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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Working for Families - Further Advice on Options for Meeting on 8 March 2011

Date:	7 March 2011	**Report No:**	T2011/350

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** the contents of this report	4pm, Tuesday 8 March

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Simon MacPherson	Manager, Workforce Attachment and Skills	[1]	✓
[1]	Analyst, Workforce Attachment and Skills		

Minister of Finance's Office Actions

Forward this report to the Minister for Social Development and Employment and the Minister of Revenue for their information

Enclosure: **No**

Treasury Report: Working for Families - Further Advice on Options for Meeting on 8 March 2011

Executive Summary

Purpose

This report responds to a request for further advice and fiscal costings of some packages of options to reform the Working for Families (WFF) scheme. At a meeting on 1 March 2011 between the Ministers of Finance and Revenue, and the Minister for Social Development and Employment, Ministers requested further advice on:

- Option 2 - Remove the automatic indexation of family tax credit amounts, but introduce a new child allowance payment to compensate beneficiaries from A) 1 April 2012, or B) 1 April 2014. Specifically whether there were other mechanisms to compensate beneficiaries (e.g. increasing the domestic purposes benefit) that address the concerns raised in a previous joint report (T2011/249 refers);

- Generating significant fiscal savings and minimising the impact on those families affected by the proposals; and

- Different packages of options that generate savings of approximately $400m per annum by 2014/15.

Summary of advice

Detailed advice on these points is contained in the text below. A summary of Treasury's advice is as follows:

- Given the Minister's objectives of generating fiscal savings while protecting those on the lowest incomes, and taking account of options no longer on the table, Treasury's advice is to keep indexing the Family Tax Credit (FTC) and instead make changes to the abatement rate. However, if Ministers wished to pursue the option to de-index the FTC and compensate beneficiary families there are two alternatives:

  - A child allowance payment as discussed in the previous report; and

  - An increase to the rate of core benefits (e.g. DPB), approximately equal to the average amount they would have gained under indexation.

- If Ministers want to generate fiscal savings and minimise the impact on WFF recipients, Treasury recommends the following package (see Table 2 below):

  - Increase the abatement rate by 1.25 percentage points every indexation round until it reaches 25% on 1 April 2018; and

  - Removing the indexation of FTC amounts for children 16 and over.

- If instead Ministers wish to generate greater fiscal savings of approximately $420m by 2014/15, Treasury recommends the following package (see Table 3 below):

  - Increasing the abatement rate to 24% on 1 April 2012 and 27.5% on 1 April 2014;

- Decreasing the abatement threshold to $36,000 on 1 April 2012 and $35,000 on 1 April 2014; and

- Removing the indexation of FTC amounts for children 16 and over.

Appendix 1 contains tables with packages that are made up of several options presented in a report to joint Ministers on 22 February 2011 (T2011/249 refers). The tables contain a brief description of the package, the high level tradeoffs, and the fiscal savings. The in-depth analysis or descriptions contained in previous reports is not repeated below.

Note that the Ministry of Social Development and Inland Revenue were consulted on this report.

Recommended Action

We recommend that you:

a **Note** the contents of this report.

Simon MacPherson
Manager
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Options for compensating beneficiary families

1. Option 2 provided for a child allowance payment to be paid to beneficiary families to compensate them for a loss in purchasing power over time after removing the automatic indexation of the FTC. However, a previous report (T2011/249 refers) identified some concerns with this payment, namely:

   - The small negative impacts on work incentives;
   - A lack of compensation for low income people not receiving benefits;
   - Complicated administration;
   - A lack of coherence and difficulty communicating the changes to recipients; and
   - Potential human rights issues.

2. In developing the child allowance payment, officials looked at several other alternatives for protecting the real incomes of beneficiaries and low-income families with children. These included separating the rates of FTC for beneficiaries and working families,[1] and continuing to index the FTC amounts but reducing the abatement threshold on a family by family basis.[2]

3. In addition to the options previously explored and discussed above, we have looked at two further approaches:

   1. Compensation through increases to benefit rates for families with children; and
   2. Compensation through increases to another existing instrument.

