The Treasury

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Release Document

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

WORKING FOR FAMILIES

Options for Reform – Budget 2011

Supporting Material

MINISTRY OF SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora

THE TREASURY

Inland Revenue
Te Tari Taake

January 2011

INTRODUCTION

This document sets out detailed analysis of the five options for changing the Working for Families scheme for announcement at Budget 2011. Accompanying this document will be a set of A3 sheets that include a summary of the Working for Families scheme as at 1 October 2010 and a high level description of each option for reform. These two documents are not intended to be mutually exclusive as the A3 sheets contain a number of graphs and tables that are not repeated in the analysis below.

Each section below contains a detailed description of each option, a summary of the tradeoffs, a table presenting the fiscal savings, analysis of the other 4 criteria, and a discussion of each option's merits.

Criterion for analysis

As a basis for our analysis, we have developed a set of five criteria to assess the merits of each option. These are represented as the five corners of the pentagram on the A3 sheets as follows:

Criterion 1: Fiscal Cost

This section sets out the fiscal impact on the Crown. Fiscal costs of the options have been produced for the budget forecast period from 2011/12 to 2014/15.

Criterion 2: Targeting considerations

Targeting is a measure of how well the option redistributes the allocation of WFF funding to lower income earners and beneficiaries. Lower income earners referred to throughout the analysis are defined as families earning below the current abatement threshold of $36,827. Two measures are used: the percentage of funding allocated to beneficiary families;[1] and the percentage of funding allocated to families below the current abatement threshold. As all changes take effect from 1 April 2012 the targeting analysis below is for the 2012/13 year except for Option 1A, 1B and 1C where 2014/15 has been used to more fully reflect the indexation changes.

Criterion 3: Equity and impact on disposable income

We have modelled the impacts on income poverty and income inequality for all options. In all cases the modelled impacts on the aggregate measures are not statistically significant. In most cases this is because the policy options are designed to minimise the impacts on low income and beneficiary families and in the cases where there are impacts, those impacts either affect too few people to show up in aggregate measures, or are expected to manifest only over a longer time period.

We have also modelled the disposable income changes, which show how families on different incomes are affected by each option, i.e. a winner/loser analysis. The main disposable income

[1] A beneficiary family is defined as a family who has received one of the main benefits over the last 12 months.

measure presents income changes relative to the status quo for the 2011/12 fiscal year unless stated otherwise.

Criterion 4: Effect on work incentives and efficiency

This criterion discusses how a particular reform could incentivise people to change their behaviour, e.g. lower their work hours. The analysis includes replacement rates for an example beneficiary (solo parent with two children working 40 hours per week earning $18 per hour) and changes to effective marginal tax rates (EMTRs) where applicable.

Criterion 5: Administrative simplicity and public compliance

Comments will be focused on the complexity created for IRD's administrative systems, and complexity for the public/public understanding. Note that the analysis of the options below assumes that the option will be announced at Budget 2011 with an implementation date of 1 April 2012. Moving the date forward to the earliest possible implementation date of 1 October would increase implementation costs for IRD significantly.

Also note that after feedback from earlier discussions we have ignored any options that grandparent existing recipients to avoid any nominal financial losers. Grandparenting would increase compliance, transition and implementation costs, and in many cases significantly reduce any fiscal savings.

Legend for Compliance and Administration

Note the following ranges for implementation costs:

Implementation Cost	*Range
Low	$0 - $1.5m
Medium	$1.5m - $3m
High	$3m and above

- * We have made an assumption that the non IT implementation costs would be approximately $800,000. These combined with the IT costs give the option its impact rating
- * Implementation costs for anticipated customer contacts are not included. These are dependent on how the Budget 2011 changes are packaged.

The Minimum Family Tax Credit

The Minimum Family Tax Credit (MFTC) is a payment made to families with dependent children aged 18 or younger, so they have a minimum income of $408 a week after tax. Its primary purpose is to ensure a minimum level of after-tax income to low income, non-beneficiary families, and it tends to be received mainly by sole parent families. The MFTC ensures there is an incentive to stay at work on low levels of income.

While technically a part of Working for Families, the MFTC has different indexation and abatement regimes to the other major tax credits, very low coverage, and is not directly affected by the policy changes outlined below. Therefore we have largely ignored the MFTC in any graphical representation of WFF or any detailed analysis below. We will provide further advice on any technical implications for the MFTC for any options Minsters seek further advice on.

