DEPARTMENT OF THE PRIME MINISTER AND CABINET
TE TARI O TE PIRIMIA ME TE KOMITI MATUA

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

Report

Date: 1 March 2019 **Security Level:** BUDGET SENSITIVE

To: Rt Hon Jacinda Ardern, Prime Minister, Minister for Child Poverty Reduction

Hon Carmel Sepuloni, Minister for Social Development

Indexation: issues, options and key considerations

Purpose of the report

1 This report provides advice on indexation settings, including:

- an overview of current settings, and options for a more consistent approach
- the relationship between indexation and child poverty objectives
- advice on other considerations including fiscal costs, relativities and incentives

2 It also provides advice on what could be pursued in Budget 2019, if you wish to submit a late bid.

Executive summary

The broader context for this advice

3 Ministers have requested advice on indexation within the context of their specific portfolios.

- In December 2017, MSD officials provided the Minister for Social Development with initial advice on some potential changes to the indexation regime that could be explored further [REP/17/12/1316]. Further advice was requested but the work was deferred until the report by the Welfare Expert Advisory Group (WEAG).
- The Minister for Child Poverty Reduction has requested advice on different options for indexation within the context of Budget 2019 decisions. This includes providing analysis of the impacts of potential changes to indexation settings on rates of child poverty, particularly in the context of the Government's child poverty reduction targets.
- s 9(2)(f)(iv) [redacted]

4 The WEAG has now provided the Minister for Social Development with its final report, which includes recommendations on indexation. They recommend that the Government fully index all income support payments and thresholds annually to movements in average wages and prices, whichever is greater. They also recommend that AS maxima are indexed to movements in housing costs.

5 This advice is being provided on the specific issue of indexation now, ahead of wider consideration of the Government's overall response to the WEAG's recommendations.

This is to respond to the specific requests from Ministers and to help inform decision-making for Budget 2019.

6 It should be noted that this advice has been developed in relation to the current system of payments, rather than the new system of payments recommended by the WEAG. The WEAG recommends a major redesign of Working for Families payments, including making the Best Start payment universal, significant changes to the targeting of the Family Tax Credit, and a new payment (the 'Earned Income Tax Credit') to replace the In-Work Tax Credit and the Minimum Family Tax Credit.

7 If you wish to introduce indexation changes in Budget 2019, we recommend you focus on payments which are not proposed for redesign by the WEAG: benefit rates would be the best candidate, s 9(2)(f)(iv) [redacted] We note that if payment rates are subsequently lifted, particularly to levels recommended by the WEAG, it will have a substantial impact on the longer-term indicative costings included in this paper.

Indexation: issues and options

8 There is considerable inconsistency and complexity in current indexation settings, both for different payments within the benefit system, and also across the broader benefit system and Working for Families tax credits. Some payments are regularly adjusted in line with inflation, some are adjusted only intermittently, and others are not routinely adjusted at all. This means that, left to its own devices, the income support system erodes over time, with payment levels declining in relation to the cost of living.

9 Even if income support completely maintains its relationship with the cost of living, the gap between the living standards of beneficiaries and other New Zealanders is likely to still grow, as wages generally grow faster than inflation. In recent decades, the incomes of beneficiaries have fallen progressively further behind those of working households.

10 There are multiple options and sub-options that could be considered as part of a more consistent and comprehensive approach to indexation. The approach you take is in part dependent on your objectives:

- If your objective is to maintain the value of payments in relation to the changes in living costs, you could consider changes that would ensure that all current payment levels and thresholds are adjusted in line with movements in costs and prices for low-income households. The key payment affected would be the In-Work Tax Credit (which is not currently adjusted at all), but there are also numerous other payment limits and thresholds in the income support system that could also be considered for automatic adjustment.
- An alternative objective is not simply to maintain the value of payments in relation to living costs, but also to maintain a link with the living standards of broader New Zealand society. You could explore the indexation of payments to wages, rather than prices - the most likely candidates for wage indexation are benefit rates [redacted]
- s 9(2)(f)(iv) [redacted]

