discouraging the partner from increasing or maintaining his or her work effort, as the benefit is reduced on the basis of the income earned by the partner. While this problem already exists in the current benefit system, extending the principle is likely to impose very high efficiency costs.

An alternative would be to move to assistance provided on an individual rather than household basis with support being provided irrespective of the resources of the partner. This would involve a radical departure from the current basis on which income maintenance is provided. If the state were to become involved in

this form of provision through some form of Social Insurance scheme, serious concerns would be raised about the equity of taxing poor households to support the incomes of well-off households.

It appears that while there may be significant concern about the movement in the relativity between benefits and wages in the last 15 years, it is rather more difficult to establish a firm basis on which to advocate a particular policy response. Clearly fundamental issues are involved such as defining the level of income, and the unit to which it is provided, appropriate for the current social and economic environment. However the combination of efficiency considerations of maintaining incentives to work, and equity considerations of avoiding the poverty trap that is generated by unrealistic benefit rates, suggests that benefits are now too high in relation to wages, and this cannot be sustained indefinitely without significant social costs.

## UNIVERSALITY AND TARGETING

### Introduction

We can define universal forms of assistance as those which are equally distributed or available to all members of a qualifying group. Alternatively the state can target by distributing resources to members of that group on a differentiated basis, so that some may get nothing or very little, and others get significant amounts. The basis for differentiation is often income, but other criteria can be used. For example under the Access programme a range of criteria which does not include income is used to determine differentiated funding levels.

In one sense all assistance policies are targeted, in that even the most universal of schemes are focussed on particular groups (ACC on the injured, Family Benefit on children, National Superannuation on people 60 and over). The targeting that we are discussing here relates to differentiation of the level of assistance within such groups. It does not have to involve cash payments, but can also apply in respect of the extent of support provided under other forms of government assistance. Examples exist in education and training (Access), housing (concessional interest and rentals from Housing Corporation), and health benefits and services (support for elderly in rest homes). It would be quite possible to envisage free or subsidised access to a wide range of services being targeted.

Thus there is a range of situations where the choice between universal and differential provision arises. At one end of the spectrum is the 'pure' case of income redistribution, where the sole criterion for the degree of support or taxation is the level of other income one receives. The main mechanism which falls into this category is in fact part of the revenue collection structure-the

progressive income tax scale- and not an assistance programme involving government spending. The present income tax scale is designed to collect relatively more taxes from people with higher incomes, and is a major element in the overall structure of income redistribution. There is no 'entry' qualification required other than that of receiving taxable income.

Moving a little from this point there are the main Social Welfare benefits, where to benefit one must qualify as a member of a group in terms of some particular characteristic (for example unemployed, solo parent, disabled) and, having thus become entitled, the amount of support is in broad terms targeted on the basis of other income. The family support and guaranteed minimum family income arrangements, and National Superannuation in conjunction with the tax surcharge, would also fall into this category.

The combination of all these income support arrangements should at least in principle cover the great majority of households in low income situations (possible exceptions being households where income is principally derived from self-employment, part-time work or student allowances). This raises the question as to whether these forms of income support need to maintain the range of entry barriers such as unemployment, or whether a simpler form of redistribution based solely on income could be put in place. The continuing debates on where the entry barriers should be placed (such as who should qualify for the Domestic Purposes Benefit) reflect the concerns about incentive effects discussed later. At this stage the trend of policy thinking appears to be towards a more uniform benefit structure but with a significant element of targeting continuing to be focussed on entry qualifications as well as on income. There is however room for debate as to whether concerns over incentive effects might not also be addressed by some shift in the emphasis of policy focus relatively more to benefit levels and abatement rates, and to somewhat less on the entry qualifications.

Moving further into the areas of **sectoral** social policies, the Government's support in the housing area is dominated by assistance targeted by incomes, but for interventions in the health and education sectors this is at present much less significant. As discussed in earlier sections the reasons for intervention in respect of health and education are diverse, and some of them imply that targeting is not appropriate for the full amount of assistance provided. For example support given by the Government on the grounds that part of the benefits from education are not gained by the individual but by the community as a whole, or on similar grounds in the public health area, reflect such a widespread interdependence that it would be inappropriate to target all those elements of support.

On the other hand the conclusions reached in the sections on education and health policies suggest that in principle a significant part of the justification for government intervention in those sectors is based on equity grounds, such as ability to pay in relation to incomes. Such justifications open the possibility of

targeting. Again there may be limits to such possibilities. In the discussion of health policies, the inadequacies and problems of insurance markets in dealing with long term disabilities and the inherent differences in the levels of risk facing different people suggests that significant government assistance in the provision of health care may be necessary. But within some considerable constraints there is still some scope for targeting that assistance to people on the basis of their incomes. In education much of the arguments for assistance, as distinct from the justifications for other forms of intervention, appear to be quite directly equity-based and are thus susceptible to targeting.

Thus the issue of whether to choose universal assistance or to target runs through much of social policy, and is not limited to areas of policy where the objective is purely income redistribution. The balance of this section discusses the reasons why universal or targeted assistance might be better. The discussion is cast in terms of income distribution, but the same issues arise in respect of many areas of assistance under **sectoral** social policies.

## Advantages and Disadvantages

Both universal and targeted forms of assistance have advantages and disadvantages. While there may be merits in adopting either form of provision in different circumstances, the principles which favour one approach over the other will probably have widespread application in many areas of social policy. Furthermore, adoption of either universal or targeted assistance as a general approach to income redistribution is of fundamental importance because of the impact on the economy as a whole.

