

A Review of the Financial Support for New Zealand's Children

**National Council of Women New Zealand
Economics Standing Committee**

Part A: Family Support and the Child Tax Credit

Introduction

Members of the Economics Standing Committee of the National Council of Women New Zealand believe the impact on the wellbeing of children and low income families should be given greater priority in socio-economic policy decision making. This is particularly relevant in terms of tax and benefits.

The Committee believes that through exclusion, the economic status of New Zealand's children has declined to unacceptable levels. The following statistics support this view. Between 1986 and 1996, average disposable household income rose only slightly from \$34,100 to \$35,500 (constant 1996 dollars). Over the same time period, median disposable household income fell 9% from \$31,100 to \$28,400 implying that median income was only 80% of the average (Child Poverty Action Group, 2001c). Thus more than 50% of households had lower than the average incomes and had experienced falling living standards. Statistics also show that in 1996, 49% of all children under 15 were in the two lowest quintiles of household income. Further research into poverty levels suggests that one third of children under the age of 15 are being raised in families that do not have sufficient disposable income to ensure their full development (Child Poverty Action Group, 2001b).

Given the declining financial status of many of our children, the Economics Committee calls on the government to extend the Child Tax Credit to all low income children.

Background Summary

Income support for children, in the form of a Family Benefit, first became universal in 1946 and was paid at the rate of 10 shillings per week per child (Child Poverty Action Group, 2001a, p.1). However, the Benefit was not indexed and post war adjustments were insufficient to maintain purchasing power. For example, relative to the average wage, its value declined for one child from around 8% at the end of World War 2 to 3% by 1983. It remained unaltered at its 1979 level of \$6 per week per child until it was abolished in 1991 when it represented less than 1% of the average wage.

With the introduction of Family Support in 1986, New Zealand adopted a system which treated all children from low income families the same regardless of the status of their parents. Family Support was a tax based credit system with support given to the principal caregiver on the basis

of the number of children and level of joint parental income. Following the demise of the Family Benefit, Family Support became the sole mechanism for delivery of financial assistance.

A brief summary of the current system of Family Support is as follows (Child Poverty Action Group, 2001b, p.18). For the first child under 15 years, the rate is \$47. For additional children, it is \$40 for each child aged 13, 14 and 15 years and \$32 for each child under 13 years. For every extra dollar earned over \$20,000, a family is required to pay back 18c of their entitlement. Once combined, parental income exceeds \$27,000, the claw back rises to 30c for each extra dollar. Thus to receive the maximum, a one child family requires a gross income of less than \$20,000. By \$30,946, all Family Support is abated.

More recent family support policies have been based on the notion of the “deserving poor”. For example, the 1996 Budget introduced a new concept for family assistance involving numerous measures all under the banner of Family Plus. The most significant of these, was the Child Tax Credit. Families qualify for Child Tax Credit if they are not on a benefit, student allowance, New Zealand superannuation or accident compensation for more than 3 months. The payment has a maximum value of \$15 per child per week and is abated after Family Support. To illustrate, a one child family where the child is under 13 years all family assistance, including the Child Tax Credit, is abated by total income of \$33,546 (Child Poverty Action Group, 2001b, p.18).

Review of Family Financial Support

The following discussion analyses the current system of family income support. A number of criticisms are raised both in terms of Family Support and the Child Tax Credit.

Although supplementing Family Support with the Child Tax Credit restores the real value of family assistance for those who qualify, financial support for those who do not continues to be eroded. The Economics Committee believes that all low income children should be treated the same regardless of whether the source of their parent’s low income is from paid employment or a welfare payment. Children should not be discriminated against. For example, under the current eligibility rules for the Child Tax Credit, a working parent whose partner is on the community wage does not qualify. If a parent on a benefit works part time the children do not qualify. When a parent loses his/her job through circumstances beyond control, the loss of the Child Tax Credit punishes the children. Thus although the Child Tax Credit is supposed to reward independence from the state, in reality it acts as further punishment by being withdrawn when families fall on difficult times and require a social welfare benefit. Is there justification in denying \$15 per week to a child simply because a parent has the misfortune to be ill, unemployed or old?