OPTION 1 – CHANGE THE INDEXATION OF THE FAMILY TAX CREDIT

The Income Tax Act 2007 currently requires the automatic indexation of the Family Tax Credit (FTC) when the cumulative quarterly change in the CPI reaches 5%. This will next be triggered on 1 April 2012 when rates will need to be adjusted by 5.22%. The costing below also allows for a further increase on 1 April 2014 of 5.28%. Below we present three options changing the indexation of the FTC:

Option 1A: Remove the automatic indexation of the FTC entirely, with decisions about future increases made on an ad hoc basis by Ministers at Budget time

Description

Option 1A removes the requirement from the Income Tax Act 2007 to automatically index FTC rates when the cumulative quarterly change in the CPI reaches 5 percent. Future rate increases would then be at the discretion of Ministers during the annual budget process.

Tradeoffs – This option generates fiscal savings and results in no nominal losers but lowers real disposable income over time, and may have a significant impact on child poverty over time.

The fiscal savings are presented in Table 1 below:

Table 1: Fiscal Savings ($m) – Option 1A

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 1A	41	161	200	325	**727**

Analysis

- **Targeting –** There are only very small changes to both targeting measures.

- **Equity and disposable incomes –** The analysis for this option uses the 2014/15 fiscal year instead of the 2011/12 fiscal year. This is because the effects of not indexing the FTC will take a few more years to make significant changes to our measures. Depending on whether ad hoc adjustments are made to FTC rates in the future, this option could result in significant increases in child poverty over time. Because the child component of main benefits is now wrapped up in the FTC rates, this would effectively de-index the main form of financial support for children. The data shows that almost all WFF recipients will receive a fall in their disposable income relative to the status quo. However, their nominal disposable income will be unchanged. The losers are evenly distributed across the income range.

- **Work incentives and efficiency –** Incentives to work are relatively unaltered under this option. However, if FTC rates remain unchanged for longer, the attraction of paid work, assuming wages increase with inflation, will increase. This option has no impact on replacement rates.

- **Compliance and Administration –** Both the upfront implementation costs and ongoing administration costs of this Option 1A are low. The impact on customers is minimal as most are currently unaware of the indexation of FTC amounts.

Discussion

There are two main advantages of removing the indexation of FTC rates: the fiscal savings (represented in Table 1 above), and the ability to avoid any nominal financial losers. However, without automatic indexation real payments will fall during this time, leaving families financially worse off in real terms, lowering their standard of living and increasing child poverty. This could be countered by ad hoc decisions to increase rates at budget time.
Also note that before WFF, multi-child rates were built into beneficiaries' main benefit and therefore, rates were automatically indexed each year. Removing automatic indexation for beneficiaries will therefore make them worse off compared to before the payments were merged with the FTC.

Some of these disadvantages, however, can be countered by Ministers increasing payments on an ad hoc basis at budget time. This has the added advantage of allowing Ministers to assess rate increases against other spending priorities – ensuring welfare spending is allocated to where it is needed most. Note that there is a legislative requirement to review the level of the IWTC and PTC every three years. If indexation were removed a requirement to review the FTC payment level would be desirable.

In addition, Option 1A is expected to result in some small offsetting costs, through increased uptake of other hardship related programmes delivered by the Ministry of Social Development (for example Temporary Additional Support and Special Needs Grants).

Option 1B: Index FTC rates but only for lower income earners

Description

This option involves retaining the indexation of FTC rates, but only for those income earners who earn below the current abatement rate of $36,827 (shown in red in Figure 1 below). To avoid an abatement cliff-face, Option 1B would also shift the abatement threshold back to a lower income level. This ensures the abatement rate remains at 20 percent from the new abatement threshold. The new abatement threshold would depend on the size of the family and, assuming no change in the payment schedule (option 3), the age of the children. Therefore, this would create multiple abatement thresholds for each family size.

