Dissecting the *Working For Families* Package

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New Zealand Business Roundtable

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List of acronyms

APW	Average production worker
CB	Child Benefit (United Kingdom)
CTC	Child Tax Credit (United Kingdom)
DPB	Domestic Purposes Benefit
EMTR(s)	Effective marginal tax rate(s)
EITC	Earned Income Tax Credit (United States)
FTB	Family Tax Benefit (Australia)
GDP	Gross domestic product
IB	Invalid's Benefit
IWP	In Work Payment
NA	Not applicable
OECD	Organisation for Economic Cooperation and Development
SB	Sickness Benefit
UB	Unemployment Benefit
WFF	Working for Families, 2004 budget package of family assistance
WB	Widow's Benefit
WTC	Working Tax Credit (United Kingdom)

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Dissecting the *Working For Families* Package

> Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution … [O]f the vast increase in the well-being of hundreds of millions of people that has occurred in the 200-year course of the industrial revolution to date, virtually none of it can be attributed to the direct redistribution of resources from rich to poor. The potential for improving the lives of poor people by finding different ways of distributing current production is *nothing* compared to the apparently limitless potential of increasing production.
>
> Robert E Lucas Jr, 1995 Nobel Laureate[1]

Overview

- The key objectives of *Working for Families* (WFF), the welfare package announced in the 2004 budget, are to "make work pay", to "ensure income adequacy" and to "achieve a social assistance system that supports people into work".
- WFF includes substantial additional family income, housing and childcare assistance, and a reduction in hardship support (Special Benefit). Most families with dependent children will benefit from WFF.
- About 63 percent of the total additional assistance to be provided in 2007/08 ($697 million) will be allocated to families that do not receive a benefit during that year. The balance (37 percent) will be provided to families on a benefit or families receiving a benefit and income from work.
- About 51 percent of all families receiving family income assistance, the largest component of WFF, are forecast to be in work whereas the balance are expected to be on a benefit (28 percent) or in work and receiving a benefit (21 percent).
- Once fully implemented, family income assistance is forecast to increase the income of families that are in work by an average of $4,314 a family a year. The corresponding average annual increase for families on benefits or in work and receiving a benefit is forecast to be $2,550 a family.
- From an income support (welfare) perspective, the dominant effect of WFF is to boost the incomes of sole parents. About 75 percent of beneficiary families (including those engaged in work) that will benefit from additional family income assistance are forecast to be on the Domestic Purposes Benefit (DPB).

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1 Lucas Jr, Robert E (2004), 'The Industrial Revolution: Past and Future', *The Region*, 2003 Annual Report issue, Federal Reserve Bank of Minneapolis, http://minneapolisfed.org/pubs/region/04-05/essay.cfm (emphasis in the original).

- New Zealand's family assistance in 2007/08 will be more tightly targeted than comparable programmes in the United Kingdom and Australia, which contain universal elements. All three countries are likely to be among those Organisation for Economic Cooperation and Development (OECD) member countries with the highest levels of spending on family benefits relative to GDP.

- Under half the member countries of the OECD provided benefits in 2002 that are conditional on work, such as New Zealand's Child Tax Credit and the new In Work Payment (IWP).

- WFF does little to make the taking up of work or additional work more rewarding than non-work and is therefore unlikely to have a noticeable (if any) net positive effect on aggregate employment.

- Indicative examples examined by officials suggest that WFF will reduce replacement ratios (the ratio of net income on a benefit to net income in work) between April 2005 and April 2007. The income gain from moving off a benefit and into work, though increased, remains modest.

- The Treasury's costing of WFF assumes that just 2 percent of sole parents will move off the DPB and into work. On this basis, family income assistance might encourage about 2,160 beneficiaries to move off the DPB and into work in 2006/07 at an extraordinary cost of up to $84,600 for each person moved into work.

- The government estimates that additional expenditure on the IWP arising from families that move off benefits will be just $8 million in 2006/07, confirming this minor effect.

- The Treasury estimates that the mean rate of tax on each additional dollar earned by all individual taxpayers (the mean effective marginal tax rate) in 2007/08 will be 29.7 percent with WFF compared with 28.6 percent without it, an increase of 3.8 percent.

- The higher mean effective marginal tax rate will increase deadweight costs at the margin – the loss of output caused by the impact on behaviour of taxes on the next dollar of income. WFF is therefore expected to discourage productive activities and aggregate employment.

- The government's aim of returning beneficiaries to full-time work is endorsed. However, WFF fails to meet its objective of making work pay. There is also little reason to conclude that the social assistance system will be significantly more effective in supporting people into work.

- A key weakness in WFF is that it extends high effective marginal tax rates (EMTRs) further up the income distribution, thereby discouraging productive activities, while doing little to alleviate the problem of high EMTRs as people transition from benefits to work.

- Families with dependent children risk being locked into high EMTRs over wide ranges of income, from which many will have difficulty escaping, even in the medium term. The pattern of EMTRs under WFF will be difficult to sustain.

- The pattern of EMTRs is distorted by raising income levels for families on benefits and in work. The approach is implicitly driven from the bottom up. Beneficiaries, however, are a minority of potential low-paid workers.

- The government's income adequacy objective is imprecisely defined and unable to be monitored against actual outcomes. The risk is that more redistribution will always be viewed as desirable.

- The problems of child poverty and income insufficiency largely arise from welfare dependency. Families dependent on welfare in New Zealand and in a sizeable majority of OECD countries are reported to be in poverty because incomes of last resort are usually set below commonly adopted relative poverty lines.

- The striking reduction in forecast child poverty arises because the incomes of many families are presently not far below the poverty benchmarks and because income gains provided by WFF for people on low incomes are substantial.

- Providing higher income transfers, without addressing the underlying cause of welfare dependency, is likely to accentuate the problem of dependency over time.

- WFF is poorly targeted. A third of the cost of WFF arises from the provision of assistance to families earning over $35,000 a year after tax, including middle and upper income households.

- The performance of the economy in producing a growing supply of goods and services that consumers are willing to buy and generating jobs for everyone who is willing to work – not redistribution – ultimately determines the material standards of living of citizens.

- The total cost of WFF is equivalent to about a 2.2 percent increase in aggregate annual wages. The additional assistance is, however, concentrated among families with dependent children, most of which are currently receiving family, housing and/or childcare assistance.

- Redistribution can make some people better off but only at the cost of making others worse off. Because costs are incurred in redistributing income, it involves a net reduction in national output and income. Over the longer term, even groups that are perceived to benefit from redistribution may be disadvantaged if such policies constrain growth in per capita incomes.

- The alternative direction in which policy should move is as follows:

  - The government should focus on broad policies that will generate a sustained increase in national output and income, including the removal of impediments to employment, and lower government spending and taxes.

  - The government's approach to welfare should encourage self-reliance and the acceptance of personal responsibility, and support vital institutions such as the family.

  - The government's income redistribution policies should focus on the prevention and alleviation of hardship. The grounds for focusing on income inequality *per se* are weak.

  - The problem of welfare dependence should be addressed directly. Reliance on work incentives and income effects to induce people into employment are not sufficient. Greater obligations should be imposed on people receiving taxpayer support, including the introduction of time limits for benefits and additional work requirements.

- The level of the main benefits should generally determine the minimum acceptable income of people dependent on benefits.

- The policy of encouraging part-time work and part benefit income should be replaced by greater emphasis on people exiting entirely from benefits and moving into full-time, full-year work where feasible.