11 Given the multiple options involved, we have grouped the various options into the two broad approaches:

Cost of living indexation **(Approach 1)**	This could involve: • using Household Living Price Indexes for adjusting rates • s 9(2)(f)(iv) [redacted] • s 9(2)(f)(iv) [redacted] • s 9(2)(f)(iv) [redacted] - [redacted] - [redacted] - [redacted]
Wage indexation **(Approach 2)**	This could involve: • indexing benefit rates to wages • s 9(2)(f)(iv) [redacted] • s 9(2)(f)(iv) [redacted] • s 9(2)(f)(iv) [redacted] - [redacted] - [redacted] - [redacted]

12 s 9(2)(f)(iv) [redacted] This approach would ensure the living standards of low-income families are maintained relative to the living standards of broader New Zealand society.

Relationship to the Government's child poverty targets

13 Changing indexation settings would support the Government's objectives for a sustained reduction in child poverty on all of the measures, but different indexation arrangements will likely mean different levels of progress on each measure:

- Achieving the target on the before-housing-cost moving line measure requires that the incomes of the poorest households not only keep pace with those on middle incomes, but that they *increase in relative terms*. If the Government decided to index payment rates of benefits s 9(2)(f)(iv) [redacted] to wages, this would help ensure the distance between the incomes of low-income households and middle-income households would not grow.

- Achieving the target on the after-housing-cost fixed line measure requires incomes to increase faster than housing costs for low-income families. In times of general economic growth, poverty measures using a fixed line approach can generally be expected to decline, even on the after-housing-cost measures, through improved wages for low-income households. However, there is a limit to how low these rates can fall, as there is a large beneficiary population on incomes that do not (often) rise in real terms. Without regular adjustment of the AS maxima, residual incomes (incomes after housing costs) are likely to decline for those with high housing costs.

- Levels of material hardship are determined by a much broader range of factors than current income and housing costs, but levels of residual income still have a strong influence on rates of material hardship. Any of the more generous indexation arrangements in this paper would support progress on this measure, s 9(2)(f)(iv) [redacted]

14 While some of the progress required to achieve the targets could be achieved through increases in wages for low-income households, it is likely that a proportion will need to occur through income support transfers – s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

15 s 9(2)(f)(iv) [redacted]

16 s 9(2)(f)(iv) [redacted]

17 s 9(2)(f)(iv) [redacted]

Some key considerations

18 There are some additional factors that need to be considered when reviewing indexation settings:

- indexation changes relative to the status quo carry an additional fiscal cost, which becomes more and more substantial in outyears. For example, indicative costings show wage indexing main benefits would cost $50m in 2020/21, rising to $130m in 2022/23 and $700m in 2028/29. Over time, the stronger level of wage growth over inflation will accumulate, so the costs will grow significantly outside of the budget forecast period. However we also note that, as a proportion of overall GDP, estimated expenditure on social assistance is still expected to steadily decline – both on current settings and for all the options in this paper.
- due to the additional fiscal costs, automatic indexation using wages could constrain government flexibility to use one-off rate increases to adjust real relativities between different parts of the social assistance system.

Next steps

19 Please indicate if you would like to submit a late Budget bid for indexation of any payments which are not proposed for major redesign by the WEAG. If you wish to proceed with a late bid, we can provide a joint report with advice on implications of such changes - this would seek agreement from the Ministers responsible for the relevant payments, as well as provide a draft letter to the Minister of Finance informing him of the late bid.

20 We will also provide you with follow-up advice on the overall approach to indexation as part of the process of broader response to the WEAG's recommendations.

Recommended actions

It is recommended that you:

1 **note** that the current advice has been developed in relation to the current system of payments, rather than the new system of payments recommended by the WEAG

2 **indicate** if you would like to submit a late Budget bid for indexation of any of the following payments in Budget 2019 which are not proposed for major redesign by the WEAG

2.1 wage indexation of main benefit rates

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

2.2 s 9(2)(f)(iv) [redacted]

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

2.3 s 9(2)(f)(iv) [redacted]

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

3 s 9(2)(f)(iv) [redacted]

4 s 9(2)(f)(iv) [redacted]

5 **forward** this report to the Minister of Housing and Urban Development

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

6 **forward** this report to the Minister of Finance

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

7 **forward** this report to the Minister of Revenue.

