MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

Report

Date: 6 December 2018 **Security Level:** BUDGET SENSITIVE

To: Hon Carmel Sepuloni, Minister for Social Development

Welfare Overhaul Budget 2019: Further advice on the Welfare Overhaul Package

Purpose of the report

1 This report provides you with further detailed advice on the individual and combined components of the Welfare Overhaul Budget 2019 proposals following initial decisions made on the preferred options. s 9(2)(f)(iv) [redacted]

2 This report has been jointly produced with the Child Poverty Unit in the Department of Prime Minister and Cabinet.

Executive summary

3 The Government's vision is for a welfare system that ensures people have an adequate income and standard of living, are treated with and can live in dignity and are able to participate meaningfully in their communities.

4 Initial advice on the Welfare Overhaul Budget 2019 initiatives was provided to you on 25 October 2018 [REP/18/10/1443]. You asked officials to progress the following Budget 2019 Welfare Overhaul bids:

- Repeal of Section 192 (formerly Section 70A)
- s 9(2)(f)(iv) [redacted]
- Changes to benefit abatement settings

Summary of the impacts of the individual initiatives

5 Removing Section 192 (S192) sanctions will increase the incomes of around 12,000 of the lowest income families with children, and provide them with more financial resources to meet their basic needs. While it is unlikely to have a material impact on rates of the income-based primary measures of child poverty, this is in part because the incomes of affected families are well below the poverty lines – there is a strong rationale for making the change on child poverty grounds. The financial incentives to work will not be substantially affected by this change.

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

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

7 Increases to the benefit abatement thresholds will benefit those on comparatively higher incomes, relative to the other options being considered. It would increase the incomes of around 63,000 working individuals and families (37,000 of which are families with children) by on average $22 per week. The impact on the primary measures of child poverty are likely to be limited as the majority of those families with children who gain have incomes that are already above the BHC50 and AHC50 poverty lines (that is, equivalised incomes above 50% of the median before deducting housing costs (BHC), and after deducting housing costs (AHC)). s 9(2)(f)(iv) [redacted]

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

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

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

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

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

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

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

There are some additional considerations

13 A higher Minimum Family Tax Credit (MFTC) due to changes to the abatement threshold, may make it more difficult/costly to make more fundamental changes to MFTC going forward (by introducing more gradual abatement, or replacing/removing it altogether) because people may be more reliant on the payment. You may wish to keep the MFTC at current levels to minimise these impacts, however this would undermine the policy objective of the MFTC of ensuring people are better off in work than on benefit.

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

Summary table of the impact of the changes

15 The table below provides a summary of the high level impacts of the changes, including the latest updated fiscal costs. We will continue to refine the costings for the budget bids in line with your decisions.

Package component	Ongoing annual cost (including operational costs)	Number of family units that gain	Average gains
Repeal of S192	$43m	12,000	$34

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

Recommended actions

It is recommended that you:

1 **note** that this report provides further detailed advice on the individual and combined components of the Budget 2019 welfare overhaul proposals

2 **indicate** if you would like to discuss this report with officials

YES / NO

3 **agree** to forward a copy of this report to the Minister for Child Poverty Reduction

AGREE / DISAGREE

4 **agree** to forward a copy of this report to the Ministers of Finance, Housing and Urban Development, Revenue and Children.

AGREE / DISAGREE

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s 9(2)(a) [redacted]
Policy Manager
Income Support Policy

Date

Hon Carmel Sepuloni
Minister for Social Development

Date

Background

16 The Government's vision is for a welfare system that ensures people have an adequate income and standard of living, are treated with and can live in dignity and are able to participate meaningfully in their communities.