Below are some examples of the new abatement threshold using the two indexation increase points of 5.22% on 1 April 2012 and 5.28% on 1 April 2014:

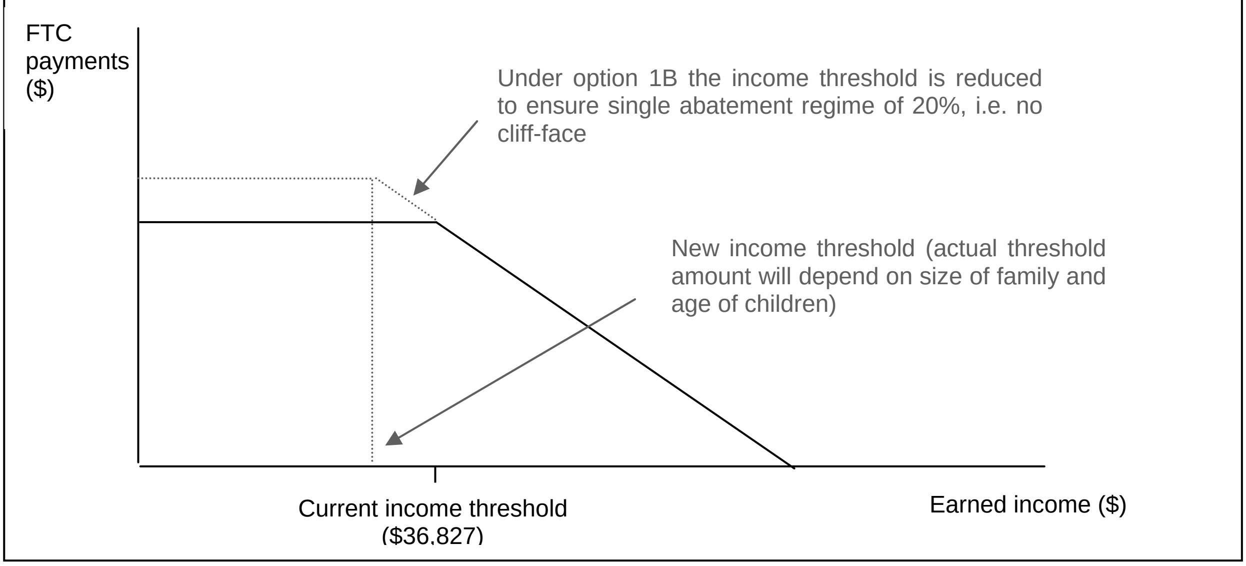
Family	New Abatement Threshold as at 1 April 2012	New Abatement Threshold as at 1 April 2014
1 Child (10)	$35,632	$34,362
2 Children (10, 13)	$34,802	$32,647
3 Children (10, 13 & 16)	$33,667	$30,302
4 Children (10, 13, 16 & 17)	$32,427	$27,747

5 Children (8, 10, 13, 16 & 17)	$31,597	$26,032
6 Children (6, 8, 10, 13, 16 & 17)	$30,767	$24,317
7 Children (4, 6, 8, 10, 13, 16 & 17)	$29,937	$22,602

Tradeoffs – This option generates fiscal savings and improves targeting but has significant adverse equity impacts, lowers real disposable income over time for a number of families, increases complexity and reduces work incentives.

This is represented in Figure 1 below:

Figure 1: Option 1B – FTC rates indexed with income threshold reduced to ensure no cliff-face



The fiscal savings are presented in Table 2 below:

Table 2: Fiscal Savings ($m) – Option 1B

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 1B	22	86	109	184	**401**

Analysis

- ***Targeting –*** There are only small changes to both targeting measures

- ***Disposable Income –*** As with Option 1A, the disposable income analysis is based on the 2014/15 fiscal year instead of the 2011/12 fiscal year. The analysis shows that only families with incomes over $25,000 will face a fall in their real disposable income. i.e. only about half of all WFF recipients.

- ***Work incentives and efficiency –*** For the majority of WFF recipients, incentives to work are unaltered under this option. However, EMTRs will increase by 20 percent for those income earners between the old and new abatement thresholds. This may have some minor impact on employment decisions for low income earners. The replacement rate analysis shows only a very minor decrease relative to the status quo for our example beneficiary working 30 hours per week.

- ***Compliance and Administration –*** The upfront implementation costs and ongoing administration costs of Option 1B are medium. This option requires the calculation of a separate abatement threshold for each family depending upon the age and number of children. The impact on customers is medium. The reduction in FTC amounts would be difficult to explain to customers and would result in increased contacts and communication.

Discussion

Option 1B is a compromise between removing indexation and only indexing for certain people, creating an abatement cliff-face. Its main advantage is that it can target assistance to those on the lowest incomes, without creating large EMTRs and therefore perverse work incentives. It will also generate fiscal savings, although these will be more modest than option 1A, and avoids creating any nominal financial losers.