Like many targeted entitlements, the Child Tax Credit can be criticised in terms of the difficulty of its administration. For example, as it is received only for the number of days of the year that families are not receiving any state payment, families on and off benefits, during the year, are likely to miss out even for the times they do qualify.

One of the major concerns associated with Family Support is its failure to be automatically adjusted for inflation. Over time, it has been subject to attrition both with respect to (1) the real level of spending power it represents and (2) the levels of income from which it is abated. To illustrate, since 1986 when Family Support was introduced, there has been only a \$5 per week increase (from \$42 to \$47) in the weekly payment for the first child. In real terms this amounts to 34% fall in purchasing power (St John, 2001). If Family Support had been properly adjusted for inflation, the maximum for the first child would be \$72 per week. In addition, the top threshold from which the abatement of Family Support is 30%, has remained at a joint income of \$27,000 since 1988. If proper indexation had been operating since 1988, the top threshold of \$27,000 of joint parental income from which Family Support abates at 30% would currently be around \$37,000.

Analysis carried out by the Child Poverty Action Group (2001a, p.4) shows that many low income families do not receive maximum payment as their income falls over the abatement threshold. For example, a one child family on three quarters of the average weekly earnings in 1986 was entitled to \$35. A similarly placed family in 2002 is entitled to \$23.60, representing a decrease in purchasing power of 60%. Such a family would require an extra \$3,130 per year to achieve the same real value of family assistance as in 1986. To summarise, for 2002, the first abatement threshold would need to be raised to \$24,000 and maximum family support to \$72 to restore the 1986 levels.

A three child family with all children under 13 on the average weekly earnings has also suffered erosion in purchasing power of family assistance since 1986. The effect is even more marked for a middle income family on 1.5 times the average weekly earnings due to the loss of Family Benefit and the increased targeting of assistance for incomes above \$27,000 (Child Poverty Action Group, 2001a, p.5).

As there is no catch up in the Family Support system to allow for past inflation, the real value of future assistance is destined to sink further. To illustrate, 2001 Budget Tables show that Family Support is projected to change from \$910 million to \$911 million over the next 5 years (St John, 2001). Over the same period, Gross Domestic Product is expected to increase by 26%.

Other welfare payments, including the state pension, have an automatic allowance for inflation built into their projections. To illustrate, no matter how affluent an individual over 65 is and whether or not in paid employment, he/she is guaranteed an inflation-adjusted pension. Thus most affluent retired couples, even if both are on the top tax rate, get an extra weekly payment in the hand of at least \$261 – the poorest one child family gets at the very most \$47.

The establishment of the New Zealand Superannuation Fund in 2001 is likely to make it difficult to challenge the contrast between universal pensions for the old and the highly income tested payments for the young. Increasingly the obligation to pay into the Superannuation Fund will constrain the ability of the Government to increase either social welfare benefits or family payments.

However, reducing the pension or making it means tested will not solve the problem. The New Zealand pension is a success story as it has removed most of the elderly from poverty – an attack on the elderly cannot help the young. It is though, unjust to apply the universal principle so selectively. To be equitable, the costs of paying pensions to the very well-off older people without requiring any additional claw back, must be compared with the costs of extending the Child Tax Credit to all low income families.

Summary

The abolition of the Family Benefit in 1991 began the current trend of delivering specific assistance for children via the tax system. This paper has identified several major problems associated with this trend:

- Thresholds for the abatement of Family Support have been inadequately adjusted for inflation.
- Difficulties exist in administering the Child Tax Credit.
- The Child Tax Credit introduces a differential treatment of children in low income families based on the origin of that low income.
- Access to tax credits has been poor with little effort made by the Inland Revenue Department or Work and Income New Zealand to improve access or take-up rates.