Approach One: Increasing Benefit Rates

4. Compensating beneficiary families for the de-indexation of FTC amounts could be provided by increasing benefit rates for families with children. Current benefit rates include a sole parent rate and a couples rate for most benefits. The rates are the same regardless of whether or not a family has a child. Benefit rates from 1 April 2011 for families with children are shown below:

Unemployment/ Sickness Benefit	**Net weekly rate**
Sole parent with children	$288.47
Couple (with or without children)	$335.66
Domestic Purposes Benefit	
Sole parent with children	$288.47
Invalids Benefit	
Sole parent with children	$330.70
Couple (with or without children)	$419.46

1 This approach would have the drawbacks of introducing a new payment as well as additional administrative problems for Inland Revenue.

2 Ministers considered and rejected this approach at the meeting on 2 February.

5. Benefit rates do not vary with the number of children in the family as financial support for children is provided primarily through the FTC. Increases to benefit rates therefore will not perfectly match the impact of removing the indexation of FTC amounts. Benefit rates are also indexed every year rather than when inflation reaches 5%. Smaller families will benefit whereas larger families receive less than under the child payment option. If the same level of funding was used as for the child payment, the estimated increases in benefit rates are $6.80 per week from 1 April 2012 with a further $7.20 per week from 1 April 2014. A decision would be needed on whether increases in FTC amounts beyond 2014 would result in increases in benefit rates.

6. For comparison, the estimated rates of payment for the child allowance are shown in the table below. These rates are also what the beneficiary family would have received under the status quo, i.e. indexation of the FTC.

Number of children	**Rate of child payment ($/week)**	
	From 1 April 2012	From 1 April 2014
One	$4.60	$9.48
Two	$7.79	$16.08
Three	$10.98	$22.67
Four	$14.17	$29.27
Five	$17.37	$35.87

7. While the current benefit rates structure does not have separate rates for couples with children, introducing a separate benefit rate would be relatively straightforward. The alternative option of increasing rates of payment for sole parents but not for couples with children, is not recommended as this would withhold financial support from a significant group of parents in need. At the end of February 2011 there were around 114,000 sole parents and 16,000 couples with children receiving benefits.[3]

8. Increasing benefit rates does not perfectly target compensation, but it would significantly reduce complexity and improve coherence, and reduce some of the human rights issues associated with the child allowance approach. It would, however, slightly worsen work incentives, and fail to compensate low income families not receiving benefits. If Ministers wish to remove the indexation of FTC amounts, this would be a robust approach to compensating beneficiary families.

9. As the payment is included in main benefit rates, there will be a number of flow-on impacts on other supplementary assistance payments (e.g. accommodation supplement and temporary additional support payments will be reduced for many people, partially or fully offsetting the increase in the benefit rate). There would also be some operational cost to MSD (one-off costs estimated at $0.3 million in 2011/12), and the addition of couple with children rates of benefit would require amendment to primary legislation.

Approach two: Increasing another instrument

10. We have looked at increasing other payments made to beneficiaries and low income earners such as the Accommodation Supplement, Temporary Additional Support or Childcare Assistance. The advantage of this approach is that these payments are available to beneficiaries as well as non-beneficiaries, but because they are paid in respect of costs and are not specifically for children, they are not received by all low income people with children. They are also received by low income people without children who do face those costs. We therefore do not recommend this approach.

[3] As at the end of February 2011, 52% of beneficiaries with children have 1 child, 29% have 2 and 19% have 3 or more.

Options that minimise the impact on WFF recipients

11. Officials were asked to come up with an example package of options that generates significant fiscal savings, as well as minimising the impact on WFF recipients. Treasury prefers a package that gradually increases the abatement rate to 25%, and removes the indexation of the FTC amounts for children 16 and over. However, we have also cost an option that gradually decreases the abatement threshold to $35,000. The two variations are as follows:

12. *Variation 1 (Treasury's preferred option)*:

    - Increase the abatement rate by 1.25 percentage points every indexation round until it reaches 25% on 1 April 2018; and

    - No indexation of FTC amounts for children 16 and over.