While this option may seem appealing initially, there are two major drawbacks: complexity for clients and difficulties in administering the policy. Avoiding a cliff-face requires pushing back the income threshold and calculating multiple thresholds depending upon the number of children in the family and the ages of these children. Therefore, administering the scheme and communicating to applicants could become very difficult. Note also that the larger the family size, the lower the income at which WFF tax credits would start to abate.

Combining this option with simplifying the current payment schedule (see Option 3 below), would reduce some of these problems.

Option 1C: Remove indexation of the FTC but introduce a new child allowance to compensate beneficiaries

Description

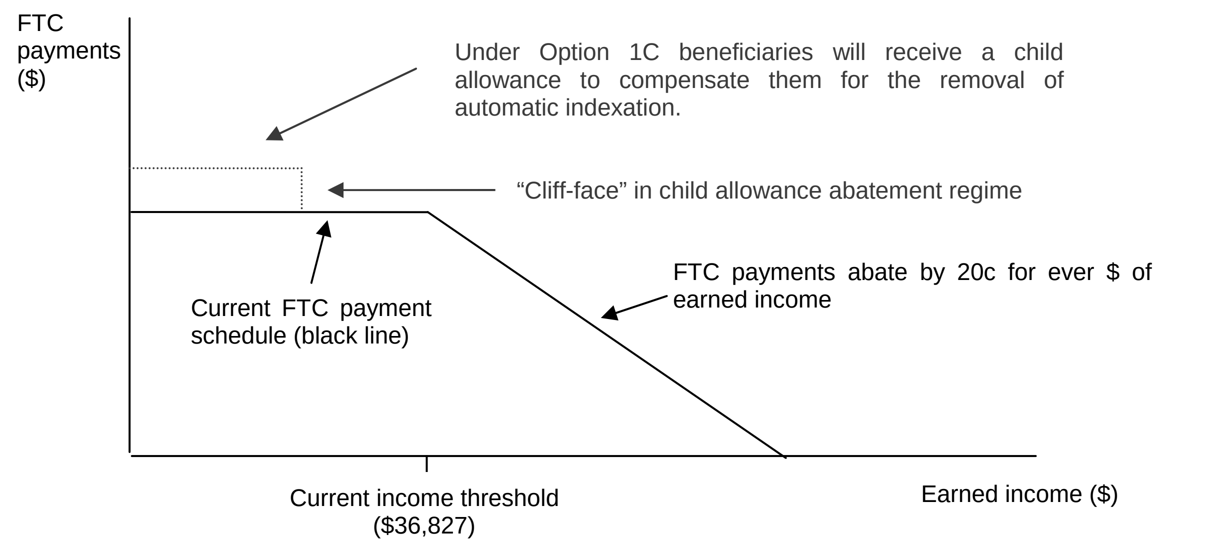
Like Option 1A, Option 1C removes the requirement from the Income Tax Act 2007 to automatically index FTC rates when the cumulative quarterly change in the CPI reaches 5 percent. However, to compensate beneficiaries for a loss in purchasing power due to inflation, a child allowance will be created and paid to those on the current main benefits. Effectively the child allowance is a 'top-up' to the FTC to maintain purchasing power and will be equivalent to the level they would have received had the FTC been indexed. Future increases in the child allowance will coincide with cumulative CPI reaching 5 percent. As the next indexation point is 1 April 2012, the child allowance would also take effect from this date.

MSD would administer and pay the child allowance to beneficiaries in addition to the payment that beneficiaries currently receive for the FTC. Once a beneficiary moves off a main benefit and receives their FTC through the tax system and is also eligible for the IWTC, they will no longer be eligible for the child allowance.

Tradeoffs – This option generates fiscal savings, improves targeting and protects the incomes of beneficiaries, but lowers real disposable income for working families over time, increases complexity and reduces work incentives.

Option 1C is represented in Figure 2 below:

Figure 2: Option 1C – Remove indexation of beneficiaries, but introduce a new child allowance to compensate beneficiaries



The fiscal savings are presented in Table 3 below:

Table 3: Fiscal Savings ($m) – Option 1C

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 1C	24	94	114	183	**415**

Analysis

- **Targeting –** The targeting analysis shows small increases in the targeting measures meaning the child allowance does better target assistance to the lowest income earners.

- **Disposable Income –** This option has no measurable impact on aggregate poverty and income inequality measures, and is not expected to worsen these measures over time. As with the previous two options, we have used the 2014/15 fiscal year instead of the 2011/12 fiscal year for the disposable income analysis.

