



MINISTRY OF
SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora



Date: 12 December 2003

Security Level: Sensitive - Budget Secret

Report to: Minister of Finance and Revenue
Minister for Social Development and Employment

FUTURE DIRECTIONS: MEETING WITH JOINT MINISTERS 15 DECEMBER 2003

Executive Summary

- 1 You are scheduled to meet on Monday 15 December 2003 at 4pm to discuss the development of the Future Directions package.
- 2 We attach the following papers for this meeting:
 - Agenda
 - Annotated agenda
 - Agenda item papers
- 3 We consider that the main focus of this meeting should be on:
 - firming up the key parameters of the design of the new in-work payment (IWP) in particular
 - whether to introduce a work hours requirement for the IWP
 - the abatement regime for Family Support and the IWP
 - the shape of the IWP rate (flat rate or two-tier)
 - the level of Family Tax Credit

the issues presented here are framed in terms of Ministers' Preferred Future Direction Option (Option 16). The issues will equally apply to any scaled or other variants of that Option that emerge as the funding position becomes clearer. Discussion of these issues and "in principle" decisions now will facilitate final design and decisions on the final package.

- exploring approaches and options to the Special Benefit and Child Care issues with a view to coming back to these issues again in the New Year for decisions around firm options
- confirming the Housing Assistance proposals
- if time allows, discussing subsidiary IWP, Family Support issues and flow effects

4. There is potentially a lot of material to get through. We have sought to assist your decision-making by structuring the Annotated Agenda to highlight the key decisions needed at this meeting. We will prepare a minute to record your decisions from the meeting and circulate this through your advisers to ensure that you are comfortable with this as the basis for moving forward.

Future Work Programme and Meetings

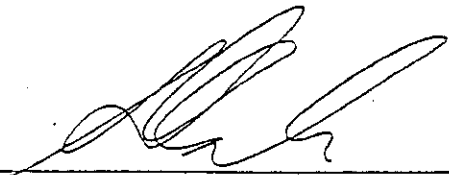
5. While we are making good progress in terms of working through the policy design issues, there are still a number of loose ends that will need to be tied up quickly in the New Year if we are to meet the Budget timetable. We understand that the Future Directions Budget bilateral is likely to be held in early March. We consider that we will need at least two further meetings with you in February to work through the outstanding issues – particularly in relation to Special Benefit and Child Care – so that you are in a position to take final decisions on the package at the bilateral in March and for the legislation to be prepared in time for introduction along with the Budget. We are concerned that we may not be leaving sufficient time for the drafting of legislation. This would normally start in late January.
6. We will come back to your offices after the Monday meeting with firm proposals for further meetings and a decision-making timetable.
7. We have consulted officials from the Department of Inland Revenue in the development of this report and the attached papers.

Recommended Actions

We recommend that you:


- 1 note that the key decisions needed at your meeting on Monday 15 December are outlined in the attached Annotated Agenda
- 2 note that we propose that the focus of this meeting be on:
 - 2.1 firming up the key parameters of the design of the new in-work payment (IWP) in particular
 - o whether to introduce a work hours requirement for the IWP
 - o the abatement regime for Family Support and the IWP
 - o the shape of the IWP rate (flat rate or two-tier)
 - o the level of Family Tax Credit
 - 2.2 exploring approaches and options to the Special Benefit and Child Care issues with a view to coming back to these issues again in the New Year for decisions around firm options
 - 2.3 confirming the Housing Assistance proposals
 - 2.4 if time allows, discussing subsidiary IWP, Family Support issues and flow effects.

3. note that officials will provide a timetable of further meetings over February/March after the meeting on Monday.



Sue Mackwell
Manager, Social Assistance Policy
Sector Policy

12/12/03
Date



Paul Clarke
for Secretary to the Treasury

12/12/03
Date

Steve Maharey
Minister for Social Development and
Employment

Date

Hon Dr Michael Cullen
Minister of Finance

Date

File Reference : PI/FD/9/04

Agenda

Future Directions Meeting: 15 December 2003

Key Issues for In Work Payment and Family Support

- Item 1: A Work Hours Requirement for the IWP
- Item 2: Abatement Regime for FS/IWP
- Item 3: IWP rate
- Item 4: The Level of the Family Tax Credit

Other Work Streams

- Item 5: Special Benefit
- Item 6: Child Care
- Item 7: Housing Assistance

Subsidiary and In Work Payment and Family Support Issues

- Item 8: Which parent receives the IWP payment?
- Item 9: Adjusting FS and IWP over time
- Item 10: Family Support Rates and Structure

Flow-on Impact Items

- Item 11: Child Support
- Item 12: Community Services Card
- Item 13: Orphans Benefit, Unsupported Childs Benefit and Foster Care Allowance
- Item 14: Other Flow-on Impacts

Annotated Agenda

Future Directions Meeting: 15 December 2003

Note

The issues presented in this agenda and the associated papers are framed in terms of Ministers' Preferred Future Direction Option ("Option 16").

However, the issues will equally apply to any scaled or other variants of that Option that emerge as the funding position becomes clearer.

Discussion of these issues and "in principle" decisions now will facilitate final design and decision on the final package to be put to Cabinet in the Budget process.

Key Issues for In Work Payment and Family Support

Item 1: A work hours requirement for In Work Payment

- 1.1 A decision needs to be made on whether the in-work payment has a work hour requirement (as with FTC), rather than simply having an off-benefit rule (as with CTC). The case for having a work hours requirement relates to the IWP being a payment to support families in work. Without such a requirement the IWP would be available to families who were neither on benefit nor in employment (or in less than full-time employment) largely for "life style" reasons. Officials recommend that a work hours requirement apply to IWP.
- 1.2 Having such a requirement would differentiate the IWP from CTC (which has an off-benefit rule, but not a work hours rule). It would also reinforce the objective of the provision.
- 1.3 Introducing a work hours rule could create some losers (those currently getting CTC but not working full-time). This could be avoided if that rule was introduced in April 2005 alongside the Family Support (FS) increases. Officials are exploring this option.
- 1.4 The work hours requirement which officials favour is a modification of that applying to FTC – a minimum requirement of 20 hours pw for sole parents and 30 hours pw for couple. The modification relates to the self-employed, who are currently excluded from FTC (because it is an income guarantee without the type of maximum rate which is proposed for IWP)
- 1.5 *Ministers are asked to agree to a work hour's requirement, using the FTC work requirement (but expanded to include self-employed), as it best supports the objectives of the IWP. Officials are exploring the option of introducing this requirement from April 2005 in order to avoid losers.*

Yes/No

Item 2: Abatement regime for FS/IWP.

2.1 The current FIA option includes increases in both the 18 percent and 30 percent Family Support abatement thresholds in the second year. The thresholds are proposed to increase as follows:

	Abatement rate 18%	Abatement rate 30%
Current	\$20,356 pa	\$27,481 pa
From April 2006	\$22,956 pa	\$31,641 pa

2.2 The opportunity exists to simplify the existing abatement regime to a single 30 percent abatement rate or, with a lower threshold increase, to set the single abatement rate at 25 percent.

2.3 The current two step abatement regime gives lower effective marginal tax rates (EMTRs) than would be the case if the higher abatement rate cut in from the first threshold, however a greater increase to that threshold could achieve the same effect.

2.4 Two options for simplifying the abatement regime have been worked up:

- a single rate at 30% with a threshold of \$26,000, which would give somewhat higher gains for those on incomes below \$31,000 than the proposed 2 step regime, and somewhat lower gains above this level – cut outs would be slightly reduced from the 2 step proposal, and
- a single rate at 25% with a threshold of \$23,000, raising EMTRs against the 2 step proposal for those on incomes between \$23,000 and \$31,641 but reducing them over that point. It would therefore reduce gains at lower income levels (e.g. by \$13pw for a couple with 2 children on \$30,000 income) and increase them above that level (e.g. by \$15.80pw for a couple on \$60,000). It would also have higher cut-out points for FS.

2.5 *Ministers are asked to:*

a) *agree that the FS abatement regime be simplified to have a single abatement rate, and*

Yes/no

b) *(if you agree) indicate whether further work proceed on the basis of:*

i) *a single 30% abatement from approximately \$26,000*

ii) *a single 25% abatement from \$23,000*

(i or ii)

Item 3: IWP rate

3.1 The Option discussed by Ministers has a \$60pw IWP with an additional \$15pw for fourth and subsequent children.

3.2 An alternative, which avoids any per child component (which is a feature of the CTC) but costs the same, would be a flat rate IWP of \$65pw. However, this would mean that families with more than 5 children would be losers in the phase 2 changes.

3.3 *Ministers are therefore asked to confirm the "\$60 + \$15" formulation.*
Yes/No

Item 4: The level of Family Tax Credit.

4.1 The FTC guarantees a level of income for low income families in employment (and not receiving a core benefit). Under the proposed option for FIA there will still be a small income range over which some couples moving off-benefit into low paid employment will be worse off, even including the FTC top-up.

4.2 This could be avoided by a relatively small increase in the level of FTC - of \$698 per annum, from \$14,872pa to \$15,570pa, from April 2005. (A very preliminary estimate is that this would cost less than \$3m pa).

4.3 The downsides of the FTC are its 100% abatement, however, the marginal increase means this would impact on fewer people than options for a substantially greater increase which were explored when an option for FIA that did not include an IWP was being considered. On balance officials consider a small increase in FTC to be warranted.

4.4 *Do Ministers agree to increase FTC by \$698 per year from 1 April 2005?*
Yes/No

Other Work Streams

Item 5: Special Benefit

5.1 Numbers on Special Benefit have grown in recent years due to the erosion of the values of the likes of FS, and due to delivery changes made in order to ensure that low income people in hardship can access their entitlement. FIA and AS increases will reduce the level of hardship for SpB recipient with children, and in many cases, remove it altogether.

5.2 For the increases in FIA to deliver a reduction in SpB, the SpB formula (contained in the Ministerial Direction that guides the programme) will have to be changed. This is because of the way in which it currently excludes Family Support (FS) as income. Given the fact that SpB is a hardship provision, it makes sense that the increases through Future Directions should be recognised. (The increases in AS do not present a parallel issue, as AS is treated differently from FS).

5.3 Officials have developed a proposal which would treat FS as income for SpB purposes, and also includes FS in the base for calculating standard costs (currently the basic benefit and AS are included in the standard cost calculation – approximately 70% of this income is deemed to cover standard costs for SpB formula purposes).

5.4 Changes to SpB which off-set the increases in FIA and AS will affect how the FIA and AS changes can be presented. (e.g. it will not be possible to say all beneficiary families will be better off, because some beneficiary families would have had their SpB reduced to match their FS increase).

5.5 There are options open to Ministers in terms of timing of SpB changes that are made to accommodate the FIA increases, and these include:

- effective for all on 1 April 2005
- effective from next review
- some other time.

5.6 There are other reforms to SpB to help make the programme more robust, which could be dealt with at the same time or subsequently. These reforms may create losers, and officials would welcome a chance to discuss the timing for them. However, officials consider priority should be given to deal with the FIA and AS driven changes first.

5.7 The key questions for Ministers with regard to the flow-on issues for SpB are:

- a) Do they want the SpB programme amended to take account of the FIA and AS changes (so that the FIA and AS gains are netted out – in full or in part – from SpB)?
- b) If so:
 - how do they want the SpB amended to take account of the FIA and AS changes? and
 - when do they want those SpB changes to apply from (the start date of the AS and FIA changes, or "at next review" or some other time)?