17 As part of the Welfare Overhaul, you asked officials to progress the following Budget 2019 Welfare Overhaul bids:

- **Repeal of S192** – under S192 of the Social Security Act 2018 (previously S70A), if a sole parent does not identify the other parent of the child and apply for Child Support they are subject to a benefit reduction of $22 per child (another $6 a week after 13 weeks). You are exploring the removal of this sanction.
- s 9(2)(f)(iv) [redacted]
- **Changes to abatement settings** – Jobseeker Support recipients are subject to an abatement regime intended to encourage them to take up full-time work (income over $80 a week is abated at 70 cents in the dollar), with separate settings designed to encourage part-time work for Sole Parent Support (SPS) and Supported Living Payment (SLP) recipients (30 cents for each additional dollar over $100 and 70 cents for each dollar over $200). The New Zealand Superannuation income threshold for non-qualifying spouses is also $100 a week abated at 70 cents in the dollar, to encourage full-time work. The different abatement settings are partly in recognition of the importance of caring responsibilities for beneficiaries who have them. s 9(2)(f)(iv) [redacted]

18 Advice on these Budget Bids was provided to you on 25 October 2018 [REP/18/10/1443]. It was noted that officials would provide further advice on the combined impacts of the proposals once initial decisions on the preferred options were made. As such, this report provides further information on:

- the fiscal cost of the combined package of initiatives
- analysis of the number of families who gain, and average gains, by incomes after housing cost. This analysis equivalises incomes to allow for comparisons between different household types and uses after housing cost incomes as this is more relevant when considering the financial resources available to families
- the impacts on measured poverty
- the impacts on the incentives to work
- the implementation of the initiatives and consequential impacts.

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

Fiscal costs of the combined package of initiatives

20 Previous fiscal costs provided did not account for interactions between the various initiatives. In addition, they did not factor in all of the additional flow-on impacts, operational costs, the latest Half Year Economic and Fiscal Update 2018 forecasts [redacted] s 9(2)(f)(iv) [redacted]

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

21 Updated fiscal costs, excluding operational costs which are provided later, are in the table below. The S192 s 9(2)(f)(iv) [redacted] changes are currently intended to be implemented on 1 April 2020 s 9(2)(f)(iv) [redacted]

Package component	2019/20	2020/21	2021/22	2022/23 & outyears	Total
Repeal of S192	$6m	$31m	$38m	$43m	$117m
s 9(2)(f)(iv) [redacted]					

22 As noted in previous advice to you [REP/18/10/1443], there are flow-on implications of these initiatives on the MFTC and Income Related Rent Subsidy, of which vote responsibility sits with the Ministers of Revenue and Housing and Urban Development. The costs of the MFTC have been included in the table above (around $14m per annum) which has resulted in a higher fiscal cost of changing the abatement thresholds than previously estimated. Further work is required to include the savings for Income Related Rent Subsidy, as well as the potential flow-ons to other tax credits.

23 The estimated operational costs for each initiative, including the costs for Inland Revenue, are provided in the table below. The main on-going costs are related to the additional FTEs required because of the initiatives.

Package component	2019/20	2020/21	2021/22	2022/23 & outyears	Total
Repeal of S192	$0.9m	$0.2m	$0.1m	$0m	$1.2m
s 9(2)(f)(iv) [redacted]					

24 We will continue to refine the costings for the budget bids in line with your decisions. This is not expected to materially impact the costs.

Approach taken to assess the impacts on poverty

25 The Child Poverty Reduction Bill has ten measures of child poverty – four primary measures, and six supplementary measures. All of the measures are important, even though only the primary measures are required by legislation to have targets.

26 The Government has announced targets for the three primary measures for which data is available, using percentage point reductions. The targets are:

- **Before-housing-costs 50% primary measure** - over ten years reduce the rate by ten percentage points, and over the next three years by six percentage points (approx. 70,000 children).

[1] Due to interactions between the proposals, the individual cost of the bids will not add to the combined cost of the package.

