

Regulatory Impact Statement: April 2022

Working for Families changes

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing: final Cabinet decisions
Advising agencies:	Inland Revenue, Ministry of Social Development, The Treasury, The Department of Prime Minister and Cabinet
Proposing Ministers:	The Minister for Child Poverty Reduction and the Minister for Social Development and Employment
Date finalised:	28/10/2021
Problem Definition	
<p>The Government is reviewing the Working for Families scheme in response to recommendations from the Welfare Expert Advisory Group (WEAG). Phase one of the review has considered a redistributive package of changes through Budget 2022 to provide further support to low-income families and contribute toward the Government's child poverty reduction targets.</p>	
Executive Summary	
<p>Overview of proposals discussed</p> <p>Options for phase one of the WFF review</p> <p>The proposed options for phase one of the Working for Families (WFF) review are discussed in this Regulatory Impact Statement (RIS). These consist of modest-cost options for Budget 2022 that increase and redistribute support to low-income families alongside an anticipated adjustment of family tax credit (FTC) and Best Start tax credit (BSTC) rates in April 2022 in line with CPI inflation. These options are intended to contribute towards the Government's child poverty reduction targets and the objectives of the WFF review.</p> <p>Related changes outside of the WFF review</p> <p>A proposed remedial adjustment to how Consumer Price Index (CPI) increases are calculated will proceed under the counterfactual and is discussed in this RIS for context and completeness.</p> <p>Increases to Orphan's Benefit (OB), Unsupported Child's Benefit (UCB) and Foster Care Allowance (FCA) payment rates as a consequence to a proposed increase in FTC rates are also discussed in this RIS. Income Support Ministers have agreed to these consequential increases.</p> <p>The costs associated with the annual minimum family tax credit (MFTC) threshold change are noted in this RIS for context but the change is not analysed as it has previously been agreed to by Cabinet [CAB-21-MIN-0116].</p>	

Background to the WFF review

In 2018, the Government established the Welfare Expert Advisory Group (WEAG) to advise them on the future of New Zealand's social security system, including the WFF scheme. The WEAG recommended fundamental changes to the design and targeting of WFF as well as significant increases to main benefits and the FTC.

Following the WEAG's report, *Whakamana Tāngata: Restoring Dignity to Social Security in New Zealand*, the Minister for Child Poverty Reduction requested a broader review of WFF. The WFF review is part of the broader Welfare Overhaul work programme.

Ministers have agreed the original objectives for WFF [Cabinet minute (04) 13/4 refers] remain important. These were to:

- make work pay by supporting families with dependent children, so that they are rewarded for their work effort
- ensure income adequacy, with a focus on low and middle-income families with dependent children to address issues of poverty, especially child poverty
- achieve a social assistance system that supports people into work, by making sure that people get the assistance they are entitled to, when they should, and with delivery that supports them into, and to remain in, employment.

Ministers have also agreed the following objectives for the review of WFF:

- Objective 1: target support more to lower-income families rather than more universal support
- Objective 2: focus on low-income working families, while maintaining support for beneficiary families
- Objective 3: help make work pay and assist with the costs for people in work.

These objectives cannot all be met at the same time, and Ministers will need to consider the relative balance between the objectives throughout the review.

There are two phases to the review:

- Phase one will consider modest-cost options for Budget 2022 that increase and redistribute support to low-income families alongside the planned CPI adjustment in April 2022
- Phase two will consider more fundamental changes to s 9(2)(f)(iv) WFF payments, with a particular focus on in-work support, and changes to improve administration, operations and client experience.

Phase one is the subject of this RIS and canvasses the following options:

- Increases to the FTC
- Increases to the WFF abatement rate

CPI adjustment

Under the status quo, FTC and BSTC rates are increased by a corresponding amount once cumulative increases to CPI (since the rates were last increased) reach 5%. This policy is forecast to trigger increases in FTC and BSTC rates for 1 April 2022.

All options considered in phase one of the review would be implemented in April 2022, coinciding with the CPI indexation increases to the FTC and BSTC rates. Therefore, the impacts of these options have been modelled both including and excluding the impact of

counterfactual indexation to demonstrate what customers will experience and the real value of the options themselves respectively.

CPI remedial

A remedial amendment to the way in which CPI increases are calculated for the purposes of indexation is proposed and would apply from 1 January 2021. This remedial would remove the exclusion of increases in the prices of cigarettes and other tobacco products from the calculation of increases in the CPI for the purposes of indexing FTC and BSTC rates and returns the calculation of indexation to increases in CPI all groups. Cabinet only intended the exclusion of cigarettes and other tobacco products for the purposes of indexing social assistance to last until the end of the 2020 calendar year so the impact of this remedial is included in the counterfactual for the purpose of analysing the options for phase one of the WFF review.

Modelling the impact of CPI indexation

The impacts of each option were modelled using the Treasury's micro-simulation model (TAWA).¹ Modelling the options was required to inform advice to Ministers before the September 2021 quarter update for CPI was released.² Therefore, in advice provided to Ministers all outputs were calculated using a counterfactual based upon the CPI increases forecast in the 2021 Budget Economic and Fiscal Update (BEFU). Thus, all outputs were subject to change.

An updated costing for Ministers' chosen option is used in the Cabinet paper, based on a counterfactual that was calculated using the actual CPI increase for the September 2021 quarter. This updated costing is included below. However, all other outputs in this RIS match those originally provided to Ministers. We note that the actual CPI increase for the September 2021 quarter was materially higher than forecast, which will flow through to the distributional impacts of the policy agreed.

FTC rates and WFF abatement rate changes

Initially, agencies provided advice to Income Support Ministers on a range of options for changes to the FTC which varied by cost and the approach to abatement. Based on this advice, Ministers chose a set of parameters which were used to develop a final set of four options for them to decide between. These final options are summarised in the following table. Note that, unless otherwise stated, all outputs do not include the impact of CPI indexation.

- Options A1 - A3 relate to a \$5 FTC increase
- Option B relates to a \$7.50 FTC increase

¹ These TAWA modelling results use data from the IDI, which was provided by Stats NZ under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results are the work of the author, not Stats NZ or individual data suppliers.

²An increase in FTC & BSTC rates is triggered once cumulative increases to the CPI since the last adjustment of FTC and BSTC rates reaches 5%. Once the 5% threshold has been reached, FTC and BSTC rates will be scheduled to increase from 1 April of the upcoming year. The percentage they are increased by is based on the cumulative actual increase in CPI up until the end of the September quarter after the 5% threshold was reached.

FTC rate and abatement rate options	FTC increase per child		Abatement rate	Annual cost	Children lifted from poverty ³		Gains and losses for households			
	Rate change	Total with CPI (eldest & subs. child)			BHC50 ⁴	AHC50 ⁵	Winners	Average gain	Losers	Average losses
A1 (\$5 FTC, 25% abmt)	\$5	\$11.71 and \$10.42	25% (No change)	\$158m	5,000 (\pm 4,000)	9,000 (\pm 6,000)	316,000	\$10	S ⁶	S
A2 (\$5 FTC, 26% abmt)	\$5	\$11.71 and \$10.42	26%	\$111m	5,000 (\pm 4,000)	9,000 (\pm 6,000)	287,000	\$8	26,000	-\$1
A3 (\$5 FTC, 27% abmt)	\$5	\$11.71 and \$10.42	27%	\$68m	5,000 (\pm 3,000)	8,000 (\pm 6,000)	223,000	\$8	89,000	-\$6
B (\$7.50, 28% abmt)	\$7.50	\$14.21 and \$12.92	28%	\$103m	7,000 (\pm 5,000)	10,000 (\pm 6,000)	223,000	\$12	89,000	-\$8

Options A2, A3 and B explore changes to the WFF abatement rate. The WFF abatement rate applies to a family's in-work tax credit (IWTC) (or CTC⁷) and FTC entitlements once their annual income surpasses the WFF abatement threshold. The abatement rate determines the rate at which a family's WFF entitlement is reduced once their income crosses the threshold, i.e. how many cents in each dollar earnt over the threshold a family will lose from their entitlement. Currently, the WFF abatement rate is 25% (25c in each dollar) and the abatement threshold is \$42,700.

Abatement rate increases reduce the fiscal cost of an FTC rate increase and target support more towards lower-income families. Abatement rate increases meet the WFF review's objective to "target support more to lower-income families rather than more universal support".

Updated impacts of the final option agreed by Ministers

Ministers have chosen to progress option A3 (a weekly increase in FTC rates of \$5 and an abatement rate of 27%). The following are the updated modelled outputs of option A3 using a counterfactual calculated with the updated CPI figure. Note that, unless otherwise stated, all outputs for this option do not include the impact of the FTC and BSTC rates increase due to CPI indexation.

³ Note there is significant statistical uncertainty in the child poverty reduction estimates.

⁴ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

⁵ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

⁶ S = suppressed due to Statistics NZ confidentiality rules.

⁷ The Child Tax Credit (CTC) was 'grandparented' once it was replaced by the In-Work Tax Credit. Very few families still receive it.

FTC rate and abatement rate options	FTC increase per child		Abatement rate	Annual cost	Children lifted from poverty ⁸		Gains and losses for households			
	Rate change	Total with CPI (eldest & subs. child)			BHC50 ⁹	AHC50 ¹⁰	Winners	Average gain	Losers	Average losses
A3	\$5	\$14.69 and \$12.83	27%	\$66m	5,000 (\pm 4,000)	6,000 (\pm 5,000)	223,000	\$8	91,000	-\$6

Option to pass on increase to other caregivers (Oranga Tamariki comment)

There is also the option to extend the FTC increase to the rates of Orphan's Benefit (OB), Unsupported Child's Benefit (UCB), and Foster Care Allowance (FCA), costing an average of \$8.2m per annum for a \$5 increase to rates, or an average of \$12.3m per annum for a \$7.50 increase to rates. By convention, any FTC increase is passed on to these payments – this is because caregivers are not able to receive the FTC, and the FTC makes a partial contribution towards the costs of raising children.