5.8 *Given the complexity of these issues, officials suggest that it would be useful to dedicate a meeting to Special Benefit matters in early February.*

Yes/no

Item 6: Child Care

This section is based on advice prepared by MSD, on which Treasury has some significant issues. These are mainly about readiness to seek a mandate from Ministers for further work. Treasury is providing a separate note on this.

6.1 In Future Direction work to date provision has been made for approximately \$32m pa expenditure on the Childcare subsidy (CCS), based on proposals to increase rates and thresholds as well as improve delivery. More recent work has focussed on ensuring these proposals are consistent with the Early Childhood Education (ECE) developments and the latest FIA package.

6.2 The focus of current work is on three main areas:

a) Subsidy rates.

- The options being progressed here include bringing the out of school care (OSCAR) subsidy rate up to the pre-school subsidy rate, and
- Increasing rates though a "percentage of cost" subsidy (system to the AS subsidy) or a flat rate (as currently exists).

b) Increasing income thresholds – including looking at the case for setting the thresholds for those in work, education and training so as to support second earners. Lifting the threshold to a level which deals with the second earner issue would be more expensive than an increase which might otherwise be considered. Officials propose to report back to you in February on the nature of issues for second earners (including the nature of problem – if there is one - and if so, for which income ranges etc), and whether increases in the income thresholds for CCS addresses those problems.

c) Increasing the number of hours of non-activity tested childcare subsidy for lower income families to augment the ECE proposals, as one option for promoting child development outcomes.

6.3 For rates, officials consider that a "percentage of cost" subsidy is more effective, as it targets more assistance to people using higher cost services, is more responsive to ECE cost changes, could be simpler to administer, and prevents dead-weight costs where providers set fees to meet the subsidy maxima. However, it represents a larger order change and would take longer to implement.

6.4 There are trade-offs between the size of potential increases in rates and increases in income thresholds – the later increases the size of the eligible population while the former increases the affordability of childcare for the eligible population. In addition, the cost of enhancements to the Childcare Subsidy will be sensitive to take up rates.

6.5 Officials are also exploring a range of delivery enhancements and propose to report on those February 2004.

6.6 *Ministers are asked to agree that officials report to you in early February with options for enhancing the Childcare Subsidy that:*

- *Increase the income thresholds for activity tested purposes, including options which help make work pay for second earners in low and middle*

income families (Official will also report on the issues facing second earners)

Yes/no

- *Increase the subsidy rate as a flat rate subsidy or (officials preference) as a "percentage of costs" subsidy and*

Yes/no

- *Increase the hours of subsidy available for non-activity tested purposes*

Yes/no

Item 7: Housing Assistance

7.1 Ministers are asked to confirm the proposed changes to Accommodation Supplement which contribute to addressing problems related to housing affordability and work incentives.

7.2 Ministers are asked to confirm the following changes, for implementation from 1 October 2004, at a full year fiscal cost of \$101m:

a) increasing the number of AS areas to four by splitting the Auckland region into two areas, regroup some localities into higher maxima areas and increase the maxima.

Yes/no

b) increasing some of the maxima

Yes/no

c) introducing an abatement-free zone for AS beneficiary recipients for the first \$80 of income per week.

Yes/no

d) lowering the AS entry thresholds for non-beneficiaries from 25% (renters and boarders) and 30% (for mortgagors) of the relevant rate of *Invalids Benefit* (plus first child FS where there are children) to the same shares of the relevant rate of *Unemployment Benefit*.

Yes/no

e) increasing the *income* thresholds for non-beneficiaries from the relevant rate of gross IB plus \$17.92 per week to the relevant UB cut-out points.

Yes/no

Subsidiary IWP and FS items

Item 8: Which parents receives the IWP payment?

8.1 A decision is required on which parent in a couple situation should receive family income support. Currently all family assistance (FS, CTC and FTC) is paid to the principal carer – usually the mother. The case for continuing to pay FS to the principal carer is strong. There is a case for paying the IWP to the working parent, however, this would require significant systems changes which make it difficult to pay one component to the principal carer and the other to the working parent. On this basis, officials recommend that both FS and the IWP be paid to the principal carer.

8.2 *Do Ministers agree that both Family Support and IWP be paid to the principal carer?*

Yes/No

Item 9: Adjusting FS and IWP over time.

9.1 The Speech from the Throne makes reference to moving towards annual reviews of FS and FTC rates and thresholds. The issue of a process for reviewing the FS and IWP rates and thresholds over time has not been addressed specifically as yet. We propose to undertake some work on this and provide further advice in the New Year. This would look at the basis for regular adjustment, and broader issues such as protecting real values, the impact on relativities with wages and fiscal cost.

9.2 It would be useful for Ministers to give officials a steer on whether they want to announce a position on on-going adjustment when the Future Directions package is announced.

9.3 *Ministers to note that officials will report back on this issue in February 2004.*

Yes/no

9.4 *Do Ministers intend to announce a policy on on-going adjustment when the Future Directions Package is announced?*

Yes/no

Item 10: Family Support Rates and Structure

10.1 The current rates structure within FS has built up over time. Officials have looked at the case for changes to relativities across various FS rates, while maintaining the broad shape of Ministers' preferred option. The changes proposed through rates increases and the benefit off-set in the first stage of the FIA roll-out are broadly consistent with research on cost of children and living standards. Officials recommend that no further changes be made to those rates (other than for scaling purposes as the fiscal position is confirmed).

10.2 However the proposed stage 3 increases (currently a \$10 flat increase to all FS rates) could be revised to differentiate rate changes to achieve more effective targeting and rate simplification within the same cost envelope (approximately \$200m).

10.3 *Ministers are asked to agree that officials review the proposed stage 3 FS increases with the aim of improving targeting and rate simplification (subject to the same order of costs) and report back in February.*

Yes/no

Flow-on Impact Items

Item 11: Child Support

11.1 The amount of Child Support a liable parent is required to pay depends on a number of factors, including the liable parents "living allowance". For liable parents with dependent children the allowance is currently based on the gross couple Invalids Benefit rate plus FS at the subsequent child rate, for up to four children. Increasing FS but making no changes to the Child Support living allowance would result in some custodial parents receiving lower payments of Child Support and in the Crown receiving lower payments of Child Support in respect of custodial parents who are beneficiaries. There is income of an estimated \$10.85m to the Crown and \$6.65m for custodial parents which would be lost if the flow-on is allowed.

11.2 Maintaining the status quo – and letting the reduction in Child Support flow through – is one option. However officials recommend a second option: to legislate for the current FS rates in the Child Support formula, and to index these to the CPI, as this protects the level of Child Support available to custodians.

11.3 *Ministers are asked to agree to change the living allowance formula for liable parents by fixing the current FS levels, to be upgraded by the CPI, rather than to let the new rates of FS flow through into the formula.*

Yes/no

Item 12: Community Services Card

12.1 On account of FIA changes, many Community Service Card (CSC) card holders will have higher incomes, such that an estimated 10,000 existing cardholders will lose their card under the proposed FIA reforms unless the income limits for the CSC are adjusted.

12.2 It would be possible to increase the CSC limits at each of the FIA roll-out stages, to ensure that existing CSC recipients remain eligible. (Doing this would also, however, bring in a number of other families which are currently not eligible). This proposal has yet to be costed.

12.3 *Ministers are asked to*

- *agree, in principle and subject to a report back on costs, that CSC thresholds be increased at each of the three stages of the FIA reforms to ensure existing CSC recipients continue to remain eligible for CSC.*

Yes/no

- *agree that the impact on health expenditure from any flow-on increases to CSC thresholds be funded as part of the Future Directions package*

Yes/no

- *agree that the Ministry of Health be consulted on this issue*

Yes/no

Item 13: Orphans Benefit and Unsupported Childs Benefit and Foster Care Allowance

13.1 Recipients of Orphans Benefit (OB), Unsupported Childs Benefit (UCB) and Foster Care Allowance (FCA) cannot receive Family Support (FS) for the same child because the rates of these allowances were designed to cover the equivalent of the FS payment. This means that unless the rate of OB/UCB and FCA are increased to take account of the increased rates of FS, recipients of OB, UCB or FCA will not benefit from the Future Directions package.

13.2 To pass on an equivalent increase would cost around \$17m pa for the 2005 increase in FS and a further \$7m pa from the 2007 increase. However a full pass on raises issues of the interface between these rates and youth benefit rates.

13.3 There are several options open to Ministers, including a full pass-on, a partial pass-on, and a more fundamental review of the relativities across the various provisions (either with or without a one-off increase to enable some advantage for recipients of these provisions). A review would take 6 months and raises issues of timing for any subsequent changes, however it would enable changes to be other than ad hoc in nature. Officials prefer a review, with an interim one-off increase in the meantime.

13.4 Ministers are asked to agree to a review of relativities across FS, OB/UCB and FCA, and youth benefit rates, but with a one-off increase to OB/UCB and FCA from April 2005, so that recipient families get an increase in their income

Yes/no

Item 14: Other FIA Flow-on Impacts

14.1 There are a number of further flow-on issues which need decision.

AS Entry Cost Thresholds

14.2 The AS entry cost threshold for beneficiaries is based on clients' net benefit rate, plus first-child FS. The FIA proposals increase the FS and reduce the basic benefit by the child component, resulting in a net reduction in base AS entitlement, which will reduce the level of net gains from the over all package for families receiving both AS and FS. If the flow-on is allowed, recipients would continue to be better off in net terms. In the past increases to FS have flowed through to AS, lifting the entry threshold and thereby reducing the level of AS. Allowing the flow-on will significantly reduce the cost of the overall package.

14.3 Ministers are asked to agree that the FS increase be allowed to flow-on to AS as has been the case in the past.

Yes/no

Income Related Rents (IRR)

14.4 The IRR formula sets net rents at 25% of income, which is defined in the same way as for AS. The 2005 changes will increase assessable income and result in a marginal increase in rents for those not already at the market rent. Overall IRR recipients will continue to be better off in net terms even if the flow-on is allowed. Allowing the flow-on will reduce the cost of the overall package by an estimated \$11.3m pa.

14.5 Ministers are asked to agree that the FS increase be allowed to flow-on to IRR recipients as has been the case in the past.

Yes/no

Student Allowance (SA) Rates

14.6 Student allowance rates are set equal to benefit rates. It is strongly desirable to maintain this relationship. To do so would mean that students with children would benefit from the FIA increases in the same way as social security benefit recipients. The potential off-set savings from student allowance have not previously been factored in, and are estimated at \$3.3m per annum.

14.7 Ministers are asked to agree to pass on the reduction in benefit rates and the increase in FS to SA recipients

Yes/no

Pathways Payment

14.8 The Pathway Payment is equivalent to 2 weeks benefit for long term beneficiaries with dependent children who move into full-time work (not including children). The reductions in core benefit rates will reduce the level of the Payment, if this flow-on is allowed.

14.9 While the real value of the Payment could be maintained, the rationale for the rate would soon be lost. As there would be no losers from allowing the flow-on (as it is only available to new exits), it would be simpler to maintain the benefit rate link. There would be very small fiscal savings from doing so.