- **After-housing-costs 50% primary measure** - over ten years reduce the rate by ten percentage points, and over the next three years by four percentage points (approx. 40,000 children).
- **Standard material hardship measure** - over ten years reduce the rate by seven percentage points, and over the next three years by three percentage points (approx. 30,000 children).[2]

27 Maintaining progress towards achieving the targets is very important, from both a political accountability perspective and from the perspective of improving the lives of New Zealand children. Driving and maintaining such progress necessitates some consideration of the extent to which various policies will shift households over each threshold for the primary measures. Some policy changes will impact on the primary measures in a major way, others may move families from just under a threshold to just over it, and yet others may impact only on some of the supplementary measures, for example on the more stringent AHC 40 line or those in severe material hardship. One of the values of having a wide range of measures is that together they give a more comprehensive picture of the impact of various policy initiatives.

28 Some policy initiatives may not have any measureable impact on any one of the ten measures, either because they impact only a few families or because they impact mainly on families well below the more stringent lines but are not sufficient to lift them over. In the latter case, the extra assistance to these families and their children will still make a positive difference and is therefore valuable in the wider goal to reduce child poverty, even though that improvement won't show up on any of the ten measures.

29 In order to assess the impact of the policies on child poverty, we have received modelling from the Treasury Tax and Welfare Analysis (TAWA) model, which uses data from the Household Economic Survey to estimate the impact on before-housing-cost measures. However, as TAWA is based on data from the Household Economic Survey it does not contain the information required to estimate the impacts of repealing S192 [redacted] s 9(2)(f)(iv)

We have explored the use of MSD administrative data to assess the impact of policy changes on the income measures of poverty

30 While there are some benefits with using MSD data, such as being able to model policy changes that TAWA cannot model, being able to model flow-on impacts on Temporary Additional Support and having more accurate administrative data, there are two main issues with using MSD data to estimate what the impact on the measures of poverty will be.

1. **Measures of poverty use the *household* as the income-sharing unit for measurement purposes.** 'Household' refers to those who live together in a dwelling, and share resources in some way such as by jointly purchasing food. This differs from the income-sharing unit used as the basis for benefit eligibility, which is based on the 'family unit': individuals, couples, and parents with dependent children. Comparison of these data sets shows that:

    - a number of beneficiaries live in multi-family households (for example they flat with friends or live with parents), particularly those without children and sole parents. Around half of beneficiary sole parents live in multi-family households

[2] The income measures are:
1. children living in households with equivalised incomes of 50% of the median, before deducting housing costs (BHC), using a line that moves with the median in any given year.
2. children living in households with equivalised incomes of 50% of the median, after deducting housing costs (AHC), using a line anchored in a particular year

- around half of families who would be 'in poverty' when using the family as the unit of analysis, are not on a household basis.

2. **MSD's administrative datasets only have housing costs for those who receive the Accommodation Supplement and the Income Related Rent Subsidy**. For those who are not receiving either form of housing assistance, their weekly costs have been 'imputed', using an estimate based on the entry threshold of the Accommodation Supplement. This is likely to overestimate the housing costs of these people and understate their after-housing-cost income.

31 Despite the limitations with MSD data, we have included this analysis in our advice because it allows some high level conclusions to be made on the impact of policy changes on beneficiary incomes. It also allows conclusions to be made on the potential size of impacts on the poverty measures. Nevertheless, we recommend using the MSD administrative data only to consider the income levels of families who gain from various policy changes and compare poverty impacts between policies. We strongly advise against using it for precise estimates in any public communications around the impact of particular policies on poverty.

32 Estimates of child poverty reduction that rely solely on the use of MSD data are likely to overestimate numbers of beneficiaries that live in households in poverty, and therefore also the number who move out of poverty. This is because around half of those who would be in poverty when using the family as the unit of analysis, live in a multi-family household so the combined household income is likely to be higher. We have tried to adjust for the likelihood of families living in multi-family households based on estimates of the poverty impacts from TAWA and MSD models for initiatives that can be estimated by both models.

33 Neither data source can be used to model material hardship, however we do have some information that can be used to help inform our assessment of its expected impact. There is considerable overlap between those with low BHC incomes, those with low AHC incomes and those in material hardship. This overlap is likely to be greatest on the income measures, as material hardship is influenced by a much broader range of factors and is seen further up the income distribution.