⁸ Note there is significant statistical uncertainty in the child poverty reduction estimates.

⁹ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

¹⁰ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

Limitations and Constraints on Analysis

The options presented in phase one have been limited by:

- The scope of the review and the specific parameters set by Ministers for phase one options
- The modest fiscal envelope of the review
- The tight timeframes required to make system changes before April 2022
- No public or stakeholder consultation
- The desire to minimise design constraints on phase two
- Data uncertainty

Phase one parameters

The proposed changes were prepared within the final parameters set by Ministers, following earlier advice. These parameters were that the options:

- have modest increases to the rate of FTC
- cost around \$50 - \$100 million per year
- retain a single abatement threshold at the current level of \$42,700
- reduce child poverty
- minimise the number of losing families, particularly for those with incomes below \$100,000 per year.

The fiscal envelope

There is limited funding available for Budget 2022 due to the tight fiscal environment and prior Government expenditure on support to mitigate the effects of the COVID-19 pandemic.

Ministers originally agreed that any changes to WFF should be broadly within the existing fiscal envelope. Officials provided advice in August 2021 where modelling demonstrated that the level of redistribution required to make income adequacy-focused options fiscally neutral resulted in many of the lowest-income working families being financially disadvantaged. It is also difficult to reduce the costs of WFF increases without high abatement rates which can result in very high effective marginal tax rates (EMTRs), countering the objective of making work pay.

To avoid financially disadvantaging low-income working families and creating very high EMTRs, officials provided advice on changes to the FTC to coincide with the scheduled CPI indexation round. Following this advice, Income Support Ministers decided that phase one options would include modest FTC increases costing up to \$100m per year. Modelling suggests that medium-cost redistributive options can reduce child poverty.. In addition, when the proposed changes are combined with the scheduled CPI increases, the estimated numbers of recipients who would be worse off are reduced. However, the modest fiscal envelope for phase one still limits the ability of options to reduce child poverty without increases to abatement rates (which result in much higher EMTRs).

Tight timeframes

Policy development has been constrained by the tight timeframes required to make system changes in time for an April 2022 implementation. To avoid confusion and reduce administrative complexity, all system changes are made prior to January each year to ensure the changes can be incorporated into the annual “rollover” process which calculates WFF entitlements for the coming tax year and issues notices of entitlement to customers. To meet this deadline, Inland Revenue requires Cabinet decisions on policy settings by the end of November 2021. This significantly limits opportunities for analysis

and consultation, meaning that more substantial, structural changes could not be considered in phase one.

No consultation on phase one

Ministers have agreed to defer public engagement with the WFF review until April/May 2022. This aligns with the longer development timeframe for the more substantial options canvassed in phase two. The options canvassed in phase one cannot be submitted for consultation as they are budget sensitive.

Impact on phase two

Options for phase one of the review also need to be considered within the context of the broader review. Options which do not unnecessarily limit the scope for phase two, which will consider more fundamental changes to s 9(2)(f)(iv) WFF, are preferred.

Data uncertainty

These options have been modelled by Treasury's Tax and Welfare Analysis (TAWA) model. Treasury warns that there are significant uncertainties when estimating future poverty metrics due to the underlying data and economic forecasts. When Inland Revenue modelled the same outputs for quality assurance the following differences appeared. This comparison is based on TAWA outputs using unequivalised family taxable income, and Inland Revenue administrative data.

Option	Losers (N)	Winner (N)	average loss per week \$	average win per week \$	Cost \$m
A1	N/A	30,000	N/A	-1	-2
A2	13,000	15,000	0	-1	-8
A3	18,000	9,000	0	-1	-10
B	-1,000	28,000	-2	-1	14

These differences most likely reflect the fact that, unlike Inland Revenue modelling, TAWA modelling assumes full take up and does not take relationship changes into account, leading to an overestimation of the impact of changes on the population.

TAWA modelling does not take into account any behavioural changes that may result from the policy changes, such as changes in employment.

The MFTC threshold changes were forecast by Inland Revenue's forecasting team according to their usual annual process, based on the data available.

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28/10/2021

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28/10/2021

Quality Assurance

Reviewing Agency:

Inland Revenue

Panel Assessment & Comment:

The Quality Assurance reviewers at Inland Revenue have reviewed Regulatory Impact Statement: April 2022 Working for Families changes and consider that the information and analysis summarised in it **partially** meets the quality assurance criteria of the Regulatory Impact Statement framework

This RIS has been prepared in a constrained timeframe. There was no public consultation on these proposals. However, we note that the direction of the proposals was signalled in the WEAG report and are consistent with the Government's targets for child poverty. The changes will not have any significant adverse impacts on stakeholders given the changes are to systems which are already in place.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

Government commitment to improving child poverty

In 2018, the Government passed the Child Poverty Reduction Act whose purpose is to help achieve a significant and sustained reduction in child poverty in New Zealand by provisions that:

- encourage a focus by government and society on child poverty reduction
- facilitate political accountability against published targets
- require transparent reporting on levels of child poverty.

This Act bound the Government to set:

- long-term targets for reducing, over a long-term period (10 financial years), child poverty
- intermediate targets that support, over an intermediate period (three financial years), current long-term targets.

In line with these requirements, the Government has so far set one set of long-term, 10-year targets and two sets of intermediate, three-year targets to lower the rate of child poverty. These targets, measured against the AHC50¹¹ and BHC50¹² poverty thresholds, are outlined in the following table.¹³

Poverty measure	Unit	Baseline year (2018)	Current rate	First three-year target	Second three-year target	Ten-year target
		2017/18	2019/20	2020/2021	2023/2024	2027/28
AHC50	Child poverty rate	22.8%	18.4%	18.8%	15%	10%
	Number of children in poverty	253,800	210,500	218,000	174,000	~120,000
BHC50	Child poverty rate	16.5%	13.8%	10.5%	10%	5%
	Number of children in poverty	183,400	157,800	122,000	116,000	~60,000

¹¹ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

¹² The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

¹³ Government has also set targets measured against material hardship but the AHC50 and BHC50 measures are the only ones that will be used in this document for the sake of simplicity and consistency with the modelling of outputs by TAWA.

The Government has a series of mechanisms at its disposal with which it could reduce child poverty to meet its targets and improve income adequacy for low- and middle-income families generally. Examples of these are the minimum wage, rent controls, benefit rates and the WFF scheme. These tools do not necessarily target the same population groups.

The introduction of the Families Package in 2018, along with significant recent increases to the minimum wage and benefit rates, have helped the Government towards achieving its targets. The following table outlines child poverty rates since the introduction of the Child Poverty Reduction Act in 2018.

Poverty measure	Year	Rate		Annual change in rate		Number		Annual change in number		Total number of children
		Percent	Level sampling error	Percentage points	Sampling error on the change	(000s)	Level sampling error	(000s)	Sampling error on the change	(000s)
AHC50	2018	22.8	1.9	0.4	2.8	253.8	21.6	6.3	31.0	1,113.3
	2019	18.3	1.1	-4.5	2.4	207.7	12.9	-46.1	27.4	1,132.8
	2020	18.4	1.3	0.1	1.8	210.5	15.2	2.8	20.0	1,144.2
BHC50	2018	16.5	1.1	2.3	1.6	183.4	12.2	27.1	17.4	1,113.3
	2019	13.5	0.9	-2.9	1.7	153.2	10.1	-30.1	19.6	1,132.8
	2020	13.8	1.2	0.3	1.5	157.8	13.5	4.5	16.7	1,144.2

The Government recognises the current WFF review as an important opportunity to further reduce child poverty rates.

The WFF scheme

The WFF scheme has two primary objectives:

- to support income adequacy and reduce child poverty
- to improve financial incentives for low-income earners to participate in the labour market.

It must achieve these objectives at a sustainable cost to government.

The scheme was introduced between 2004 and 2007 and has undergone multiple changes under successive governments.

Increases to the FTC rates are a particularly useful way to address child poverty and income adequacy as the credit's eligibility requirements make it well targeted to low- and middle-income families with children, regardless of their work status.

Background to the WFF review

In 2018, the Government established the WEAG to advise on the future of New Zealand's social security system, including the WFF scheme. The WEAG recommended fundamental

changes to the design and targeting of WFF, and significant increases to main benefits and the FTC.

Following the WEAG's report *Whakamana Tāngata: Restoring Dignity to Social Security in New Zealand*, the Minister for Child Poverty Reduction requested a broader review of WFF. The WFF review is part of the broader Welfare Overhaul work programme.

Scope of the WFF review

The WFF review will explore whether policy settings can be adapted to better address the scheme's objectives.

Ministers have set the scope of the review to:

- Working for Families settings s 9(2)(f)(iv)
- The Accommodation Supplement
- Options for supporting disabled people in work, s 9(2)(f)(iv)

The impacts of related workstreams, progressing in parallel to the review, will also be considered.

Income Support Ministers have agreed the review should focus on:

- low-income working families, while maintaining support for beneficiary families
- options that target support more to lower-income families rather than more universal support
- the principle of making work pay and assisting with the costs for people in work.