14.10 Ministers are asked to agree to allow the flow on to reduce the level of Pathways Payment.

Yes/no

Stand-down

14.11 The benefit stand-down formula is based on income in the previous 26 weeks, relative to the average wage. There is an adjustment to allow \$80 for a partner and \$50 for each dependent child. The per child element was derived from rounding the FS rate for the first child. Maintaining the relationship could be done by increasing the per child add-on to \$80 per child in 2005 but not increasing it again in 2007). This would equate it to the spouse add-on. This would have a very small cost.

14.12 Ministers are asked to agree to increase the per child add-on from \$50 to \$80 to reflect the increases in FS.

Yes/no

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE- IN-WORK PAYMENT- WORK TEST

Issues

- 1 The key issue considered in this paper is whether eligibility to the in-work payment (IWP) should be made subject to a work test. The introduction of a work test would help to underline the labour market objectives of the IWP and emphasise its difference from the child tax credit. Certain drawbacks should also be noted, however, namely the associated administrative difficulties for clients and Government and the potential for losers in 2006 (although it may be possible to time changes to avoid these).

Proposed solution

- 2 It is proposed that a work test should be introduced for the IWP. We would suggest that this test is modelled on the existing hours-based test already used for family tax credit, but widened slightly to allow the self-employed to qualify as well as employees.

Impacts

- 3 The introduction of a work test for IWP would disqualify some people who currently receive child tax credit. In practice, most families who are not on benefit (or student allowance) will be in work, but there are bound to be some who are not - most obviously, those with private incomes and people who fail the (unemployment benefit) requirement to be available for and seeking full-time work. Further analysis is needed to establish the likely number of families affected, and the associated savings.
- 4 The introduction of a work test for the IWP would create the potential for losers in April 2006, since people would have already pocketed the 2005-06 family support increases. Officials will explore whether the work test could be introduced in April 2005 - alongside the initial increases in family support - to avoid losers.

Recommended actions

We recommend that you:

- 1 agree that eligibility to the IWP should be made subject to a work test, and that this should be an hours-based test which:
 - 1.1 like the test that already applies to people claiming the family tax credit, requires that:
 - 1.1.1 sole parents work at least 20 hours a week, and
 - 1.1.2 for couples, the partners work a total of 30 hours or more a week between them
 - 1.2 unlike the family tax credit test, takes account of hours worked as a self-employed person as well as those worked as an employee

AGREE/DISAGREE

- 2 note that officials will explore whether it would be possible to introduce the work test for IWP in April 2005 (rather than April 2006) to avoid losers

Discussion

- 1 To date, the working assumption has been that the IWP would generally be available to anyone not in receipt of an income-tested benefit or student allowance, irrespective of whether or not they actually worked. A similar "off benefit rule" is currently used to determine eligibility to the child tax credit. There is, however, a case for supplementing this off-benefit rule with an express requirement for the family to be in work. A work test already applies to those receiving the family tax credit.

The case for introducing a work test

- 2 Making eligibility to the IWP subject to a work test will ensure that it is aimed unequivocally at encouraging and assisting families in low-paid work. It would help to underline the labour market objectives of the payment, and, by limiting entitlement to families who were actually working, would ensure that resources were more precisely targeted towards achieving those objectives.
- 3 The introduction of a work test may also have certain presentational advantages. In particular, it would help to make clear that the IWP is qualitatively different to the child tax credit, which it replaces. It would allow for a strong message that the new payment was intended to help people into work and to make work pay - a message that may be harder to communicate convincingly if we are not able to state that *only* people who work qualify.
- 4 In terms of the impact of the payment on actual levels of labour market participation, the case for a work test is perhaps less clear cut. We might still expect to see a generally positive labour market response to the introduction of the IWP, even if it does not include a work test. While there would obviously be greater scope for some families to reduce the amount of work they do, families for whom only a minimum level of labour market participation is possible may be encouraged to work part time rather than not at all, since they would still be able to qualify. On the other hand, the evidence does suggest that rules requiring a minimum level of labour market participation can be helpful in encouraging some families to increase the amount of work they do, and can discourage people from responding to increased levels of assistance by choosing to work less. Overall, it is probably fair to say that a work test would be helpful in encouraging "full time" working amongst families¹.

¹ "Full time" in this context should be interpreted fairly loosely, however. It really just means the minimum amount of work that the Government chooses to require people to do in order to qualify for additional assistance. For the family tax credit, this is 20 hours a week for a sole parent, and a total of 30 hours a week for couples.

The design of the work test

- 5 If a work test is introduced, we would recommend that it be modelled on the existing hours-based test used for the family tax credit, only widened slightly to allow the self-employed to qualify as well as employees.

Hours rather than earnings

- 6 The main alternative to an hours-based test is an approach that instead measures work by reference to earnings. One advantage of this alternative approach is that earnings are more easily tracked than hours worked, allowing less scope for fraud (see paragraph 13 et seq below). Nevertheless, there are a number of practical reasons for preferring an hours-based test over an earnings-based test. In particular:
- Measuring work by reference to earnings really means looking to earnings alone. But family assistance is abated according to all market income. Using one measure of income to trigger entitlement to the IWP and another to phase it out would be messy.
 - Unemployment benefit and family tax credit both measure work by reference to hours worked. Using a different measure for the IWP would be inconsistent with these existing systems, and would risk leaving gaps in support.
 - Attempting to measure work by reference to earnings is likely, in practice, to lead to some system of weekly assessment of earnings - cutting across the relatively light-touch system of annual reporting of income used for abatement purposes.
- 7 An hours-based test also has certain policy advantages. In particular, it allows us to target the highest levels of support to people on the lowest rates of pay. This is the group for whom an earnings supplement is most likely to be important in terms of making work financially worthwhile.

The number of hours required

- 8 As for how much work should be required, we would recommend using the same thresholds that are currently used for family tax credit, so that:
- sole parents need to work at least 20 hours a week to qualify, and
 - for couples, the partners must between them work a total of 30 hours or more a week.
- 9 These thresholds require a meaningful but achievable level of labour market participation, while still allowing families a degree of choice about how much work they do and, for couples, how the partners share child care responsibilities. Using the family tax credit threshold also ensures consistency across instruments.

The treatment of the self employed

- 10 There is one point on which we would suggest that the work-test for the new in-work payment differs to that currently used for the family tax credit, namely the treatment of the self-employed.
- 11 The self-employed cannot receive the family tax credit. This is because the family tax credit provides a minimum income guarantee for working families - topping up their net income to \$14,872 in every case. Making it available to the self employed would amount to an effective government subsidy of unprofitable or barely profitable businesses. The less profitable the business, the greater the subsidy.
- 12 The same issue does not really arise in relation to the in-work payment, which will generally provide a maximum entitlement of \$60 a week per family.² The self-employed can receive the child tax credit now, and there seems no good policy rationale for denying them access to the IWP in future.

Points to watch

- 13 As discussed above, we do see some overall advantage in introducing a work test. But the judgement is a fine one. The introduction of a work test would also have certain drawbacks.
- 14 The major long-term drawbacks relate to the practical administration of the work test, which will impact on the Government and clients:
 - The introduction of a work test would add a new layer of complexity for many families³. Families would need to report the number of hours they worked and notify the Inland Revenue Department (IRD) if they fell below the required minimum. For many people, hours worked are fairly stable, but for others they can vary considerably from week to week, potentially causing entitlement to stop and start repeatedly. It may be possible to devise rules that smooth over such short-term fluctuations to some extent, but this would mean further complexity and would only offer a partial solution.
 - A work test would also be difficult for IRD to police. Without imposing new burdens on businesses, IRD will have very limited ability to check whether people are actually working the number of hours they claim to be. (The problem will be particularly acute in relation to the self-employed, for whom there is really no way of verifying hours worked, even in individual cases.) We will therefore need to rely on the work test being largely self-policing.
- 15 There is also the potential for the introduction of a work test to create losers. Although the proposed increases in family support are sufficient to avoid any net losers from the package as a whole, the bulk of those increases are scheduled for April 2005. Introducing a work-contingent IWP in April 2006 would give rise to cash losers at that point, namely people who (having already pocketed the 2005

² Plus an extra \$15 a week for the fourth and each subsequent child in larger families.

³ While a work test already applies to those claiming family tax credit, the number of families affected is very small. The eligible population for the IWP will be far larger.

increases in family support) now found themselves losing the child tax credit and ineligible for the IWP because they were not working the required number of hours. Further analysis is required to establish the likely number of families affected.

- 16 It may be possible to avoid losers if the work test were introduced in April 2005, alongside the family support increases. The child tax credit could perhaps be re-badged as a new in-work payment at this point, with the introduction of the work test as the defining difference. This would then form stage one in a two-stage reform to refocus and improve work-related assistance, the second stage being the reform of the rate structure in April 2006. Further analysis of the operational implications is needed to determine the feasibility of introducing the work test in April 2005 rather than April 2006.

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: FAMILY SUPPORT ABATEMENT REGIME

Issue

The Option discussed by Ministers includes increases in the 18 percent and 30 percent abatement thresholds for Family Support (FS) from 1 April 2006. These increases provide an opportunity to simplify/restructure the abatement regime should Ministers wish to. Under the current option the thresholds would be as in Table One below.

Table One: Family Support abatement regime under current option

	18 percent abatement threshold	30 percent abatement threshold
Current (from April 04)	\$20,356pa	\$27,481pa
From 1 April 2005	\$20,356pa	\$27,481pa
From 1 April 2006	\$22,956pa	\$31,641pa

There is no strong rationale for having a lower abatement rate for the first zone, although it could be argued that lower effective marginal tax rates (EMTRs) around the \$20,000pa - \$30,000pa income range are beneficial in helping secure people onto sustainable employment pathways.

Further information is available in Appendix 2.

Possible alternative solutions

Officials have considered two single rate abatement regimes that cost about the same as the proposed 2006 changes. These are:

- i. a single rate of 30 percent with the threshold of approximately \$26,000pa (the exact figure could be set such that the total cost is the same as the current option)
- ii. a single rate of 25 percent with the threshold set at \$23,000pa.

Impacts

The effect of alternative (i) above is some additional gain for those on incomes below about \$31,000, and slightly lower gains above that level. Compared to the current option, EMTRs would be lower for those below \$26,000, higher between \$26,000 and

\$31,641 and the same for those above that income. Cut-out point will also be slightly lower than otherwise.

Compared to the current option, alternative (ii) has the effect of raising EMTRs for those between \$23,000 and \$31,641, but reducing them for those above it. Further up the income scale those who would not otherwise be eligible for FS would also face higher EMTRs. It also alters the distribution of gains somewhat more than the other alternative. Relative to the option Ministers discussed earlier or the alternatives set out above, this approach would reduce the gains at lower income levels and raise them at higher incomes. For example, compared with the current option, a couple with two children on \$30,000pa would receive approximately \$9.25pw less and a couple on \$60,000pa would receive about \$15.80pw more.

Recommended action

We recommend that you:

1. agree that the Family Support abatement regime be simplified to a single abatement rate and threshold from 1 April 2006.
2. If you agree with recommendation 1 above, indicate whether further development of the package should be on the basis that the Family Support abatement regime to apply from 1 April 2006 should be:

EITHER:

- i) a single rate of 30 percent with the threshold of \$26,000pa

OR:

- ii) a single abatement rate of 25 percent with the threshold set at \$23,000pa

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: IN-WORK PAYMENT RATE STRUCTURE

Issue

The Family Income Assistance (FIA) option recently discussed by Ministers includes an In-Work Payment (IWP) of \$60pw plus an additional \$15pw per child for the fourth and subsequent children. This structure has the advantage that all Child Tax Credit (CTC) recipients who qualify for the IWP will be better off when the IWP is introduced on 1 April 2006 (CTC is paid at \$15pw per child). The disadvantage is that it retains in part the per child element of the CTC.