Minister for Child Poverty Reduction	**Yes / No**	*Minister for Social Development*	**Yes / No**

Kristie Carter **Director** **Child Poverty Unit**	Rt Hon Jacinda Ardern **Prime Minister** **Minister for Child Poverty Reduction**
….../…../2019	….../…../2019
s 9(2)(a) [redacted] **Policy Manager** **Income Support Policy** **Ministry of Social Development**	Hon Carmel Sepuloni **Minister for Social Development**
….../…../2019	….../…../2019

1. Issues with Current Indexation Settings

21 The current system of income support for beneficiaries is based around three tiers of payment:

- a first tier of working age benefits intended to provide an income to meet the general cost of living;
- a second tier of additional assistance for specific on-going costs, such as accommodation, disability and children; and
- a third tier of targeted assistance that is generally provided in relation to presenting hardship, and available only for costs considered 'essential'.

22 The implicit objective of current settings in the benefit system is to ensure that households' standards of living are maintained relative to changes in living costs. Rates of main benefits (i.e. first tier assistance) have a legislative requirement to be adjusted annually on 1 April by the rate of upwards movement in the Consumer Price Index (CPI). In the second and third tiers, rates of assistance are generally either adjusted by inflation (such as Family Tax Credit and Childcare Assistance payment rates), or the cost itself is part of the formula used to determine the value of the payment (AS). More detailed information on current indexation settings can be found in the appendix.

23 The objective underpinning current settings, which is to maintain the value of payments in relation to the costs they cover, is not currently being met for a number of reasons.

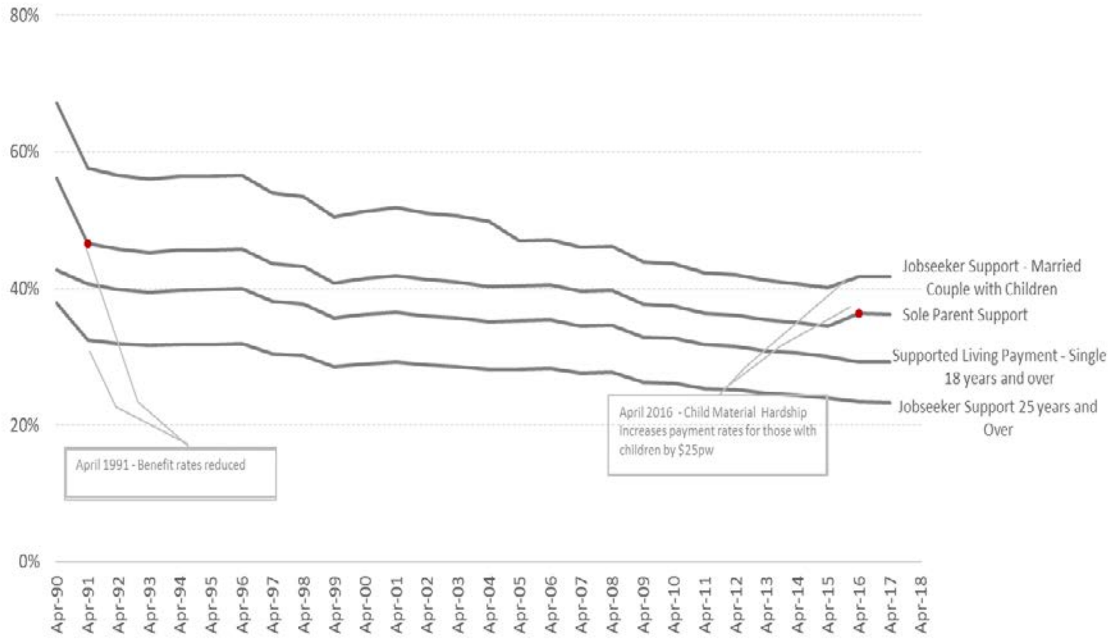
- *The way the CPI index is calculated may not accurately reflect changes in the costs of living for households receiving social assistance payments, particularly for housing costs.* The CPI calculates inflation based on a 'basket of goods' for a single representative household, which does not always align well with inflation experienced by different demographic groups, such as beneficiaries and low-income households. Due to methodological issues with how housing costs are treated, there is also a mismatch between rent price inflation as measured by the CPI and rental costs experienced by low-income households.
- *Payment limits and thresholds in the second and third tiers of assistance are not all routinely adjusted, and their relative values have declined.* A number of payment limits and thresholds are not routinely adjusted at all, and many have not been adjusted for some time. The payment with the greatest impact on overall incomes is the AS, which has a maximum payment limit that is not indexed. Between 2006 and 2017, the AS maxima were not adjusted at all, and residual incomes fell for AS recipients.