These objectives have been noted by Cabinet. Cabinet has indicated that the review will be the primary vehicle for achieving the second, three-year child poverty targets. However, making significant improvements via phase one will be challenging given the tight fiscal environment.

Review phases

Following advice in August 2021, which covered initial options in line with Minister's objectives for the review, officials have split advice on the review into two phases. These are:

- phase one, which will consider modest-cost options for Budget 2022 that increase and redistribute support to low-income families alongside the planned CPI adjustment of FTC and BSTC rates in April 2022
- phase two, which will consider more fundamental changes to s 9(2)(f)(iv) WFF payments, with a particular focus on in-work support, and changes to improve administration, operations and client experience.

Phase one is the subject of this RIS and includes the following options

- increases to the FTC to support income adequacy
- WFF abatement rate changes to target assistance more tightly to lower-income families.

The counterfactual

In the absence of government changes, the number of children living in poverty is expected to slightly increase.¹⁴ Although benefit and some WFF rates are indexed to inflation (wage growth and the CPI respectively), these maintain the real value of payments over time; i.e., these indexation adjustments lower the likelihood that child poverty rates would increase, rather than actively reduce them.

Developments in the wider economy could influence child poverty rates, positively or negatively. However, the only way to ensure that poverty rates reduce is by making changes targeted to achieve this end. The WFF review is a key opportunity to do so.

Option to pass on increase to other caregivers (Oranga Tamariki comment)

There is also the option to extend the FTC increase to the rates of the OB, UCB and FCA. Increases to the FTC have been applied to the rates of OB, UCB, and FCA in 2005, 2007, and 2018, as caregivers receiving these payments cannot receive the FTC in respect of the same child, and the FTC makes a partial contribution towards the costs of raising children.

¹⁴ According to TAWA forecasts.

What is the policy problem or opportunity?

The problem

The central issue which phase one of the WFF review seeks to address is the persistence of child poverty and income inadequacy for low- and middle-income families in New Zealand. Although poverty and income inadequacy exist for individuals without children, the scope of this review is limited to families with children.

In the year ended June 2020, 207,700 children, 18.4% of the children in New Zealand, were living in AHC50 poverty.¹⁵ This means these children were growing up in families whose annual household equivalised disposable income (HEDI¹⁶), after deducting housing costs (AHC), was less than 50% of the median HEDI in New Zealand.¹⁷ If housing costs are not deducted, 157,800 children, 13.8% of children in New Zealand, were living in BHC50 poverty.^{18 19}

In the same year, 165,400 households, 9% of all households in New Zealand, reported that the adequacy of their income was “not enough” to support their needs. A further 432,600 (24%) reported that their income was “only just enough” to support their needs.²⁰

Part of the government’s role (as emphasised by the Child Poverty Reduction Act 2018) is to alleviate issues of poverty and income adequacy in society. It does so through various means, but most explicitly by targeting financial transfers to affected groups of the population via the welfare system and the WFF scheme. The fact that poverty, particularly child poverty, and income inadequacy persist demonstrates that these tools have not solved the problem. Although the Government has not committed to eliminating these issues, it has set targets to significantly reduce the number of children in poverty.

The stakeholders

The primary stakeholders in this issue are the families and children living in poverty or with inadequate income. They have a significant, personal interest in this issue as living in poverty or without income adequacy has the potential to restrict or negatively influence all aspects of their lives. Restricted access to material goods or restricted capacity for social participation can have significant flow on effects to other areas of life such as physical and mental health, educational outcomes and thus work opportunities.

In many ways, wider society is also a stakeholder in this issue. The consequences of poverty lead to greater public expenditure, particularly on healthcare and the justice system, as well

¹⁵ According to Stats NZ..

¹⁶ HEDI is household total income, net of tax, adjusted to allow comparison of income adequacy between households with different composition. This involves an equivalence factor that accounts for the number and age of household occupants and economies of scale. TAWA and official child poverty metrics use OECD equivalence, where $HEDI = DI/(1+0.5*(N_GTE14-1) + 0.3*N_LT14)$. It is essentially a per-person, disposable income where the first person 14 or older counts as 1 person, subsequent people 14 or older count as 0.5 and each child under 14 years counts as 0.3.

¹⁷ According to Stats NZ.

¹⁸ According to Stats NZ.

¹⁹ Note that the AHC50 poverty measure is fixed-line (the median HEDI is calculated using the 2017/18 base financial year then adjusted for CPI inflation up to the financial year in which poverty is being measured), whereas the BHC50 poverty measure is moving-line (the median HEDI is calculated using the financial year in which poverty is being measured).

²⁰ According to Stats NZ.

as the loss of potential tax revenue. Although increased expenditure on welfare may appear to negatively impact the taxpayer, reductions in poverty rates will lead to savings in other areas.

Disproportionally affected groups

Māori, Pacific people, people with disabilities and women are overrepresented in low-income earners and evidence indicates these groups are likely to be among the hardest hit by COVID-19 economic impacts. Māori and Pacific women in particular are over-represented in low-wage employment as well as casual, temporary and other forms of insecure employment. COVID-19 has only exacerbated the situation for these groups, who are also more likely to be in industries impacted by COVID-19 restrictions. Women with caring responsibilities, especially sole parents, are also exposed to the adverse effects of economic recessions that can lock in long-term unemployment and poverty (including in-work poverty) and lead to increased rates of child poverty.

Changes to the FTC considered in this RIS provide increases to families with the lowest incomes. They are therefore likely to disproportionately benefit Māori, Pacific people and women.

Another key consideration is the impact of any solutions specifically on children. Contributing to child poverty reduction is one of the main objectives of the WFF scheme. Better targeting of WFF aims to increase the income adequacy of families in which the most vulnerable children live, and greater work incentives help to provide pathways for families out of poverty. This may include increased opportunities for their children as they move into education and work. Research indicates people who come onto benefits before the age of 20 are more likely to stay on benefit longer.

Option to pass on FTC increase to other caregivers population - (Oranga Tamariki comment)

There are around 15,000 families caring for around 24,000 children supported by the OB, UCB, and FCA. Around half of caregivers outside of the State care system (6,000 families) are earning less than \$43,000.

Targeting the problem

The eligibility criteria of the WFF tax credits are designed to target support to low- and middle-income families through income thresholds at which entitlements begin to abate. Out of these, the FTC best targets families experiencing poverty and income inadequacy as it is not linked to work or benefit status.

The changes to the FTC rate and abatement rate that are considered in this RIS are redistributive options within the WFF scheme. Ministers have indicated that changes to WFF should be a primary lever to help meet child poverty reduction targets. The options are aimed at more effectively targeting WFF payments to support lower income families and to reduce child poverty.

An increase in the base FTC rate is most closely aligned to the WFF review's objective of supporting low income working families, while a change to the abatement rate is more closely aligned to the objective of targeting financial assistance rather than providing more universal support.

What objectives are sought in relation to the policy problem?

The three primary objectives to be considered for any policy changes to WFF are to:

1. Improve income adequacy for beneficiaries and low-income people
2. Improve financial incentives to work
3. Pay welfare support at a sustainable cost to government

These objectives must be considered when evaluating any proposed changes to WFF along with any more specific objectives that are being sought in relation to a particular proposal or set of proposals.

1. Improving income adequacy for beneficiaries and low-income people

While recent changes to the welfare system (including the Families Package, the \$25 increase to main benefits on 1 April 2020 and the indexation of main benefits to average wage) will help to improve the living standards of low-income people, income adequacy and child poverty issues remain. Any changes to the WFF should have a net positive impact on these issues, particularly as these credits are an important tool with which to meet the Government's child poverty targets.

2. Improving financial incentives to work

Improving financial incentives to work will encourage people who are able to work to seek employment. For most people, paid work is a key means of achieving improved wellbeing. However, financial incentives are only one (and not necessarily the most important) of many factors that influence people's decisions on whether, or how much, to work.

3. Paying welfare support at a cost that is sustainable to government

The Government is required to act and pursue its policy objectives in accordance with the principles of responsible fiscal management as set out in the Public Finance Act 1989, such as managing fiscal risks facing the government, having regard for the impact on present and future generations and ensuring the Crown's resources are managed effectively and efficiently.

Any changes proposed in this RIS must be at a sustainable cost to government, particularly given the current tight fiscal environment following the range of initiatives implemented by the Government in response to COVID-19.

The iron triangle

These three objectives make up the "iron triangle" of trade-offs inherent to income support. It is generally possible to achieve two of the three objectives for any given policy change, but not all three.

The current WFF review

Income Support Ministers have agreed, and Cabinet has noted, that the current review of WFF should focus on:

- income support for low-income working families, while maintaining support for beneficiary families
- targeting support more to lower-income families rather than more universal support
- considering the principle of making work pay and assisting with the costs for people in work.

Ministers also agreed, following initial advice, that options for phase one must be modest-cost. Ultimately, Ministers narrowed the fiscal envelope of the final options analysed in this RIS to between \$50 -100m.

Although these review objectives maintain the original objectives, their focus on targeting and the modest fiscal envelope indicate that objective 3 (to pay welfare support at a sustainable cost to government) is a priority. As phase one's scope is limited to options which improve income adequacy and child poverty, objective 1 (to improve income adequacy for beneficiaries and low-income people) must also be a priority. Therefore, options have been designed to fulfil objectives 1 and 3, even if that comes at the expense of objective 2 (to improve financial incentives to work).

Section 2: Deciding upon an option to address the policy problem

What scope will options be considered within?