For further information see Appendix 2.

Possible alternative solution

A possible alternative that avoids this disadvantage would be to have a flat rate IWP set such that the total cost was approximately the same as the proposed structure. This would mean a flat rate of \$65pw.

Impacts

The effect of a flat-rate \$65 IWP would be that families with five or more children would be worse off, with the loss getting larger as family size increases. Families with three or fewer children would gain an additional \$5pw.

Recommended action

We recommend that you:

1. confirm that further development of the package be based on an IWP of \$60pw plus an additional \$15pw per child for the fourth and subsequent children.

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: RAISING THE FAMILY TAX CREDIT

Issue

Under the current option and (and under the status quo) it is possible for some couples with children to be worse off moving from benefit into 30+ hours of work, even after receiving Family Tax Credit (FTC).

For further information see Appendix 2.

Proposed solution

This can be resolved by a relatively small increase in the FTC level from \$14,872pa net to about \$15,570pa net (an increase of \$698pa) from 1 April 2005. The exact size of the increase necessary depends on other FIA parameters. Once these are confirmed officials will calculate, and cost, the increase needed. The total cost is expected to be under \$3m.

Impacts

Increasing the level of the FTC income guarantee will prevent couples moving from benefit to 30+ hours work being worse off. The disadvantage of this alternative is that it extends the FTC 100 percent abatement zone slightly higher up the income scale. It should also be noted that the effectiveness of FTC will be constrained by the extent of take-up.

Recommended action

We recommend that you:

1. Agree that further development of the package be on the basis that the Family Tax Credit level be increased to ensure that couples with children who move off benefit into 30 hours work will not be worse off (the exact size of the increase depends upon other IWP design decisions but is in the order of a \$700pa increase)

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

SPECIAL BENEFIT: FUTURE DIRECTIONS FLOW-ON EFFECTS AND OTHER ISSUES

Issues

Growing numbers

1. As Ministers are aware there has been significant growth in the number of people receiving Special Benefit (SpB) in recent months (163% growth in the 16 months to 21 November 2003). The growth is the result of the combined effect of delivery changes by Work and Income to better ensure that low income people are aware of their potential entitlement to SpB when they are in hardship, and the fall in the real value of second tier social assistance over time, due to partial or irregular adjustment.
2. While SpB plays an important role in addressing hardship, it has a number of down sides: as it is highly targeted it has a 100% abatement rate, which has negative work incentives. The programme is very intensive to administer, but more importantly risks locking recipients into the benefit system, rather than helping them (or Work and Income) proactively address their hardship.

Future Directions will reduce hardship, especially for families

3. Future Directions will address the fall in real value of the Accommodation Supplement (AS), family income assistance (FIA) and the Child Care Subsidy (CCS). Those changes will reduce the level of financial hardship for those SpB recipients with children, and in many cases, remove it altogether.

The formula will need to be changed if the FIA changes are to see SpB numbers reduce.

4. For the increases in FIA to deliver a reduction in SpB, the SpB formula (contained in the Ministerial Direction that guides the programme) will have to be changed. This is because of the way in which it currently excludes Family Support (FS) as income. Given the fact that SpB is a hardship provision, it makes sense that the increases through Future Directions should be recognised. (The increases in AS do not present a parallel issue, as AS is treated differently from FS in the assessment formula).
5. Officials have developed a proposal which would treat FS as income for SpB purposes, and also includes FS in the base for calculating standard costs (currently the basic benefit and AS are included in the standard cost calculation –

approximately 70% of this income is deemed to cover standard costs for SpB formula purposes).

6. If the formula is not changed, the increases in family assistance will – according to the formula – have no impact on SpB numbers or expenditure.

Any SpB changes will impact on how FIA changes can be presented

7. The analysis of impacts from the increases in FIA under Ministers' preferred option shows that around 260,000 families with dependent children (representing 55% of all families with dependent children) gain from the 2005 changes, and with the average gain being \$32 per week for families with a total income of less than \$45,000 per annum. By 2007, the average gains have increased substantially. However, this analysis does not take into account the fact that around 29,000 low income families (current numbers) also get SpB, and that their net gain will be much smaller (for some, no gain at all) if the total value of the FIA increases is netted off the SpB.
8. If Ministers want to be in a position to present the FIA changes so that all low income families receive a net benefit from the Future Directions changes, it will be necessary to ensure that the SpB changes allow for this. However, such an accommodation would mean that some SpB recipients would in fact not be in hardship and that numbers on SpB and expenditure on that programme would remain higher than would otherwise be the case.

Timing Options for any Special Benefit changes depend on Minister's priorities

9. If Ministers give a priority to reducing SpB numbers and expenditure as soon as possible it would be possible to make changes which off-set all of the increase in FIA from 1 April 2005. This would involve an automatic off-set for all current SpB recipients on that date.
10. If Ministers wish to give priority to ensuring that all low income families get some advantage from the FIA changes, this could be achieved by allowing the increases in FIA to stand until the next SpB review (which would range from almost immediately – e.g. there was a routine review scheduled for the day after the FIA increases – through to six months later). This would have a cost. It would mean that some people could perceive themselves as "losers" when their SpB is next reviewed, however, this risk could be managed down by informing recipients that the higher rates of FS would be factored into their SpB at next renewal.
11. Either change could be made by amendment to the Ministerial Direction. Neither requires legislation.

Other changes to SpB

12. The FIA and AS changes will address some of the issues with SpB, but other issues remain. These include:
- the need to review the treatment of certain costs under the formula (such as the basis for assessing the standard costs a family faces)
 - reforming the role of "rules" (so as to give greater certainty) and how and where discretion is exercised
 - the shape of the legislative basis for SpB, including whether the authority for Special Benefit should continue to be cited in a Ministerial Direction or in legislation limiting the extent of discretion, and
 - the case for a maximum level of SpB.
13. While Future Directions gives an opportunity for some change to SpB, there are pros and cons associated with making all the possible changes at one time. The factors to be taken into account include the need for legislation, the implementation timeframes, and the extent to which minor changes could distract from the Future Directions message.

A strategy for progressing Special Benefit reforms

14. In order to ensure that the Special Benefit is fulfilling the function it should as a robust hardship assistance programme which is able to be administered consistently, without the current risk of legal challenge will involve several stages:
- a) addressing the adequacy of first and second tier assistance
 - b) addressing issues within the SpB formula, and
 - c) addressing how the SpB is administered (given its current discretionary nature).
15. The Future Directions changes to FIA and AS respond directly to the adequacy issue.

Recommended Action

We recommend that you:

1. note that the key questions for Ministers with regard to the flow-on issues for Special Benefit are:
 - a) Do they want the Special Benefit programme changed to take account of the FIA and AS changes (so that the FIA and AS gains are netted out – in full or in part – from Special Benefit)?
 - b) If so:
 - how do they want the Special Benefit changed to take account of the FIA and AS changes? and

- when do they want those changes to apply from (the start date of the AS and FIA changes, or "at next review" or some other time)?

2. agree that, given the complexity of these issues it would be useful to dedicate a meeting to Special Benefit matters.

AGREE/DISAGREE

12 December 2003

Minister of Finance
Minister for Social Development and Employment

CHILDCARE ASSISTANCE OPTIONS

Issues and solutions

- 1 We provided initial advice on possible enhancements to childcare assistance in our 22 August 2003 report, *Future Directions: issues, objectives and options*. That report identified a need to boost the value of childcare assistance and to extend eligibility further up the income scale. Accordingly, increases in both rates and thresholds were recommended.
- 2 Since August, the family income assistance (FIA) package for Budget 2004 has started to firm up, as have proposals for the new Early Childhood Education (ECE) funding arrangements. We have also had an opportunity to undertake further analysis of families' use of and need for childcare assistance. That further analysis supports our earlier view that a mix of both rate and threshold changes is needed, and has allowed us to refine our thinking about how best to shape and deliver that mix of enhancements.

Increasing income thresholds

- 3 We see merit in increasing childcare assistance thresholds in such a way as to provide some assistance to low to middle-income two-earner families and a higher level of assistance to lower-income sole parents and single-earner families. Increasing thresholds to allow two-earner families to qualify will help to facilitate labour-market participation by second-earners. (The design of the new in-work payment will not improve work incentives for second earners.)

Increasing rates

- 4 We also see a need to increase the rates of childcare assistance. As a first step, we would suggest bringing rates for Out of School Care (OSCAR) subsidy up to the level of Childcare Subsidy (CCS) rates. From there, we have explored two possible alternatives:
 - our favoured approach is to move away from the current flat-rate subsidy to a system where both OSCAR subsidy and CCS meet a certain percentage of a family's childcare costs (up to a given limit) with the percentage reducing as income increases. This would target more assistance to families with higher childcare costs and be more responsive to changes in the ECE funding environment. Yet families would still have an incentive to shop around for childcare that is reasonably priced
 - the alternative approach would be to retain a flat-rate subsidy, but introduce an across-the-board increase in both OSCAR subsidy and CCS rates. This

increase could be introduced earlier than the "percentage of costs" approach and with less implementation risk, but would be less responsive to actual costs borne by parents and result in higher transition costs (or losers) if a move to a "percentage of costs" approach was made at a later date.

Non-activity tested childcare assistance and other issues

- 5 We see a case for introducing more modest increases in income thresholds for non-activity tested childcare assistance than for childcare assistance generally. This will ensure that it continues to be targeted at lower-income families. We would also like to explore the possibility of increasing the maximum number of hours for which this non-activity tested assistance is available (it is currently available for up to nine hours care a week). Such an increase is likely to help the Government to meet its ECE and social development objectives for low-income and disadvantaged families. This will need to be considered in the context of developments in ECE funding and measures to assist disadvantaged families.
- 6 We are also examining a range of delivery enhancements and smaller policy and administrative changes to improve take up and cut compliance costs. We will report on this work in the new year.
- 7 For further information see appendix 5.

Impacts

- 8 Both the timetable for and cost of the childcare package are likely to be affected by the decision about whether to move to the "percentage of costs" approach described above, or to deliver increases through the existing flat-rate structure. Also, there is a balance to be struck between extending the population eligible for CCA and increasing the actual value of the subsidy. A smaller increase in thresholds may enable a higher level of CCA subsidy to a tighter target group but could prevent two-earner families from becoming eligible for assistance.
- 9 Possible timetables and estimated costs for each approach are given in tables 1 and 2 below. The costs are based on reasonably high settings, and could be scaled back if need be. (Note that the costs are likely to rise more significantly in out years, as a result of improved take-up.)