- **Work incentives and efficiency –** A person loses their eligibility for the child allowance once they also lose eligibility for the benefit. At the margin, there is an incentive not to work an extra hour of paid work in order to avoid losing the child allowance. However, the effects of these high EMTRs at the margin are not so clear. The replacement rate analysis shows that our example beneficiary working 30 hours per week at $18 per hour is $8.46 worse off compared to the status quo. This reflects the loss in their child allowance payment as they move off a main benefit. In initial rounds of indexation this impact could be readily absorbed by the IWTC and MFTC, but the issue would increase over time.

- **Compliance and Administration –** The upfront implementation costs and ongoing administration costs of this option are low. This option requires a new payment to be established within the benefit system, which could be similar to the compensation payment mechanism used in the 2010 tax package. The impact on beneficiaries is medium. The new payment would be difficult to explain to beneficiaries and would result in increased enquiries.

Discussion

Option 1C was designed to remove the automatic indexation of the family tax credit, while ensuring beneficiaries are compensated from rising living costs. The advantage of this option is that it increases assistance to those on the lowest incomes without having to give across-the-board increases in assistance, therefore better targeting the system. It will also produce fiscal savings for the Crown, although these will be less than complete removal of indexation. This option, as with 1A and 1B, will avoid nominal financial losers.

However, paying assistance to only a certain group and leaving abatement rules unchanged creates cliff-face in the abatement regime as illustrated above. As mentioned above this is where assistance will disappear when a beneficiary enters full-time work, creating perverse work incentives at the margin i.e. $1 over the threshold. In addition to this, this incentive problem is likely to worsen over time presuming the same mechanism was used the next time indexation was to be applied. While these are likely to be mitigated by the MFTC and the IWTC, it sends the wrong signals about paid work to beneficiaries entering the workforce.

OPTION 2: INCREASE THE ABATEMENT RATE

Option 2A: Increase the universal abatement rate from 20% to 22.5%, 25% and 30%

Description

The abatement rate for the WFF tax credits (excluding the MFTC) is currently 20 c/$ from an income of $36,827. Option 2A increases the abatement rate of all tax credits from this income band reducing the coverage of WFF, lowering the payments received by many middle to high income households.

Tradeoffs – This option generates significant fiscal savings and improves targeting but significantly reduces incentives to work and lowers disposable income for middle to high income families.

The fiscal savings are summarised in Table 4 below:

Table 4: Fiscal Savings ($m) – Option 2A

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 Year total
22.5% Universal	114	119	120	125	**478**
25% Universal	209	217	216	224	**866**
30% Universal	351	363	363	379	**1456**

Analysis

- ***Targeting –*** The targeting analysis shows small to medium changes in the measures. The percentage of funding below the threshold increases from 60% to 62%, 64% and 68% percent for the three variations and the percentage funding allocated to beneficiaries increases from 47% to 49%, 51% and 53%. This indicates that increasing the abatement rate shifts the relative allocation of funding from higher to lower income earners.

- ***Disposable Income –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. Disposable incomes of middle to high incomes earners are reduced by as much as $45 per week under a universal abatement rate of 30%. Obviously no family earning under $36,827 is affected by this option. As expected those with the biggest fall in disposable income are in the $75,000 - $100,000 income band.

- ***Work incentives and efficiency –*** This option alters incentives to work by changing EMTRs. All those recipients earning more than the current abatement threshold of $36,827 and less than the income level where all tax credits abate will face higher EMTRs. However, income earners who no longer receive WFF payments will see a reduction in their EMTRs, improving their incentives to work. The replacement rate analysis shows very minor changes in the incentives for beneficiaries to enter paid employment.

- ***Compliance and Administration –*** Both the upfront implementation costs and ongoing administration costs of this option are low. The impact on customers is minimal.

Discussion

This option generates significant fiscal savings as well as better targeting assistance to those most in need – taking away credits from higher income earners. However, anyone earning more than the current abatement threshold of $36,827 would have a fall in assistance and higher EMTRs – lowering incentives to work.

Option 2B: Increase the Abatement of the In-work Tax Credit only

Description

The In-work Tax Credit is a tax credit that is paid to families in work – $60 per week for the first 3 children, $15 per week for each additional child. It is currently abated at 20 cents in the dollar. This option increases the abatement of the IWTC only, to 25% and 30%. This option also involves a changing to IRD’s administrative systems to abate the IWTC first. Currently the FTC is abated first, then the IWTC, then the PTC. Switching the order so the IWTC is abated first generates significantly more fiscal savings.