34 That said, the lower a household's income, the more likely they are to be in material hardship, particularly when AHC income is used. Families in material hardship are more likely to be in poverty on the AHC measures than on the BHC measures.

35 There is also usually a lag between families receiving an increase an income and any impact being seen on the material hardship measures.

Approach taken to assess the impacts on the incentives to work

36 The financial incentives to work can influence peoples' decisions to work, or work additional hours. Evidence suggests that financial incentives to work are only one factor that affects work decisions, and while they can impact those decisions, the impacts are usually modest. Other factors which influence people's decisions to work include the availability and cost of suitable childcare and suitable employment.

37 The financial incentives to work, or work additional hours, are influenced by:

- the extent to which incomes on benefit replace in-work income – known as replacement rates
- the extent to which incomes increase by working additional hours (eg the increase in income from moving from part-time employment into full-time employment). The Effective Marginal Tax Rate (or EMTR) is the effective tax rate that is paid on an additional $1 of income, when considering the impact of any taxes and abatement
- the extent to which benefit income provides a sufficient standard of living.

38 When considering the financial incentives to work, it is important to also understand current settings and how the design and assistance levels of the existing system work together to encourage or discourage work.

39 First, there is a reasonable gap between incomes on benefit and work, which has grown over the past two decades. This gap has been preserved by recent packages such as the Child Material Hardship and Families Packages, as there were increases in assistance to both those on benefit and those on work. Currently, the net income of a sole parent beneficiary with one child on benefit in AS Area 1 is around $690 per week, whereas the income of a sole parent working 40 hours on the minimum wage receiving their entitlements is around $940. This means assistance to beneficiaries can be increased, and they should still be better off in work.

40 Second, the current tax and transfer system results in EMTRs for a small number of families, particularly low income sole parents. This is in part due to both the highly targeted nature of the current income support system, and also due to the design of the MFTC.

41 The MFTC currently has a big impact on the incomes of around 3,500 low-income families. It was introduced to ensure that work pays more than a benefit at a time when the gap between benefits and wages was not as prevalent. The MFTC provides for a guaranteed minimum income, currently $26,156 a year (or $503 per week), for sole parents working at least 20 hours or for couples working at least 30 hours. It in effect tops up a family's income to this amount, and results in EMTRs of 100% until a family's income increases above the MFTC threshold. This means when a parent works takes on additional hours of work, their income remains the same, or actually decreases if they are subject to ACC levies or have student loan repayments.

42 This paper compares income levels on benefit and at various hours worked (from 0 to 40) to understand the impacts of the Budget 2019 initiatives on the financial incentives to work.