24 These issues mean that, left to their own devices, the adequacy of payments erodes over time. Combined with rising housing costs, this has contributed to a growing reliance on the second and third tiers of payments as a core part of the income support system.

The gap between the living standards of beneficiaries and other New Zealanders has grown

25 Even if income support had completely maintained its relationship with prices in recent decades, the gap between the living standards of beneficiaries and other New Zealanders would have grown. This is because wages have generally grown faster than inflation over the past two decades. As the graph below shows, benefit levels have declined as a proportion of average wages; overall, the incomes of beneficiaries have fallen further behind working households.

Net Payment Rates as a Proportion of the Net Average Wage
Main working age benefits – 1990-2018



There is also inconsistency in Working for Families, which means payments decline in real terms for low-income working families

26 There are also inconsistencies in the Working for Families Tax Credits available to low-income working families. Rates of Family Tax Credit and Best Start Tax Credit are only inflation adjusted when the cumulative CPI reaches 5%. By contrast, the In-Work Tax Credit (IWTC) is not inflation-adjusted at all, and is simply required by legislation to be reviewed every three years.

27 The different arrangements for the IWTC in part relate to the different objectives for this payment. The stated purpose of the IWTC is to “make work pay” – both by making a contribution towards the additional costs of work and also by ensuring that work “pays more than a benefit”. In the last scheduled review in 2017, the payment was not adjusted, on the grounds that the gap between benefits and work has grown.

28 While the purpose of the IWTC is to “make work pay”, in practice it also contributes towards the more general income adequacy of low-income working families. In effect, the current approach means that the value of the payment declines over time, and any increases in wages for low income parents are partially offset by a gradual reduction in the real value of the payment.

2. Options for Improving the Indexation Regime

29 There are multiple options and sub-options for possible indexation changes, but the key decisions are:

- whether to index benefit rates to wages or continue to index using prices and, if the latter, what mechanism to use (CPI or household living-cost price indexes);
- s 9(2)(f)(iv) [redacted]
- s 9(2)(f)(iv) [redacted]
- s 9(2)(f)(iv) [redacted]
- s 9(2)(f)(iv) [redacted]

30 If you were looking to take a consistent conceptual approach based on common objectives, these various options can be grouped into the following:

- **Cost-of-living indexation** – this would aim to ensure standards of living are maintained from year to year, by adjusting settings in line with the cost of living for beneficiaries and low-income households. s 9(2)(f)(iv) [redacted]

- **Wage indexation** – this would be a shift towards maintaining a link between the living standards of low-income families and the living standards of broader New Zealand society. Rather than a 'wage floor' approach (as used for New Zealand Superannuation), you could simply adjust payment levels by the growth rate in average wages, where this is higher than CPI. The most likely candidates for wage indexation are benefit rates s 9(2)(f)(iv) [redacted]

- s 9(2)(f)(iv) [redacted]

31 s 9(2)(f)(iv) [redacted]

- s 9(2)(f)(iv) [redacted]

- s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

32 s 9(2)(f)(iv) [redacted]

- s 9(2)(f)(iv) [redacted]

- s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

33 s 9(2)(f)(iv) [redacted]

34 s 9(2)(f)(iv) [redacted]

3. Indexation and the Child Poverty Targets

35 When considering potential changes to indexation, an important contextual consideration is the Government's objectives for child poverty reduction, including its child poverty targets. Changing indexation settings would support the Government's objectives for child poverty reduction on all the measures, but different indexation arrangements will likely mean different levels of progress on each measure.