To alleviate these problems, the Economics Committee believes that the Child Tax Credit should be extended to all families. While the cost of doing so would be significant, this would restore the real value of state assistance to low income children. It is likely that additional children, qualifying for an extension of the Child Tax Credit, will be in the lowest income families and

therefore would be a highly effective way to help that group without “middle class capture” criticisms. Once catch up is achieved, future budgets should ensure that all aspects of the welfare system affecting children are properly linked to an inflation index.

Finally, extension of the Child Tax Credit would be administratively easy given that it would involve a simple adjustment to Family Support payments that are already made. There is likely to be an overall saving in administration costs as the current discriminatory system requires costly monitoring of eligibility. In summary, extending the child tax credit and linking all child income support entitlements to an inflation index would be a significant step in improving the welfare state of the nation’s children.

Part B: Universal Family Benefit

Introduction

The second part of this paper reviews the arguments for the reintroduction of a universal child benefit. It concludes with the members of the Economics Standing Committee of National Council of Women New Zealand calling on the Government to replace the Child Tax Credit with a universal benefit for children indexed to inflation.

The committee argues that the lack of improvement for poor families, despite economic growth, is partly due to tight targeting of government assistance. This makes it difficult for those in the lowest income groups, including many in full time work, to improve as earning extra income results in a claw back of state assistance. This is particularly true when targeting is based on the family unit as opposed to the individual. During the past decade the dominant philosophy in New Zealand has been to provide welfare “only for the poor” and accordingly there has been a sharp shift towards a tightly targeted policy framework.

The idea of greater targeting of welfare payments features in many public debates on the welfare state and is even claimed to be superficially attractive (Atkinson, 1993). The concentration of benefits to those in need, is an objective which often commands wide support. For example, the 1990 World Development Report states “a comprehensive approach to poverty calls for a program of well-targeted transfers and safety nets as an essential complement to the basic strategy” (World Bank, 1990, p.3).

At a national level, more efficient targeting is viewed as the key to reform of social welfare. Government policy in many areas indicates a belief that resources must be directed more effectively to areas of greatest need and therefore resources must be targeted effectively and efficiently. In policy terms, this implies a shift towards income related transfers and a move away from universal benefits paid without a means test. For policy makers, there is much appeal in the idea that the existing total of transfers can be reallocated to increase their effectiveness in combating poverty. To summarise, advocates claim targeting is more fiscally prudent, efficient and equitable (Richardson, 1990). The provision of universal assistance is viewed as unjustified and damaging.

In contrast advocates of universality believe there are robust, moral and economic justifications for universal programmes in certain situations. They argue that targeting can often be both inefficient and inequitable as well as generating numerous administrative problems, stigmatising

the poor and undermining middleclass support for social programmes and income redistribution. The following quote by Bertram illustrates this view: “Universal provision improves resource allocation, minimises qualitative differentiation of service, is politically sustainable because of the wide spread of beneficiaries and performs an important socially integrative function by underpinning the rights of citizenship” (Bertram, 1998, p.135).

The following discussion looks at the major issues in the targeting debate. Although politically fashionable, the Economics Committee believes that the calls for greater targeting need to be treated with caution.

Targeting versus Universality – the Issues

(a) Fiscal Costs

Targeting is often defended on the grounds that in a world of resource scarcity and fiscal constraints, it is better that limited public funds should be directed to those in greatest need (Dalziel and St John, 1999, p.95). A targeted social policy regime provides the cheapest and most cost effective way of eliminating poverty and providing a minimum standard of living for all. However, as later discussion illustrates, if the targeting regime is excessively tight it may not produce the hoped for fiscal savings.

A strong argument often advanced for targeting is that a government can afford to give the recipients of assistance more generous levels of support. By contrast, universal programmes must spread a lower level of assistance across the whole population or relevant group. Thus given a fixed quantum of public resources, those on low incomes may not receive enough, while those on high incomes will receive assistance they do not need.

However, on the whole, targeted welfare arrangements tend to be more vulnerable to government expenditure cuts than programmes that also benefit the middle class (Barry, 1990). This is particularly relevant to New Zealand where, far from producing a more generous level of assistance, targeting has been associated with benefit cuts and more restrictive criteria.