Tradeoffs – This option generates fiscal savings and improves targeting but reduces incentives to work and lowers disposable income for middle and high income earners.

The fiscal savings are summarised in Table 5 below:

Table 5: Fiscal Savings from Option 2B

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
25% IWTC	93	94	93	101	**381**
30% IWTC	160	162	161	168	**652**

Analysis

- ***Targeting –*** The targeting analysis shows small changes in the measures. That is, funding below the threshold increases from 60-62% and funding to beneficiaries increases from 47-49%.

- ***Disposable Income –*** Disposable incomes of some middle incomes earners are reduced by almost $20 per week under a 30% IWTC abatement rate. As with 2A, no family earning under $36,827 is affected by this option. The losers are relatively evenly distributed among the higher income bands.

- ***Work incentives and efficiency –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. Lowering IWTC payments has negative effects on incentives to work for all middle income earners and abating the IWTC faster than the other tax credits sends mixed signals about the benefits of paid employment. This option increases abatement rates and therefore EMTRs of all middle income earners up to the point where the IWTC is fully abated. However, as with Option 2A, the replacement rate analysis shows very minor changes in the incentives for beneficiaries to enter paid employment. While all WFF recipients earning over the abatement threshold will receive a fall in their payments, EMTRs remain the same for the majority of recipients. For those at the highest income levels who no longer receive any assistance, their EMTRs will decrease improving their work incentives.

- ***Compliance and Administration –*** The upfront implementation cost for Option 2B is medium and ongoing administration costs are low. This option requires changes to IRD's systems to allow for the separation of abatement rates from universal to single rates. The impact on customers is minimal but it will require some communication, particularly to those families whose entitlements abate more quickly.

Discussion

Option 2B has the advantage of only affecting middle to higher income earners, better targeting WFF tax credits. However, this needs to be balanced against affecting incentives to work and lowering disposable income for middle income earners. There is also a risk of this option sending the wrong signal about the benefits of paid employment as the IWTC is abated at a higher rate than the other tax credits. In addition there are implementation costs associated with changing the order of abatement although ongoing costs will be minimal.

OPTION 3: SIMPLIFY THE FAMILY TAX CREDIT PAYMENT SCHEDULE

Description

The FTC's current payment schedule has five different rates where families receive more money depending on the age of their child. There are two payment rates for a first child, and three rates for subsequent children described in Table 6 below:

Table 6: Current FTC payment schedule

Age/number of children	Weekly payment rate*
First child if under 16	$88.03
First child if 16 or over	$101.98
Subsequent child rate if under 13	$61.19
Subsequent child rate if 13 to 15	$69.78
Subsequent child rate if 16 or over	$91.25

*Rates current as at 1 October 2010

This option proposes a simplified payment schedule: one rate for a first child (paid at the under 16 rate) and one for a subsequent child (paid at the under 13 rate). This is shown in Table 7 below:

Table 7: Proposed FTC payment schedule

Age/number of children	Weekly payment rate
First child	$88.03
Second Child	$61.19

Tradeoffs – This option generates small fiscal savings and lowers complexity for IRD and claimants but lowers income adequacy for those families with teenagers.

The fiscal savings from changing the schedule are presented in Table 8:

Table 8: Fiscal Savings – Option 3

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 3	72	75	74	76	**297**

Analysis

- ***Targeting –*** There is virtually no change in our targeting measures for this option.

- ***Disposable Income –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. For the relatively small number of families affected, there may be an increase in the incidence of child poverty. This option evenly reduces disposable income across all income bands. Most notably those reporting zero or negative income will lose over $20 per week on average.

- ***Work incentives and efficiency –*** While this option reduces payments for those families with older children, it actually improves work incentives for those families who no longer receive any WFF payments. The replacement rate analysis shows no change from the status quo for our example beneficiary. Families with teenagers will likely face small decreases in their incentive to move into paid employment or work more hours to qualify for the IWTC.

- ***Compliance and Administration –*** The upfront implementation costs are low. A simplified payment schedule for the FTC would reduce ongoing administration costs.

Discussion

A simplified payment schedule would result in modest fiscal savings but at the same time, takes assistance away from families with older children. While it may cost more to care for older children than younger children, the WFF evaluation concluded that the benefits of investing in children are greater for those of a younger age.