13. *Variation 2:*

    - Increasing the abatement rate by 1.25 percentage points every indexation round until it reaches 25% on 1 April 2018;

    - Decreasing the abatement threshold by $456.75 every indexation round to decrease from $36,827 prior to 1 April 2012 to $35,000 on 1 April 2018; and

    - Removing the indexation of the FTC amounts for children 16 and over.

14. The fiscal costs and the tradeoffs of these options are presented in Table 2 in Appendix 1.

Removing indexation of the FTC amounts for children 16 and over

15. An additional option considered after finishing the joint report was removing the indexation of the FTC amount for children 16 and over. This means that over time the FTC payment schedule would reduce to one payment for a first child and two payments for a second child (0-12, and 13 and over). Our overall assessment of this option is that it generates modest fiscal savings with relatively small impacts. Families would not receive approximately $5 per week for each 16-18 year old as a result of the non-indexation of the eldest child FTC amount. Twenty three percent of all WFF recipient families have at least one 16-18 year old (only 3% have more than one 16-18 year old).

16. However, this option could have implications for the wider social security system. From age 16 years on, children begin to become eligible for some social welfare payments. They may receive the Invalids' Benefit, and emergency benefit in some circumstances (e.g. if they have had a child themselves) or the independent youth benefit (if there has been a breakdown in the relationship with their caregiver). In most cases the best outcome is for the child to remain in the care of an adult receiving the FTC in respect of that child.

17. The presence of these other payments can create incentives for 16 and 17 year olds to try to qualify for these more generous payments. As those payments are indexed, allowing the FTC rate to erode could put pressure on the assessment of eligibility for these other benefits. However, as these incentives already exist in the system and the impact of this option is marginal, we expect the overall impact to be minimal.

18. The other issue with it is that where a child is being cared for by an adult other than their parent (e.g. due to CYF intervening), there is a complex array of possible benefits that the adult can receive. If they take on full guardianship of the child they can qualify for FTC, but also available are the unsupported child's benefit, which is paid at a higher

rate. Again, reducing the relative value of the FTC will worsen incentives for caregivers to take on full guardianship.

Packages that generate approximately $420m in 2014/15

19. Joint Ministers have asked officials to come up with a range of options that generate approximately $400m per annum by 2014/15. [3]

These options are outlined in Table 3 in Appendix 1.

20. If Ministers had this desired savings target, Treasury would recommend the following package of options:

- Increasing the abatement rate to 24% on 1 April 2012 and 27.5% on 1 April 2014;
- Decreasing the abatement threshold to $36,000 on 1 April 2012 and $35,000 on 1 April 2014; and
- Removing the indexation of FTC amounts for children 16 and over.

Appendix 1: Option tables

Table 1: Previous options still being considered

		Fiscal Savings ($m)				
Old Option	**Tradeoffs**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**4 Year Fiscal Saving**
Option 2 Remove the automatic indexation of family tax credit amounts, but introduce a new child allowance payment to compensate beneficiaries from A) 1 April 2012, or B) 1 April 2014	• Generates fiscal savings, improves targeting and protects the income of beneficiary families • Lowers real disposable income for working families over time • Increases complexity and reduces work incentives over time • Has human rights implications	1 April 2012 - 31 1 April 2014 - 40	1 April 2012 - 123 1 April 2014 - 159	1 April 2012 - 152 1 April 2014 - 188	1 April 2012 - 247 1 April 2014 - 284	**1 April 2012 - 553** **1 April 2014 - 671**
Option 3 Increase the universal abatement rate to: A) 22.5%; or B) 25% *[Officials preferred option as per previous advice]*	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for middle to high income families • Minimal impact on work incentives for beneficiaries, and protects the real value of disposable incomes for low income families	22.5% - 30 25% - 55	22.5% - 120 25% - 219	22.5% - 122 25% - 219	22.5% - 128 25% - 228	**22.5% - 399** **25% - 722**
Option 5 • Remove indexation of FTC amounts • Pay child allowance from 1 April 2012. • 22.5% abatement rate	• Generates significant fiscal savings, improves targeting and protects the income of beneficiary families • Lowers real disposable income for working families over time • Increases complexity and reduces work incentives • judgement • Has human rights implications	59	236	264	356	**$916m**