Dalziel and St John (1999, p.96) conclude that a key reason why a targeted system is cheaper than a universal one is that it facilitates lower, not higher, levels of support for those most in need. From a political economy perspective, explanation for this is not hard to fathom. People are often more willing to pay taxes to fund programmes that benefit them personally than those that assist only the poor. Politically it is more difficult to reduce expenditure on social

programmes that benefit a large proportion of the population, particularly if the beneficiaries are well equipped to defend their interests – well educated middle-class citizens are generally better at such tasks than the poor.

(b) Efficiency

Universal policies are often criticised for their presumed detrimental impact on economic efficiency (Dalziel and St John, 1999, p.97). For example, higher levels of public expenditure and taxation necessitated by universalism are claimed to have harmful effects on economic growth. One reason for this is that higher average and marginal tax rates are believed likely to reduce profitability, enterprise and innovation, undermine work incentives, lower private savings and increase dependency on the state.

However, efficiency arguments against universalism are by means as compelling as is often thought. For example, the claim that higher levels of public expenditure and taxation lead to lower rates of economic growth is not unequivocally confirmed by the evidence. This is particularly so for the range of expenditure and taxation levels common within OECD countries (Atkinson, 1995).

The greater the scope and tightness of targeting, the higher the effective marginal tax rates (EMTRs) faced by many low to middle income earners often resulting in poverty traps. An EMTR is calculated by adding the relevant income tax rate and the abatement rate applying to targeted forms of social assistance and indicates the proportion of an extra dollar that is unavailable.

Effective Marginal Tax Rates occur as follows. As more social assistance is means tested, there is more to “claw-back” as other income increases. To exclude those above the narrow entitlement range, targeting must be tight. Abatement of benefits that occurs as other income increases pushes up effective marginal tax rates. When individuals receiving income assistance earn an extra dollar, it is taxed and levied for ACC. However, it also causes them to lose eligibility for a portion of family assistance. As a result, EMTRs for those on social benefits under a targeted regime, quickly become much higher than the current top income tax rate of 39%. To illustrate, parents receiving targeted payments for children with a combined income of more than \$519 per week, face effective marginal tax rates of 46.3% or 52.3% depending on individual income (Child Poverty Action Group, 2001b, p.19)). Such high tax burden applies to joint income over \$27,000 per year.

High EMTRs tend to reduce the incentives for people to increase their hours of work, or to change their jobs for better paid employment. The greater the proportion of means-tested services, the larger the number of people affected by high EMTRs and the more severe the incentive problems are likely to be. In New Zealand, the shift towards full targeting of most types of social provision has resulted in many people being affected by overlapping income tests which generate very high and often arbitrary EMTRs.

To conclude, it can be considered inequitable for people to lose most of their additional income when they choose to work harder or longer (Atkinson, 1993, p. 60). Thus in the same way that many people question the fairness of high marginal tax rates on top-income earners, so too the fairness of high EMTRs on low income earners can be challenged.

(C) Equity

It is often argued that the problem with universality is that middle to high income individuals and families also benefit as much as the poor so that the redistributive impact is regressive. This is sometimes referred to as “middle class capture”(Le Grand, 1982). If the central aim of the welfare state is greater vertical equity, the argument for targeting appears to be convincing. However, there are powerful reasons for questioning this argument.

While redistribution from the non-poor to the poor and the alleviation of poverty is certainly a central aim of the welfare state, it is by no means the only objective, nor the only one with redistributive effects. Other important redistributive goals include (1) redistribution over a person’s life cycle (between work and retirement), (2) redistribution from those without children to those with and (3) redistribution from the employed to the unemployed. The goals of the welfare state also include the promotion of social cohesion and racial tolerance, the minimising of social differentiation and stratification and the pursuit of various efficiency objectives.