Relativities between benefits and wages are key to the target on the BHC50 moving line measure

36 The **before-housing-cost** primary income measure (BHC50) in the Child Poverty Reduction Act 2018 uses a moving line threshold - this means that the threshold changes from year to year, based on the median income level for that year. The general historical pattern, particularly in times of continued economic growth, is for incomes around the median to rise every year, and more quickly than for those of lower-to-middle income households.

37 Because the median tends to increase in real terms each year, the general trend is for child poverty rates on the moving line income measures to gradually rise. In order to achieve a reduction and meet its target for this measure, the Government must ensure that the incomes of New Zealand's poorest families not only keep pace with those in the middle, but actually *increase in relative terms*.

38 While some of this growth in incomes could be achieved by rising real wages for lower income households, there are likely to be limits to how much progress can be achieved through wage growth alone. If the Government decided to index payment rates of benefits and Working for Families to wages, this would help ensure the distance between the incomes of low-income households and middle-income households would not grow. Even with this change, however, it is likely that occasional one-off increases to income support levels would still be necessary to reduce (rather than merely sustain) levels of child poverty – though indexation changes are likely to mean any such income support packages will not need to be as large.

For the AHC50 fixed line measure, it is about the balance between income and housing costs

39 The **after-housing-cost** primary income measure (AHC50) uses a 'fixed line' threshold, which means it is unaffected by trends around the median. In order to achieve progress on this measure, incomes must increase more quickly than housing costs for those on the lowest incomes.

40 In times of good economic growth, rising employment, and declining unemployment, poverty measures using a fixed line approach can generally be expected to decline, even on the after-housing-cost measures. However, there is a limit to how low these rates

can fall if relying on general economic growth and rising wages alone, as there is a large beneficiary population on incomes that do not (often) rise in real terms.

41 Any changes to indexation arrangements that result in incomes increasing faster than inflation would help towards the achievement of the targets on this measure. s 9(2)(f)(iv) [redacted]

Residual incomes also have a strong influence on rates of material hardship

42 Levels of **material hardship** are determined by a much broader range of factors, other than current income and housing. Nevertheless, residual income has a strong influence on rates of material hardship, and there is considerable overlap between those in poverty on the AHC measures, and those in material hardship. Improving residual incomes can be expected to reduce material hardship, and worsening residual incomes can be expected to increase it.

Wage indexation would have a discernible impact on poverty on the BHC50 measure

43 Indexation changes are more relevant to the long-term targets rather than the short term targets, with the impact of indexation changes likely to steadily grow over time. Because Treasury TAWA modelling is only available up to 2022/23, for illustrative purposes we have used modelling which shows the impact of the change had it been implemented following the Families Package, taking effect as part of adjustments from April 2019 onwards.

44 TAWA is currently only able to model the impacts of changes to indexation settings on the before-housing-cost income measure. As one can see, the number of children in households below BHC50 is estimated to increase by around 10,000 over four years under the status quo, whereas a more generous indexation regime that links incomes to general living standards would result in no increase in poverty on the BHC50 line.

45 s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

46 The table below provides a summary of the estimated reduction in children in poverty on the BHC50 measure for different combinations of options, compared with the status quo.

Option	**Reduction in child poverty compared to status quo**			
	2019/20	**2020/21**	**2021/22**	**2022/23**
s 9(2)(f)(iv) [redacted]				
Wage indexation of benefits	0	0	0	-5,000
s 9(2)(f)(iv) [redacted]				

47 Modelling is not currently available on the AHC50 or material hardship measure, which significantly constrains our ability to compare the impact of different options. [redacted] s 9(2)(f)(iv) [redacted]

48 s 9(2)(f)(iv) [redacted]

4. Key Considerations with Indexation

Wage indexation may make it more costly for Government to shift underlying policy settings

49 In recent decades, successive Governments have often used income support packages to 'catch up' levels of financial support and adjust the underlying policy settings at the same time. Wage indexation would make it more expensive for the Government to adjust real relativities between different parts of the social assistance system.