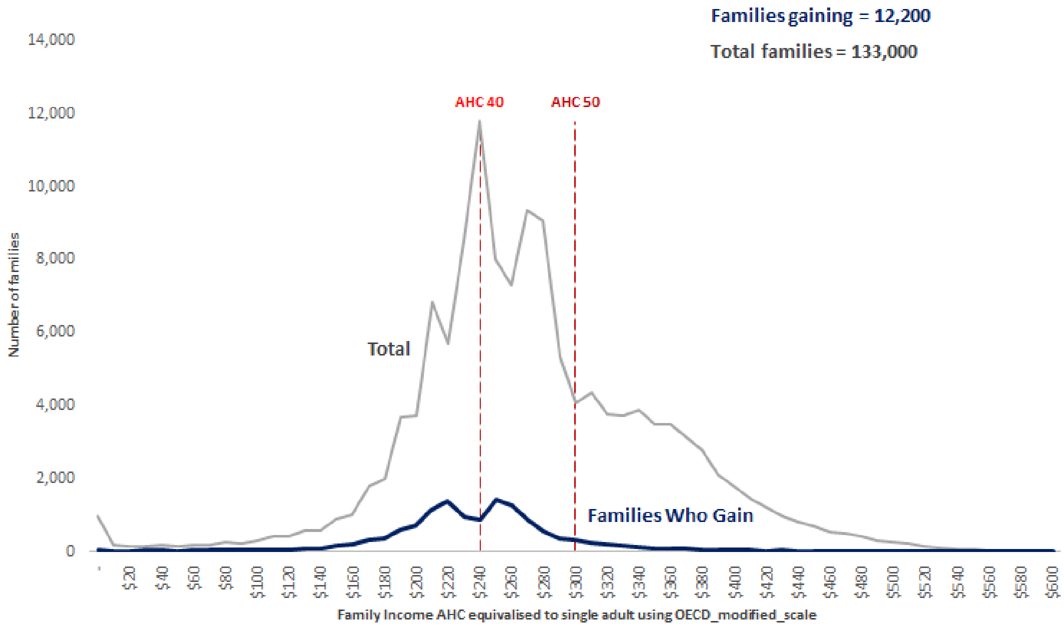
Repeal of S192

Distributional impacts

43 Families subject to the S192 sanction include beneficiaries with children on some of the lowest incomes. Removing the S192 sanction will benefit around 12,000 sole parent beneficiaries by on average $34 per week. Most families will gain by $28 per week. Removing S192 will provide these families with more financial resources to meet their basic needs.

44 The graph below shows the number of all families with children receiving income support from MSD (in grey) and the number of families who gain (in blue), by their equivilised income after housing costs. For example, around 1,400 families with equivilised after housing incomes of $250 per week will gain.

Number of families who gain by equivilised family AHC incomes



Poverty impacts

45 The repeal of S192 will have a meaningful impact on affected families who have relatively low incomes. However it will have a minimal impact on measured poverty due to the relatively small number of affected families. The amount gained also means that the change will not make a significant difference to the primary income measures.

46 Analysis of MSD data indicates that this change on its own would lift the incomes of around 2,000 children in families above the BHC50 poverty line, and around 1,000 children over the AHC50 line. However, as noted earlier the impact on measured poverty is likely to be lower when factoring in the income of all members of the household, as opposed to just the immediate family. When accounting for these differences, our best estimate of the impact on the income measures is around 500-1,500 children on the BHC50 measure, and 0-1,000 children on the AHC50 measure. We strongly advise against using these numbers in public communications, given the level of uncertainty involved.

Work Incentives

47 There are minimal impacts on work incentives. The financial incentives to work for affected sole parents would align with other sole parents not currently subject to a S192 sanction.

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

[redacted]

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

[redacted]

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

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

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

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

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

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

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

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

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

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

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

Poverty impacts

59 Analysis of MSD's administrative data suggests that the majority of those who gain have incomes that already put them above the BHC and AHC poverty lines. This change on its own would lift the family incomes of around 1,000 children over the BHC50 poverty line, and around 3,500 over the AHC50 line. However, as signalled earlier the impact on measured poverty is likely to be lower when factoring in the income of all members of the household, as opposed to just the immediate family. Our best estimate of the impact on the poverty measures is around 0-1,000 on the BHC50 measure, and 1,500-2,500 on the AHC50 measure. We strongly advise against using these numbers in public communications, given the level of uncertainty involved.

60 TAWA modelling estimates that between 2,500-5,000 children move out of poverty on the BHC50 measure, and no impact on the BHC60 measure. It is important to note that the TAWA model looks at income over the year as opposed to a point in time estimate extrapolated over the year as done by the MSD model. This, in addition to TAWA containing a higher proportion of working beneficiaries than the administrative data, can explain the differences in modelling using different datasets.

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

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

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

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

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

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

Please note: Pages 15-16 have been withheld under Section 9(2)(f)(iv)

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

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

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

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

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

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

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

79 s 9(2)(f)(iv) [redacted] k.

Implementation dates

80 The S192 and benefit abatement changes are currently intended to be implemented on 1 April 2020 s 9(2)(f)(iv) [redacted] The S192 and abatement changes will allow sufficient time for the legislation to be passed and will be implemented at the same time as the Annual General Adjustment.

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

Consequential impacts

82 As noted in the previous advice on the Budget 2019 Welfare Overhaul proposals, the social welfare system is complex and the component parts are often interdependent. Changes in one type of assistance often cause a change in entitlement to other assistance. While these “flow-on” impacts are often appropriate, they can create unintended financial disadvantage for a small number of clients.