To summarise, the “middle-class capture” argument has relatively little substance. Above all it ignores the fact that the welfare state has both redistributive and non-redistributive objectives and is concerned with egalitarian and non-egalitarian principles of justice. It is because of these multiple objectives, of which vertical equity is but one that some governments throughout the OECD have chosen to make extensive use of universal social programmes.

Even if the goal of social assistance is to enhance vertical equity and in particular to alleviate poverty, there are still grounds for a degree of universality. In contrast to universal programmes, targeting frequently ends up excluding some of the very people most in need of assistance

because of low-take up rates thereby reducing its relative effectiveness as a policy instrument. Various factors contribute to low take-up rates. For example, some people may be unaware of their entitlements. Others may want to avoid being stigmatised or may want to protect their privacy. Some individuals may have difficulty securing their entitlements because of ill-health or infirmity. In addition, there may be high transaction costs involved in securing the relevant benefit, such as time-consuming procedures and complex forms to fill in.

Attempts to use targeting to assist the poor, however well motivated, are invariably less successful than intended. Means testing encourages those who find themselves ineligible for social assistance to alter their behaviour so that they enjoy at least some of the direct benefits of targeted programmes. Well-off individuals and families are often able to manipulate complex bureaucratic rules to their advantage or organise their financial affairs and domestic arrangements so they appear poor and thus become eligible for assistance.

Under a tightly targeted regime, the objective of alleviating poverty comes up against the major dilemma that the larger the amount of assistance, the larger the income range of abatement. Thus switching from a balance of universal and targeted provisions to full targeting could result in a reduction over time in assistance to the most needy, not an increase. The dilemma is illustrated by the changes that have occurred in family assistance. The abolition of the universal component (family benefit) in 1991 did not initially result in more assistance in total going to the poorest families. Indeed, assistance fell in real terms (Dalziel and St John, 1999, p. 102). During the 1994-97 period, in response to evident hardship and the desire to foster independence from the state, there have been significant increases in targeted family assistance for selected families, including the introduction of the Child Tax credit. The price is that families with two or more children are affected by the abatement regime well in to the \$40,000 and even \$50,000 of family income with EMTRs of over 60% being common over long income ranges.

To conclude, attempts to assist the poor via targeting may actually leave some poor individuals and families worse off, both in absolute and relative terms.

(d) Altruism and Charity

An argument often used to defend tightly targeted and minimalist forms of social assistance, is that they leave scope for private caring initiatives, where as more generous and extensive welfare programmes may undermine altruistic behaviour and charitable giving (Dalziel and St John, 1999, p. 104).

While private and voluntary agencies have much to commend them, the capacity of the informal market and voluntary sectors to replace the state's current role, in areas such as income support, appears to be relatively limited. Many of New Zealand's voluntary organisations have struggled during the 1990s to fill gaps left by state reductions in levels of social assistance.

(e) Administrative Problems and Intrusiveness

Attempts to means-test social assistance raises a plethora of complex administrative issues including determining the appropriate unit of assessment, whether there should be an assets test as well as an income test, the appropriate income threshold and abatement rate, the range of family circumstances that should be taken into account, the relationship between different targeted programmes and the methods of implementation, monitoring and enforcement. How these matters are resolved will have important implications for income distribution both within and between families, economic incentives, lifestyle choices, stigmas, privacy, the exchange of information between government agencies and the costs of administration.

In broad terms, there is little doubt that targeted schemes are more intrusive and a greater threat to liberty than universal schemes, with individuals being required to supply much more information to state agencies about their financial and personal circumstances. Targeting invariably entails higher transaction costs through universality for both the state and citizens, in the form of administration costs, compliance costs, monitoring costs and enforcement costs. Targeting may also require more bureaucrats to understand its complex and changing rules of application.