- While a modest increase in family assistance may well be warranted, the levels of family assistance should be reduced from those announced in WFF and be more tightly targeted.

- The indexation of family income assistance should be put on hold, at least until the real level of such assistance reduces to a more appropriate level.

- The new income thresholds for family childcare and housing assistance should be revised downward.

- Assistance should begin to be abated at a lower income than that provided in WFF but, as far as possible, the application of multiple rates of abatement as income increases should be avoided.

- A lower overall tax burden, including lower spending on WFF, and a lower and flatter tax structure would provide more 'headroom' for high EMTRs to be reduced.

Introduction

Most families with dependent children will qualify for additional family, childcare or housing assistance under the government's Working For Families (WFF) policy which was announced in the 2004 budget.[2] WFF is being introduced in stages between October 2004 and April 2007, and will cost an estimated $1.1 billion a year or 0.7 percent of forecast GDP when fully implemented.

The analysis that follows draws on published information, including papers released under the Official Information Act and answers to parliamentary questions. The data are not always consistent. Joint family income, for instance, comprises taxable income in some cases and includes certain non-taxable income, such as child support, in other instances. Similarly, some data are based on after-tax income whereas most are gross of tax. Official data are also incomplete. Some policy measures, such as changes in the Accommodation Supplement, were often omitted from analyses prepared in response to parliamentary questions, apparently because of the complexity involved.

The structure of the paper is as follows. The objectives of WFF and its components and cost are summarised. An international comparison of family income assistance is presented. The implications for economic efficiency of WFF are then examined. The impact on child poverty and the distribution of income of WFF are discussed. The paper concludes by outlining an alternative and more desirable direction for policy.

Working for Families

The government's policy objectives

According to the Hon Dr Michael Cullen, minister of finance and revenue, and Hon Steve Maharey, minister for social development and employment, the key objectives of WFF are as follows:

- To "make work pay by supporting families with dependent children, so that they are rewarded for their work effort. This involves better alignment of benefits and in-work support … so that people are better off as a result of the work they do".
- To "ensure income adequacy, with a focus on low and middle income families with dependent children, to significantly address issues of poverty, especially child poverty."
- To "achieve a social assistance system that supports people into work, by making sure that people get the assistance that they are entitled to, when they should, and with delivery that supports people into employment. This involves steps to streamline the social assistance system so that it is easier for people to

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2 A family for the purposes of the policy typically includes a couple or sole parent with dependent children but single people without children may qualify for the Accommodation Supplement.

understand and access, and initiatives to improve [the] take-up [of assistance] and enhance the effectiveness of [its] delivery".[3]

Dr Cullen and Mr Maharey wrote that WFF focuses on families with dependent children because "many low income families with children are little or no better off in low paid work once work-related costs, benefit abatement and tax are taken into account". Another reason advanced for focusing on such families is because of the "incidence of child poverty and the negative effects low living standards have on the well-being and development of children, particularly over time."[4]

WFF emerged from a plan to revamp the benefit system. Further changes to benefits were foreshadowed in the 2004 budget. The government subsequently announced its intention to move toward a single core benefit.[5]

A summary of WFF

WFF comprises many elements (the cabinet minute is 25 pages long).[6] The main components are listed below:

- The provision of additional family income assistance, most notably through a substantial increase in the level of Family Support, the introduction of an In Work Payment (IWP) and changes to the abatement of family income assistance. Family Support is available to families in work or on a benefit.[7] The IWP is to be made available to parents who work for an aggregate of at least 30 hours a week (20 hours a week for a sole parent) and are not on a benefit. The Child Tax Credit is to be abolished, other than where certain circumstances apply. The Child Tax Credit is presently available to families in work (that is, those who do not receive certain government income assistance such as an income-tested benefit, New Zealand Superannuation, a student allowance or weekly accident compensation payments, except for a short period). Unlike the IWP, a minimum number of hours of work are not required to obtain the Child Tax Credit.

- An increase in housing assistance provided by the Accommodation Supplement. Entry thresholds (the minimum level of housing costs required to be eligible) are to be reduced by about 10–20 percent. The maximum level of assistance is to be increased by 0–50 percent depending on the area (with the largest increases in new area 1, for example Auckland City) and household composition. Income thresholds (the levels at which the Supplement begins to abate) are also to increase by about 8–20 percent. More income will be able to be earned before the

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3 Cullen, Michael and Maharey, Steve (2004), 'Reform of Social Assistance: Working for Families Package', Report to the Cabinet Policy Committee, Office of the Minister of Finance and Revenue and Office of the Minister for Social Development and Employment, Wellington, p 2. Papers on WFF prepared by officials and ministers are available at www.msd.govt.nz/work-areas/working-age-people/future-directions.html.

4 Cullen and Maharey (2004), *op cit*, p 2.

5 Maharey, Steve (2005), 'Simplified Benefit System Roll-out Begins in May', media release, Office of the Minister for Social Development and Employment, 22 February, Wellington.

6 Cabinet Office (2004), 'Reform of Social Assistance: Working for Families Package: Revised Recommendations', Cabinet Minute, CAB Min 04 13/4, 3 May, Cabinet Office, Wellington.

7 Unless the context indicates otherwise, a family described as not being on a benefit is not in receipt of an Unemployment Benefit (UB), Domestic Purposes Benefit (DPB), Invalid's Benefit (IB) or Sickness Benefit (SB), or another comparable income-tested benefit. Such families may, however, be in receipt of supplementary support such as the Accommodation Supplement or the Community Services Card.

Accommodation Supplement is abated. The increase in the Accommodation Supplement for beneficiaries in receipt of the Special Benefit is to be offset by a reduction in the Special Benefit.

The abatement of the Accommodation Supplement paid to beneficiaries in respect of the first $80 a week of gross income was removed in October 2004. The Accommodation Supplement was not previously abated for income earned over $80 a week because this would have generated a steep rise in the effective marginal tax rates (EMTRs) of affected beneficiaries because income-tested benefits begin to be abated once income exceeds $80 a week. Thus the Accommodation Supplement is not now abated until a beneficiary exits from the benefit. This change is intended to encourage beneficiaries to engage in part-time or full-time work.

Previously, the Accommodation Supplement paid to some beneficiaries was reduced when they exited from the benefit and took up employment. This problem will remain, however, where a beneficiary is on a benefit that is set at a higher level than the UB (for example the DPB) and income in work is up to the level at which the UB is fully abated because the new income threshold for non-beneficiaries has been set at the income level at which the UB is fully abated.[8]

The Accommodation Supplement of some beneficiaries previously increased when they took up employment. With the removal of the abatement of the first $80 of income a week, this will no longer be the case. In those circumstances, the net increase in assistance in work will be somewhat less than otherwise.[9]

The Accommodation Supplement is not available to Housing New Zealand tenants.

- An increase in subsidies for childcare. The subsidy rates are to increase by 21 or 57 percent. The new maximum income beyond which families become ineligible for the highest of the three rates of subsidy is to increase from $27,040 to $40,040 for the first child. The equivalent income for the lowest rate of subsidy with three children is to increase from $44,200 to $69,160.

- An increase in the Family Tax Credit from $15,080 to an estimated $17,490 in 2007/08. The Family Tax Credit guarantees a minimum income after tax for a small number of families with dependent children that work for 30 hours a week (20 hours for a sole parent) and are not on a benefit.