Options were presented in two stages: initial and final. Subsequent to the confirmation of the WFF review objectives in April 2021 and the setting of the second set of three-year child poverty targets in June 2021, the scope for initial options was defined as modest-cost options for Budget 2022 that increase and redistribute support to low-income families.

After analysing initial advice, Ministers narrowed the scope for final options. The following table summarises the factors considered by Ministers in initial advice and their decisions on the scope for final options. These are discussed in more detail below.

	Scale of package	Approach to abatement
Link to criteria	Fiscal cost Impacts on child poverty	Impacts on work incentives Impacts on future reform
Options canvassed in initial advice	A range of options for an FTC increase were presented to Ministers ranging from a \$5 to \$15 per child increase. The options were broadly grouped into low cost (\$50-\$200m p.a.), and high cost (\$200-\$400m p.a.). The larger increases to the FTC had greater impacts on child poverty.	There were three broad sets of approaches to abatement explored: <ul style="list-style-type: none"> - Modest two-tier structure - Sharper two-tier structure - One-tier abatement structure
Constraints from Ministers for final advice	As a result of initial advice, Ministers agreed the following constraints around the scale of the package : <ul style="list-style-type: none"> - Modest increases to the rates of FTC - Cost around \$50 - \$100 million per year - reduce child poverty 	As a result of initial advice, Ministers agreed the following constraints on the approach to abatement : <ul style="list-style-type: none"> - retain a single abatement threshold at the current level of \$42,700 - minimise the number of losing families, particularly for those with incomes below \$100,000 per year.

Initial advice on options for phase one

An initial, broader series of options for phase one was presented to Ministers in the 17 September *Working for Families Review: update and options for Budget 2022* report. These options included:

- a redistributive package focused on changes to the FTC
- and concurrently

s 9(2)(f)(iv)

The redistributive package

Options for the redistributive package included \$5, \$7.50, \$10 and \$15 FTC rate increases combined with a series of abatement rate and threshold options that included the possibility of introducing a second tier of abatement threshold. The details of these options and their outputs (modelled by TAWA) are outlined in the table below.

Option	FTC increase		Children lifted from poverty		Two tier abatement approach			Single tier abatement approach		
	FTC increase above CPI	FTC increase with CPI (eldest & subs. child)	BHC50 ²¹	AHC50 ²²		Second abatement threshold	Second abatement rate		Abatement threshold	Abatement rate
Lowest cost (\$60-90m)	\$5	\$11.71 and \$10.42	5,000	7,000-8,000	A	\$60,000	29%	C	\$42,700	27%
						\$65,000	31%		\$45,200	29%
					B	\$75,000	33%			
						\$75,000	35%			
Lower cost (\$130-170m)	\$7.50	\$14.21 and \$12.92	7,000-8,000	11,000 - 12,000	A	\$60,000	29%	C	\$42,700	27%
						\$65,000	31%		\$45,200	29%
					B	\$75,000	33%			
						\$75,000	35%			
Higher cost (\$200-240m)	\$10	\$16.71 and \$15.42	11,000-13,000	15,000-16,000	A	\$60,000	29%	C	\$42,700	27%
						\$65,000	31%		\$45,200	29%
					B	\$75,000	33%			
						\$75,000	35%			
High cost (\$360-400m)	\$15	\$21.71 and \$20.42	16,000-17,000	22,000-23,000	A	\$60,000	29%	C	\$42,700	27%
						\$65,000	31%		\$45,200	29%
					B	\$75,000	33%			
						\$75,000	35%			

Ministers were advised that:

- The single-tier options redistribute funding from a much broader range of middle-higher income families and have a more modest impact on EMTRs.
- The two-tier options redistribute funding from a smaller group of comparatively higher income families, and a significant increase in EMTRs is concentrated within this group.
- Some of the impacts on work incentives created by the options in this paper could potentially be mitigated by further changes progressed as part of phase two of the review. However, such options may turn out to be limited if fiscal, operational, or other constraints arise in the intervening period, and some of the more expensive options in this paper may limit ‘headroom’ for further WFF reform.

²¹ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

²² The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

Options that increase the FTC rate by \$10 or \$15 and most of the \$7.50 increase options have the greatest impact on child poverty but are also relatively higher cost. Ultimately, Ministers ruled these out.

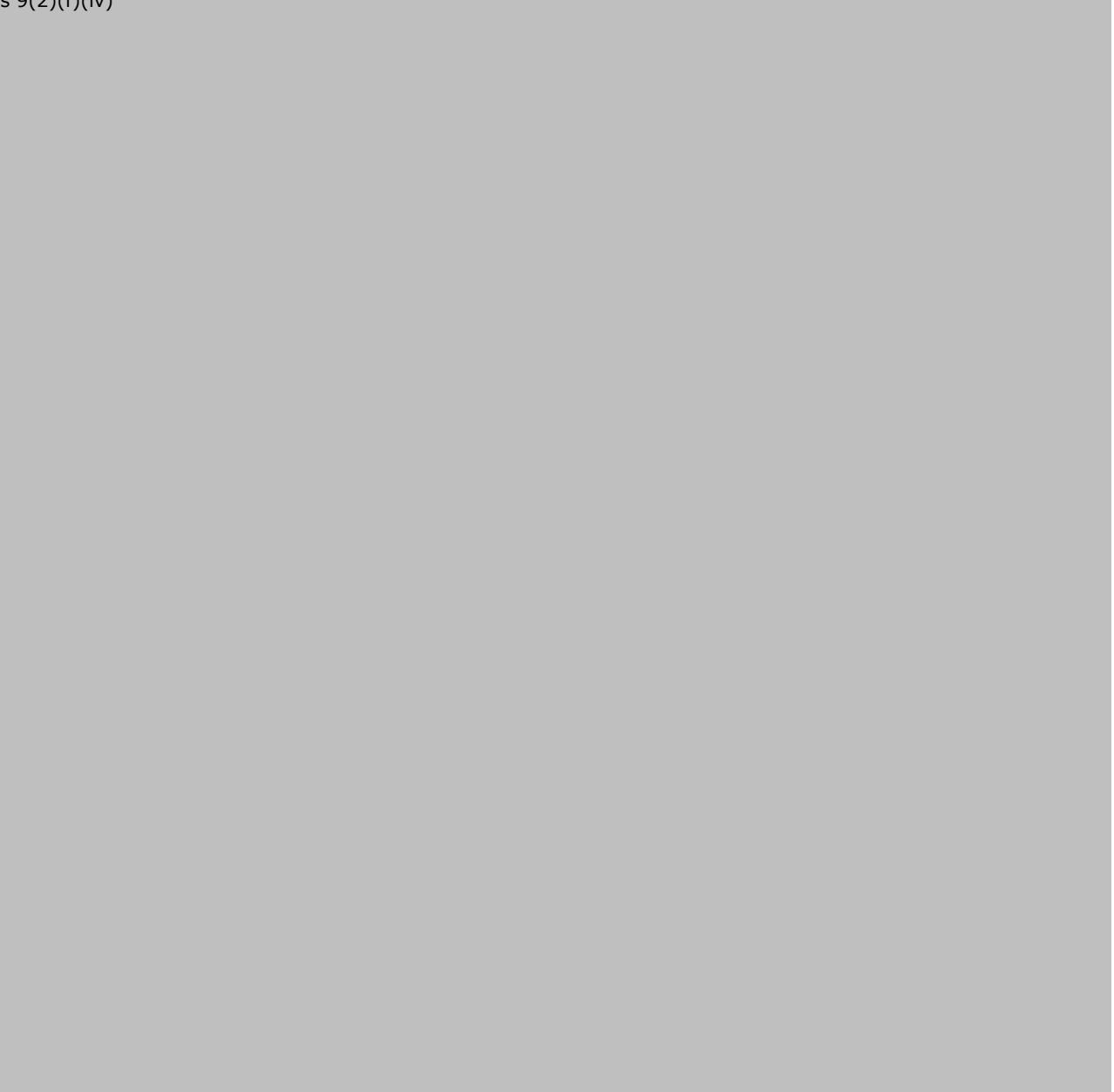
Options that change the existing WFF abatement threshold or which introduce a second WFF abatement threshold are more significant structural changes that could pre-empt the work that will take place in phase two. They often resulted in high increases to EMTRs and a significant number of losers. These options were also ruled out by Ministers.

Most of the options that were progressed in the *Working for Families Review: further advice on options for Budget 2022* (A2, A3 and B) were chosen for their lower fiscal cost, minimal impact on EMTRs and relative simplicity. Although option A1 was outside of the fiscal envelope Ministers outlined for options in this stage of advice, it was included to allow for comparison with an option that did not tighten targeting.

Concurrent options

The following options were presented to Ministers as part of initial advice alongside the redistributive package.

s 9(2)(f)(iv)



s 9(2)(f)(iv)

Subsequent advice to Ministers on final options for phase one

Following the first round of advice, Ministers requested further advice on Budget 2022 options which:

- have modest increases to the rate of FTC
- cost around \$50 - \$100 million per year
- retain a single abatement threshold at the current level of \$42,700
- reduce child poverty
- minimise the number of losing families, particularly for those with incomes below \$100,000 per year.

This commissioning, combined with timing considerations, has limited options to minor increases to the FTC rate and changes to the WFF abatement rate. Phase one will also include the annually required MFTC threshold increase to reflect 2022 increases in benefit rates.

The options canvassed for phase one of the review are Budget sensitive, meaning that no stakeholder engagement has taken place (other than with other government agencies).

No in-depth review of international literature has taken place in relation to the options in this RIS. This is due to timing constraints and that the options considered consist of simple changes to rates within the existing WFF regime, rather than substantive policy changes.