(f) Social Differentiation

In considering the relative merits of targeted versus universal social policies, it is important to assess their impact on the tone of society and degree of social differentiation. What effect do alternative welfare arrangements have on the sense of community, belonging and social solidarity? Are they unifying or divisive? Whereas targeted policies often create problems of stigma and loss of privacy, universal policies tend to reduce social differentiation, especially if they involve both public funding and provision. To illustrate, targeting has the potential to stigmatise the recipients of social spending (Goldsmith, 1998, May). It exaggerates the gap between those who are beneficiaries and those who are not as well as the gap between those who are deserving beneficiaries and those who are not. Targeting requires individuals seeking help to identify themselves or be identified by others as being in need of assistance. The need for assistance can imply failure and provoke a sense of shame.

Thus any society concerned to build a strong sense of community, common identity and shared citizenship will need to ensure that there are at least some social institutions that are shared by the whole population. The methods of means-testing that stigmatise the poor and make them feel like second-class citizens should be avoided.

(g) Other Issues

Universal provision puts the child at the centre of policy. As the coverage is comprehensive, it allows for a central register of children to be maintained. It assists tracking children, through the receipt of monies, who otherwise might disappear from the watchful eye of the Plunket nurse or education system. Such a register may also improve the uptake of additional targeted assistance where it is necessary, by providing a means of contact with the family.

Targeting can fail to operate effectively because it relies on joint means testing (Child Poverty Action Group, 2001b). Income is often inequitably shared within families. Children are often left dependent on the goodwill of parents to ensure that their allocation is signed over to the caregiver or the assistance is used for their benefit. In contrast, universal payments allow for regular income paid into the care giver's account. Such moneys can be relied on in times of family breakdown.

Finally, under a system of universal provision, everyone in the community has a stake in the welfare state and therefore an interest in protecting it.

Summary and Conclusion

Despite the apparent logic of focusing limited resources only on the poor, the outcomes suggest that child poverty in New Zealand has actually worsened (Child Action Poverty Group, 2001b).

Figures produced by the Child Poverty Action Group (Child Poverty Action Group, 2001d, p.7) show that there are approximately 874,000 children under the age of 15 in New Zealand of which approximately 320,000 are in households receiving some form of income support. To a large extent, the economic future of New Zealand depends on whether this cohort of children can realise their potential skills and ability.

If the Child Tax Credit was replaced with a universal family benefit set at \$15 per week per child, Child Poverty Action Group estimates this would cost \$510 million per year. Children from low income families would receive an extra \$250 million. The Economics Committee believes this

would have a significant impact on childhood poverty. Since there is a correlation between poverty and the number of children in a family, a universal child benefit would be an effective way to alleviate child poverty.

In 1996, instead of adjusting Family Support for all children, the Child Tax Credit was introduced. However, it does not go to many of the children who need it the most. Instead it rewards independence from the state. Thus it acts as further punishment by being withdrawn when families must rely on state assistance. This reinforces the perception that children whose parents are not working are less valued by society and violates the requirement of horizontal equity. Horizontal equity requires that there is adequate recognition of the extra costs that children cause at all income levels. The issue of a universal child benefit as a mechanism to address some of this inequity is important.

A universal benefit would also alleviate the problem of effective marginal tax rates arising from benefit abatement. Such a move to universality would directly benefit poor working families who currently receive a “Child Tax Credit” and who are faced with high effective marginal tax rates as they move out of the income range which entitles them to tax credits.

A universal child benefit recognises that households with children face higher costs for all income brackets compared to equivalent households with no children. Since it is today’s children that will provide the workforce for a strong and prosperous economy in the future, there is a strong public good argument calling for a redistribution between households with no children towards households with children at all income levels.

A universal child benefit has the potential to increase social solidarity, is inclusive and avoids the social opprobrium associated with targeted welfare programmes. In addition, a universal benefit represents a secure source of income that stays with the care giver of the child even during times of family breakdown as well as facilitating a mechanism to maintain a national register of all children.

To conclude, the Economics Committee argues that the emphasis on targeting, since the early 1990s in New Zealand, has been detrimental to children. Highly targeted policies should be modified and more universality introduced for children. The time has come for an understanding and appreciation of the advantages that would stem from a Universal Child Benefit. The Committee supports every child’s right to inclusion in society, secured by universalism in the economic and social treatment of children.

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