Considerations relevant to the choice of universal or targeted provision of state assistance include:

- administrative simplicity. Universal provision of assistance is easier and often less costly to administer because resources are not tied up with determining differential entitlements. However it has to cover more people, and the overall extra costs of public sector management may outweigh the higher per capita administration costs of a targeted system.
- universal provision avoids stigmatisation associated with having to declare income in order to receive assistance under a targeted system.
- uniformity of provision. It is sometimes argued that it is important that when dealing with the 'essentials' of human life such as health care, housing and education, that the state must ensure that all people receive the same service, or at least the same minimum level of service.

However this is not the same as saying that the State should fund that level of service for all, and there are severe costs in imposing uniformity of provision and reducing the choices available to meet the diverse requirements that people have. Universal approaches, for example the education system, also may not achieve the flexibility to help those within them who are most in need.

- under a universal approach particularly if there are relatively high tax rates at middle income levels, there is very little income redistribution. Instead there is a lot of recycled income or income churning among middle income earners. The efficiency costs which arise from imposing high taxes are incurred with very little redistributive effect and no apparent benefit for middle income earners. It has been argued that there would be concern among such people if universally provided services were not available to them. However they would need to assess this cost against the offsetting gain in net income and choice over its use.
- the fiscal costs of a universal form of assistance will be greater than that of a targeted provision if the same level of assistance is given to low income people under each alternative. In some universal programmes, attempts are made to reduce the costs associated with universal provision by holding down the level of payments. This creates an outcome which may not be what is intended, with low income households receiving inadequate levels of assistance while well-off households receive assistance, albeit in small amounts, that they don't need. Two current examples of this are Family Benefit and the General Medical Services Benefit for adults. The issue is whether the policy objective should be to give a small amount of help to all families with children and to all adults visiting the doctor, or to give greater amounts of help to those people where their incomes are low.
- if universal provision of income support and a wide range of social services is made available at a level adequate for lower income people, the costs are likely to be huge. There are significant disincentive effects which may have a considerable impact on the economy as a whole, as a result of the level of government revenue and intervention required. Similarly, however, there are disincentive effects from policies which involve targeting, as they may have a major impact on the behaviour of people who get assistance under targeted programmes. The remainder of this section discusses these incentive issues.

## Universality, Targeting, and Incentives

Universal assistance programmes which provide support at levels which give reasonable help to lower income people across a range of income support and social service policies generate high revenue requirements. In effect, the average tax rate has to be high. There appear to be considerable constraints on achieving the high average tax rates associated with large revenue requirements by raising the marginal tax rates of high income earners. These constraints are discussed in more depth in the section on personal tax in Chapter 4, but the effects are of concern not only because they erode the tax base but because they also generally involve a shifting of resources into less productive activities, with a net loss of potential output or utility to the economy. Because relatively little revenue is raised by having high marginal tax rates for only high income earners, tax rates for those further down the income scale also have to be higher as a result of universal provision than would otherwise be the case. The overall impact on people's well-being and on the economy, when the extra costs of public sector management and income churning are also taken into account, is considerable.

Targeted assistance also creates significant disincentive effects for those affected by the schemes. The lower total cost may mean that average tax rates are lower, with benefits to the economy as a whole, and that the wasted costs of middle income churning are reduced. However where support is targeted, it has to abate as incomes increase. The abatement of targeted support means that people receiving such support can face high effective marginal tax rates which are a disincentive to action (such as increasing the hours worked) which would increase their other income.

This is of concern because of the arguments which suggest that low income groups, (as well as high income groups) are particularly sensitive to high effective marginal tax rates. In some cases this arises because people who are not in the work force may see high effective tax rates as a significant barrier to entry-young people on unemployment benefit with weakly formed work habits are an obvious group. Second income earners in households having to overcome additional costs such as child care fees are also likely to be discouraged from further participation in the workforce if faced with rapid abatement of assistance such as Family Support.

Although the costs inherent in the disincentives associated with targeted assistance programmes are not small, they are likely to be less than those associated with universal entitlement programmes. The issue being faced is that if the equity objective of assistance to lower income groups is to be achieved, there is a choice to be made between two approaches, each of which carry significant costs. Targeted support programmes are likely to be better than universal entitlements.

However, under that targeted approach, lower income people are likely to continue to face high effective tax rates.

Various tax and income support abatement rates can rapidly accumulate to produce effective marginal tax rates of 100 percent. This is currently the case for beneficiaries earning over \$80 per week and recipients of Guaranteed Minimum Family Income (GMFI). This problem would be compounded if family and other income support measures were more tightly targeted and a move was made to target health, education and other social services. A family on a modest income receiving targeted social services and Family Support could face extremely high effective marginal tax rates. There are no simple solutions to this problem, but it may be with some innovative thinking about administration of assistance, aided by technological developments a system could be devised for ensuring entitlements are rationalised, while minimising the loss of dignity for recipients of assistance.

Whether or not new technologies are adopted it seems that the appropriate balance between redistribution aims and the incentive problems posed by effective marginal tax rates is to provide more social assistance on a targeted basis. While care would need to be taken to ensure administrative procedures preserve the dignity of those receiving assistance, moving towards more targeting of assistance would permit a lower overall average tax rate.

With a slightly lower average tax rate as a result of greater targeting of social assistance, there should be some scope for rationalising the abatement of targeted assistance. However the current abatement rates of up to 100 percent for many income support policies would still not be able to be reduced greatly. Part of the reason is that benefit levels are somewhat closer now than in the past to average incomes leaving little room to abate income support gradually. Unless relative benefit levels were reduced, effective tax rates when tax and benefit abatement are combined are likely to remain in the 60-100 percent range.