- The Special Benefit is to be replaced by a new benefit, Temporary Additional Support, the '15 hour rule' which limits the extent to which people receiving the IB can work is to be relaxed, less stringent stand-down arrangements for the IB are to be implemented, and certain other changes to social assistance arrangements are to be introduced.

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8 The Ministry of Social Development advised in June 2004 that the transition from benefit to work for recipients of the IB, DPB and the Accommodation Supplement "has not been completely resolved".

9 Patrick Nolan examined the impact of changes in the Accommodation Supplement on the incentive to exit the benefit and to engage in work, see Nolan, Patrick (2004), 'When Work Does Not Pay: Family Structures and Poverty Traps in New Zealand's Social Security System', unpublished paper, 45th annual conference of the New Zealand Association of Economists, 30 June to 2 July, Wellington.

Family Support absorbed the child component of benefits and student allowances on 1 April 2005. The rates of UB, SB, DPB, WB and IB paid to a sole parent with two or more children were replaced with a single rate set equal to the rate of benefit paid to sole parents with one child. The rates of UB and SB paid to married couples with a child or children were replaced with the rate paid to married couples with no children. These changes mean that some beneficiaries and students will not benefit fully from the increase in the levels of Family Support. On the other hand, Family Support is generally abated at a lower rate than benefits. The affected weekly benefits net of tax (but before abatement) are estimated to be between $17.54 (married couple on UB or SB) and $20.37 or $21.89 (sole parent on UB, SB, DPB, WB or IB) lower than otherwise. Some of the changes to the Accommodation Supplement are related to the abolition of the child component of benefits.

- The level of much of the assistance is to be indexed to the CPI or reviewed periodically.[10]

Analysis of WFF assistance

The increase in the maximum annual levels of Family Support and the IWP (ie before abatement) is shown in table 1.[11] WFF is to be fully implemented in 2007/08. Family Support is to increase by between 42 and 78 percent. The IWP is additional for families in work but the Child Tax Credit is to be abolished (except in certain circumstances) as a transitional measure.

One argument advanced for increasing Family Support is that its levels have not been adjusted since 1998.[12] However, the increases far exceed the cumulative inflation of 15 percent recorded between April 1998 and April 2005 when the first increase was implemented.

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[10] The Ministry of Social Development reports that since October 2004 the number of working people granted an Accommodation Supplement or childcare assistance has doubled and tripled respectively compared with the same period of the previous year. Changes to both programmes came into effect on 1 October 2004. The Ministry did not comment on whether the level of new grants is in line with forecasts. See Ministry of Social Development (2005), 'Gains for Working Families', *MSD News*, no 1 (April), 2005, p 1.

[11] The assistance discussed is only available to families that satisfy eligibility criteria, including minimum hours of work in the case of the IWP. Changes to the Accommodation Supplement and childcare subsidies may affect the extent to which total assistance changes when a person leaves the benefit and engages in work. These factors are not taken into account in tables 1 to 6. The impact on the level of income assistance available to beneficiary families of the proposal to ring fence such assistance for the purposes of calculating the annual square-up is not taken into account in any of the quantitative analyses presented. The proposal is discussed briefly below.

[12] Cullen and Maharey (2004), *op cit*, p 9.

Table 1: Maximum Increase in Family Income Assistance Between 2004/05 and 2007/08

Component	Family Support and IWP 2007/08	Family Support and Child Tax Credit 2004/05	Increase in Family Income Assistance	
	$/year	$/year	$/year	%
Family Support[1]				
Eldest child aged 16–18 years	4,940	3,120	1,820	58
Eldest child aged under 16 years	4,264	2,444	1,820	75
Each other child aged 16–18 years	4,420	3,120	1,300	42
Each other child aged 13–15 years	3,380	2,080	1,300	63
Each other child aged under 13 years	2,964	1,664	1,300	78
In Work Payment[2, 3]				
One child to three children	3,120		3,120	
Each additional child	780		780	
Child Tax Credit[3, 4]				
Each child		780	–780	

1 Family Support was increased on 1 April 2005 by $25 a week ($1,300 a year) for the first child and $15 a week ($780 a year) for other children. It will increase again on 1 April 2007 by $10 a week for each child ($520 a year). In the case of beneficiaries, the increase in Family Support may, to some extent, be offset by changes to the child component of benefits.
2 IWP is to be introduced on 1 April 2006.
3 Does not apply to people on a benefit.
4 The Child Tax Credit is to be replaced from 1 April 2006 by the IWP but continues as a transitional measure for those families in work who do not qualify for the IWP. The rules relating to these programmes are not the same. Unlike the Child Tax Credit, the criteria for the IWP include a minimum hours of work requirement.

Table 2 shows the maximum increase between 2004/05 and 2007/08 in the annual level of family income assistance for families in work with up to six children. The calculation has been simplified by assuming that each child is under 13 years of age. (The same assumption is made in preparing the tables that follow.) This assumption does not affect the level of the increase in family income assistance but it affects the total amount of such assistance.

The extent to which family income assistance for families in work is increased by WFF is highlighted in table 2. The level of income assistance for a family of one child will increase by up to 129 percent whereas that for a family with two children will increase by up to 83 percent. About 39 percent of families with dependent children have one child and a further 38 percent have two children. The maximum increase for other families in work is between 59 and 64 percent.

Table 2: Maximum Increase in Family Income Assistance by Family Size Family in Work Between 2004/05 and 2007/08

Children[1]	Family Support and In Work Payment 2007/08[2]	Family Support and Child Tax Credit 2004/05[2]	Maximum Increase in Family Income Assistance	
No	$/year	$/year	$/year	%
1	7,384	3,224	4,160	129
2	10,348	5,668	4,680	83
3	13,312	8,112	5,200	64
4	17,056	10,556	6,500	62
5	20,800	13,000	7,800	60
6	24,544	15,444	9,100	59

1 All children are assumed to be less than 13 years of age. If the second child and subsequent children were aged 13 years and over the level of assistance in 2004/05 and 2007/08 would be higher but the increase in the level of assistance would not be affected.

2 Excludes the Accommodation Supplement and childcare subsidies.

The next table (table 3) shows the maximum increase between 2004/05 and 2007/08 in the level of family income assistance for a beneficiary family with up to six children. The adjustment for the child component of benefits is shown. The level of the child component that applied before 1 April 2005 differed depending on benefit type and family circumstances. It increased the level of benefits for the first child (married couples) or the first and second child (sole parents). Benefits were not increased with the addition of subsequent children. The adjustment to the child component of benefits has no effect on a sole parent with one child. A sole parent with two or more children or married couples with children will receive a lower benefit than otherwise.

These arrangements mean that the maximum offset to Family Support in 2007/08 is expected to be $1,138 a year ($21.89 net of tax a week). This amount reflects benefit rates that were applicable in 2004/05. Benefit levels are adjusted annually in April for the change in the CPI in the previous calendar year. The child component has been increased to estimated 2007/08 levels by assuming annual rates of inflation similar to those forecast by the Reserve Bank in its December 2004 *Monetary Policy Statement*.[13]

Family income assistance for a family on a benefit with one child is to increase by up to 75 percent. The increase for families with more than one child is between 46 and 66 percent.

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13 Reserve Bank of New Zealand (2004), 'Monetary Policy Statement: December 2004', http://www.rbnz.govt.nz/monpol/statements/0094172.html.