Non regulatory options have not been considered because financial transfers from government need appropriation, which requires legislative authority.

What criteria will be used to compare final options to the counterfactual?

Fiscal cost

Ministers prefer options of \$100m or less, in line with the modest fiscal envelope available for phase one of the review. This limits the impact of options on the criteria of child poverty and work incentives.

Impacts on child poverty

These will be measured using fixed line AHC50²³ and BHC50.²⁴ Options which have greater reductions in the number of children in AHC50 and BHC50 poverty are preferred. Options should not be so tightly targeted that they push more children into poverty or deepen the poverty of those already under the line.

Impacts on work incentives

The impact of these proposals on financial incentives to work are considered. These will be measured using EMTRs, which are incentives to earn an additional dollar, and participation tax rates (PTRs) which are incentives to enter employment. Ministers have indicated they prefer options that will not significantly increase already high EMTRs.

Impacts on future reform

Changes should not be so substantial that they limit the scope of options available for Ministers to consider through phase two of the review.

Weighting

The fiscal cost and child poverty impact criteria will be given the highest weighting as they are prioritised in this phase of the review. Incentives to work will be addressed in phase two of the review.

²³ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

²⁴ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

What options are being considered?

The counterfactual

Currently, the FTC rates are \$113 p/w (\$5,878 p/a) per eldest child and \$91 p/w (\$4,745 p/w) for each additional child. For every dollar of income a family earns above \$42,700, they will lose 25c of their annual FTC entitlement.

Under the status quo, FTC and BSTC rates are increased by a corresponding amount once cumulative increases to CPI (since the rates were last increased) reach 5%. This is forecast to trigger increases in FTC and BSTC rates for the income year starting 1 April 2022.

All options considered in phase one of the review would be effective from 1 April 2022, coinciding with the CPI indexation increases to the FTC and BSTC rates. Therefore, the impact of these options has been modelled both including and excluding the impact of counterfactual indexation to demonstrate what customers will experience and the real value of the options themselves respectively.

Because modelling took place ahead of time, officials do not know the final rate of CPI inflation up to April 2022. Therefore, all outputs relating to counterfactual indexation were calculated using the CPI increases forecast in the 2021 BEFU. Thus, all outputs that include the impact of (forecast) counterfactual indexation are subject to change.

CPI measure – remedial amendment

A CPI remedial amendment, updating the CPI measure used in the FTC and BSTC CPI indexation provisions of the Income Tax Act 2007, will be required. Legislation currently requires FTC and BSTC rates to be increased in line with cumulative increases to all groups of the CPI excluding tobacco and cigarette products (CPIX). However, Cabinet only intended the exclusion of tobacco to last the duration of the 10% annual increases to tobacco excise taxes, the last of which took place in 2020 (CAB-16-MIN-0189). Therefore, the remedial amendment would return FTC and BSTC indexation to CPI (all groups) from quarter 1 of 2021. Although increases measured by CPI (all groups) are slightly different than under CPIX, the remedial amendment is not expected to materially change the fiscal impact of the FTC and BSTC indexation increases. This remedial is considered part of the counterfactual for analysis of the options in phase one of the WFF review.

Annual MFTC adjustment

The purpose of the MFTC is to ensure that families who are in-work and off-benefit are financially better off than they would be on a benefit. This is done by “topping-up” families’ earned income to a prescribed level (the MFTC threshold) that is higher than what their income could be when on a benefit. This intends to incentivise sole parent families with children to move off-benefit and into greater amounts of paid work.

If the MFTC threshold is not adjusted in line with benefit changes, the policy objective would not be met. Therefore, the MFTC threshold should be adjusted to reflect increases to main benefit rates (which are indexed to wage growth) that will take place under the status quo.

In April 2021, Cabinet agreed to an April 2022 increase in the MFTC threshold to reflect increases in main benefits [Cab-21-Min-0116].

Forecast changes to the MFTC threshold are summarised in the table below. Changes to the FTC rate or WFF abatement rate will not impact the MFTC threshold.

Tax year	1 April 2022	1 April 2023	1 April 2024	1 April 2025
MFTC threshold	\$32,864	\$33,280	\$33,644	\$34,112

Adjustments to the MFTC threshold are not being considered as part of phase one of the WFF review and are therefore not analysed further.

Options A and B

The following make up the final options that were presented to Income Support Ministers for phase one of the WFF review:

- A1: \$5 FTC increase and no abatement change
- A2: \$5 FTC increase and 26% abatement rate
- A3: \$5 FTC increase and 27% abatement rate
- B: \$7.50 FTC increase, 28% abatement rate

Each of these options is mutually exclusive but all would take place on top of the indexation changes anticipated in the counterfactual.

The impacts of these options are outlined below. All outputs, except the settings (produced by Inland Revenue), have been produced using Treasury's TAWA model.

Settings

The following table demonstrates what the WFF settings would look like in April 2022 under each option. The status quo FTC and BSTC rates have increased from current settings due to indexation. All amounts are annual.

Scenario	FTC eldest child	FTC subsequent child	IWTC per family	IWTC extra child	WFF abatement rate	BSTC	MFTC
CF	\$6,227	\$5,027	\$3,770	780	25%	\$3,306	\$32,864
A1	\$6,487	\$5,287	\$3,770	780	25%	\$3,306	\$32,864
A2	\$6,487	\$5,287	\$3,770	780	26%	\$3,306	\$32,864
A3	\$6,487	\$5,287	\$3,770	780	27%	\$3,306	\$32,864
B	\$6,617	\$5,417	\$3,770	780	28%	\$3,306	\$32,864

Child poverty impacts

The following tables demonstrate the reduction in child poverty that would take place under each scenario when measured against the AHC50²⁵ and BHC50²⁶ poverty thresholds. As TAWA modelling assumes full take up, results will overestimate the number of families impacted. Some numbers may seem not to correspond due to rounding.

²⁵ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

²⁶ The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

Scenario	Population (,000) with income below the AHC50 poverty threshold		Difference (,000) from counterfactual	
	Families ²⁷	Children ²⁸	Families	Children
CF	323	160	-	-
A1	320	151	-4	-9
A2	320	151	-4	-9
A3	320	152	-3	-8
B	319	150	-4	-10

Scenario	Population (,000) with income below the BHC50 poverty threshold		Difference (,000) from counterfactual	
	Families ²⁹	Children ³⁰	Families	Children
CF	183	92	-	-
A1	181	87	-3	-5
A2	181	87	-3	-5
A3	181	87	-3	-5
B	179	84	-4	-7

Option B, with its greater weekly increase of \$7.50, has the greatest positive impact on child poverty measured by either threshold. When measuring against AHC50, option A3, which combines the smaller increase of \$5 with a 2% abatement rate increase, has the smallest positive impact on child poverty. When measuring against BHC50 options A1-3 appear to have the same impact.

Fiscal impact

The following table breaks down the annual fiscal impact of each option by source. Although the FTC is the only payment rate which would change, the interlinked abatement and eligibility settings of social assistance payments mean these increases have flow-on effects to the accommodation supplement (AS), the IWTC and the IETC.

Option	Total (\$m)	AS (\$m)	FTC (\$m)	IWTC (\$m)	IETC (\$m)
A1	\$158	-\$3	\$143	\$20	-\$1
A2	\$111	-\$3	\$115	-\$1	\$0
A3	\$68	-\$3	\$90	-\$20	\$1
B	\$103	-\$5	\$136	-\$29	\$1

Option A1 has the greatest fiscal cost as, although it consists of the smaller \$5 increase, it offsets none of the extra cost with increased targeting (abatement). This means expenditure will be spread higher up the income scale. Option A3 has the smallest cost as it offsets the costs of its payment rate increase with a 2% abatement rate increase, more tightly targeting expenditure. Although option B has the highest payment rate increase of \$7.50, the fiscal cost of this is partially offset by the largest abatement rate increase of 3%.

²⁷ Out of the 2,691,000 families in New Zealand.

²⁸ Out of the 1,155,000 children in New Zealand.

²⁹ Out of the 2,691,000 families in New Zealand.

³⁰ Out of the 1,155,000 children in New Zealand.

Winners and losers

The following table summarises the average gains and losses and the total winners and losers seen under each option. Results are presented both including and excluding the impact of counterfactual indexation.