50 A related disadvantage of wage indexation is that other factors are also relevant to setting social assistance thresholds. In particular, benefit-wage relativities are important both in maintaining financial incentives to work and, over the longer term, in determining equitable standards of living for beneficiaries compared with other groups in society.

s 9(2)(f)(iv) [redacted]

51 s 9(2)(f)(iv) [redacted]

Compared to the status quo, indexation will carry a significant fiscal cost

52 Officials have costed a series of indexation options, including both the budget forecast period and over a 10 year time horizon. As this shows, over time the difference between wage growth and inflation accumulates, and means that the fiscal costs will grow significantly outside of the budget forecast period.

53 The table below shows the fiscal costs for various options over the budget forecast period, assuming an implementation date of 1 April 2020. These are provisional estimates only and would likely change as the costs are refined.

Option	Fiscal Cost (per year)			
	2020/21	2021/22	2022/23	2028/29
1: Wage indexation of working age benefits	$50m	$100m	$130m	$0.7b

s 9(2)(f)(iv) [redacted]

54 s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

55 s 9(2)(f)(iv) [redacted]

- [redacted]
- [redacted]

56 s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

A note on the reliability of TAWA modelling in this report

57 This advice uses the Treasury's TAWA Model to estimate both fiscal costs and the impact on poverty on before-housing-cost measures. The Treasury considers:

- the fiscal costs to have medium reliability and moderate risk.
- the low-income poverty estimates to have low reliability and moderate risk.

58 Access to the anonymised data used in this advice was provided by Statistics NZ in accordance with security and confidentiality provisions of the Statistics Act 1975 and secrecy provisions of the Tax Administration Act 1994. Statistics NZ confidentiality protocols were applied to the data sourced from MSD. The results in this paper have been confidentialised to protect individual persons, households, businesses and organisations from identification. The results presented in this study are the work of the Treasury, not Statistics NZ.

Next steps

59 As noted earlier, the WEAG has recommended that the Government index all income support payments and thresholds annually to movements in average wages and that AS maxima are indexed to movements in housing costs.

60 Please indicate if you would like to submit a late Budget bid now for indexation of any current payments which are not proposed for major redesign by the WEAG. s 9(2)(f)(iv) [redacted]

- wage indexation of main benefit rates and/or
- s 9(2)(f)(iv) [redacted]
- [redacted]

61 If you wish to proceed with a late bid, we can provide a joint report with advice on implications of such changes - this would seek agreement from the Ministers responsible for the relevant payments, as well as provide a draft letter to the Minister of Finance informing him of the late bid.

62 s 9(2)(f)(iv) [redacted]

Appendix One: Summary of Indexation Settings

63 It is useful to consider indexation settings in the context of the three tiers of social assistance for beneficiaries.

- a first tier of working age benefits intended to provide an income to meet the general cost of living;
- a second tier of additional assistance for specific on-going costs, such as accommodation, disability and children; and
- a third tier of targeted assistance that is generally provided in relation to presenting hardship, and available only for costs considered ‘essential’.

First tier of assistance

64 Rates of main benefits have a legislative requirement to be adjusted annually on 1 April by the rate of upwards movement in the CPI. The CPI measures the change in price of goods and services acquired by New Zealand households. The inflation adjustment has occurred every year since the early 1990s.

Second tier of assistance

65 Second tier assistance refers to additional assistance to people for specific on-going costs, such as accommodation, disability and the direct costs of children. A number of supplementary payment rates are adjusted each year according to movements in the CPI (this is mostly done by convention, as there is no legislative requirement). This includes payment rates of Disability Allowance and Childcare Assistance.

