THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Indexation of Financial Assistance - Options and Next Steps

Date:	27 March 2009	**Report No:**	T2009/717

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Provide feedback** on the attached *draft* Cabinet Paper	30 March 2009

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[deleted – privacy]	*[deleted – privacy]*	*[deleted – privacy]*	*[deleted – privacy]*	✓
Simon MacPherson	Manager	*[deleted – privacy]*	*[deleted – privacy]*	

Minister of Finance's Office Actions (if required)

Refer (if agreed by the Minister) a copy of the attached draft Cabinet Paper to the Prime Minister, Minister of Revenue, Minister of Labour and Minister for Social Development

Enclosure: **Yes**

Treasury Report: Indexation of Financial Assistance - Options and Next Steps

Executive Summary

Attached to this Treasury Report is a copy of a draft Cabinet Paper on *Indexation of Financial Assistance*. The Cabinet Paper seeks approval to draft a Bill to:

- put into legislation the current convention that main Benefits be increased every year in line with the Consumer Price Index (CPI)
- remove from legislation requirements that automatically increase Government expenditure on other areas of financial assistance, namely family tax credit, paid parental leave and childcare assistance.

Treasury supports introducing this Bill as it will ensure primary income support is automatically increased by statute, but changes to forms of financial assistance outside the main benefit framework can be decided upon by Ministers.

Ministers are also asked to decide which secondary financial assistance payments they want to stop indexing now (or as soon as possible). Decisions by 20 April 2009 to no longer index increases will be counted as savings for Budget 2009. Treasury supports no longer indexing family tax credit income thresholds, paid parental leave rates and childcare assistance income thresholds (producing a saving of $229 million over the forecast horizon).

However, we do not recommend stopping the indexation of family tax credit *amounts*. Although this will deliver large fiscal savings (around $300 million over the forecasts horizon), we think there are other options for amending the Working for Families system – and other areas of lower value social security entitlement expenditure – that could deliver similar magnitude levels of savings, but with less impact on income adequacy.

Recommended Action

We recommend that you:

a **Read, and provide any feedback on**, the attached Cabinet Paper *Indexation of Financial Assistance*

Policy rationale

b **note** that the Treasury supports the introduction of an indexation of financial assistance Bill (to put into primary legislation the requirement to automatically increase main benefits, while also removing automatic indexation requirements to forms of financial assistance outside the main benefit framework: family tax credit income thresholds and amounts, paid parental leave rates and childcare assistance income thresholds)

Indexation of main benefits

c **indicate** which of the following benefits you would like to be indexed in primary legislation:

Invalids Benefit	**Yes/No**
Sickness Benefit	**Yes/No**
Domestic Purposes Benefits (Sole Parent, Care of Sick and Infirm, Women Alone)	**Yes/No**
Unemployment Benefit	**Yes/No**
Widows Benefit	**Yes/No**
War Disablement Pension	**Yes/No**
Independent Youth Benefit	**Yes/No**
Unsupported Child Benefit	**Yes/No**
Orphans Benefit	**Yes/No**
Student Allowance	**Yes/No**
Student Loans living cost allowance	**Yes/No**
Any others (please indicate)	**Yes/No**

d **indicate** whether you want indexation of main Benefit rates to be linked to:

EITHER *movements* in the CPI (up *or* down); **Yes/No**

OR *increases* only in the CPI **Yes/No**

De-indexation policy

e **note** that you have previously indicated that you would like the Cabinet Paper to include options to remove family tax credit indexation (amounts and thresholds) and Paid Parental Leave rates

f **agree** that the Cabinet Paper on financial assistance indexation also include an option to remove the automatic indexation of childcare assistance income thresholds

Agree/disagree.

g **note** that the Treasury supports no longer indexing family tax credit *income thresholds*, paid parental leave rates and childcare assistance income thresholds

h **note** that not indexing the policies in recommendation (g) would result in fiscal savings in Budget 2009 of approximately $229 million over the forecast horizon (2009/10 to 2012/13)

i **note** that the Treasury supports continuing to index family tax credit *amounts*, ie do *not* include as a saving for Budget 2009 (we think there are other options for amending the Working for Families system – and other areas of lower value social security entitlement expenditure – that could deliver similar magnitude levels of savings, but with less impact on income adequacy)

j **note** that if you no longer indexed family tax credit amounts this would result in a saving in Budget 2009 of approximately $300 million over the forecast horizon

k **indicate** whether you would like to decide now to stop indexing family tax credit *amounts* (ie include as a saving for Budget 2009) **Yes/No**

Next Steps

l **indicate** whether you would like to meet with Treasury officials to discuss your feedback on the draft Cabinet Paper **Yes/No**

m **note** that, following any feedback you provide, we will provide a second draft of the Cabinet paper to your Office by Wednesday 1 April 2009, for lodging with Cabinet Office by 2 April 2009

n **agree** that we can consult with named, senior officials from the Department of Labour (in relation to the proposed changes to the Parental Leave and Employment Protection Act) and the Ministry of Justice's Bill of Rights team

Agree/disagree.

o *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

p **refer** a copy of the attached draft Cabinet Paper to the Prime Minister, Minister of Revenue, Minister of Labour and Minister for Social Development

Agree/disagree.