Table 1: Possible timetable(s) for reform

Moving to a percentage-of-costs system		Retaining the flat-rate approach	
1 Oct 2004	Increases to income thresholds	1 Oct 2004	Increases to income thresholds
1 Oct 2004	Increases to OSCAR subsidy rates to bring them up to CCS rates	1 Oct 2004	Increases to OSCAR subsidy rates to bring them up to CCS rates
Early 2006	Move to a percentage of costs system	1 Oct 2004	Increases to all rates by 15%
1 Jan 2007	Increase maximum hours available under non-activity tested provision	1 Jan 2007	Increase maximum hours available under non-activity tested provision

Table 2: Estimated Crown cost of the proposals (not including increase in hours for non-activity tested provision)

Moving to a percentage-of-costs system		Retaining the flat rate approach	
Year	Cost (\$m)	Year	Cost (\$m)
2004-05	9.3	2004-05	12.3
2005-06	15.7	2005-06	16.9
2006-07	18.1	2006-07	17.0
2007-08	18.3	2007-08	17.1

Recommended actions

We recommend that you:

- 1 agree that officials should progress to the next stage of development on the following options for childcare assistance and report back to you with further advice in the new year:
 - 1.1 increase income thresholds to levels that would target most additional assistance to low-income sole parent and single-earner families but also help make work pay for second earners in low and middle-income two-parent families

AGREE / DISAGREE
 - 1.2 as a first step in improving rates of assistance, bring OSCAR subsidy rates up to the level of CCS rates

AGREE / DISAGREE
 - 1.3 in addition to the increase in OSCAR subsidy rates referred to in recommendation 1.2, enhance both OSCAR subsidy and CCS rates by:

EITHER

 - 1.3.1 moving from a flat-rate subsidy to a "percentage of costs" approach (officials' preferred option)

AGREE / DISAGREE

OR

 - 1.3.2 introducing an across-the-board increase in the flat-rate subsidies

AGREE / DISAGREE
 - 1.4 review the rules for non-activity childcare assistance, with a view to:
 - 1.4.1 setting income thresholds for non-activity tested assistance to ensure it is targeted to low-income families
 - 1.4.2 increasing the maximum number of hours available to help meet Government's ECE and social development objectives for low-income and disadvantaged families.

AGREE / DISAGREE

12 December 2003

Minister of Finance
Minister for Social Development and Employment

HOUSING ASSISTANCE

Issues

- 1 Officials have analysed the Accommodation Supplement (AS) and housing-related issues and have identified a number of problems in relation to housing affordability and work incentives. The following key problems have been identified:
- current AS areas and groupings of localities within areas, which are used to define AS maxima, are not optimal
 - a significant number of AS recipients experience housing affordability problems, and for some recipients these are persistent
 - in high housing price markets there is increasing pressure on maxima, which contributes to housing affordability problems
 - irregular adjustment of the maxima has also contributed to the growth in the uptake of Special Benefit
 - the AS contributes to making work pay for beneficiaries moving into part-time or full-time employment. However, in some instances the design of the AS abatement regime and income and entry thresholds discourages movement into work.

Proposed Solutions

- 2 Officials are proposing the following adjustments to existing AS policy settings¹ that can be implemented in the short term:
- increase the number of AS areas from three to four by splitting the Auckland region into two areas, and regroup some localities into higher maxima areas
 - increase the maxima using the formula approach developed in 1997 to adjust the maxima²
 - remove abatement of the AS for beneficiaries by introducing an abatement-free zone for AS beneficiary recipients for the first \$80 of income per week
 - lower the AS *entry* thresholds for non-beneficiaries. The entry threshold is currently set at 25% (renters and boarders) and 30% (mortgagors) of the relevant rate of *Invalids Benefit* (IB), plus first child Family Support where recipients have dependent children. It

¹ Changes to existing policy settings have been defined to include adjustments to the abatement regime and area maxima

² The formula equals 70% of the relevant median regional rent minus 25% relevant weighted average benefit [CAB (97) M 8/10 refers]

is proposed to lower this threshold to 25% and 30% of the relevant rate of *Unemployment Benefit (UB)*, plus first child under 16 rate of Family Support where recipients have dependent children

- increase the *income* thresholds for non-beneficiaries from the relevant rate of gross IB plus \$17.92 per week to the relevant UB cut-out points.
- 3 The proposed implementation date for the proposals outlined above is 1 October 2004.
 - 4 Officials propose to undertake another review of 12 months of Tenancy Bond data in January/February 2004 to ensure that the AS maxima and AS area settings accurately reflect current market trends.
 - 5 Officials propose to undertake a medium term review in 2006 of the Accommodation Supplement's policy objectives, effectiveness and role in achieving the Government's desired housing outcomes, as outlined in the New Zealand Housing Strategy.

Impacts

Adjustments to area structure and maxima

- 6 Tenancy Bond data indicates that there are pronounced sub-markets in Auckland. Lower quartile rents in Central and North Auckland are significantly higher than in South and West Auckland, averaging \$30-\$40 more per week. Splitting up the Auckland Region allows for maxima increases to be targeted to higher accommodation cost areas where AS recipients are more likely to have housing affordability problems, ie Central and North Auckland.
- 7 Adjusting the maxima will only alleviate housing affordability problems for those restricted by the maxima. Nevertheless, the area maxima proposal assists 38,800 AS recipients who are better off on average by \$16 per week. The majority of expenditure is targeted to Area 1 (50%), while approximately 73% of expenditure is targeted to single adults and sole parents who collectively represent a group with high housing affordability problems.

Abatement free-zone, income and entry thresholds

- 8 Introducing an abatement free-zone will make 60,700 beneficiaries with other income better off by \$15 per week on average. Single adults and sole parents (52,700) will benefit the most from this proposal with 86% of expenditure targeted to this group (\$49m). This proposal will increase part-time work incentives and will have an indirect positive effect on housing affordability outcomes for those in employment.
- 9 Adjusting the AS entry and income thresholds for non-beneficiaries will make 20,800 non-beneficiaries better off by \$18 per week on average. Families with children (14,700) will benefit the most from this proposal with 78% of expenditure targeted to this group (\$15m). This proposal will increase work incentives by addressing the problem that some beneficiaries experience a sudden reduction in AS entitlement when moving off benefit from part-time work.

Impacts of combined proposals

- 10 The combined proposals will make 105,100 people better off by an average of \$19 per week. Families with children will benefit most from the proposals (66,300), particularly sole parents (51,000), with 67% of expenditure targeted to this group (\$78.4 million). Under the combined proposals, 24,000 non-beneficiaries will be better off by \$21 per week on average.

Recommended actions

We recommend that you:

- 1 agree that the Accommodation Supplement proposals include the following components:
 - 1.1 increase the number of Accommodation Supplement areas to four
 - 1.2 increase some of the maxima, using the formula approach developed in 1997 to adjust the maxima based on 70% of the relevant median regional rent minus 25% relevant weighted average benefit [CAB (97) M 8/10 refers]
 - 1.3 remove abatement of the Accommodation Supplement for beneficiaries for the first \$80 of income per week
 - 1.4 reduce the Accommodation Supplement entry thresholds for non-beneficiaries from 25% (renters and boarders) and 30% (mortgagors) of the relevant rate of *Invalids Benefit*, plus first child Family Support where recipients have dependent children, to 25% and 30% of the relevant rate of *Unemployment Benefit*, plus first child under 16 rate of Family Support where recipients have dependent children
 - 1.5 increase the income thresholds for non-beneficiaries from the relevant rate of gross *Invalids Benefit* plus \$17.92 per week to the relevant *Unemployment Benefit* cut-out point

AGREE / DISAGREE

- 2 agree that the implementation date for the adjustments to the Accommodation Supplement is 1 October 2004

AGREE / DISAGREE

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: IN-WORK PAYMENT: PAYMENT AND ELIGIBILITY

Issues

- 1 The key issue considered in this paper is: which partner in a couple should receive payments of family assistance¹. All family assistance is currently paid to the partner who has day-to-day responsibility for the care of the children (the principal carer). The issue is whether this should continue, or whether some or all of the payments should in future be made to the working partner (where different to the principal carer).
- 2 The paper also notes that further work is needed on a range of more detailed issues, on which we shall provide advice early in the new year. We shall also review the proposed design of the IWP to ensure compatibility with the Human Rights and Bill of Rights Acts.

Proposed solution

- 3 The proposed solution to the key issue considered in this paper is that all payments of family assistance should continue to be made to the principal carer. Research supports the view that the current approach of paying family assistance to the principal carer is in the best interests of the children. While there may be a case in principle for making payments of the IWP to the working partner to strengthen the link to work, in practice, this could only be achieved by also switching payments of family support and family tax credit away from the principal carer.

Impacts

- 4 Continuing to pay all family assistance to the principal carer represents a continuation of the status quo and would therefore have no impact as such. Increases in rates of various elements of family assistance mean that the level of payments to the principal carer will increase.

¹ Family support, family tax credit and the child tax credit (in future, IWP).

Recommended actions

We recommend that you:

- 1 agree that all family assistance - including the IWP, when introduced - should continue to be paid to the principal carer.

AGREE/DISAGREE

Discussion

Payments to couples

- 1 Currently, all family assistance due to a couple is paid to the partner who is the "principal carer" of the children - that is, to the person responsible for the children's day-to-day care. In cases where the principal carer does not work, there is a case for paying IWP to the working partner, underlining the message that work pays. In practice, however, this could only be achieved by also switching payments of family support and family tax credit to that partner. There are robust policy arguments for ensuring that payments of family support, in particular, are always made to the principal carer. Accordingly, we would recommend that the existing arrangements are not disturbed, and that all family assistance (including the IWP) continues to be paid to the principal carer.

Paying family support and family tax credit to the principal carer

- 2 The purpose of family support is to help families with the financial costs of bringing up children, and thereby to deliver improved child outcomes. Research carried out in the UK suggested that money was more likely to be spent on children if it was paid to the mother: women typically take the main responsibility for restraining their own and their partners' spending in order to prioritise the children's needs and are more likely than men to go without to ensure that those needs are met. Payment of family support to the mother in every case would be discriminatory. Continuing to make payments to the principal carer therefore seems to represent the best option.
- 3 There is also a good case for continuing to pay the family tax credit to the principal carer, notwithstanding that entitlement is contingent on work status. Family tax credit performs - and will continue to perform - a dual role, not only making work pay but also guaranteeing income adequacy for some families. Given its on-going role in ensuring income adequacy, it seems sensible to continue to pay family tax credit to the principal carer, increasing the chances that it is spent in the best interests of the children.

Payments of IWP?

- 4 As noted above, there is a case for making payments of the IWP to the working partner (if the principal carer for the children does not work). Paying the working partner would arguably help to emphasise the message that work pays (although there is little or no evidence that allows us to assess how much of a difference this would make to work incentives in practice). Paying the working partner would also help to disassociate the in-work payment from support for children and from its predecessor, the child tax credit.
- 5 However, there would be significant operational difficulties associated with paying the in-work payment to one partner and family support and family tax credit to a different partner. Without significant systems changes, the end-of-year square up would have to be done manually for any household where payments went to

different partners. This isn't really feasible, given the large number of households potentially affected. Thus, the practical choice is between continuing to pay *all* family assistance to the principal carer on the one hand, and switching payments of *all* family assistance to the working partner (or allowing couples to elect for such a switch) on the other.

Conclusion

- 6 There is good evidence that making payments of family assistance to the principal carer is in the best interests of the child. Since payments of IWP cannot easily be untangled from the other elements of family assistance, moving away from the current presumption of payment to the principal carer in all cases would involve some transfer of family assistance from "purse to wallet". Accordingly, we would recommend that the existing arrangements - whereby *all* family assistance is paid to the principal carer - are carried forward.