Table 2: Package of options that generates fiscal savings and minimises the impact on families

Package	Tradeoffs	Fiscal Savings ($m)								
		11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	Fiscal Saving
Variation 1: • Increase the abatement rate by 1.25 percentage points every indexation round until it reaches 25% on 1 April 2018 • No indexation of FTC amounts for children 16 and over *[Treasury preferred option if Ministers wanted to minimise impacts on families]*	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for middle and high income families • Minimal impact on work incentives for beneficiaries families, and protects the real value of disposable incomes for the majority of low income families • Real disposable incomes of families with children 16 and over will fall over time	21	84	104	163	179	236	249	295	4 year total to 2014/15 **$373m** 8 year total to 2018/19 **$1,331m**
Variation 2: • Increase the abatement rate by 1.25 percentage points every indexation round until it reaches 25% on 1 April 2018 • Decreasing the abatement threshold by $456.75 every indexation round to decrease from $36,827 prior to 1 April 2012 to $35,000 on 1 April 2018 • No indexation of FTC amounts for children 16 and over	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for low, middle and high income families • Minimal impact on work incentives for beneficiaries families, and protects the real value of disposable incomes for the majority of low income families • Real disposable incomes of families with children 16 and over will fall over time	26	103	127	200	219	290	306	367	4 year total to 2014/15 **$455m** 8 year total to 2018/19 **$1,638m**

Table 3: Packages that generate approximately $420m per annum in 2014/15

Option	Tradeoffs	Fiscal Saving 2014/15
• Increase the abatement rate to 24% on 1 April 2012 and 27.5% on 1 April 2014. • Decrease the abatement threshold to $36,000 on 1 April 2012 and $35,000 on 1 April 2014. • No indexation of FTC amounts for children 16 and over *[Treasury preferred option if you wanted to generate $420m p/a by 2014/15]*	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for low, middle and high income families • Minimal impact on work incentives for beneficiaries families, and protects the real value of disposable incomes for the majority of low income families • Real disposable incomes of families with children 16 and over will fall over time	$420m
• Increase the universal abatement rate to 32%	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for middle to high income families • Minimal impact on work incentives for beneficiaries, and protects the real value of disposable incomes for low income families	$431m
• Remove indexation • Pay child allowance from 1 April 2012. • 25% abatement rate	• Generates significant fiscal savings, improves targeting and protects the real disposable income of beneficiary families • Lowers real disposable income for working families over time • Increases complexity and reduces work incentives • Has human rights implications	$434m
• Increase the abatement rate to 30% in two jumps at indexation points • No indexation of FTC amounts for children 16 and over	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for middle to high income families • Minimal impact on work incentives for beneficiaries, and protects the real value of disposable incomes for low income families • Real disposable incomes of families with children 16 and over will fall over time	$415m
• Increase the abatement rate to 25% • Decrease the abatement threshold to 32,000	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for low, middle and high income families • Minimal impact on work incentives for beneficiaries, and protects the real value of disposable incomes for low income families	$422m
• Increase the abatement rate to 27.5% • Decrease the abatement threshold to 34,000	• Significant fiscal savings and improves targeting • Reduces marginal incentives to work and lowers disposable income for low, middle and high income families • Minimal impact on work incentives for beneficiaries, and protects the real value of disposable incomes for low income families	$425m