Simon MacPherson
Manager, Workforce Attachment and Skills
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Treasury Report: Indexation of Financial Assistance - Options and Next Steps

Purpose of Report

1. This report provides advice on some of the key issues included in the Cabinet Paper we are drafting for you on *Indexation of Financial Assistance* (attached at the end of this report). In particular this report:

   - asks which changes to main benefit rates you would like to put into primary legislation

   - asks whether you would like to remove the legislative requirement to index childcare assistance income thresholds

   - highlights key trade-offs (and other potential options) involved in removing the different legislative requirements, particularly the decision whether or not to continue paying increased family tax credit (FTC) *amounts*

2. This report also highlights other areas of Government expenditure where automatic upward adjustments take place, either because of convention, previous Cabinet decisions or because of complex legislative flow-ons. We do not propose to include these areas in the above Cabinet paper, but you may wish to consider these in the near future.

Background

3. On 17 March 2008 you directed Treasury officials to prepare a Cabinet paper seeking the removal of the automatic indexation of Working for Families (WFF) tax credits (see *Aide Memoire: Working for Families – Costs and Options*). In subsequent advice, you indicated your interest in this Cabinet paper covering the:

   - putting into legislation of the National Party pre-election commitment to index main benefits

   - removal of the indexation of both family tax credit amounts and income thresholds

   - removal of the automatic indexation of Paid Parental Leave rates.

4. Cabinet approval for these changes needs to be obtained by 20 April 2009 if you want the associated savings included in Budget 2009.

Analysis

Policy rationale

5. The attached draft Cabinet Paper sets out the rationale for shifting the balance between what changes to financial assistance should be automatically changed according to statute, and what should be decided upon by Cabinet. Currently, primary income support (main benefit) rates are decided upon by Joint Ministers (through an Order in Council), while a range of secondary income support (such as FTC amounts

and income thresholds, and childcare assistance thresholds) are included in primary legislation.

6. The proposed Bill will move decision-rights, so that changes to main benefits are set in legislation while other assistance is decided upon by Ministers. **Treasury supports this move, including removing from primary legislation the automatic increases to family tax credit income thresholds and amounts, paid parental leave rates and childcare assistance income thresholds**.

7. In addition to changing the balance on decision-rights, there is also a further question about which forms of automatic increases to secondary income support the Government wants to stop doing now, and hence would be included as savings for Budget 2009.

8. The following table illustrates the additional weekly assistance that different family types would receive if the FTC amounts and income thresholds, PPL rates and childcare assistance rates continue to be indexed:

$ per week	Case 1: Sole Parent on Benefit	Case 2: Sole parent, low income ($32,000)	Case 3: Working Couple, just above average wage	Case 4: High income couple ($92,000)
FTC Income threshold only	-	-	$7.75	$7.75
FTC amounts only	$8.02	$8.02	$8.02	$2.08
FTC amounts and income threshold	$8.02	$8.02	$15.77	$9.83
Childcare Assistance income threshold indexation	-	-	-	$76.33
PPL Rate Indexation	-	$25.80	$25.80	$25.80

* All figures relate to April 2011.
* Assumes 2 children aged under 12
* CA assumes 1 child in care for 50 hours a week
* PPL is the weekly gain for 14 weeks when a family has an additional child

Indexation of Main Benefits

9. In its election manifesto the National Party committed to cementing the CPI-indexing of benefits into legislation. By convention a suite of first tier benefits are increased every year by the CPI. In addition to four main benefits - Unemployment Benefits, Sickness Benefit, Invalids Benefit and the Domestic Purposes Benefits (Sole Parents, Care of Sick and Infirm and Women Alone) – there is a range of other benefits. We are seeking your feedback on which increases in these other benefits you would like included in the proposed legislation: see recommendation (c).

10. We would also like your feedback on whether you wish to adjust the rates of main benefits in line with *movements* in the CPI (up or down) or only *increases* in the CPI.

De-indexation policy options

11. The Cabinet Paper also seeks approval to remove from legislation the requirement to de-index current policies relating to FTC, PPL and childcare assistance. As currently drafted, the Cabinet Paper explains the advantages and disadvantages of each approach.

12. Our recommended approach on each of these areas is set out below. We have sought to balance the need to find fiscal savings with our assessment of the quality of spending in each of these areas. In reverse order (from lowest to highest quality spending):

a) Indexation of family tax credit income thresholds

13. The Income Tax Act 2007 includes a provision that the income threshold after which WFF tax credits begin to abate must increase every time the cumulative quarterly change in CPI reaches 5%. The effect of this is to increase in nominal terms (but maintain in real terms) the incomes of families earning above the old threshold (currently $36,827). It also pushes out in nominal terms the point on the income scale where families are no longer entitled to WFF payments.

14. Currently a family with 3 children under the age of 12 can receive WFF payments while earning up to $105,500. If this threshold increased by the minimum 5% then this cut off point would rise to around $110,400 in 2011.

15. No longer indexing the FTC income thresholds would result in a fiscal saving of $181 million over the forecast period (2009/10 to 2012/13).

	2009/10	2010/11	2011/12	2012/13	Total
Not indexing FTC threshold	-	$19m	$76m	$86m	**$181m**

16. No families earning below $36,827 would be affected.

17. Treasury's assessment is that the additional financial assistance associated with increasing the FTC threshold would not be well-targeted to those with greatest need. In particular, the 2006 changes to WFF (which increased the threshold from $27,481 to $35,000; further increased in 2008 to $36,827) mean that the payments are less effective at meeting the policy's original income adequacy objectives. The 2006 WFF changes were also criticised by child poverty groups for not assisting families on low incomes. These changes were also criticised by the Human Rights Tribunal.