Other issues

- 7 There is a range of more detailed IWP eligibility issues in relation to which we propose to undertake further analysis and report back early in the new year. To some extent, that analysis will be informed by decisions taken now about broader questions of eligibility.

Groups currently excluded

- 8 Various groups are currently excluded from the child tax credit, the family tax credit, or both. For example, neither people with suspended benefit entitlement nor recipients of a veterans pension or NZ superannuation can currently receive child tax credit. We will need to decide whether or not to carry those exclusions forward and apply them to the IWP. The answer to that question is likely to depend, at least to some extent, on whether a work test is introduced. A work test should render some of the current exclusions unnecessary.
- 9 We are also exploring with the Department of Labour whether there is scope to modify or abandon the current exclusion of recipients of long-term accident compensation payments when child tax credit is replaced by the IWP.

Shared care and joint custody

- 10 The change from the per-child child tax credit to an IWP with a large per-family element raises some new issues in relation to cases where care for a child is shared between more than one household and/or child support is in payment. It makes sense to take the opportunity to review more generally the rules dealing with such situations, with a view to ensuring that future arrangements are internally consistent and supported by a clear policy rationale. This work will also take account of related issues for orphans benefit, unsupported child's benefit and foster care allowance.

Human Rights Act and Bill of Rights Act

- 11 We need to review the proposed design of the in-work payment to ensure that it is consistent with the Human Rights and Bill of Rights Acts.
- 12 The introduction of an IWP raises prima facie issues of discrimination on the basis of both family status and employment status. In some respects, these issues are likely to be similar to those that already arise in relation to the child tax credit, although there are also likely to be points of difference. We will continue to explore these issues with our legal advisers, and with the Ministry of Justice, as the policy design firms up.

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: ADJUSTMENT OF FAMILY INCOME ASSISTANCE RATES AND THRESHOLDS OVER TIME

Issue

To date, the question of adjustment of Family Income Assistance (FIA) rates and thresholds over time has not been addressed. The Speech from the Throne stated that 'it is intended to move towards annual reviews of Family Support and Family Tax Credit rates and thresholds'. We are keen to get Ministers' guidance on the approach they would like us to take to this.

Officials see a need for some form of regular review process. A key issue is one of consistency in terms of income adequacy. One assumption underlying the social assistance system is that core benefits plus Family Support provide the minimum level of income required to meet a family's basic needs. With a key part of the system (FS) not regularly adjusted for cost of living increases, this level of income is maintained for beneficiaries without children but not for families. In recent times the declining real value of Family Income Assistance (FIA) has contributed to pressure on other parts of the social assistance system. Longer-term, the problem will be exacerbated by the proposed changes because of the transfer of the child component out of the (indexed) core benefit and into the (non-indexed) FS.

If FS thresholds remain fixed, the level at which a family is expected to start contributing more towards their children's living costs declines over time. In addition, we now have a situation where the highest benefit rate (IB couples with children) exceeds the FS threshold. This is inconsistent in that on the one hand the IB rate represents the minimum amount these families need, while on the other they are deemed not to require full Family Support assistance. In practical terms the effect is that this group loses part of each year's cost of living increase through a manual adjustment to their FS entitlement.

While Ministers might not need to decide adjustment issues until 2007, Ministers may want to be able to announce policy for future adjustment of FIA rates and thresholds at the same time that the rest of the package is announced. It should be noted that, if Ministers' so wish, the \$10pw across the board increase in FS rates scheduled in the current option for 1 April 2007 provides some opportunity for considering options for adjustment processes.

Possible solutions

There are a number of ways in which FIA rates and thresholds could be regularly reviewed and adjusted. One approach would be to legislate for a review, similar to the annual review of the statutory minimum wages under the Minimum Wages Act. Such a review may or may not result in any change in either rates or thresholds.

A second approach would be to include FIA rates and/or thresholds in the annual general adjustment of benefit rates and thresholds that is carried out each April. This adjustment, which is based on Cabinet decision, not legislation, adjusts benefit rates for movements in the Consumer Price Index.

A third approach would be to provide for some form of periodic review and adjustment process (possibly through legislation) that takes into account a wider range of factors. Aside from cost of living increases, a number of other factors and indicators are also relevant in determining FIA rates and thresholds, including wage movements, living standards data, social values and the Government's fiscal position. This approach could provide for a formal process for adjusting rates and thresholds whilst still giving flexibility to take the full range of factors into account.

Impacts

Impacts will depend on the approach adopted.

Recommended action

We recommend that you:

1. Indicate when you wish to announce proposals for annual reviews of Family Income Assistance rates and thresholds.
2. Indicate what approach or approaches you would like officials to further develop and report back on.

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY SUPPORT RATES AND STRUCTURE

Issue

1. Current Family Support rates may be considered an ad hoc product of historical changes.
2. Stage 1 proposals are broadly consistent with research on the cost of children and living standards research. However, proposed stage 3 increases (currently a \$10 flat increase to all Family Support rates) could be revised to differential rate changes in light of research, to achieve more effective targeting.

Proposed Solution

3. We seek Ministers agreement to develop a revised stage 3 Family Support proposal (subject to the current budget of \$200 million) so as to be more consistent with research findings with the aim of improving targeting.

Recommended Actions

We recommend that you:

1. agree that officials review the proposed stage 3 Family Support increases in light of research findings with the aim of improving targeting and report back in February 2004

AGREE/DISAGREE

2. indicate whether that the above review should include simplification as an objective.

YES/NO

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE FLOW-ON EFFECT – CHILD SUPPORT

Executive summary

Issues

1. As part of the Future Directions initiatives, it is proposed to increase the level of Family Support. This measure will have the effect of increasing the living allowance for some liable parents under the current Child Support formula. As a result, some custodial parents will receive lower payments of Child Support. The Crown will also receive lower Child Support payments in respect of custodial parents on benefit.

Proposed Solutions

2. The two options are:
 - to maintain the status quo and allow the increase in FS to flow through to the Child Support formula. The cost to the Crown is estimated at \$10.85 million for the first year increase of \$25 per child and the reduction in Child Support payments to custodians is estimated at \$6.65 million; or
 - to legislate for the current FS levels in the Child Support formula and index these levels to the CPI. There is a minimal fiscal impact in indexing FS to the CPI (for Child Support purposes) but we do not have a costing yet. This option is strongly recommended as it ensures that custodians are not worse off under the proposed increases to FS.

Impacts

The cost of Option 1 to the Crown is estimated at \$10.85 million for the first year increase of \$25 per child. The reduction in Child Support payments to custodians is estimated at \$6.65 million.

There is a minimal fiscal impact under Option 2 of indexing the current levels of Family Support to the CPI. A costing, however, is not yet available.

Recommendation

We recommend that you:

- 1 agree to legislate for the current levels of Family Support contained in the calculation of living allowance in the Child Support payment formula and index these levels to the CPI.

AGREE/DISAGREE

Policy Considerations

3. The amount of Child Support to be paid by a liable parent depends on a number of factors, including the liable parent's living allowance, which is deducted from the liable parent's taxable income. The living allowance for a liable parent with dependent children is calculated based on the gross married rate of Invalid's Benefit (IB) plus FS at the subsequent child rate for up to four dependent children.
4. Reductions in the Child Support liability will either result in a reduction in Crown Revenue, where the custodian is in receipt of a social security benefit, or reduced income for custodians. The Crown retains Child Support payments for custodians who receive a benefit and so would bear some of the cost of lower payments.
5. Up until now, changes to the relevant FS rate have flowed through into an increase in the Child Support living allowance rates. The largest previous increase was \$130.50 per annum per child in 1996.

The Flow-on effect to custodians

6. Custodial parents receiving a benefit only receive that portion of Child Support that exceeds the level of their benefit. To the extent that the benefit exceeds the Child Support liability, the Crown does not pass on any of the Child Support. Therefore, a decrease in the Child Support payments from liable parents to custodial parents receiving a benefit will result in a fiscal cost to the Crown. Those custodial parents receiving a benefit who do not work number 28,586, about 53% of total custodians.
7. If the custodial parent is in full-time paid employment, he/she receives the full amount of Child Support paid by the liable parent. Any decrease in the level of Child Support is therefore borne by them. This means that maintaining income adequacy in one family comes at the cost of reducing another's income. This category of custodial parents numbers 25,029, approximately 47% of total custodians.
8. For those custodians that also receive FS, however, any loss of Child Support will be offset by an increase in the level of FS they receive. For this group, generally custodial parents are better off the lower the level of the liable parent's income. As the liable parent's income increases, the custodian's net gain from an increase in FS decreases.

Equity between liable parents

9. Liable parents who have other children in their care get a reduction in their liability as a result of the increase in FS, while those who have no children do

not. This could send a mixed message about primary responsibility to first children.

10. Alternatively, this may be viewed as a reduction in the costs imposed on some families with children.

Equity between Custodians

11. Those custodial parents whose corresponding liable parent has children in a new relationship already consider themselves to be disadvantaged by the recognition of those children in the living allowance. They may consider it unfair that they get a reduction in their Child Support while other custodians do not.

Options

12. There are two options being considered to address the effect of an increase in FS on Child Support liabilities.

Option 1 – allow the increase in Family Support to flow through

13. The first option is to simply allow the effect of an increase in FS to be reflected in the calculation of a liable parent's living allowance and the subsequent lower Child Support payments.
14. The advantage of this approach is that it is consistent with the principle that the level of liability to be paid is determined according to the financial capacity of the liable parent.
15. Further, a precedent has been set whereby previous increases in FS have flowed through to an increase in living allowances, albeit at much lower levels.
16. The disadvantage is that those custodial parents who do not receive any FS because their income fully abates the payment are worse off. There also exists a category of custodial parents who are working part-time and whose FS is abating. They will be better off, but will not receive the full benefit of the increase in FS. There are currently 25,029 custodians in both these categories. The total cost to this group is estimated at \$6.65 million.
17. In addition, because the changes would affect only those liable parents who have dependent children in their care, there are issues of equity as between liable parents who have children and those who do not. In particular, custodians whose level of Child Support is affected by the children in the liable parent's subsequent family already consider that they are unfairly disadvantaged.
18. The fiscal cost of allowing a \$25 per child increase in FS to flow through to the calculation of the Child Support formula is \$10.85 million. This cost relates to the additional proportion of the benefit paid by the Government to custodial parents who are not in full-time employment and who receive a benefit. Note that this cost is only for the first-year changes to FS.

Option 2 – Legislate for current levels of Family Support in the Living Allowance formula

19. The second option is to legislate for the current levels of FS that are used to calculate the living allowance. This measure would effectively allow for an increase in FS as well as maintain current levels of Child Support. The child component of the living allowance, previously represented by FS, could then be indexed to the CPI to ensure there is no future erosion of Child Support liabilities.
20. The benefit of this approach is that it ensures that custodians do not receive less Child Support as a result of any increases in FS rates.
21. This approach also maintains the current relativity between liable parents who have no children and those who have children and receive FS, and who would, under Option 1, receive an increase in their living allowance.
22. The calculation of the living allowance will still be based on the gross married rate of IB which, although this is not tied to the number of dependent children, still provides for a minimum standard of living and is itself adjusted annually in line with the CPI. Further, the level of FS legislated for would be indexed to the CPI to ensure it does not erode over time.
23. However, the increase in FS is designed to recognise the need for a higher level of income required to meet a minimum standard of living for those liable parents with dependent children. By removing the link to FS when calculating the living allowance, there is an argument that the living allowance would no longer reflect the minimum standard of living. It should be noted, however, that this approach treats the issue of allowable costs differently to our proposals for Special Benefit which sets provides only 70% of the excess of the minimum standard of living costs over and above the benefit received.