83 In previous reforms such as the Families Package, a small fiscal provision was set aside for a payment to families who were financially disadvantaged. Such a payment ensures that complexity in the system does not create unintended consequences for families receiving financial assistance.

85 Some people may receive less financial assistance because:

- of a loss of the Temporary Additional Support (TAS) disability allowance exception amount. These families will lose their disability allowance exception as a result of increases to rate of benefit or other supplementary assistance, resulting in them moving off the TAS upper limit and becoming ineligible for the Disability Allowance exception.
- increases to financial assistance could lead to some families currently receiving Childcare Assistance seeing a reduction in their Childcare Assistance payment. This is because the Accommodation Supplement, and other supplementary assistance, is considered income for determining eligibility for Childcare Assistance.
- dollar for dollar reductions in TAS and Special Benefit could result in some people losing by less than $1 per week. This is because TAS and Special Benefit does not allow for payments of less than $1 per week, if the formula results in a deficiency of less than $1. Such losses are unlikely to eventuate if the policy changes are implemented at the same time as increases to payments as part the Annual General Adjustment on 1 April.
- s 9(2)(f)(iv) [redacted]

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

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

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

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

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

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

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

Next steps

91 The final budget initiatives need to be submitted to the Treasury on 14 December 2018. We will continue to refine the costings for the budget bids in line with your decisions. You may wish to discuss the contents of this paper with officials.

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

Appendix One: Equivalised residual incomes of all families with children receiving assistance from MSD

	Number of people who gain s 9(2)(f)(iv)	
Current residual equivalised income	Repeal of S192	s 9(2)(f)(iv) [redacted]
$100 or less	67	[redacted]
$110	31	
$120	26	
$130	59	
$140	58	
$150	155	
$160	175	
$170	315	
$180	320	
$190	591	
$200	691	
$210	1127	
$220	1349	
$230	928	
$240	840	
$250	1407	
$260	1230	
$270	832	
$280	528	
$290	341	
$300	283	
$310	211	
$320	164	
$330	136	
$340	101	
$350	73	
$360	79	
$370	41	
$380	21	
$390	7	
$400	8	
$410	4	
$420	1	
$430	2	
$440	0	
$450	0	
$460	0	
$470	0	
$480	0	
$490	0	
$500	0	
$510	0	
$520	0	
$530	0	
$540	0	
$550	0	
> $550	0	
All	12201	

Appendix Two: Further information on the abatement of income

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

94 The amount received through main benefit is determined by abatement settings. Once people receive income over an initial abatement-free threshold, the level of main benefit reduces (abates) as peoples' incomes increase. The point at which a person's benefit payment reduces to zero because of their income is known as the income 'cut-out point'. Once income reaches this level, the Accommodation Supplement starts abating at 25% (25c in the $1).

95 TAS is a payment of last resort to help people with regular essential living costs that cannot be met from their income or assets. TAS is calculated as the difference between peoples' essential costs and their income (a 'deficiency'), up to an 'upper limit' of 30% of the main benefit. TAS is not abated, but because the calculation is based on a deficiency, any increase in income is automatically off-set by a decrease in TAS, giving the payment an effective abatement rate of 100%.

96 The number of hours worked in paid employment also affects eligibility for support. Once a sole parent works at least 20 hours, or a couple works at least 30 hours, they become eligible for both the Minimum Family Tax Credit and the In-Work Tax Credit so are better off not receiving a main benefit. This results in a significant increase in income once a family with children move out of the benefit system.

97 The MFTC tops up a family's income to a set amount of $503 a week ($26,156 a year), which means it has effective abatement rate of 100%. Once a family's income exceeds this amount the MFTC is longer paid. When family income reaches $42,700 a year (gross), the Family Tax Credit is abated at 25% (25c in the $1). Once the FTC has been fully abated away, the In-Work Tax Credit begins to abate at the same rate of 25% (25c in the $1).

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

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