18. **Treasury supports no longer continuing to index family tax credit income thresholds (ie include as a saving for Budget 2009)**.

b) Indexation of childcare assistance income thresholds

19. As described in more detail in the attached draft Cabinet Paper, childcare assistance provides targeted financial assistance to eligible caregivers who are working, studying or ill for up to 50 hours per week.

20. The income thresholds (below which families are able to receive the various different rates of early childhood care and out of school care subsidies) have been increased several times from 2004. For example, in 2004 the maximum a family with 3 children could earn and still be eligible was $44,199. Currently a family with 3 children could earn up to $99,320 and still be eligible.

21. No longer indexing childcare assistance income thresholds would have no effect on families earning below $66,248. It would result in the following fiscal saving:

	2009/10	2010/11	2011/12	2012/13	Total
Childcare Assistance	-	$1m	$4m	$4m	**$9m**

22. Treasury's assessment is that this provision is not well targeted to those with greatest financial need. Removing the indexation provision may increase barriers to families earning middle-to-high incomes. However, these impacts are likely to be relatively small, at least in the short-term.

23. **Treasury supports no longer continuing to index childcare assistance income thresholds (ie include as a saving for Budget 2009)**.

c) Indexation of Paid Parental Leave

24. As described in the attached Cabinet Paper, the Parental Leave and Employment Protection Act 1987 includes provisions to make payments to parents who have been working at least 10 hours per week over the previous six months.

25. No longer indexing PPL would result in the following fiscal saving:

	2009/10	**2010/11**	**2011/12**	**2012/13**	**Total**
PPL Saving	$4m	$9m	$12m	$14m	**$39m**

26. PPL aims to provide a source of income stability for working parents at a time of change. It also aims to foster workforce attachment because only parents who were in paid employment prior to having their child are eligible for financial support.

27. Treasury's assessment is that while PPL provides genuine support to many families, it is not well targeted. Not indexing these payments would, at least in the short-term, have little impact on work incentives.

28. **The Treasury supports no longer continuing to index paid parental leave rates (ie include as a saving for Budget 2009)**.

d) Indexation of Family Tax Credit <u>amounts</u>

29. The decision relating to the indexation of FTC amounts (ie the dollar amount that each eligible family receives) involves the most difficult assessment of trade-offs.

30. *Advantages*: FTC is not particularly well-targeted (hence, families with incomes greater than $100,000 can receive WFF payments). Note that there are not strong grounds for continuing with this payment on the basis of it providing a fiscal stimulus. The Government is already providing an appropriate fiscal stimulus (eg through tax cuts and infrastructure spending). By 2011 (when the indexation is due to be applied) the Government will need to be consolidating spending.

31. *Disadvantages*: On the other hand, not increasing FTC amounts will, in real terms, reduce the incomes of all eligible families, including low income families. In the original WFF package, the Government removed child-related payments from main benefits and transferred these into the FTC. If FTC amounts were no longer indexed, then – in one sense – beneficiaries with children may consider themselves worse off than before WFF (because their main benefits were, and will still be, increased every year by changes in the CPI).

32. Not increasing FTC amounts may also worsen our child poverty statistics. The preferred OECD measure uses the percentage of families earning below 50% of the median household income. The Ministry of Social Development (MSD) is currently preparing some advice on this, but we understand that not indexing these amounts could lead to a rise in *measured* child poverty. We also intend to explore with the Ministry of Justice's Bill of Rights team whether not indexing FTC amounts could be challenged as a Human Rights issue.

33. The *direct* fiscal savings from no longer indexing FTC amounts would be:

	2009/10	2010/11	2011/12	2012/13	Total
Not indexing FTC amounts	-	$33m	$136m	$156m	**$325m**

34. You should note, however, that there will be an increase in offsetting costs associated with flow-ons to the Accommodation Supplement, Income-Related Rents, Special Benefit and Temporary Additional Support. We are still working through these, but we expect them to *reduce the above savings by around $10-15 million per annum*. Note that these offsets only apply to changes in FTC amounts (not to changes in income thresholds).

35. Treasury's assessment is that FTC is not particularly well-targeted. However, we think that there are other changes that can be made to the WFF system – and indeed to other areas of social security entitlement expenditure – that would deliver changes of a similar fiscal magnitude, but would have lower income adequacy impacts. For example, we could re-assess the current income threshold of $36,827. Reducing this threshold back to $27,481 (as it was in 2004) would better target WFF payments and would result in large fiscal savings. We could also consider the pros and cons of reducing FTC amounts and redirecting this money to support vulnerable low income families (although this risks disincentivising paid employment).

36. **Treasury does <u>not</u> support ending the current indexing of family tax credit *amounts* (ie do <u>not</u> consider as a saving for Budget 2009)**. Instead, we recommend officials consider other options to change the WFF system (and other areas of social security entitlement expenditure). Depending on this advice, and the particular economic and fiscal situation at that time, you could choose then whether or not to remove this indexation requirement.