Option	FTC increase per child		Abatement rate	Gains and losses for households (excluding CPI indexation)				Gains and losses for households (including CPI indexation)			
	Rate change	Total with CPI (eldest & subs. child)		Winners	Average gain	Losers	Average losses	Winners	Average gain	Losers	Average losses
A1	\$5	\$11.71 and \$10.42	25% (No change)	316,000	\$10	S	S	345,000	\$20	S	S
A2	\$5	\$11.71 and \$10.42	26%	287,000	\$8	26,000	-\$1	340,000	\$18	S	S
A3	\$5	\$11.71 and \$10.42	27%	223,000	\$8	89,000	-\$6	330,000	\$16	8,000	-\$1
B	\$7.50	\$14.21 and \$12.92	28%	223,000	\$12	89,000	-\$8	309,000	\$20	27,000	-\$3

To assess the targeting of the gains and losses of these options these results have been modelled by income distribution. The following graphs are divided by their exclusion or inclusion of the impacts of counterfactual indexation and by their income measure in the following order:

- Exclusion of counterfactual, by taxable income
- Exclusion of counterfactual, by HEDI³¹
- Inclusion of counterfactual, by taxable income
- Inclusion of counterfactual, by HEDI

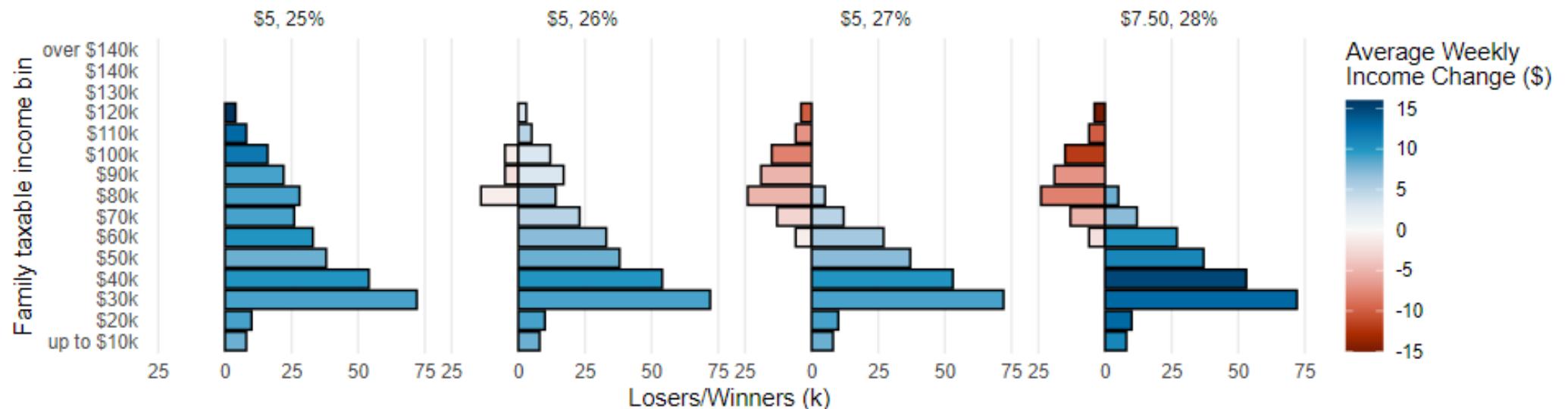
Graphs excluding the impacts of counterfactual indexation will demonstrate the real value of each option versus doing nothing. Graphs including these impacts will demonstrate what customers will experience if one of these options is introduced alongside indexation in April 2022.

Graphs using taxable income band demonstrate the actual income available to families who are experiencing the gains or losses. Graphs using household equivalised disposable income (HEDI) adjust income for household size. This removes anomalies seen in taxable income graphs where greater average gains appear to be received by higher income bands when this is merely a result of larger families receiving greater entitlements to meet their greater needs.

³¹ HEDI refers to Household Equivalised Disposable Income which is household total income, net of tax, adjusted to allow comparison of income adequacy between households with different composition. This involves an equivalence factor that accounts for the number and age of household occupants and economies of scale. TAWA and official child poverty metrics use OECD equivalence, where $HEDI = DI / (1 + 0.5 * (N_{GTE14-1}) + 0.3 * N_{LT14})$. It is essentially a per-person, disposable income where the first person 14 or older counts as 1 person, subsequent people 14 or older count as 0.5 and each child under 14 years counts as 0.3.

Impacts excluding counterfactual indexation, by taxable income

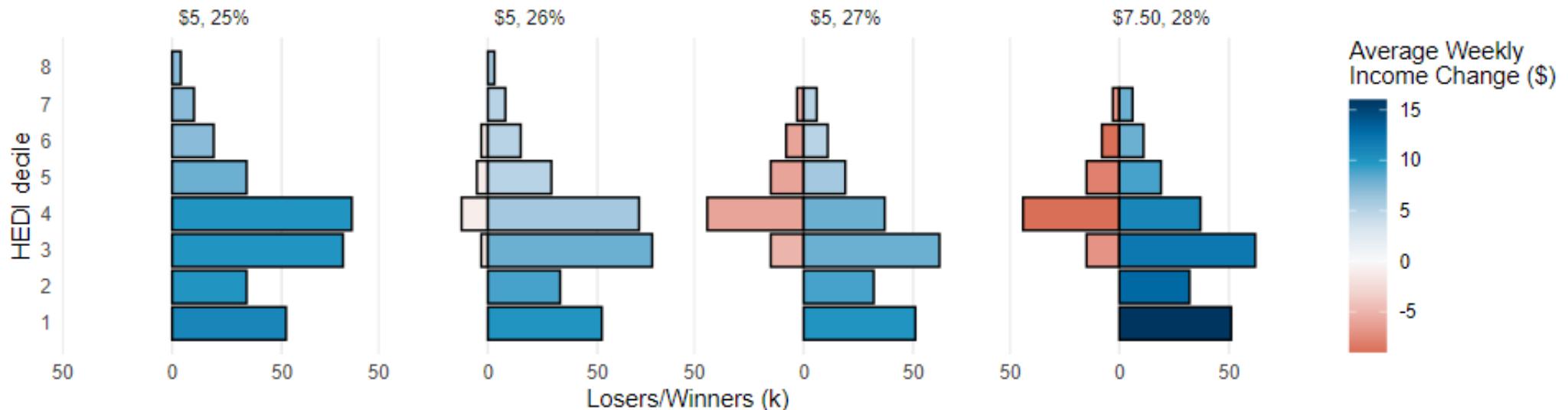
Options are in order from A1 on the left to B on the right.

Family winners and losers not including indexation

A1 is the only option without losers as it is the only option that does not increase targeting through abatement rate increases. However, A1's greatest weekly increases appear to be in the highest income bands. This may be because families who are receiving the FTC with higher incomes have multiple children, and therefore they would receive the \$5 increase per child per week. Option B creates the greatest weekly gains, albeit with the greatest losses. However, the gains are targeted to benefit low-income families, with increases averaging from \$11 to \$15 p/w in the \$0-60k income bands while losses only occur for families earning \$60k or more a year.

Impacts excluding counterfactual indexation, by HEDI

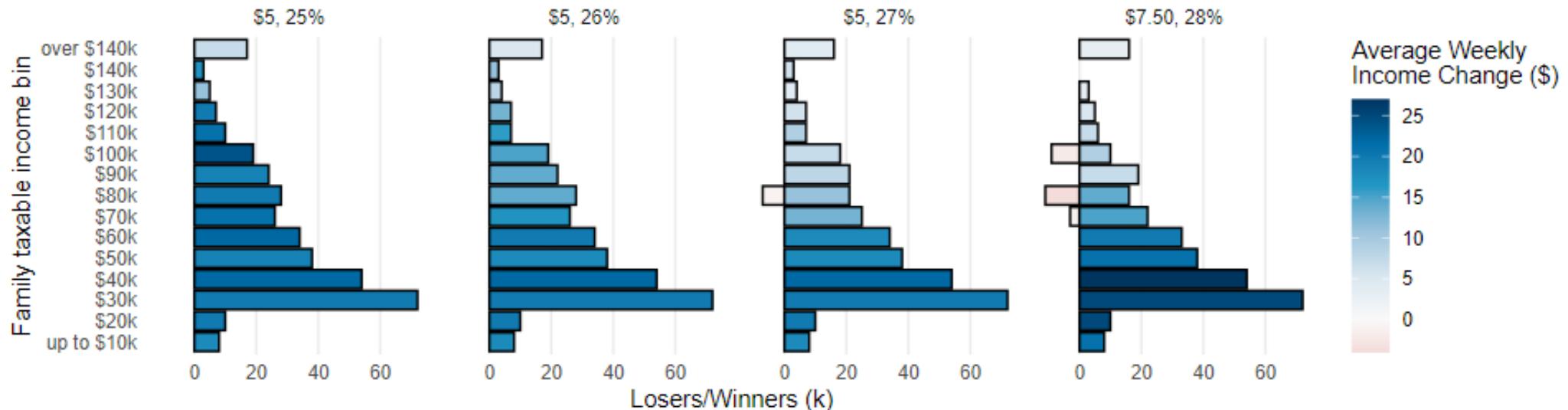
Household winners and losers not including indexation



Measuring by HEDI demonstrates that, despite what the previous graph might imply, option A1 provides the greatest gains (\$10 to \$11 p/w) to families with the greatest need. However, it still spreads expenditure higher up the income bands than other options as it is not combined with an abatement rate increase. This makes it less effectively targeted than the other options as a smaller proportion of its (much larger) fiscal cost is concentrated towards lifting children out of poverty. However, this less targeted expenditure will still be beneficial to other low- and medium-income families as it will improve their income adequacy.