Table 3: Maximum Increase in Family Income Assistance by Family Size Beneficiary Family Between 2004/05 and 2007/08

Children[1]	Family Support 2007/08	Adjustment for Child Component[2]	Net Increase in Family Income Assistance 2007/08[3]	Family Support 2004/05	Maximum Increase in Family Income Assistance	
No	$/year	$/year	$/year	$/year	$/year	%
1	4,264	NA	4,264	2,444	1,820	75
2	7,228	–1,234	5,994	4,108	1,886	46
3	10,192	–1,234	8,958	5,772	3,186	55
4	13,156	–1,234	11,922	7,436	4,486	60
5	16,120	–1,234	14,886	9,100	5,786	64
6	19,084	–1,234	17,850	10,764	7,086	66

1 All children are assumed to be under 13 years of age.
2 The maximum adjustment for the child component that applies to a sole parent family is assumed to apply. It has been adjusted for forecast inflation through to 2007/08.
3 Excludes the reduction in the Special Benefit, and increases in childcare subsidies and the Accommodation Supplement.

The maximum percentage increase in family income assistance for a family in work with up to three children is much larger than for a similar sized beneficiary family (tables 2 and 3). The increase for the family in work with four children is a little larger than for the comparable family on a benefit. However, the percentage increase in family income assistance for a family on the benefit with five or six children is larger than that for a comparable family in work. The maximum increase in family income assistance for all families with up to six children is, however, substantial. It is at least 46 percent.

Table 4 shows the maximum levels of income assistance payable in 2007/08 to a family in work or on a benefit with up to six children. A sole parent family on a benefit receives Family Support which is shown net of the adjustment for the child component. A family in work and not on a benefit may qualify for Family Support and the IWP. While substantial additional family assistance is available to a family in work with one child or two children compared to a family on a benefit, the percentage margin for a family in work reduces as the number of children increases but is still considerable. This outcome arises because the IWP is not increased until the family in work exceeds three children. Thereafter the increase in the IWP merely offsets the loss of the Child Tax Credit. The loss of this credit also means that the percentage increase in net additional assistance for a family in work with two or three children is less than for a family with one child.

Table 4: Maximum Levels of Income Assistance for Family on Benefit and Family in Work by Family Size 2007/08

Children[1]	Total for Family on Benefit[2, 3]	In Work Payment	Total for Family in Work[4]	Margin for Family in Work[5]
No	$/year	$/year	$/year	%
1	4,264	3,120	7,384	73
2	5,994	3,120	10,348	73
3	8,958	3,120	13,312	49
4	11,922	3,900	17,056	43
5	14,886	4,680	20,800	40
6	17,850	5,460	24,544	37

1 All children are assumed to be less than 13 years of age.
2 The maximum adjustment for the child component that applies to a sole parent family is assumed (see table 3).
3 Excludes the reduction in the Special Benefit, and increases in childcare subsidies and the Accommodation Supplement.
4 Excludes increases in childcare subsidies and the Accommodation Supplement.
5 Total assistance for a family in work less total assistance for a family on a benefit expressed as a percentage of total assistance for the family on a benefit.

Table 5 shows the maximum increase in income assistance for a family in work relative to that on a benefit between 2004/05 and 2007/08. WFF increases the maximum level of assistance for a family in work or on a benefit but it also increases the income of a family in work relative to that on a benefit. The margin for a family in work will increase substantially, especially for a family with one child or two children.

Table 5: Maximum Increase in Income Assistance for Family in Work Relative to Family on Benefit by Family Size Between 2004/05 and 2007/08

Children[1]	2007/08			2004/05			Increase in Margin for Family in Work[5]	
	Total for Family in Work[2]	Total for Family on Benefit[3, 4]	Margin for Family in Work	Total for Family in Work	Total for Family on Benefit	Margin for Family in Work		
No	$/year	$/year	$/year	$/year	$/year	$/year	$/year	%
1	7,384	4,264	3,120	3,224	2,444	780	2,340	300
2	10,348	5,994	4,354	5,668	4,108	1,560	2,794	179
3	13,312	8,958	4,354	8,112	5,772	2,340	2,014	86
4	17,056	11,922	5,134	10,556	7,436	3,120	2,014	65
5	20,800	14,886	5,914	13,000	9,100	3,900	2,014	52
6	24,544	17,850	6,694	15,444	10,764	4,680	2,014	43

1 All children are assumed to be less than 13 years of age.
2 Excludes increases in childcare subsidies and the Accommodation Supplement.
3 The maximum adjustment for the child component that applies to a sole parent family is assumed.
4 Excludes the reduction in the Special Benefit, and increases in childcare subsidies and the Accommodation Supplement.
5 The increase in the margin for a family in work between 2004/05 and 2007/08 expressed as a percentage of the margin for a family in work in 2004/05.

The next table (table 6) shows the maximum levels of family income assistance payable to a family in work or on a benefit in 2007/08, the increase in such assistance from 2004/05 and the margin for a family in work all expressed as percentages of the estimated gross wage of a full-time average production worker (APW) in 2007/08. The Organisation for Economic Cooperation and Development (OECD) uses APW earnings to compare tax and benefit programmes in member countries and a similar approach is adopted in this report. The OECD estimates APW earnings for New Zealand to be NZ$41,778 in 2004.[14] The level of such earnings has been projected to 2007/08 ($46,387) assuming that the annual average rate of growth in such earnings between 2002 and 2004 (3.55 percent) remains constant.[15]

Table 6 shows that the maximum level of family income assistance in 2007/08 for families in work who have one or two dependent children will amount to 16 and 22 percent of the earnings of the APW respectively.[16] The level of such assistance increases as the number of children increases, reaching 53 percent of the earnings of the APW for a family with six children. The maximum increase in family income assistance for families in work is equivalent to between 9 and 20 percentage points of the earnings of an APW and between about three and six years annual growth in such wages at recent rates.

Table 6: Maximum Levels and Increase in Family Income Assistance by Family Size Relative to APW Earnings Between 2004/05 and 2007/08

	Family in Work[2]		Family on Benefit[3, 4]		Margin for Family in Work[5]	
Children[1]	Maximum Family Income Assistance 2007/08	Maximum Increase in Family Income Assistance 2004/05 to 2007/08	Maximum Family Income Assistance 2007/08	Maximum Increase in Family Income Assistance 2004/05 to 2007/08	Maximum Margin 2007/08	Increase in Maximum Margin 2004/05 to 2007/08
No	%	Percentage Points	%	Percentage Points	Percentage Points	Percentage Points
1	16	9	9	4	7	5
2	22	10	13	4	9	6
3	29	11	19	7	9	4
4	37	14	26	10	11	4
5	45	17	32	13	13	4
6	53	20	39	15	14	4

1 All children are assumed to be less than 13 years of age.
2 Excludes increases in childcare subsidies and the Accommodation Supplement.
3 The maximum adjustment for the child component that applies to a sole parent family is assumed.
4 Excludes the reduction in the Special Benefit, and increases in childcare subsidies and the Accommodation Supplement.
5 The margins derived from data shown in the table may not equal those shown in this column due to rounding.

The maximum level of family income assistance for a family on the benefit with up to six children is equivalent to between 9 and 39 percent of the earnings of the APW. As with families in work, the maximum increase in assistance increases as the number of

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14 OECD (2005), *Taxing Wages 2003–2004*, OECD, Paris, table 1.1, p 13.