In addition, Option 3 is expected to result in some small offsetting costs, through increased uptake of other hardship related programmes delivered by the Ministry of Social Development (for example Temporary Additional Support and Special Needs Grants).

OPTION 4: CHANGE THE IN-WORK TAX CREDIT TO INDIVIDUAL CHILD RATES

Option 4A: Change the In-work Tax Credit to $15 per child per week

Description

As mentioned above the In-work Tax Credit is a payment of $60 per week for the first 3 children and $15 per week for each additional child. This option would change the IWTC payment schedule to $15 per week per child, or $780 per child per year, removing the single payment of $60 per week for one, two or three children.

Tradeoffs – This option generates fiscal savings and improves targeting but significantly reduces incentives to work and reduces disposable income for all income earners not receiving a benefit.

The fiscal savings from this option are presented in Table 9 below:

Table 9: Fiscal Savings – Option 4A

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 4A	318	316	306	304	**1244**

Analysis

- ***Targeting –*** The targeting analysis shows significant increases in the funding allocated to both families below the abatement threshold and beneficiaries.

- ***Disposable Income –***This option reduces disposable income of all income bands, most notably for those between $25,000 and $75,000.

- ***Work incentives and efficiency –*** Incentives to work are significantly reduced for the majority of WFF recipients. The IWTC is one of the main incentives for those on benefit to enter paid employment i.e. it is designed to make work pay. Therefore removing a part of the IWTC lowers this incentive. This is reflected in the replacement rate analysis as our example beneficiary will be $30 per week worse off when entering full time work under Option 4A relative to the status quo. However, as higher income earners no longer receive WFF tax credits they will face decreased EMTRs and therefore have an increased incentive to work. On balance we expect the overall effect to be negative.

- ***Compliance and Administration –*** The upfront implementation costs are low. A simplified payment schedule for the IWTC would reduce ongoing administration costs.

Discussion

This option would adversely affect the majority of low to middle income families and especially those with one, two, or three children. It also has large implications for the 'make work pay' objective of the In-work Tax Credit and would send mixed signals to recipients. The In-work Tax Credit has a key role in making work pay more than remaining on a benefit for families with children. Significant reductions in the IWTC's value would mean that sole parents in particular may not be better off undertaking paid work> Therefore, the IWTC could end up undermining work testing to some degree.

Option 4B: Change the IWTC to $20 per child per week for the first three children, then $15 per week per child thereafter

Description

Option 4B changes the IWTC payment to $20 per week per child for the first three children and to $15 per week for subsequent children. This leaves families with 3 or more children no worse off than under the status quo.

Tradeoffs – This option generates significant fiscal savings and improves targeting but reduces incentives to work and reduces disposable income for the majority of recipients not receiving a benefit.

The fiscal savings from this option are presented in Table 10 below:

Table 10: Fiscal Savings – Option 4B

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 4B	210	209	202	200	**821**

Analysis

- ***Targeting –*** Option 4B shows improved targeting as a higher proportion of the funding is allocated to both families below the abatement threshold and to beneficiaries.

- ***Disposable Income –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. Option 4B reduces disposable income of almost all income bands, most notably for those between $25,000 and $75,000.

- ***Work incentives and efficiency –*** Incentives to work are significantly decreased for the majority of WFF recipients. The IWTC is one of the main incentives for those on benefit to enter paid employment i.e. it is designed to make work pay. Therefore removing a part of the IWTC lowers this incentive. This is reflected in the replacement rate analysis as our example beneficiary will face a fall in their weekly income of $20 per week relative to the status quo. However, as higher income earners no longer receive WFF tax credits they will face decreased EMTRs and therefore have an increased incentive to work. On balance we expect the overall effect to be negative.

- ***Compliance and Administration –*** The upfront implementation costs are low. A simplified payment schedule for the IWTC would reduce ongoing administration costs.

Discussion

Like Option 4A, this option could adversely affect the majority of low to middle income families but unlike 4A will only affect those families with one or two children. Families with 3 or more children will receive the same IWTC payment. However, as a significant proportion of WFF families have 1 or 2 children so this option still has implications for the 'make work pay' objective of the In-work Tax Credit as discussed above. This option is therefore valuable if you wanted to reduce the cost of the IWTC but only take funding away from those families with 1 or 2 children.