Impacts including counterfactual indexation, by taxable income

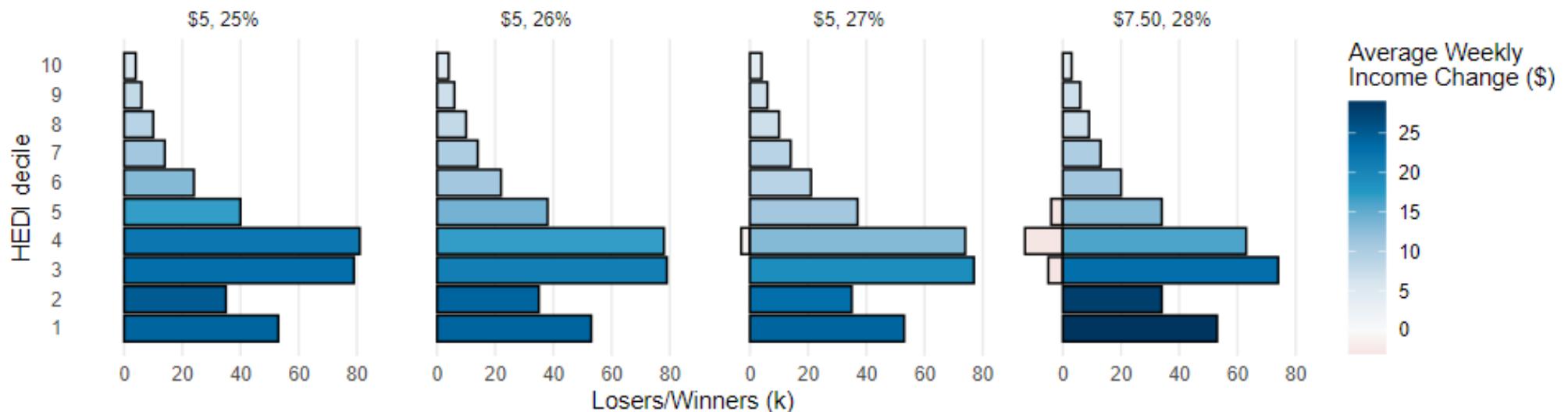
Family winners and losers including indexation



When options are combined with counterfactual indexation very few customers experience losses. Similar to the results in the previous graphs, option B produces the largest weekly increases (from \$20 to \$27 p/w) for families in the bottom income bands (\$0-60k) while options A2 and A3 produce lower increases (\$18 to \$22 p/w for the same bands). Although option B still produces some losers in the >\$60k income bands, on average customers in these bands experience increases of \$3 to \$15. When combined with indexation, option A1 produces average gains of around \$20 p/w spread reasonably evenly across income bands.

Impacts including counterfactual indexation, by HEDI

Household winners and losers including indexation



As was also demonstrated by the previous HEDI graph, most of the expenditure for each option will be concentrated in families with the greatest need. Although A1 (when combined with indexation) appeared to provide a total average gain of \$20 when measured by family taxable income, when measured by HEDI, the first four deciles see average gains of \$22 to \$25 p/w with \$6 to \$17 gains in the upper deciles. The targeting of option B also appears tighter when measured by HEDI, with average gains of \$23 to \$29 pw in the first three deciles and \$4 to \$16 in the higher deciles. However, this graph does raise concern that option B creates losers in the low- to middle-income deciles of 3, 4 and 5.

Work incentive impacts

The impact each option would have on a family's total income has been modelled to assess how the changes affect EMTRs³² and PTRs³³ at different hours of work for different family types. The three example families are a sole parent, a couple with one earner and a couple with two earners. The

³² How much of each extra dollar of income an individual will lose to tax, levies and abated social assistance.

³³ How much of the income received when entering work an individual will lose to tax, levies and abated social assistance.

examples assume each family has two children aged 2 and 5, has weekly rental costs of \$500 and receives Accommodation Supplement (area 1) if eligible, earns \$20 per hour, and pays ACC levy.³⁴

The following table outlines the impact of the options on income and work incentives.³⁵

Option	Impact		Sole parent	Couple with one earner	Couple with two earners ³⁶
	On income	By hours worked			
CF (excluding indexation)	Income after taxes and rental costs ³⁷	20	\$731.06	\$742.02	\$939.66
		40	\$767.88	\$775.62	\$1046.27
A1 (\$5 FTC, 25%)	Income gain from work at	0-10 hours	\$150.22	\$134.22	\$96.98
		10 to 20 hours	\$99.77	\$19.05	\$67.07
		20 to 40 hours	\$36.82	\$33.60	\$106.60
	Income change from CF	20	\$9.10	\$9.10	\$9.10
		40	\$9.10	\$9.10	\$9.10
	Change to EMTRs and/or PTRs	None	None	None	None

³⁴ These example families are for illustrative purposes only. The assumptions around rental costs follow the approach used by the WEAG; they assumed the families used were based in Manurewa, South Auckland (Accommodation Supplement Area 1), and that the families were paying rent in the lower quartile. As at September 2021, lower quartile rent for Manurewa is \$500 per week.

³⁵ All data in the following table is taken from TAWA excluding PTR's which are taken from Inland Revenue internal data.

³⁶ Assumes that the primary earner works a fixed amount at 40 hours at \$20 per hour, and the second earner earns \$20 per hour.

³⁷ Status quo refers to 1 April 2022, post-CPI indexation.

A2 (\$5 FTC, 26%)	Income gain from work at	0-10 hours	\$150.22	\$134.22	\$96.30
		10 to 20 hours	\$99.77	\$18.80	\$62.07
		20 to 40 hours	\$36.82	\$32.73	\$102.60
	Income change from CF	20	\$9.10	\$8.84	\$5.29
		40	\$9.10	\$7.97	\$1.29
	Change to EMTRs and/or PTRs		This option would minimally increase EMTRs by 1% beyond 40.95 hours of work once \$66,956 of net income is exceeded.	This option would minimally increase EMTRs by 1% beyond 42.25 hours of work once \$66,993 of net income is exceeded.	This option would increase EMTRs by 1% between 2.25 hours and 56.44 hours of work once \$67,157 of net income is exceeded. Similarly, this option would increase PTRs by around 1% for the second earner entering the workforce.
A3 (\$5 FTC, 27%)	Income gain from work at	0-10 hours	\$150.22	\$134.22	\$95.61
		10 to 20 hours	\$99.77	\$18.54	\$63.07
		20 to 40 hours	\$36.82	\$31.86	\$98.60
	Income change from CF	20	\$9.10	\$8.58	\$1.48
		40	\$9.10	\$6.84	-\$6.52
	Change to EMTRs and/or PTRs		This option would increase EMTRs by 2% beyond 40.95 hours of work once \$66,956 of net income is exceeded.	This option would minimally increase EMTRs by 2% beyond 42.25 hours of work once \$66,979 of net income is exceeded.	This option would increase EMTRs by 2% between 2.25 hours and 54.35 hours of work once \$67,143 of net income is exceeded. This option would increase PTRs by around 2% for the second earner entering the workforce.

B (\$7.50 FTC, 28%)	Income gain from work at	0-10 hours	\$150.22	\$134.22	\$94.93
		10 to 20 hours	\$99.77	\$18.28	\$61.07
		20 to 40 hours	\$36.82	\$30.99	\$94.60
	Income change from CF	20	\$13.65	\$12.88	\$2.22
		40	\$13.65	\$10.26	-\$9.79
	Change to EMTRs and/or PTRs		This option would increase EMTRs by 3% beyond 40.95 hours of work once \$67,193 of net income is exceeded.	This option would increase EMTRs by 3% beyond 42.25 hours of work once \$67,202 of net income is exceeded.	This option would increase EMTRs by 3% between 2.25 hours and 53.55 hours of work once \$67,366 of net income is exceeded. This option would increase PTRs by around 3% for the second earner entering the workforce.

This table demonstrates that the options have minimal or no impacts on work incentives due to the minor nature of their increases to the abatement rate. Option A1 will have no impact on work incentives and options A2, A3 and B will not impact the work incentives for a single earner family working full time on minimum wage.

However, options A2, A3 and B will impact families with higher wages and secondary earners in low-income households. They will have a minor (1-3%) impact on the EMTRs of single earner families who cross the abatement threshold (i.e. who earn above minimum wage). They will also impact the participation tax rate of secondary earners who already have very low work incentives, although this impact will also be limited to a 1-3% increase.

Overall, the increase in EMTRs is minimal and therefore unlikely to materially impact financial incentives to work.

Cumulative impact of changes

However, consideration should be given to the accumulation of abatement rate changes over time. For example, as part of the Families Package changes in 2018, the WFF abatement rate increased from 22.5% to its current 25% setting. When WFF was first introduced (between 2004 and 2007), the abatement rate was 20%. These changes, particularly when considered with the Ministers' preferred option, represent a significant increase in abatement rate in a relatively short period.

Distributional impacts

These options are targeted towards low-income families (beneficiary or otherwise) receiving the FTC. Modelling has taken place for their impact on families in different income bands (all positive for those earning <\$60k annually³⁸) and children in poverty (all positive) but not for other specific groups such as Māori, women, or those with disabilities.

It is likely that there will be a disproportionate impact on Māori when any changes are made within the tax and transfer system because they are over-represented in the benefit system. As at November 2018, Māori made up 15% of the New Zealand population, but 36% of benefit recipients (Welfare Expert Advisory Group 2018 Welfare System: statistics).

The impact of the options on other groups may be proportionate to their representation in the target group of low-income families. Inland Revenue cannot model these impacts as it does not collect data on gender, ethnicity, or disability. Time constraints have further limited the ability to access and analyse relevant data that may be held by external sources.

Option to pass on FTC increase to other caregivers – distributional impacts (Oranga Tamariki comment)

Passing on the FTC increase to the rates of the OB, UCB and FCA would also impact children and Māori - There are around 24,000 children being cared for by around 15,000 caregivers, both inside and outside of the State care system. Over half of children living with caregivers are Māori, and a significant proportion of their caregivers are also Māori.

Stakeholder support

No stakeholder feedback is available for these options as they are budget sensitive. Previous feedback from the WEAG supports increases to the FTC with a preference for universalism over tight targeting which indicates that they would not be in favour of options which increase abatement rates (options A2, A3 and B).

Option to pass on an increase in FTC to other caregiver payments

There is also an option to pass on any increases to the FTC to rates of OB, UCB and FCA. There are around 24,000 tamariki being cared for by around 15,000 caregivers, both inside and outside of the State care system. Caregivers who received OB, UCB and FCA do not qualify for FTC for the same child. However, increases to FTC rates have resulted in commensurate increases to the base rates for OB, UCB and FCA in 2005, 2007 and 2018. Most recently OB, UCB and FCA rates were increased in July 2020 by \$25 per week, in line with increases to main benefits, to support caregivers against the impacts of COVID-19 and support placement stability.