15 The assumed annual average rate of growth in APW earnings from 2004/05 through to 2007/08 is somewhat lower than the average rate of growth in average hourly ordinary time earnings for all salary and wage earners of 3.8 percent assumed in the government's December 2004 Economic and Fiscal Update.

16 In contrast to APW earnings, family income assistance is not taxable. The average rate of income tax and ACC (before family income assistance) on an income of $46,387 in 2004/05 was 23 percent. Thus the level of family income assistance relative to after-tax APW earnings is about 30 percent higher than that shown in the table.

children increases. The maximum increase in such assistance is between 4 and 15 percentage points of earnings and is equivalent to between about one and five years annual growth in such earnings.

The level of income assistance available to a family in work is between 7 and 14 percentage points of APW earnings higher than that for a comparable family on a benefit. The margin for a family in work will increase in 2007/08 by between 4 and 6 percentage points of APW earnings.

Who benefits from WFF?

Table 7 shows the number of families with dependent children that the government expects to benefit from WFF. Most families will benefit from WFF.[17] Of the 292,000 families that are expected to benefit from additional family income assistance in 2007/08, just 48,000 (16 percent) do not presently benefit from such assistance. Similarly, about 15,000 new recipients will receive the Accommodation Supplement each year. Some of these will be families without dependent children or single people.[18]

Table 7: Families Expected to Benefit from WFF 2007/08

Component	Families that Benefit[1]		Average Increase in Income	
	No	%	$/week	$/year
Family income assistance	292,000	61	66	3,432
Housing assistance[2, 3]	99,500	17	19	988
Childcare	28,000	6	23	1,196

1 Families that are eligible for more than one component are included in the count for each component that applies.

2 Excludes a further 3,400 recipients who are likely to receive the Accommodation Supplement as a result of "delivery enhancements".

3 Includes single people without dependent children (except for the percentage – 17 percent – in the third column). About 62 percent of the additional spending on housing assistance will benefit families with children. In response to parliamentary question 08065 (2004) (corrected), Mr Maharey said that 137,000 families with dependent children would receive the Accommodation Supplement and benefit from WFF. The uncorrected answer to the question stated that 81,000 families with dependent children (about 17 percent of all families) would benefit from changes to the Accommodation Supplement alone. The correction related to the interpretation of the question asked rather than the data supplied. Thus about 18,500 recipients of the Accommodation Supplement (99,500–81,000) would appear to be people other than families with dependent children.

Source: Cullen and Maharey (2004), Appendix 1, p 8, Appendix 2, pp 12–13 and Appendix 3, p 18.

The next table (table 8) shows a breakdown of families receiving family income assistance by whether they are in work and not receiving a benefit, in work and receiving a benefit (which may be abated) or on a benefit and not in work. Once WFF is fully implemented, 150,000 (51 percent) of all families receiving family income assistance are

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17 There were about 483,000 families with dependent children in 2004/05. By April 2007 there are expected to be 476,000 working families with dependent children of which 184,000 will not benefit from WFF. A total of 522,000 families, including couples without dependent children, expected to engage in work in April 2007 will not receive a benefit and not gain from additional family income assistance. This information is contained in Dr Cullen's answers to parliamentary questions 07449 (2004) and 08430 (2004).

18 Cullen and Maharey (2004), *op cit*, Appendix 1, p 8, Appendix 2, pp 12–13 and Appendix 3, p 18.

forecast to be in work whereas 82,000 (28 percent) are expected to be on a benefit. Some 62,000 families (21 percent) are forecast to be in work and receiving a benefit.

Table 8: Number of Families in Work or on Benefit Receiving Family Income Assistance 2004/05 to 2007/08

Year[1]	Families in Work[2]	Families in Work and on Benefit[3]	Families on Benefit[4]	Total
	No (000)	No (000)	No (000)	No (000)
2004/05	98	64	82	244
2005/06	118	64	82	264
2006/07	146	62	82	290
2007/08[5]	150	62	82	294

1 Year ended 31 March (ie tax year).
2 Families in work are defined as those that do not receive a benefit and earn at least $1,000 a year in wages, salaries or income from self-employment.
3 Comprise families in work (as defined above) that also receive some income from a benefit.
4 Comprise families on a benefit that do not earn at least $1,000 a year in wages, salaries or income from self-employment.
5 The discrepancy between the total for 2007/08 cited in table 7 and in this table is assumed to be due to rounding errors.

Source: Dr Cullen's reply to parliamentary question 8359 (2004).

Once fully implemented, family income assistance is forecast to increase the income of families that are in work by an average of $4,314 a family a year. The corresponding average annual increase for families on benefits or in work and receiving a benefit is forecast to be $2,550 a family.[19] This result is consistent with the above tables which showed that, on average, WFF increases the incomes of families in work by more than those on benefits.

WFF provides significant additional support for many families on benefits, especially those on the DPB. About 75 percent of beneficiary families (including those engaged in work) that will benefit from additional family income assistance in 2006/07 are on the DPB. A further 15 percent are on the UB and the balance are on other benefits and New Zealand Superannuation.[20]

The additional assistance provided to beneficiaries is to be offset by savings from changes in the Special Benefit. Spending on the Special Benefit has grown rapidly over the last few years. The number of recipients increased from 11,200 in 1999/00 to a forecast of 55,100 in 2004/05 and its cost has risen from $35 million in 1999/00 to an estimated $164 million in 2004/05.[21]

The government published a handful of examples of the income gains that WFF will provide for families in work. The government's first example, that of Rod and Barbara, is examined in detail in box 1.

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19 Dr Cullen's answer to parliamentary question 07448 (2004).

20 Dr Cullen's answer to parliamentary question 07450 (2004). The question did not ask for data for 2007/08 but it can be inferred from table 8 that there is unlikely to be a significant change between 2006/07 and 2007/08. The majority of beneficiaries, other than those on the DPB, are single without dependent children. Although many superannuitants are couples, they generally do not have dependent children.

21 Cullen, Michael (2004a), *Estimates of Appropriation*, parliamentary paper B5, vol 1, p 1196.

Rod and Barbara are a single-income family with three young children. Rod earns $52,000 a year before tax. In 2007/08 Rod and Barbara will receive $9,342 ($180 a week) from the Accommodation Supplement, Family Support and the IWP (childcare subsidies were not included in the example), of which $8,822 ($170 a week) is additional support provided by WFF. WFF increases their disposable income (taking account of Family Support, the IWP and the Accommodation Supplement) by 22 percent.

Rod and Barbara, however, constitute an atypical example of a working family. Rod earns 125 percent of APW earnings in 2004/05. Only 15 percent of all individual taxpayers are forecast by the government to earn a taxable income of over $50,000 in 2004/05.[22] According to the answer to parliamentary question 08943 (2004) Rod and Barbara is one of only six families that are estimated to earn between $50,000 and $55,000 in 2004/05, have three children and qualify for the Accommodation Supplement. A total of 313 people or families with an income over $50,000 are expected to benefit from the Accommodation Supplement in 2007/08.

If Rod earns an additional dollar in 2007/08, 89.2 cents will be taken in extra income tax, ACC and the abatement of family income and housing assistance compared with 59.2 cents in 2004/05. If Barbara were to earn a dollar of income from employment in 2007/08, 71.2 cents would be taken compared with 41.2 cents in 2004/05. Rod and Barbara's family income would need to rise to about $71,900 (an increase of 38 percent) before their assistance is fully abated. Until that happens they would be subject to very high EMTRs which discourage work effort, saving and a host of choices that they face. Thus the increase in income that Rod and Barbara benefit from is accompanied by greatly distorted incentives.