Other Areas of Indexed Spending

37. FTC, PPL and childcare assistance are the primary areas in which increases in amounts, rates or income thresholds are set in statute. However, there are other areas where increases have a legislative basis. These include the accommodation supplement, income-related rents, special benefit, temporary additional support and the minimum family tax credit. Aspects of these payments can change as a consequence to alterations in other areas of social spending (such as changing main benefit rates or tax credits for families).

38. We do not recommend including these other areas of spending in the proposed financial assistance indexation Bill. This is because each of these areas has their own (sometimes complex) policy rationale. Decisions about each of these areas should be considered as part of a deeper look at the quality of social security entitlement expenditure. We are not able to undertake such analysis in time for decisions to be included in the attached Cabinet Paper. Any additional changes to legislation would therefore need to be considered in a further amendment Bill.

39. There is also a range of Social Security spending that, by convention or following previous Cabinet decisions, has been increased by changes in the CPI (or other indexation methods). Such expenditure includes changes to main benefits, student allowance, community services card income thresholds, the residential care subsidy and long-term hospital rates. These are covered in the Annual General Adjustment reports, the 2009 version of which was sent to you and the Minister for Social Development for approval in February.

40. We now understand that you are looking for all such increases in expenditure to be actively considered by Ministers.

41. Other areas of non-social security expenditure that have, by convention or previous Cabinet decisions, been automatically linked to indexation changes include school transport and the formula for adjusting DHB and national health service spending based on demographic changes.

Next Steps

42. We will re-draft the Cabinet Paper, in consultation with your Office, on the basis of your feedback. We will provide a second version to your Office by Wednesday 1 April (for lodging with Cabinet Office on Thursday 2 April).

43. We also seek your permission to consult with named, senior officials from the Department of Labour (because of the proposed changes to the Parental Leave and Employment Act) and to the Ministry of Justice's Bill of Rights team.

44. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Office of the Minister of Finance

CHAIR
CABINET EXPENDITURE CONTROL COMMITTEE

DRAFT VERSION FOR CONSULTATION – NOT GOVERNMENT POLICY

INDEXATION OF FINANCIAL ASSISTANCE

Proposal

1. This paper proposes to:
    a. put into legislation the current convention that main Benefits be increased every year in line with the Consumer Price Index (CPI)
    b. remove from legislation requirements that automatically increase Government expenditure on other areas of financial assistance, namely Family Tax Credit, Paid Parental Leave and Childcare Assistance.

Executive Summary

2. [To come]

Background

3. The Government is committed to a welfare system that provides:
    a. a genuine safety net in times of need
    b. temporary support to people as they return to independence
    c. indefinite, compassionate support to people who are unable to support themselves.
4. The welfare system should provide support that reflects an individual's needs and circumstances, but it should also to be well targeted to those most in need and remain affordable.

Comment

5. This Paper seeks to shift the balance between what changes to financial assistance should be automatically changed according to statute, and what should be decided upon by Cabinet. Currently, primary income support (main benefit) rates are decided upon by Joint Ministers (through an Order in Council), while a range of secondary income support (such as FTC amounts and income thresholds, and childcare assistance thresholds) are included in primary legislation.
6. The proposed Bill will move decision-rights, so that changes to main benefits are set in legislation while other assistance is decided upon by Ministers.

Providing certainty

7. Currently, main benefits (including Unemployment Benefit, Domestic Purposes Benefit, Sickness Benefit and Invalids Benefit) are increased by the Consumer Price Index every April. However, this increase is by convention only and is not guaranteed by legislation. We are committed to ensuring future increases in main benefits and so I propose that we cement the CPI-indexing of these payments into legislation. This

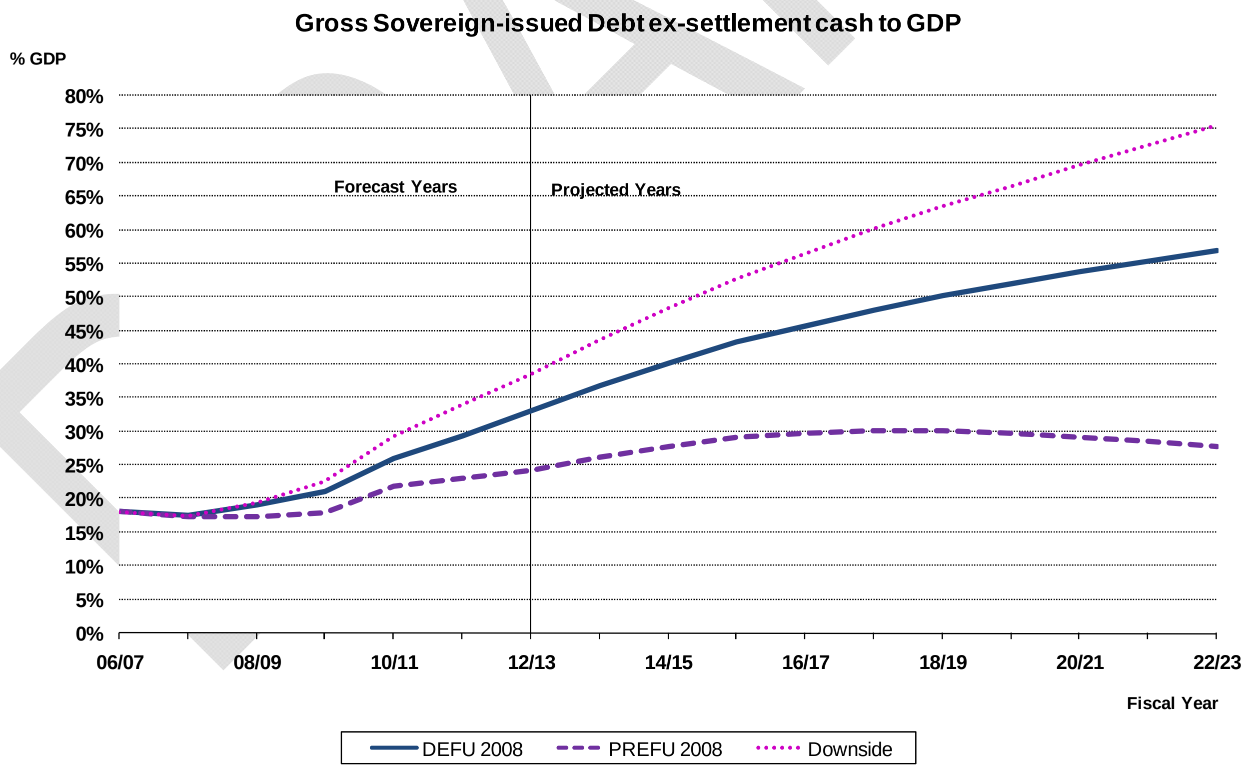
will provide certainty to beneficiaries – and those at-risk of requiring future social assistance support – of the Government's commitment to maintaining a genuine safety net.