OPTION 5: START ABATING ALL TAX CREDITS EARLIER

Currently the WFF tax credits start abating from an income of $36,827 at 20 c/$. Note that when we refer to all tax credits we are referring to the Family Tax Credit, the In-work Tax Credit and the Parental Tax Credit. As discussed in the introduction the Minimum Family Tax Credit is on a different abatement regime. Below we present two options for lowering the abatement threshold from $36,827.

Option 5A: Lower the abatement threshold to $30,000

Description

The option would start abating the WFF tax credits from a lower income level of $30,000.

Tradeoffs – This option generates significant fiscal savings and improves targeting but reduces incentives to work for some people and reduces disposable income for some low income families.

This fiscal savings from this option are presented in Table 11 below:

Table 11: Fiscal Savings ($m) – Option 5A

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 5A	262	265	259	261	**1047**

Analysis

- ***Targeting –*** The targeting analysis shows a medium shift in the funding allocated to those on lower incomes. Funding below the abatement threshold increases from 60% to 65% and funding allocated to beneficiaries increases from 47% to 51%.

- ***Disposable Income –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. This option reduces disposable income of all families above the new abatement threshold of $30,000. All of these families lose between $20 and $25 per week.

- ***Work incentives and efficiency –*** Incentives to work are mixed under this option. Those earning between the old and new abatement threshold will face a 20% higher EMTR, lowering their incentive to work. However, anyone earning between $69,685 and $76,512 will no longer receive any WFF assistance and will therefore face a fall in their EMTR of 20%. In addition to EMTR changes, the replacement rate analysis shows that under our scenario the beneficiary would be $26 per week worse off than under to the status quo. This lowers incentives for beneficiaries to move into paid work or to work more hours, although beneficiaries entering work at lower wage rates may not face this impact.

- ***Compliance and Administration –*** The upfront implementation costs are low. A higher abatement rate would reduce the number of families that qualify for WFF therefore reducing the ongoing administration costs.

Discussion

The main advantage of this option is the significant fiscal savings and the refocus of spending toward those most in need of assistance. However, this option reduces disposable income for many low and middle income earners and decreases incentives to work as more income earners are facing higher EMTRs. The replacement rate analysis also reveals a decreased incentive for beneficiaries to enter paid employment. To soften the effect on lower income earners this option could be combined with lowering the abatement rate for those on lower incomes, but would also reduce any fiscal savings.

Option 5B: Lower the abatement threshold to $25,000

Description

Option 5B lowers the abatement threshold from $36,827 to $25,000.

Tradeoffs – This option generates significant fiscal savings and improves targeting but reduces incentives to work for some people and reduces disposable income for a number of low income families.

The fiscal savings from this option presented in Table 12 below:

Table 12: Fiscal Savings ($m) – Option 5B

Fiscal years	2011/2012	2012/2013	2013/2014	2014/2015	4 year total
Option 5B	449	451	439	439	**1778**

Analysis

- ***Targeting –*** The targeting analysis shows a significant redistribution of funding to both lower income earners and beneficiaries. Funding below the abatement threshold increases from 60% to 69% and funding allocated to beneficiaries increases from 47% to 55%.

- ***Disposable Income –*** This option is expected to have no measurable impact on aggregate income poverty and income inequality measures. Similar to Option 5A, Option 5B reduces disposable income of all families above the new abatement threshold of $25,000. This option affects families earning between $25,000 and $75,000 the most with some families losing about $40 per week.

- ***Work incentives and efficiency –*** Incentives to work are again mixed under this option. Like Option 5A, those earning between the old and new abatement thresholds will face a 20% higher EMTR lowering their incentive to work. However, anyone earning between $64,685 and $76,512 will no longer receive any WFF assistance and therefore face a fall in their EMTR of 20%. In addition to this, the replacement rate analysis shows that under our scenario, the beneficiary would be $45 per week worse off compared to the status quo. This significantly lowers incentives for beneficiaries to move into paid work or work more hours to qualify for the IWTC.

- ***Compliance and Administration –*** The upfront implementation costs are low. A higher abatement rate would reduce the number of families that qualify for WFF therefore reducing the ongoing administration costs.

Discussion

Like Option 5A above, the main advantage of this option is the significant fiscal savings and the refocus of spending on toward those most in need of assistance. However, this option further reduces disposable income for many low and middle income earners and decreases incentives to work as more income earners are facing higher EMTRs. The replacement rate analysis shows significant decreased incentive for beneficiaries to enter paid employment as they would be $45 per week worse off than compared to the status quo. As with 5A, this option could be combined with lowering the abatement rate for those on lower incomes.