66 There are some notable exceptions in indexation settings of payment rates of second tier assistance:

- While the level of rent is part of the formula used to determine the amount provided, maximum rates of AS are not indexed regularly. The maxima were updated using 2016 rental costs on 1 April 2018 as part of the Families Package.
- The Family Tax Credit and Best Start payment rates have a legislative requirement to be adjusted when the cumulative CPI increase is 5 percent or more. With recent low inflation, the Family Tax Credit has not met the cumulative 5 percent threshold since 2012. Instead, an ad-hoc increase was made to rates as part of the Families Package.
- The newly introduced Winter Energy Payment is not inflation adjusted. As part of the Families Package, Ministers agreed not to index the Winter Energy Payment and to consider its indexation arrangements as part of a wider review of indexation settings.

67 There are two Working for Families payments that are for families with children who do not receive a main benefit and who work a minimum number of hours a week (20 hours for sole parents and 30 hours for couples).

- The IWTC is not indexed to the CPI and is required by legislation to be reviewed every three years. The rate was last increased (from $60 a week to $72.50 a week) in Budget 2015 as part of the Child Material Hardship package.
- The MFTC is not explicitly indexed, but as the MFTC ensures paid employment remains financially more attractive than being on a benefit – the payment rates tends to increase as benefits are indexed to inflation.

Third tier of assistance

68 Third tier assistance is tightly income and cash asset tested. It is generally provided to people in financial hardship, and available only for costs considered essential. While Temporary Additional Support payment is comprehensively inflation indexed, one-off hardship payment amounts are not.

69 One-off hardship payments generally have a maximum amount depending on the costs claimed. These maximums can be exceeded, but generally only in exceptional

circumstances. These cost categories (e.g. food, bedding) are not indexed, and have not been increased for some time.

Income and asset thresholds

70 Across the various tiers of assistance in the welfare system, there are various thresholds and limits that relate to income and assets. While most are regularly indexed for inflation by convention, some are not, including:

- AS cash asset levels (last adjusted 1988)
- Emergency Benefit/Hardship Benefits cash asset levels (last adjusted 1990)
- Abatement thresholds for main benefits (Jobseeker Support was last adjusted in 1996, while other abatement thresholds were increased in 2010)
- Childcare Assistance income thresholds (in 2010 Cabinet agreed that these thresholds would no longer be adjusted by movements in the CPI [CAB Min (10) 7/8 refers])
- Working for Families abatement thresholds (an ad-hoc adjustment was made on 1 July 2018 as part of the Families Package). As part of the Families Package, Ministers noted that the indexation of Working for Families abatement parameters would be considered as part of a wider review of the indexation of social assistance payments.

Appendix Two: The Household Living-Costs Price Index (HLPIs)

71 The Household Living-Costs Price Indexes (HLPIs) were introduced by Stats NZ in October 2016, with a historical series created going back to 2008. The HLPIs are an alternate inflation measure to the CPI that could be used to index social assistance payments and thresholds. The HLPIs provide greater insight into inflation experienced by the following household groups.

- beneficiaries
- superannuitants
- Māori
- income quintiles (five groups)
- expenditure quintiles (five groups)
- all households.

72 In addition to measuring inflation experienced by different household groups, the conceptual design of the HLPIs differs from the CPI in two important ways. The HLPIs:

- include interest payments (this includes interest payments on all consumer debt such as mortgage debt, car loans and credit cards)
- better reflect inflation experienced by a typical household.

73 The inclusion of interest payments on consumer debt better aligns with the inflation experiences of households, in particular owner-occupied households. The CPI excludes interest payments because of the CPI's principal purpose to inform monetary policy. Including interest payments in the CPI would introduce an unintended circular flow (i.e. increasing the Official Cash Rate would generally result in higher interest payments and therefore flow through to a higher CPI).