8. Currently, however, other forms of financial assistance outside the main benefit framework require indexation because of legislation. I do not consider that this is necessary and therefore propose to remove the requirements from the primary legislation.

Fiscal Situation

9. In the 2008 December Economic and Fiscal Forecasts, the Treasury's main scenario forecast New Zealand's debt-to-GDP ratio would rise to 33.1% by 2012/13. Based on this forecast gross debt projections for the period 2014 – 2023 worsen to over 55% of GDP. In addition to the main forecast, the December Economic and Fiscal Forecasts also provided a downside scenario which showed the debt-to-GDP ratio rising to almost 40% by 2012/13, and projected that – without any interventions – this could rise to over 76%.

10. Since completing the DEFU forecasts, the fiscal situation has deteriorated significantly. We are currently updating our Budget forecasts, but it is becoming increasingly apparent that the Budget Economic and Fiscal forecasts could be even worse than the DEFU downside scenario. Such a rise in Government debt is not sustainable. In the short-term it would likely result in a downgrading of New Zealand's credit rating. This would push up the cost of capital, hampering productivity increases and slowing our move out of recession. In the long-term we would be burdening future generations with very high debt levels. We need to ensure this does not happen.



11. Given the above debt projections, we need to ensure that every dollar is targeted to where it can do most good.

Proposals

12. I propose that we amend the Social Security Act 1964 so that the rates of the following main benefits be increased from 1 April every year in line with any increase in the Consumer Price Index : [to be updated following feedback from the Minister of Finance]

    a. *Unemployment Benefit*
    b. *Sickness Benefit*
    c. *Invalids Benefit*
    d. *Domestic Purposes Benefits – Sole Parent, Women Alone, and Care of Sick and Infirm*
    e. *Widows Benefit*
    f. *Any others*

13. I also propose to remove the requirement to legislate for the indexation of the amounts/rates and thresholds of the following areas of financial assistance [to be updated based on feedback from the Minister of Finance]

    a. *Family Tax Credit Income Thresholds and Amounts*
    b. *Paid Parental Leave Rates*
    c. *Childcare Assistance Income Thresholds*

14. The removal of these requirements will result in fiscal savings that can be used to help improve the current fiscal situation. The indicative savings are outlined below:

Payment	**Indexation explanation**	**Cost of indexation: 2009/10 to 2012/13**
Family Tax Credit – Income Thresholds	Increased by inflation (once cumulative quarterly increases in CPI reach 5%)	$181m
Family Tax Credit – Amounts	Increased by inflation (once cumulative quarterly increases in CPI reach 5%)	$325m
Paid Parental Leave	Rates increased from 1 July every year by increase in average ordinary weekly earnings	$39m
Childcare Assistance	Income thresholds increased by inflation (once cumulative quarterly increases in CPI reach 5%)	$9m

15. The remainder of this paper sets out the advantages and disadvantages of removing the indexation requirements for these forms of secondary assistance from legislation.

Indexation of Family Tax Credit

16. In 2004 the previous Government introduced the Working for Families package. This made a number of changes to tax credits for families, substantially increasing costs and providing financial assistance for families further up the income scale.

17. In 2006 the previous Government further increased expenditure on these initiatives by around $500 million per annum. This money was spent on decreasing the abatement rate from 30 cents to 20 cents in the dollar. Effectively this meant that recipients were able to keep more of their Working for Families payments as their income from other sources increased. It also pushed out the income threshold after which payments start to decrease from $27,500 to $35,000 (subsequently increased to $36,827 in 2008). This had the effect of targeting additional support to people on higher incomes. For example, currently a family with 3 children under the age of 12 years can still receive tax credits while earning up to $105,500.