Fiscal costs

24. There will be an overall minimal increase in Child Support payments in nominal terms as a result of indexing the current levels of FS of the Child Support formula to the CPI. This will result in a small fiscal cost that has yet to be determined.

Comparison of options

25. Table 1 summarises the net gain or loss for custodians as a result of retaining the status quo and allowing the increase in FS to flow through the Child Support formula and legislating for current levels of FS plus indexation in the formula. The summary takes into account receipt by the custodian of FS to the extent they are eligible.
26. It is clear that custodians whose FS has fully abated will receive less Child Support under Option 1. A proportion of those custodians who still receive some FS will also receive less Child Support under Option 1. Option 2 is preferable because it ensures custodians are not worse off after the reform.

Table 1 Net Loss/Gain to Custodial Parents		
Custodial Parent Income	Option 1 Allowing Flow Through of FS	Option 2 Legislating for Current Levels of FS
Beneficiary	Net Gain	Net Gain
Income > \$20,000 FS is abating	Gain until FS abates to the point where the loss in Child Support payments is greater than increase in FS	Net Gain
Income > \$20,000 FS has fully abated	Net loss	No change

27. The options considered here do not include a review of the Child Support formula. Such a review would involve consideration of the fundamental basis of the formula, in particular whether it should give priority to the minimum living allowance for the liable parent or the child-care costs incurred by the custodian.

12 December 2003

Minister of Finance and Revenue
 Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE FLOW ON EFFECTS: COMMUNITY SERVICE CARD

Executive Summary

Issue

- 1 Eligibility for Community Service Card is defined by income. Under the proposed Family Income Assistance (FIA) reforms, low income households' incomes will rise. The reforms have the potential to cause an estimated 10,000 existing Community Service Card (CSC) holders to lose their eligibility to CSC. On average this would cost current holders \$600pa, but many holders with chronic health problems have the potential to lose more from the loss of CSC subsidies than they will gain from the FIA reforms.

Proposed Solution

- 2 This paper seeks your agreement in principle to increase CSC thresholds at each stage of the reforms to ensure that existing CSC holders continue to remain eligible for CSC.

Impacts

- 3 The proposed solution would provide continued access to CSC to all existing holders, however, it is not completely efficient, in that it provides more than required for most couples with dependents. This means that some couple families who are not currently eligible will become eligible under the proposal.
- 4 This option then has an associated fiscal cost (but this has yet to be determined). This cost could be reduced if separate thresholds for sole parents and couples were introduced (although the operational feasibility of separate thresholds has yet to be explored).

Recommended Actions

We recommend that you:

- 1 agree in principle, subject to a report back on cost, that CSC thresholds be increased at each of the three stages of the FIA reforms to ensure all current CSC holders continue to remain eligible for CSC
 AGREE/DISAGREE
- 2 note that the impact on health expenditure from increasing CSC thresholds will be assessed as part of the work ahead and that the intention is to fund all flow-on costs from the Future Directions package
- 3 agree that the Ministry of Health be consulted on the associated policy and fiscal implications of the above proposal.
 AGREE/DISAGREE

Introduction

1. This paper considers the potential effect of the proposed Family Income Assistance (FIA) reforms on Community Service Card (CSC) holders, and proposes increases to CSC thresholds to ensure existing CSC holders continue to remain eligible for CSC subsidies.

Background

CSC eligibility and entitlement - problem definition

2. CSC eligibility is determined by the following income thresholds:

o 2-person household	\$30,748
o 3-person household	\$35,815
o 4-person household	\$40,883
o 5-person household	\$45,952
o 6-person household ¹	\$51,022.
3. As a result of the proposed FIA package (comprising Family Support (FS) increases, reduced child component to benefits, and changes in FS abatement thresholds), many families will have higher incomes. Expected gains vary from \$4,160pa (\$80pw) for a family of one child to \$9,100pa (\$175pw) for a family with six children. This potentially means that an estimated 10,000 CSC holders could lose access to their CSC as a result of the proposed reforms.
4. The FIA reforms will not affect the eligibility of beneficiaries or superannuitants to CSC. Beneficiaries are entitled automatically to CSC and superannuitants do not have family assistance counted as income for CSC purposes. However, non-beneficiaries have family assistance counted as income for CSC purposes. Thus the increase in FIA has the potential to cause some non-beneficiary families to become ineligible for CSC.
5. The CSC provides subsidised medical costs (in particular, on GP fees and pharmaceuticals). The average subsidy provided through CSC is estimated at around \$600 per annum for a family, but assistance to families with chronic health problems is far higher than this. The CSC can also bring with it a number of other less visible benefits such as subsidised travel, accommodation, home help and emergency dental costs.
6. Potential loss of CSC would, at least partially, offset the gains from the Future Directions package. Indeed for some families, the loss of CSC has the potential to out-weigh the gains from increased FIA assistance ie some families have the potential to lose more than they gain as a result of this undesirable flow-on effect.

Health reforms - CSC

7. Government has signalled an intention to phase out CSC over the next eight or so years, as additional funding is put into the primary health care strategy. Primary Health Organisations (PHOs) are providing services to an increasing proportion of the population, reducing the importance of CSC. However, for families living in areas that are covered by interim PHOs or where there are no PHOs, the CSC still provides government subsidies on primary health care.

¹ For families of 7 or more persons, the income limits increase by \$4,840 for each additional person.

8. Given the lessening of importance of CSC, it may be more acceptable to make pragmatic changes. Of course, any option which changes the number and/or composition of CSC holders will require agreement by relevant Ministers (and in particular, the Minister of Health).
9. The expectation is that flow on costs will be funded from the FIA package, rather than from within the Health budget. The lessening importance of CSC means that any flow on costs will gradually decrease, as use of the card declines.

Options

10. Three options have been considered to solve the problem of some holders losing access to their CSC as a result of the proposed FIA reforms:
 - no action
 - grand-parenting existing CSC cardholders
 - increase CSC thresholds.

Option 1: No action

11. Under this option, no action would be taken as a result of the flow on effect of FIA onto CSC. This would mean some 10,000 families would gain additional FIA but lose access to their CSC². For some families with chronic health problems, the net effect would be a reduction in their standard of living (rather than, the intended effect of FIA reforms, to increase families' standard of living).
12. Both the numbers affected and the size of some of the losses mean this is not considered a viable option.

Option 2: Grand-parenting existing CSC cardholders

13. Grand-parenting would ensure existing CSC holders remained eligible. However, it would cause inequity of treatment (creating Human Rights concerns). It would also have significant operational implications.
14. Grand-parenting provisions are unfair on new applicants who would immediately face the consequences of reform, while existing card holders continue to benefit. Human Rights issues would need to be worked through with the Ministry of Justice. Because of equity considerations, any grand-parenting provision should be the minimum necessary to allow card holders to make alternative arrangements for their continued economic welfare in the absence of grand-parenting. However, as previously mentioned, the Government's intention is to phase out the CSC. This means that even without a specific grand-parenting time limitation, the measure should eventually be phased out.
15. Under grand-parenting, the system needs to be able to identify those losing their card due to the reforms, as opposed to those losing their card because of other income changes. If this was to be achieved with 100% accuracy then Inland Revenue (IRD) would need to continue to assess income for existing cardholders based on the current income definition (ie including

² Note that entitlement for CSC is annual and the cards are renewed throughout the year, so most families wouldn't lose entitlement immediately.

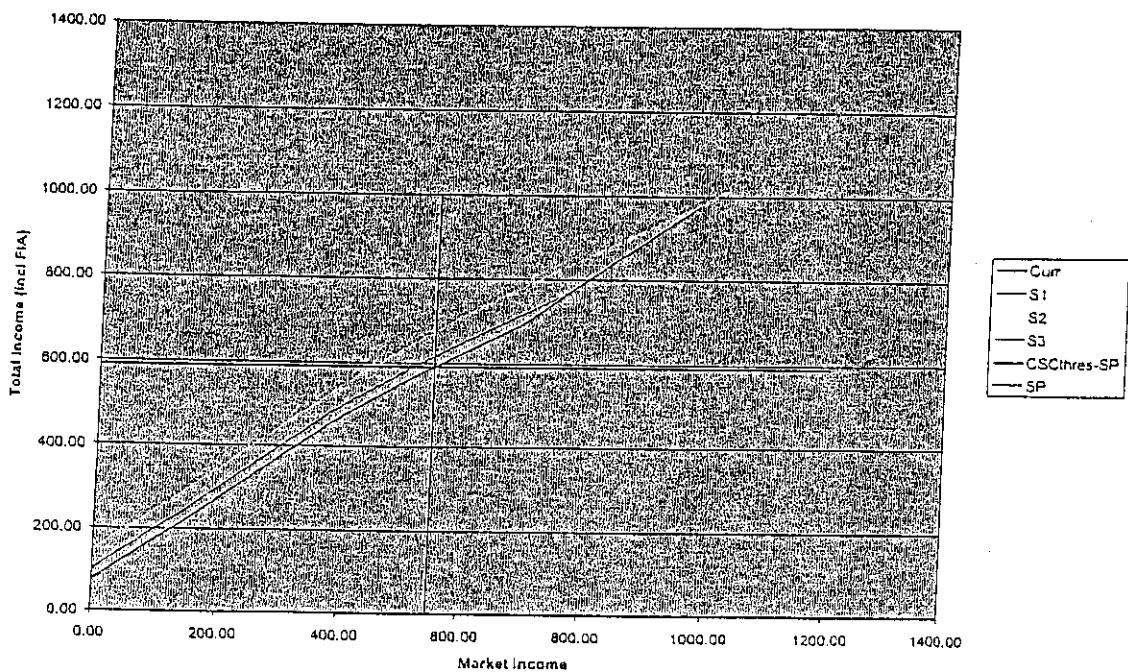
Child Tax Credits but excluding the In-Work Payment). This would require IRD to retain the current system's functionality as well as building new functionality for new holders. This is not considered feasible.

16. The alternative would be to assess all applicants using the same income definition but with grand-parented holders being assessed against slightly higher income thresholds (refer option 3 below). This would require dual SWIFTT screens and thus would require EDS system changes (probably possible given the time line, but it would require significant effort by EDS).
17. This option would likely require a change in regulations and/or special provisions incorporated into the new social security provisions under which the FIA changes are enacted. Refer *Fitzgerald v Muldoon* (1978 2 NZLR 615) relating to the suspension of the law without the consent of Parliament in relation to the grand-parenting of rest home subsidies.
18. In conclusion, any grand-parenting option would have significant operational and legal implications, would be inequitable and would create problems in relation to Human Rights. This option is therefore not favoured.

Option 3: Increase CSC thresholds

19. CSC thresholds are defined by family size. Currently a sole parent with one child is ineligible for CSC once their income (including family assistance) reaches \$30,748pa or \$591pw. This would be reached with a market income of \$565pw and abated family assistance of \$26pw (refer diagram 1 below).

Diagram 1: Total income under the proposed reforms for sole parents with one child³



³ Assumes current Family Support equals \$47pw.