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22 Cullen, Michael (2004b), 'Key Facts for Taxpayers', The Treasury, Wellington.

Box 1: The Government's Example of Rod and Barbara

The government illustrated the impact on income of working and beneficiary families of WFF with a handful of examples. The first example of a working family related to Rod and Barbara. The example is examined in detail below drawing on additional information supplied by the Ministry of Social Development.

Rod and Barbara have three children aged 7, 5 and 1 year. Rod works 40 hours a week and earns $52,000 a year. Barbara does not participate in paid employment. Rod and Barbara live on the North Shore of Auckland. Their mortgage payment is $385 a week.

Before WFF

In 2004/05 Rod and Barbara are entitled to maximum Family Support and Child Tax Credit of $8,112 for three children (see table 2) before income testing. Family Support and the Child Tax Credit are abated in turn at the rate of 18 cents in the dollar on annual family income over $20,356 and up to $27,481, and at the rate of 30 cents in the dollar on income over $27,481. Rod and Barbara's family income assistance is fully abated at an income of about $50,244.

Rod and Barbara qualify for the Accommodation Supplement. Their weekly mortgage payment ($385) exceeds the minimum entry threshold for accommodation costs for a married couple with children ($117 a week). The maximum Accommodation Supplement for their area (area 1) for a household of 3 or more persons is $150 a week. Rod and Barbara are entitled to an Accommodation Supplement of the lesser of the maximum of $150 or $187.60 being 70 percent of the difference between their weekly mortgage payment and the entry threshold (0.7*($385–$117)). The Accommodation Supplement is abated for a married couple (subject to rounding) at the rate of 25 cents in the dollar on family income ($1,000 a week) over $436.93 a week. The maximum Accommodation Supplement is abated by $140 a week, producing an Accommodation Supplement of $10 a week.

In 2004/05 Rod and Barbara earn a weekly gross family income of $1,000, pay PAYE and ACC of $243.34 and receive an Accommodation Supplement of $10 a week. Their disposable income, including the Accommodation Supplement, is $766.66 a week.

If Rod were to earn an additional dollar of income he would pay income tax at the rate of 33 percentage points and ACC of 1.2 percentage points (both assumed to be held constant through to 2007/08), and Rob and Barbara's Accommodation Supplement would be abated by 25 percentage points. These deductions total 59.2 percent of the extra dollar. This is his effective marginal rate of income tax. Rod would receive 40.8 cents in the hand by earning an extra dollar.

Box 1: The Government's Example of Rod and Barbara (continued)

If Barbara were to earn a dollar of income from employment, she would pay income tax of 15 percentage points, ACC of 1.2 percentage points and Rob and Barbara's Accommodation Supplement would be abated by 25 percentage points. Barbara's effective marginal rate of income tax is 41.2 percent. Barbara would receive 58.8 cents in the hand from her first dollar of earnings.

With WFF

On 1 October 2004 the income threshold for the Accommodation Supplement was increased from $436.93 a week to $496, thereby reducing the extent to which the Supplement is abated. This change increased the Accommodation Supplement payable to Rod and Barbara by $14 a week.

The entry threshold, that is the minimum level of accommodation costs required to qualify for the Accommodation Supplement, was also reduced from $117 a week to $101 on 1 October 2004. This change did not affect Rod and Barbara.

On 1 April 2005 the maximum level of Accommodation Supplement in new area 1, which includes the North Shore, increased from $150 to $225 a week and the entry threshold increased from $101 to $104 a week. The latter is a consequential change relating to the adjustment of Family Support and inflation adjustment of the benefit. The maximum Accommodation Supplement available to Rod and Barbara increased to $197 a week, that is (0.7*($385–$104)) rounded up. The income threshold decreased to $471 a week. This increased the level of abatement to about $132. These changes increased Rod and Barbara's Accommodation Supplement by a further $41 a week.

The Accommodation Supplement is not subsequently changed. Rod and Barbara received an Accommodation Supplement of $10 a week in 2004/05 which is boosted in two steps by a total of $55 dollars ($14 plus $41) a week to provide an aggregate Supplement of $65 a week or $3,380 a year in 2005/06 through to 2007/08.

On 1 April 2005 the first increase in Family Support came into effect. Rod and Barbara's new maximum Family Support ($8,632) is fully abated. However, because Rod and Barbara's Family Support is higher than previously and is abated first, their Child Tax Credit (maximum of $780 a child a year) is only partially abated whereas it was previously fully abated. They now receive $44.88 a week in Child Tax Credit (which the government rounded up in its example to $45.00 a week).

On 1 April 2006 the income test for Family Support will be relaxed. Family Support and then the new IWP will not be abated until annual family income exceeds $27,500. The new single rate of abatement will be 30 cents in the dollar. This change will make Rod and Barbara eligible for Family Support of $24.65 a week. (The government rounded this increase to $25 a week.) The IWP of $60 a week is also introduced in place of the Child Tax Credit. This generates a further net increase in assistance of $15.12 ($60–$44.88) a week. (The removal of the Child Tax Credit effectively reduces Family Support because it is abated first.)

Box 1: The Government's Example of Rod and Barbara (continued)

The level of Family Support will increase again on 1 April 2007. Rod and Barbara's Family Support will increase by $30 a week.

Thus in 2007/08, Rod and Barbara will earn a weekly gross family income of $1,000 and pay PAYE and ACC of $243.34 (before tax credits) as in 2004/05. However, they also receive family income assistance of $114.65 a week (comprising Family Support of $54.65 ($24.65 plus $30) and IWP of $60) and an Accommodation Supplement of $65. Aside from an initial Accommodation Supplement of $10 a week, this assistance is additional. Their weekly disposable income, including family income assistance and the Accommodation Supplement, is $936.31, an increase of $169.65 ($170 rounded) or 22 percent.

Rod and Barbara's disposable income in 2007/08 will comprise:

	$	$
Gross earnings		52,000
Income tax and ACC		(12,654)
Family Support	2,842	
IWP	3,120	
Accommodation Supplement	3,380	
Total assistance		9,342
Disposable income including assistance		48,688

Rod and Barbara's annual family assistance will amount to $9,342 in 2007/08 compared with $520 in 2004/05.

Rod and Barbara's average rate of tax, net of family income assistance and the Accommodation Supplement, is just 6 percent, about a quarter of the average for all individual taxpayers.

Their effective marginal rates of income tax are much higher than their average rate and higher than in 2004/05. If Rod earns an additional dollar in 2007/08, he would pay 33 cents in income tax and 1.2 cents in ACC, and his and Barbara's Family Support and Accommodation Supplement would be abated by 30 cents and 25 cents respectively. His effective marginal rate of income tax is 89.2 cents in the dollar. If the 10.8 cents left in Rod's hand were spent, GST of 1.35 cents would be incurred, giving an overall effective tax rate of almost 91 percent.

If Barbara were to earn a dollar of income from employment, she would pay 15 cents in income tax, 1.2 cents in ACC, and her and Rod's Family Support and Accommodation Supplement would also be abated by 30 and 25 cents respectively. Her effective marginal rate of income tax is 71.2 percent. Her overall effective rate of tax is 75 percent if GST on spending of 3.6 cents (0.125*(1–0.712)) is included.