18. In addition, the Income Tax Act 2007 was amended so that the income threshold (after which payments start abating away) and the amount (the dollar amount that recipients receive) of the FTC would in future be increased in line with inflation. This increase now applies each time the cumulative quarterly change in the CPI reaches 5%. In Budget 2008, the previous Government agreed to bring this indexation forward so that increased FTC payments would be made in October 2008 (rather than the expected April 2009). On current forecasts, this threshold will next be reached in time for increased payments to be made from April 2011.

19. The effect of indexing FTC is that, in real terms, it maintains current financial support levels for families with children. However, in nominal terms each increase is charged against the Government's operating balance (meaning that it has to be paid for out of taxes or borrowing, or else through a reduction in other areas of Government spending).

Indexation of FTC income threshold

20. Under the current law, all families receiving WFF payments whose income is above the current income threshold ($36,827) receive more money in the hand every time the threshold is increased.

21. If FTC income thresholds were no longer indexed, over time this would result in fewer families being entitled to WFF payments (as average incomes gradually rise, those on higher incomes will stop becoming eligible). WFF would effectively be increasingly targeted on those lower down the income scales.

22. Not indexing the income threshold would result in a fiscal saving of $181 million over the period from 2010/11 to 2012/13 (It would also mean the Government would not be faced with the (cumulative) impact on the operating balance that would occur each time the 5% threshold is reached. It would have no effect on families earning under the current threshold of $36,827.

Indexation of FTC amounts

23. The current policy of indexing FTC amounts financially benefits (in nominal terms) all WFF recipients, including beneficiaries. Increasing these amounts has little impact on work incentives.

24. *The major consideration against no longer indexing FTC is income adequacy. Over time real assistance for families with children across the relevant income scale would decrease. Not increasing FTC amounts risks worsening our measured child poverty statistics. [To be updated]*

25. *An additional consideration is that not indexing FTC amounts could be challenged as a Human Rights issue.* [To be updated once the Ministry of Justice has been consulted]

26. Not indexing the FTC amounts would result in a fiscal saving of $325 million from 2010/11 to 2012/13, and on-going annual savings of $156 million.

Paid Parental Leave Rates

27. The Parental Leave and Employment Protection Act 1987 (PLEP Act) includes provisions to make payments to parents who have been working at least 10 hours per week over the previous six months. The current maximum payment rate is $407.36 (gross) per week, payable for a maximum of 14 weeks.

28. Paid Parental Leave aims to provide a source of income stability for working parents at a time of change. It also aims to foster workforce attachment because only working parents are eligible for financial support (parents who are not working and are not claiming a main benefit or student allowance may be eligible to receive the Parental Tax Credit, which is not indexed).

29. Section 71N of the PLEP Act states that the PPL rate must be adjusted, as at 1 July each year, by any percentage movement upwards in average ordinary time weekly earnings. Not indexing this payment would, over time, reduce the real value of PPL. This may discourage some parents from remaining in the workforce prior to having their children. These effects are likely to be relatively small, at least in the first few years after any change.

30. Not indexing the Paid Parental Leave rate would result in a fiscal saving of $39 million from 2010/11 to 2012/13. It would also lower future impacts on the operating balance.

Childcare Assistance Income Thresholds

31. Childcare Assistance, consisting of the Childcare Subsidy and the Out of School Care and Recreation Subsidy (OSCAR) provides targeted financial assistance to eligible caregivers who are working, studying or ill for up to 50 hours per week (or 20 hours during term time for the OSCAR Subsidy). In 2007/08 the Government spent $150 million on Childcare Assistance.

32. Childcare Assistance income thresholds (the thresholds below which families are entitled to the different levels of payments) have been significantly increased since 2004.

33. The Social Security Act 1964 was also amended so that income thresholds must be increased each time the cumulative quarterly change in the CPI reaches 5%. The Ministry of Social Development forecasts the next time income thresholds will need to be increased is in April 2011.

34. No longer indexing the income thresholds would, over time, increase financial barriers for eligible families to undertake paid employment or study. However, increases in income thresholds over the last 5 years have increased eligibility to many higher income families. For example, in 2004 the maximum a family with 3 children could earn and still be eligible for Childcare Assistance was $44,199. As of 1 April 2009 a family with 3 children could earn up to $99,320 and still be eligible.

35. Removing the indexation requirement would have no impact on families earning below $66,248. Further there would be no impact on eligible families access to the 20 hours ECE policy (currently available for 3 and 4 year olds attending participating teacher-led ECE services).

36. No longer indexing the income thresholds for Childcare Assistance would result in a fiscal saving of around $9m from 2009/10 to 2012/13 and $4 million per annum on-going.

Impact of Adjustments on Weekly Family Income

37. The following table illustrates the additional weekly assistance that different family types would receive if the amounts of the FTC and income thresholds of the FTC, Childcare Assistance and Paid Parental Leave payments continue to be indexed.

$ per week	Case 1: Sole Parent on Benefit	Case 2: Sole parent, low income ($32,000)	Case 3: Working Couple, just above average wage	Case 4: High income couple ($92,000)
FTC Income threshold only	-	-	$7.75	$7.75

FTC amounts only	$8.02	$8.02	$8.02	$2.08
FTC amounts and income threshold	$8.02	$8.02	$15.77	$9.83
Childcare Assistance income threshold indexation	-	-	-	$76.33
Paid Parental Leave Rate Indexation	-	$25.80	$25.80	$25.80

* All figures relate to April 2011
* Assumes 2 children aged under 12
* CA assumes 1 child in care for 50 hours a week
* PPL is the weekly gain for 14 weeks when a family has an additional child

Other assistance

38. FTC, PPL and childcare assistance are the primary areas in which increases in amounts, rates or income thresholds are set in statute. However, there are other areas where increases have a legislative basis. These include the accommodation supplement, income-related rents, special benefit, temporary additional support and the minimum family tax credit. Aspects of these payments can change as a consequence to alterations in other areas of social spending (such as changing main benefit rates or tax credits for families).