20. Thus for sole parents with one child we need to raise the CSC thresholds so that those with a market income of \$565 would continue to hit the CSC eligibility threshold. This is the point where the vertical line in the above diagram intersects with the budget line (total income) under stage 1, stage 2 and stage 3. This means that the CSC threshold for sole parents with one child should be raised as follows:

Table 1: Implied CSC thresholds for sole parents with one child under the proposed reforms

	Current	Stage 1	Stage 2	Stage 3
Per week	\$591.31	\$616.31	\$674.67	\$684.67
Per year	\$30,748	\$32,048	\$35,083	\$35,603

21. These implied changes to CSC thresholds take into account not just the effect of increased FIA income but also the effect of abatement. Thus the increase to two person family threshold is \$4,855 (\$35,603-\$30,748), compared to the total (unabated) gain of \$4,160 (\$80pw).
22. Proposed new thresholds based on the current preferred option are shown in table 2 below. Any changes to the preferred option, would mean that these proposed new CSC thresholds would need to be revised to ensure that they remain effective (ie no resultant losers) and efficient (ie, least cost).

Table 2: Proposed revised CSC threshold under the reforms

	Gross taxable CSC income thresholds (pa)			
	Current (pa)	Stage 1	Stage 2	Stage 3
Unmarried – sharing accommodation	\$19,439	No Change	No Change	No Change
Unmarried – living alone	\$20,593	No Change	No Change	No Change
Couples no dependents	\$30,748	No Change	No Change	No Change
2-person family	\$30,748	\$32,048	\$35,083	\$35,603
3-person family	\$35,815	\$37,895	\$40,422	\$41,462
4-person family	\$40,883	\$43,743	\$45,490	\$47,050
5-person family	\$45,952	\$49,592	\$51,339	\$53,419
6-person family	\$51,022 ⁴	\$55,442 ⁵	\$57,189 ⁶	\$59,789 ⁷

23. No increases would need to be made to thresholds for families with no children (since no increase in FIA is proposed under the reforms for this group).
24. This option would provide continued access to CSC to all existing holders. However, this option is not completely efficient, in that it provides more than required for most couples with dependents. This means that some couple families who are not currently eligible will become eligible under the proposal. Essentially this is because current thresholds are a function of family size whereas the increases required are a function of both household type (sole parent/couple) and the number of children. The increase proposed is more than sufficient for

⁴ For each additional family member, add \$4,840

⁵ For each additional family member, add \$5,620

⁶ For each additional family member, add \$5,620

⁷ For each additional family member, add \$6,140.

couples (since the increase required for sole parent and couples differs and greater of the sole parent and couple increase is used). A more efficient alternative (ie, less costly) would be to revise the current structure so that CSC thresholds differ for sole parents and couples (as well as by household size).

Conclusion

25. Option 3 appears to be the only feasible option. It is reasonably tightly targeted and will have minimal operational implications.
26. Option 2 (grand-parenting) would have significant legal and technical difficulties to overcome. The status quo (option 1) leaves the problem intact, and it is considered unacceptable to have some 10,000 existing CSC holders lose their CSC benefits as a result of the proposed FIA reforms.

Operational implications

27. Increasing CSC thresholds under the current CSC structure (specified by household size) would be easy to operationalise. CSCs are renewable once a year by IRD supplying the Community Service Card Centre with families' incomes (from the previous financial year). Hence the effect of the revised thresholds will be spread throughout the year.
28. CSC thresholds would need to be increased under each of the three stages of the reform, ie, April 2005, April 2006 and April 2007.
29. Introduction of separate sole parent and couple thresholds would be less costly but likely to be more difficult to operationalise. The operational implications of separate thresholds for sole parents as opposed to couples have yet to be fully explored. In particular, Ministry of Health (MoH) and the Community Service Card Centre need to be consulted.

Legal implications

30. Increasing current CSC thresholds can be achieved by changing the regulations through Order in Council (refer section 132A of the Social Security Act 1964 and section 92 of the New Zealand Public Health and Disability Act 2000 – the regulations are made under both provisions). MoH has responsibility for administering these regulations, in consultation with the Ministry of Social Development. It is also possible to amend the regulations by Act of Parliament. The appropriate vehicle to use will be dictated by the degree of risk that the proposed changes will contain unjustified discrimination within the meaning of the New Zealand Bill of Rights 1990. This assessment has not yet been made, but will need to be canvassed in the Cabinet paper.

Fiscal implications

31. To ensure all current CSC holders remain eligible for CSC following the proposed FIA reforms, CSC thresholds should be increased under each stage of the reforms. Because the minimum necessary effective increase differs according to family circumstances (family type and children's age - FS entitlement), there is some inefficiency in the proposed raising of the thresholds and hence some fiscal cost involved.

32. This cost could be significantly reduced, if CSC eligibility can be defined by family type (sole parent and couple) as well as the number of children rather than currently, just using the total household size. However, the operational implications of this change to the CSC structure has yet to be explored (refer above).
33. As noted earlier the lessening importance of CSC means that flow on costs will gradually decrease, as use of CSC declines.

Consultation

34. IRD has been consulted in the preparation of this paper. However, consultation with MoH and the Community Service Card Centre has not yet taken place.

12 December 2003

Minister of Finance and Revenue
Minister for Social Development and Employment

FAMILY INCOME ASSISTANCE: OTHER FLOW ON EFFECTS

Executive Summary

- 1 This report seeks agreement to working solutions to each of the range of flow-on effects associated with the Future Directions Family Income Assistance preferred approach. The agreed solutions will provide us with a steer and help focus further policy work undertaken around each issue. It summarises the nature of each flow-on and recommends an approach to the issue. The flow-ons are divided into two groups according to significance. Those identified as 'insignificant' have either negligible or no policy and no fiscal impacts.
- 2 The following table briefly describes the significant flow-ons, the recommended approach and consequent fiscal impacts:

FLOW ON	DESCRIPTION	RECOMMENDED APPROACH	FISCAL IMPACT
Accommodation Supplement (AS)	Increases in assistance result in a partially offsetting reduction in AS	Allow flow-on, and note that this reduces the level of gains for people with AS	Significant Savings
Income Related Rents (IRR)	Increases in assistance result in a partially offsetting reduction in IRR	Allow flow-on, and note that this reduces the level of gains for people with IRR	Savings - \$11.3m approx.
Student Allowance (SA) Rates	Allowance rates are set equal to benefit rates.	Pass on the reduction in benefit rates and the increase in FS to SA recipients	Savings - \$3.3m
Pathways Payment	Pathways is equal to 2 weeks benefit payment.	Allow the flow-on to reduce the level of Pathways.	Very small saving
Benefit Stand Downs	The stand-down formula includes a per child add-on which is based on first child FS rates	Increase the per child add-on from \$50 to \$80.	Very small cost

Recommended Actions

We recommend that you:

- 1 agree that the package be developed on the basis that the Family Income Assistance proposals will increase Accommodation Supplement entry thresholds, and this will reduce the level of gains for people with Accommodation Supplement

AGREE / DISAGREE
- 2 agree that the package be developed on the basis that the Family Income Assistance proposals increase the level of Income Related Rent for some families and result in fiscal savings of approximately \$11.3 million

AGREE / DISAGREE
- 3 agree that changes to Family Income Assistance should be extended to student allowance recipients with children, with a corresponding reduction in the fiscal cost of approximately \$3.3 million

AGREE / DISAGREE
- 4 agree that the Pathways Payment remain linked to benefit rates, with a corresponding reduction in the level of this payment

AGREE / DISAGREE
- 5 agree that the package be developed on the basis that increases in Family Support rates will be passed through into the formula for benefit stand-downs.

AGREE / DISAGREE

Purpose of the Report

- 1 This report seeks agreement to working solutions to each of the range of flow-on effects associated with the Future Directions Family Income Assistance preferred approach. The agreed solutions will provide us with a steer and help focus further policy work undertaken around each issue. It summarises the nature of each flow-on and recommends an approach to the issue. The flow-ons are divided into two groups according to significance. Those identified as 'insignificant' have either negligible or no policy or fiscal impacts.

Significant Flow-ons

Accommodation Supplement (AS)

- 2 The AS subsidises 70% of housing costs over an entry threshold, up to a maximum subsidy amount. The entry threshold is calculated as 25% (30% for mortgagors) of the client's net benefit rate plus the first child rate of family support (FS). The proposed 2005 and 2007 increases in first child FS and the benefit reduction in 2005 will all result in a reduction in base AS entitlement for families affected by the changes. Families who receive AS will therefore have part of their FS gains reduced via the operation of the AS.
- 3 This issue demonstrates the normal operation and policy intent of the AS. There is a precedent to simply allow this as a flow-on effect, but it will result in the average gains being smaller than indicated by Taxmod. The fiscal result is a significant net reduction in the overall cost of the Future Directions package.

Income Related Rents (IRR)

- 4 IRR sets clients' net rents equal to 25% of their net income. For IRR purposes, net income is defined in the same way as it is for the AS entry threshold. The proposed changes in 2005 and 2007 will therefore increase clients' IRR by 25% of the increase in assessed income provided they are not already at the market rent for the property.
- 5 It would be consistent with the rationale behind IRR not to change the formula for assessment and to allow this flow-on. This would result in a saving that is likely to reduce the cost of the overall package by around \$11.3 million.

Student Allowance Rates

- 6 Student Allowance rates are directly linked to benefit rates. It would be logical to extend the FIA changes to students with dependent children. This means that the increases in FS in 2005 and 2007 are passed into SA rates, and the benefit cuts in 2005 are also passed through. Overall students with children would gain in the same manner as other families with children. This would reduce the overall cost of the Future Directions package by an estimated \$3.3 million.

Pathways Payment

- 7 The Pathways Payment is a payment equivalent to 2 weeks benefit, available to long term beneficiaries with dependent children who leave benefit for full-time work. The benefit reductions proposed in 2005 reduce the level of assistance available through the Pathways Payment.

- 8 It is suggested that the link with benefit rates is maintained and this would not result in losers *per se*. This would result in a drop in the value of the payment for DPB recipients with 2 or more children, and for couples with children, and would result in a small reduction in the overall cost of the Future Directions package.

Benefit Stand down formula

- 9 The formula for initial stand-down for benefits is based on the client's income over the previous 26 week period in relation to the average ordinary time weekly wage. The formula is adjusted (favourably) for clients with a partner by adding \$80 and is increased for each dependant child by \$50. Originally the \$50 allowance for dependant children was based on the \$47 first child rate of FS (rounded up).
- 10 A policy decision is needed regarding whether the \$50 for each dependent child in the initial stand-down formula should be increased to reflect the increase in FS rates. To maintain the original policy rationale, the dependant child add-on would need to be increased to \$75 in 2005 and \$85 in 2007.
- 11 We recommend increasing the dependant child add-on to \$80 per week in 2005 – equivalent to the dependant spouse add-on. This would result in some simplification of the stand-down formula, and would maintain the broad policy rationale for the dependant child add-on. This would result in some additional fiscal cost, but this is likely to be minimal.

Insignificant Flow-ons

- 12 The following list of flow-ons are insignificant in that they have either negligible or no policy or fiscal impacts. This list is provided for completeness:
- Residential support
 - Seasonal work assistance
 - Away from home allowance
 - ACC direct deduction
 - Emergency maintenance allowance
 - Student allowance transfer grant
 - Benefit debt
 - Rural assistance programme