Box 1: The Government's Example of Rod and Barbara (continued)

Comment

The Rod and Barbara is an atypical example of a working family. Rod earns 125 percent of APW earnings in 2004/05. Only 15 percent of all individual taxpayers are forecast by the government to earn a taxable income of over $50,000 in 2004/05. Rod's salary is about the level that a classroom teacher near the top of the pay scale with a bachelor's degree would earn. Many families would earn a higher family income because of the presence of a second earner.

Rod and Barbara's mortgage payment in 2004/05 is equivalent to 39 percent of gross income (51 percent of net income) and is somewhat above the normal bank maximum of 35 percent (including credit card and other financial commitments) but is not unusual in Auckland at present. Relatively high mortgage costs or rents are necessary to bring the Accommodation Supplement into play when family income is around $52,000 a year.

According to Dr Michael Cullen's answer to parliamentary question 08943 (2004), Rod and Barbara are one of only 6 families that are estimated to earn between $50,000 and $55,000 in 2004/05, have three children and qualify for the Accommodation Supplement. Furthermore, there are only 104 families (or individuals) with an income in that bracket that also qualify for the Accommodation Supplement and there are only 5 people or families in a higher income bracket who qualify for the Accommodation Supplement.

In 2007/08, just 22 families with an income between $50,000 and $55,000 and three children are expected to receive the Accommodation Supplement. A total of 313 people or families with an income over $50,000 are expected to benefit from the Accommodation Supplement in 2007/08.

If Rod's income reaches $60,000 his effective marginal rate of income tax would rise by 6 percentage points to 95.2 percent. At an income of about $65,500 the Accommodation Supplement would be fully abated and his effective marginal rate of income would then decline to 70.2 percent. At an income of about $71,900 Family Support and the IWP would be fully abated and Rod's effective marginal rate of income tax would decline to 40.2 percent (ie 39 cents in the dollar for income tax and 1.2 cents for ACC). This would require his income to rise by 38 percent. Thus Rod is confronted with a very high effective marginal tax rate over a very broad range of income which would discourage work effort and saving, and encourage tax avoidance activities.

The cost of WFF

The estimated cost of WFF is summarised in table 9. WFF is forecast to cost $1.1 billion a year when it is fully implemented. In addition, almost $190 million was provided in 2004/05 to 2007/08 for the delivery of programmes and contingencies.[23]

WFF is a substantial package. The level of spending committed to WFF when fully implemented will be broadly equivalent to forecast operating spending on defence ($1.2 billion), and 50 percent of such spending on law and order ($2.0 billion), and transport and communications ($1.9 billion). The cost of WFF will be equal to about 4.5 percent of forecast income tax payable by individuals.

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23 Cullen and Maharey (2004), *op cit*, p 21.

A breakdown of the cost of WFF is also presented in table 9. Family income assistance programmes are by far the most expensive component of the package.

Table 9: Estimated Cost of WFF 2004/05 to 2007/08

Component	2004/05	2005/06	2006/07	2007/08
	$m	$m	$m	$m
Family income assistance	96.3	503.0	765.0	1,007.6
Housing assistance	63.0	128.7	141.7	146.2
Childcare	18.8	31.0	34.2	34.6
Benefits and other	–7.4	–44.9	–75.8	–91.2
Total	170.7	617.8	865.2	1,097.2

Source: Ministry of Social Development (2004), *Working for Families: Fact Sheet 1*, www.msd@govt.nz.

About 63 percent of the total additional assistance to be provided in 2007/08 ($697 million) will go to families that will not receive a benefit during that year.[24] The balance will be provided to families on a benefit or families receiving a benefit and income from work.

The total cost of the package is equivalent to a 2.2 percent increase in current annual wages.[25] The average gain for families that qualify for WFF is, however, much higher because the assistance is concentrated on certain families (and some single people). Most families without dependent children, most single people and almost 40 percent of families with dependent children will not qualify for WFF.

International comparison of family income assistance

Family benefits and support that is conditional on employment in countries similar to New Zealand are compared with WFF below. The characteristics and levels of such assistance reflect many factors including the breadth of the income tax base, the rate of tax applicable to ordinary income and other social assistance arrangements. Thus comparisons of assistance programmes in isolation from other arrangements should be treated with caution.

Family benefits

An OECD analysis of public social expenditures in 2001 showed that gross family benefits for New Zealand were equivalent to 2.1 percent of GDP. New Zealand recorded the fourth highest level of family benefits relative to GDP, after Luxembourg (2.9 percent), and Australia and Austria (2.4 percent), out of the 28 countries examined.[26] Korea (0 percent), the United States (0.1 percent) and Japan and Spain (0.3 percent) provided the lowest level of family benefits.

The OECD includes New Zealand's Family Support, Child and Parental Tax Credits, the DPB, childcare subsidies, certain counselling and residential services funded through the

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24 Dr Cullen's reply to parliamentary question 08407 (2004).

25 Average total weekly gross earnings in 2004 were $973.2 million according to Statistics New Zealand's quarterly employment survey. On this basis annual gross earnings were $50.6 billion. The cost of the package of $1.1 billion is therefore 2.2 percent of gross earnings.

26 OECD (2004a), *Benefits and Wages: OECD Indicators*, OECD, Paris, table 1, p 9.

Child, Youth and Family Service (formerly known as CYPS) in family benefits.[27] The inclusion of the DPB may have inflated New Zealand's ranking because comparable assistance does not appear to have been included in family benefits for all countries, apparently because of problems encountered in breaking down aggregate social assistance consistent with the OECD's classification system. Without the DPB, family benefits would have accounted for 0.9 percent of GDP in 2001 and New Zealand might have been ranked as low as 19th equal out of 28.

In 2002 14 OECD countries provided universal family benefits alone, 10 provided means-tested (including income-tested only) family benefits alone and three countries provided both universal and means-tested family benefits.[28] The highest ratio of maximum assistance to the earnings of the APW for one child aged between 3 and 12 years was recorded by Australia (13 percent predominantly for a sole parent or other single-income family).[29] Austria and France (9 percent), Luxembourg (8 percent) and the Slovak Republic (7 percent) followed Australia. Canada, Germany, Iceland and New Zealand (6 percent) were in sixth equal place.[30] The analysis for New Zealand related to Family Support only.

If family benefits provided by other countries were to remain unchanged from 2002, additional income assistance provided by WFF would propel New Zealand's ranking to second behind Australia and equal with France.[31] However, the United Kingdom (and possibly other countries) has increased spending on family benefits since 2002.

The upper age limit for eligible children for family benefits in OECD countries (other than for full-time students) is generally lower than that which applies in New Zealand (18 years). This contributes to New Zealand's relatively high ratio of spending on family benefits to GDP. Australia and France (20 years), Austria (19 years) and Germany, Luxembourg, New Zealand and Norway (18 years) are the most lenient. Seven countries set the upper qualifying age at 17 years, three at 16 years, seven, including the United Kingdom and Ireland, at 15 years, and one each at 14 and 6 years. (An upper age limit was not given for the United States.) On the other hand, New Zealand does not provide family income assistance in respect of adult children who are engaged in full-time study, though student allowances and loans are available. Three countries provide family assistance for adult students up to the age of 27 years.[32]

Family income assistance provided in Australia, the United Kingdom and New Zealand is compared in greater detail below. Similar programmes to those classified by the OECD as providing family allowances and tax credits in 2001 are examined. The analysis focuses on arrangements that apply in Australia in 2005 and the United Kingdom in 2004/05, and those that will apply in New Zealand once WFF is fully implemented. The

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27 OECD (2004b), Social Expenditure Database (SOCX), 1980–2001, http://www.oecd.org/document/2/0,2340,en_2649_34635_31612994_1_1_1_1,00.html.