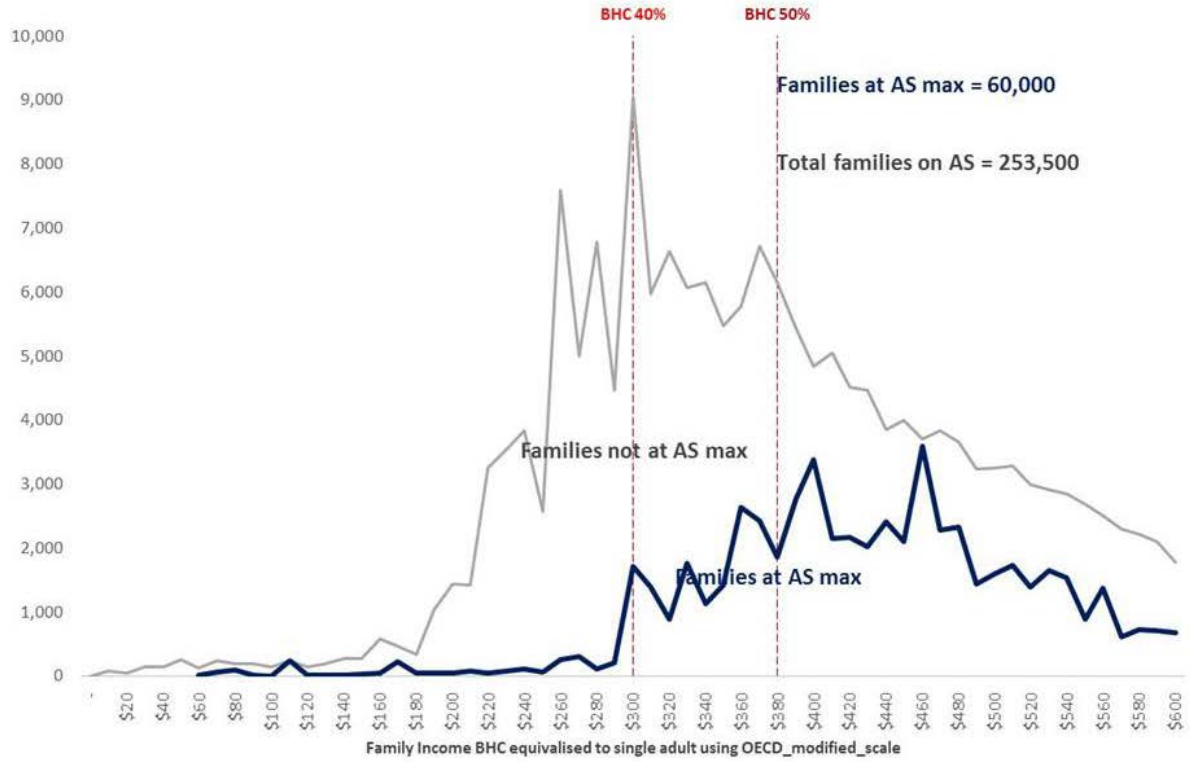
74 By treating each household equally, in terms of their influence on the expenditure items included, the HLPIs are more appropriate than the CPI for understanding inflation experienced by typical household groups. The CPI calculates inflation based on households overall (i.e. all New Zealand households are treated as one super household) and therefore higher spending households have a greater influence on the expenditure items. The approach used for the CPI is more suitable for informing monetary policy.

75 The HLPIs are more appropriate to use to index payments and thresholds as the methodology used to derive the HLPIs has been designed for indexation purposes. Adjustments would also more accurately reflect actual cost pressures faced by different household groups. For example, benefit rates could be indexed by the 'beneficiary HLPI', while NZS/VP payment rates could be indexed by the 'superannuitant HLPI' (although this is not likely to impact rates of NZS due to the wage adjustment requirement). The 'all households' HLPI could be used to adjust payments received by household groups not specifically covered by the HLPIs, such as Working for Families and Student Allowances.

76 While the HLPIs may more appropriately reflect changes in the cost of living for low-income households, their use for indexation purposes are unlikely to significantly affect the living standards of low-income households.

Appendix Three: income distribution for all families vs families at maxima

Before-housing-cost income distribution for MSD clients receiving AS



After-housing-cost income distribution for MSD clients receiving AS