³⁸ This reflects the impact of the options alone, without including the impact of counterfactual indexation.

Currently rates of OB, UCB and FCA are between \$89 and \$152 higher than the eldest child rate of FTC. This reflects the higher levels of support provided to caregivers who are caring for children when their parents are unable to, and reflects that caregivers receiving OB, UCB and FCA do not have access to some of the same supplementary assistance as other families, such as the dependent child rate of Accommodation Supplement.

The costs associated with passing on the FTC rate increase to other caregiver payments are summarised in the table below.

Increased base payment (\$,000s)	2021/22	2022/23	2023/24	2024/25	2025/26 & outyears	Forecast period Total	Average per annum
Increase of \$5	\$1,730	\$7,224	\$7,605	\$7,933	\$8,302	\$32,794	\$8,199
Increase of \$7.50	\$2,595	\$10,836	\$11,408	\$11,899	\$12,453	\$49,191	\$12,298

The payments made to caregivers are not taxable. The payments made are outside the WFF regime and they do not directly affect the WFF review phase one options considered in this RIS.

How do the options compare to the counterfactual?

	CF	A1 (\$5 FTC, 25%)	A2 (\$5 FTC, 26%)	A3 (\$5 FTC, 27%)	B (\$7.50 FTC, 28%)
Child poverty impact	0	+ <p>Modelling suggests that this option will lift 9,000 children from AHC50 poverty or 5,000 from BHC50 poverty.</p>	+ <p>Modelling suggests that this option will lift 9,000 children from AHC50 poverty or 5,000 children from BHC50 poverty.</p>	+ <p>Modelling suggests that this option will lift 8,000 children from AHC50 poverty or 5,000 children from BHC50 poverty.</p>	+ <p>Modelling suggests that this option will lift 10,000 children from AHC50 poverty or 7,000 children from BHC50 poverty. Of the options, this has the greatest impact on child poverty.</p>
Fiscal cost	0	- <p>This option has an estimated fiscal cost of \$158m for T22/23. It is the most expensive option and outside of Minister's preferred fiscal envelope.</p>	- <p>This option has an estimated fiscal cost of \$111m for T22/23.</p>	- <p>This option has an estimated fiscal cost of \$68m for T22/23. This is the least expensive option.</p>	- <p>This option has an estimated fiscal cost of \$103m for T22/23.</p>
Work incentive impact	0	0 <p>No impact</p>	- <p>Minor (maximum of 1% increase in EMTRs over an income threshold)</p>	- <p>Minor (maximum of 2% increase in EMTRs over an income threshold)</p>	- <p>Minor (maximum of 3% increase in EMTRs over an income threshold)</p>
Phase two impact	0	- <p>This option may limit the range of options available under phase two to a</p>	- <p>This option may limit the range of options available under phase two to a</p>	- <p>This option may limit the range of options available under phase two to a</p>	- <p>This option may limit the range of options available under phase two to a minimal degree</p>

		<i>minimal degree due to its fiscal cost (not design solution).</i>	<i>minimal degree due to fiscal cost and increase of the abatement rate.</i>	<i>minimal degree due to its fiscal cost and increase of the WFF abatement rate</i>	<i>due to its fiscal cost and increase of the WFF abatement rate</i>
Overall assessment		<i>This option improves child poverty without creating losers or decreasing work incentives. However, its fiscal cost is outside of the range set by Ministers.</i>	<i>Although this improves child poverty, it reduces fiscal cost at the expense of work incentives, phase two options and support for medium-income families.</i>	<i>Although this improves child poverty, it reduces fiscal cost at the expense of work incentives, phase two options and support for medium-income families.</i>	<i>Although this improves child poverty, it reduces fiscal cost at the expense of work incentives, phase two options and support for medium-income families.</i>

Key:

- ++** much better than doing nothing/the status quo/counterfactual
- +** better than doing nothing/the status quo/counterfactual
- 0 about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

The narrow scope for final options means all are essentially minor variations on the same changes (an increase in FTC rates and the WFF abatement rate). Consequentially, the differences between options are relatively minor. The minor nature of these differences increases the impact of the statistical uncertainty involved in modelling. This is particularly true of the child poverty impacts.

Option B lifts the greatest number of children from poverty: 10,000 when measured against AHC50 which is 1,000 more than the next best option (A1). At an annual cost of \$103m, option B also roughly meets the modest fiscal budget set for phase one due to its 3% abatement rate increase, which effectively targets the greatest support to those most in need.

However, although option B best fits Ministers' commissioning and most of their objectives, it has several drawbacks. Compared to the counterfactual, it makes losers of some medium-income families, and of all the options, it has the largest negative impact on EMTRs and PTRs which are already very high. It may also limit the range of options available under phase two of the review due to its 3% increase of the WFF abatement rate. Options A2 and A3 face the same issues to lesser degrees, but with lower child poverty impacts.

Option A1 increases support without changing abatement settings. This would lift 9,000 children from AHC50 poverty without creating losers or reducing incentives to work. However, option A1 has the largest annual fiscal cost of \$158m and therefore falls outside the fiscal cost parameters set by Ministers. The high fiscal cost may also potentially limit the range of options available under phase two of the review

What are the marginal costs and benefits of the option?

Ministers have indicated that they prefer option A3: a \$5 FTC increase and 27% abatement threshold.

All impacts of this option have been modelled using Treasury's TAWA which assumes full take-up and does not account for relationship changes. All outputs relate to the impact of the options excluding CPI indexation.

Option	Affected groups	Comment	Impact	Evidence Certainty
<u>Additional costs of the preferred option compared to taking no action</u>				
A3 (\$5 FTC increase, 27% abatement rate)	WFF recipients	<i>89,000 households will see a decrease in weekly income, compared to the counterfactual. This assumes full take-up</i>	Average weekly decrease of -\$6	Medium certainty as assuming full take-up impacts accuracy.
		<i>Increase in EMTRs of 2% above 42 hours at minimum wage³⁹</i>	Low	High
	The government	<i>Ongoing, annual fiscal cost. This assumes full take-up.</i>	\$68m	Medium certainty as assuming full take-up impacts accuracy.
	Total monetised costs	<i>Ongoing, annual fiscal cost. This assumes full take-up.</i>	\$68m	Medium certainty as assuming full take-up impacts accuracy.
		<i>Average weekly decrease in income</i>	-\$6	Medium certainty as assuming full take-up impacts accuracy.
	Non-monetised costs	<i>Increase in EMTRs and PTRs of 2% above 42 hours at minimum wage⁴⁰</i>	Low	High

³⁹ Once FTC/IWTC payments start to abate. This reflects the couple with one earner family type.

⁴⁰ Once FTC/IWTC payments start to abate. This reflects the couple with one earner family type.

<u>Additional benefits of the preferred option compared to taking no action</u>				
A3 (\$5 FTC increase, 27% abatement rate)	WFF recipients	<i>223,000 households will benefit from an ongoing, weekly increase in income. This assumes full take-up.</i>	Average weekly increase of \$8.	Medium certainty as assuming full take-up impacts accuracy.
	Children in poverty	<i>Although the rate increase is ongoing, we cannot predict the duration of its impact. Lifting the income of a child's family above a threshold does not guarantee that they will no longer suffer the effects of poverty or that their income will remain above the threshold permanently.</i>	8,000 children lifted out of AHC50 poverty or 5,000 out of BHC50 poverty.	Low. There are significant uncertainties with TAWA modelling for poverty metrics.
	Total monetised benefits	<i>223,000 households will benefit from an ongoing, weekly increase in income. This assumes full take-up.</i>	Average weekly increase of \$8.	Medium certainty as assuming full take-up impacts accuracy.
	Non-monetised benefits	<i>Although the rate increase is ongoing, we can not predict the duration of its impact. Lifting the income of a child's family above a threshold does not guarantee that they will no longer suffer the effects of poverty or that their income will remain above the threshold permanently.</i>	8,000 children lifted out of AHC50 poverty or 5,000 out of BHC50 poverty.	Low. Treasury warns that the uncertainties of TAWA modelling are particularly significant for poverty metrics.

Section 3: Delivering an option

How will the new arrangements be implemented?

The proposals would require amendments to the Income Tax Act 2007. The preferred option will be included in urgent primary legislation prior to December 2021. The proposed timeframe allows sufficient time for Inland Revenue and MSD to implement the necessary system changes.

Inland Revenue will be responsible for the implementation of the proposed changes, and as part of its business-as-usual function. MSD will be responsible for implementing the proposed changes for those who receive their WFF payments from MSD.

The new FTC rates and/or WFF abatement thresholds will be used to calculate recipients' entitlements from 1 April 2022 and will be reflected in the notices of entitlement that Inland Revenue sends to recipients from February as part of the annual 'rollover' process

How will the new arrangements be monitored, evaluated, and reviewed?

The effects of the proposed changes can be monitored using data Inland Revenue currently collects as part of administering WFF. This data includes the number of WFF recipients, the makeup of those families, the amount and type of payments made, and end of year assessment data on under and overpayments. This administrative data provides descriptive information about WFF recipients, and the actual fiscal cost to the Government of the chosen settings. MSD holds data about the WFF payments (FTC and Best Start) they make to main benefit recipients.

The agencies who are involved in the WFF review are currently discussing how any changes that are progressed as part of the broader WFF review will be evaluated.