39. I do not propose to include these areas in the proposed financial assistance indexation Bill because each of these areas has their own (sometimes complex) policy rationale. Decisions about each of these areas should be considered as part of a more in-depth look at the quality of social security entitlement expenditure. Any additional changes to legislation would therefore need to be considered in a further amendment Bill.

Ministry of Social Development Comment

40. The Ministry of Social Development supports proposals to remove indexation of the income thresholds for family tax credits and for childcare assistance. Ongoing adjustment of these thresholds results in income gains mainly to families on relatively high incomes. The Ministry does not consider this to be a priority for social assistance expenditure in the current economic environment.

41. However, the Ministry does not support the option of removing indexation of FTC rates as this would put financial support for children on a different basis than that for adults and it would, over time, result in increasing hardship among low income families with children.

42. Changes made to the tax and benefit systems in 2005 moved most child related financial support from main benefit rates into the FTC. As a result the FTC is now the primary form of child-related financial assistance for New Zealand families. Removing the indexation of the FTC amounts would place financial support for children onto a different footing that is inconsistent with that for adults, and would effectively remove indexation from a very significant component of core income support for beneficiaries.

43. Low income families with children have to live within very tight budgets, with little or no room to cope with additional or unexpected costs. If family incomes do not keep pace with CPI, even small increases in the cost of living can greatly increase family stress. Increasing hardship is known to have negative impacts on a range of educational, health, behavioural and other results for children in particular.

44. In the decade leading up to the mid-2000s, the gap between the incomes of low income and middle income households with children increased. This increasing disparity was especially evident for beneficiary families with children, in part because

of the non-indexation of Family Support (the previous name for Family Tax Credit) in that period.

45. In OECD rankings, New Zealand already has relatively high child poverty rates compared with overall population poverty rates. Over time, removing indexation from the main form of financial support for children is likely to worsen these relativities. The OECD and United Nations would also be likely to be critical of the impact of this policy change on child poverty rates.

46. Although removing indexation of FTC rates would yield considerable fiscal savings over time, the Ministry believes that in the current economic environment allowing the main financial support for children to erode is not the best way to achieve these fiscal savings. However, the Ministry does consider that there are opportunities to refocus other elements of the social security safety net to ensure that tax payer funds are used in a well targeted manner that is consistent with government objectives.

Inland Revenue Comment

47. [To come]

Consultation

48. The Ministry of Social Development and Inland Revenue have been consulted on this paper. The Department of Prime Minister and Cabinet have been informed.

Financial Implications

49. There is no impact on the operating balance of amending legislation so that main benefits be increased in line with the CPI. This is because successive Government have adopted this practice without the requirement being in legislation; hence, the implications of the policy are already built into operating forecasts.

50. No longer indexing FTC would improve the operating balance by the following amounts: [Note: it is possible that final BEFU 09 forecasts could push back the year when the indexation applies to 2012/13; it will not occur sooner]

	2009/10	**2010/11**	**2011/12**	**2012/13**	**Total**
Not indexing FTC amounts	-	$33m	$136m	$156m	**$325m**
Not indexing FTC income threshold	-	$19m	$76m	$86m	**$181m**
Not indexing FTC at all	**-**	**$53m**	**$217m**	**$245m**	**$515m**

Total costs are more than the sum of the individual costs, because of income threshold and rate interactions

51. No longer indexing Paid Parental Leave would improve the operating balance by:

	2009/10	**2010/11**	**2011/12**	**2012/13**	**Total**
PPL Saving	$4m	$9m	$12m	$14m	**$39m**

52. No longer indexing Childcare Assistance would improve the operating balance by:

	2009/10	**2010/11**	**2011/12**	**2012/13**	**Total**
Childcare Assistance	-	$1m	$4m	$4m	**$9m**

53. The above amounts would also be considered a saving for the purposes of the Budget 2009 operating allowance.

Human Rights

54. New Zealand's review of its Human Rights position is due to take place before the United Nations Human Rights Council on 7 May 2008. One area of focus of the oral review is likely to be the issue of child poverty and what New Zealand is doing to

reduce this. Removing some of the provisions for automatically indexing the payments discussed in this paper could be seen by the Council as a backward step in this regard.

55. *[information on possible Human Rights challenge to be included once MoJ consulted]*

Legislative Implications

56. The matters dealt with in this paper all deal with the balance between what increases in payments and entitlements should be set in statute, and what should be decided upon by Ministers. I propose the introduction of [an Omnibus Indexation Bill etc.]
57. The indexation of Family Tax Credit amount and income threshold is provided for in the Income Tax Act 2007. The indexation of Childcare Assistance income thresholds is provided for in the Social Security Act 1964. The indexation requirements for Paid Parental Leave are provided for in the Parental Leave and Employment Protection Act 1987. Setting CPI-indexed increases to main benefits would require an amendment to the Social Security Act 1964.
58. I propose that Inland Revenue be asked to draft the necessary changes to the Income Tax Act 2007 and Parliamentary Counsel Office be asked to draft the necessary changes to the Social Security and Parental Leave and Employment Protection Acts.
59. Removing the legislative requirements to increase Family Tax Credit, Childcare Assistance and Paid Parental Leave means that Cabinet would determine any future changes to rates/amounts and/or income thresholds.

Regulatory Impact and Business Compliance Cost Statement

[To be completed]

Publicity

[Need to consider]

Recommendations

It is recommended that the Committee:

Indexation of Main Benefits

1. **Agree** to amend the Social Security Act 1964 to set into legislation a requirement that main benefits be increased, as at 1 April every year, in line with any increase in the Consumer Price Index
2. **Agree** that legislation will cover indexation of the following main benefits: [insert benefit names]

Family Tax Credit

3. **Note** that the Income Tax Act 2007 includes a requirement that the Family Tax Credit rate, and the income threshold after which payments begin abating, be indexed by inflation (when the cumulative quarterly increase in the Consumer Price Index reaches 5%)
4. **Note** that the Treasury forecasts that the next indexation will occur in time for increased payments to be made from April 2011, with the following costs:

Family Tax Credit	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**Total**
Indexation of amounts only	-	$33m	$136m	$156m	**$325m**
Indexation of income threshold only	-	$19m	$76m	$86m	**$181m**
Total Indexation Costs	**-**	**$53m**	**$217m**	**$245m**	**$515m**

5. Agree to amend the Income Tax Act 2007 to:

    EITHER

    a. Remove the requirement to index Family Tax Credit **income thresholds** only;

    OR

    b. Remove the requirement to index *both* Family Tax Credit **income thresholds** *and* their **amounts**

Childcare Assistance

6. Note that the Social Security Act 1964 includes a requirement that the Childcare Assistance income thresholds be indexed by inflation (when the cumulative quarterly increase in the Consumer Price Index reaches 5%)
7. Note that the Ministry of Social Development forecasts that the next indexation will occur in time for payments to be made from April 2011, with the following costs:

Childcare Assistance	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**Total**
Indexation of income thresholds	-	$1m	$4m	$4m	**$9m**

8. **Agree** to amend the Social Security Act 1964 to remove the requirement to index Childcare Assistance income thresholds.

Paid Parental Leave

9. Note that the Parental Leave and Employment Protection Act 1987 includes a requirement that the rate of Paid Parental Leave must be adjusted, as at 1 July each year, by any percentage movement upwards in average ordinary time weekly earnings.
10. Note that Inland Revenue forecasts that indexation of Paid Parental Leave will currently have the following costs:

Paid Parental Leave	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**Total**
Indexation of rate	$4m	$9m	$12m	$14m	**$39m**

11. **Agree** to amend the Parental Leave and Employment Protection Act 1987 to remove the requirement that the rate of Paid Parental Leave be adjusted by changes in average ordinary time weekly earnings

Financial Implications [currently based on agreeing to all changes]

12. **approve** the following changes to appropriations to give effect to the decisions in paragraphs x above:

	$m – increase/(decrease)				
Vote Social Development Minister for Social Development and Employment	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13 & Outyears**
Benefits and Other Unrequited Expenses: Childcare Assistance	-	-	(1.054)	(3.908)	(3.981)
Vote Revenue Minister for Revenue					

Benefits and Other Unrequited Expenses:					
Family Tax Credit	-	-	(40.000)	(166.000)	(190.000)
In-Work Tax Credit PLA	-	-	(12.000)	(50.000)	(56.000)
Paid Parental Leave Payments PLA	-	(4.200)	(8.800)	(11.900)	(14.100)
Total	**-**	**(4.200)**	**(61.854)**	**(231.808)**	**(264.081)**

13. **agree** that the proposed changes to appropriations above be included in the 2008/09 Supplementary Estimates.

14. **Note** that there are likely to be flow-on costs to a range of other social security assistance from the removal of the requirement to index the amounts of the Family Tax Credit estimated to be in the range of $10 - $15 million per annum.

15. **Delegate** authority to the Minister of Finance and the Minister for Social Development to approve additional changes to appropriations that result from the removal of the requirement to index the amounts of the Family Tax Credit.

Legislative Implications

16. **Note** that removing the indexation requirements to increase Family Tax Credit, Childcare Assistance and Paid Parental Leave requires changing primary legislation

17. **Note** that amending legislation to remove the indexation requirements means that any future changes to rates/amounts and/or income thresholds can be decided upon by Cabinet

18. **Agree** that there be an omnibus bill amending the Social Security Act 1964, Parental Leave and Employment Protection Act 1987 and Income Tax Act 2007 to implement the government's policy on indexation of financial assistance and that this Bill have Priority Two.

19. **Invite** the Ministers of Social Development and Labour to issue drafting instructions to the Parliamentary Counsel Office for an indexation of financial assistance Bill to amend the Social Security Act 1964 and the Parental Leave and Employment Protection Act 1987 and Income Tax Act 2007 in line with the changes in recommendations x to y

20. **Invite** the Minister of Revenue to instruct Inland Revenue to draft legislation amending the Income Tax Act 2007 to remove the requirements for indexation… to be included in the Financial Assistance Bill.

Signature Block

Date:
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