28 OECD (2004a), *op cit*, table 1.1, p 19. One country (Korea) did not provide family benefits and the policies of two countries of the 30 members were not examined.

29 A two-income Australian family could obtain the maximum assistance (ie Family Tax Benefit Part A and Part B in 2004) if the income of the second earner did not exceed A$4,000 (about NZ$4,340) a year.

30 OECD (2004a), *op cit*, table 1.7, pp 37–38. The analysis focused on assistance programmes that were equivalent to Family Support.

31 The relevant ratio is that for a family on a benefit with one child in table 6 as the IWP is excluded because it is classified as a payment conditional on work rather than a family benefit.

32 OECD (2004a), *op cit*, table 1.7, pp 36–38.

information presented is therefore more up to date than the OECD study referred to above but not as broad in its coverage.[33]

Australia provides assistance through its Family Tax Benefit (FTB). FTB is paid fortnightly to the main caregiver or through the tax system as a lump sum at the end of the financial year. It comprises two parts:

- Part A is an annual tax benefit to help families with the cost of raising children. It is paid in respect of dependent children under the age of 21 years, or aged between 21 and 24 years in the case of a full-time student. The base rate (an element of FTB Part A) is also payable in respect of a child aged up to 24 years of age who is in approved care. The FTB Part A Supplement (included in Family Benefit Part A in the table below) is only paid after the end of the financial year to which it relates.

  The level of assistance depends on the age and number of children, and is subject to a two-stage income test (except for people receiving income support). When family income exceeds A$32,485 FTB Part A abates at 20 cents in the dollar until only the base rate of assistance is payable. When family income exceeds A$84,023 (plus A$3,358 for each child after the first), the base rate of assistance is abated at the rate of 30 cents in the dollar. FTB is not paid in respect of children whose income exceeds certain (low) levels.

  FTB (other than the base rate) is only payable in respect of a child from a previous relationship if reasonable steps are taken to obtain child maintenance. Maintenance is not included in family income for the purposes of the income test but is subject to a separate test which may reduce the amount of FTB that is payable.

- Part B provides extra assistance for families with one main income. Families with dependent children under the age of 16 years, or aged 16 to 18 years in the case of a full-time student, may qualify. There are two rates of assistance depending on whether the youngest child is aged under 5 years or aged 5 years or over.

  The level of assistance is set on a per family basis and, beyond the first qualifying child, does not increase as the number of children increases. FTB Part B is automatically paid to all sole parent families. A family with a second earner may also qualify for FTB Part B but the assistance is abated on income earned by the second earner in excess of A$4,000 a year at the rate of 20 cents in the dollar. (The income of the main earner is not taken into account at all.)

The United Kingdom has two main family benefit schemes, Child Benefit (CB) and Child Tax Credit (CTC), at present. They are summarised below:

- CB assists families to bring up children. It is paid in respect of children under 16 years of age, children aged 16 to 18 years who are engaged in full-time education (other than higher education) and certain children aged 16 or 17 years who have recently left school and are registered for work or training with the Careers Service (or equivalent). CB ceases if the child starts to receive Incapacity Benefit, Income Support or Jobseeker's Allowance or qualifies for a training allowance.

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[33] The main sources used were Family Assistance Office (2005), 'Guide to Payments', http://www.centrelink.gov.au/internet/internet.nsf/publications/fpr006.htm (Australia) and www.taxcredits.inlandrevenue.gov.uk/HomeIR.aspx (United Kingdom).

The level of assistance depends on the number of children and is higher for the eldest child than for subsequent children. CB is paid direct to the person mainly responsible for the care of the child. It is not income-tested.

- CTC is paid to parents and carers of children (aged 16 years and over) who are responsible for at least one child under 16 years of age, or a qualifying young person. Such a person is someone up to the age of 19 years who is in full-time education, or aged under 18 years and has recently completed full-time education and is registered with the Careers Service.

  CTC is additional to Child Benefit. It includes a family element (one per family). In addition, payments are made in respect of each child, for a child under one year of age and for children with disabilities. As with New Zealand's WFF, these elements are payable to beneficiaries and families in work. The Working Tax Credit (apart from the childcare element) is abated first, followed in turn by the childcare element of the Working Tax Credit (WTC) and the child elements of the CTC.[34] They are abated at the rate of 37 percent of annual family income in excess of £5,060. The family element of the CTC is paid unabated until family income exceeds £50,000. It is then abated by £1 for every £15 of income (ie at a rate of about 6.7 percent). The CTC is paid direct to the person mainly responsible for the care of the child. Couples are required to make a joint claim.

The key parameters of family income assistance, excluding benefits conditional on work, available in Australia, United Kingdom and New Zealand (once WFF is fully implemented) are summarised in table 10. The table shows that the maximum level of assistance available relative to APW earnings is higher in the United Kingdom and, to a lesser extent, Australia than in New Zealand.

The gap between the maximum level of assistance provided in Australia and New Zealand narrows if FTB Part B does not apply (ie where a second earner's income exceeds A$4,000). In these circumstances, New Zealand provides relatively more assistance for a first child than Australia but Australia provides more assistance for larger families.

The United Kingdom's CTC is subject to the highest abatement rate, 37 percent, although its CB is provided on an universal basis. The CTC also becomes subject to abatement at a low level of earnings. Australia's FTB Parts A and B have the lowest initial abatement rates of those programmes that are subject to an income test. FTB Part B is subject to abatement when the second earner earns a low level of income. However, this does not necessarily imply a low level of family income.

Family income assistance in both the United Kingdom and Australia contains elements that are universal or lightly targeted. New Zealand's Family Support is more tightly targeted than comparable programmes in the United Kingdom and Australia, with the possible exception of Australia's Family Benefit Part B. All three countries are likely to be among those OECD countries with the highest levels of spending on family benefits relative to GDP.

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[34] The WTC is a payment conditional on work. It is discussed below.

Table 10: Family Income Assistance Australia, United Kingdom and New Zealand[1, 2]

Key Parameters	Australia Family Tax Benefit 2005			United Kingdom 2004/05			New Zealand Family Support 2007/08
	Part A	Part B	Total	Child Benefit	Child Tax Credit	Total	
	%	%	%	%	%	%	%
Maximum assistance/APW earnings[3]							
No Children							
1	7	4	11	4	10	14	9
2	15	4	19	7	18	25	13
3	22	4	26	10	26	35	19
4	30	4	34	12	33	46	26
5	37	4	41	15	41	56	32
6	45	4	49	18	49	67	39
Abatement rate							
First threshold[4]	20	20	NA	NA	37	NA	30
Second threshold	30	NA	NA	NA	7	NA	NA
Abatement threshold/APW earnings							
First threshold	59	7	NA	NA	24	NA	59
Second threshold	152	NA	NA	NA	237	NA	NA
Income at which assistance is fully abated/APW earnings[5]							
No Children							
1	162	26	NA	NA	276	NA	90
2	179	26	NA	NA	276	NA	111
3	195	26	NA	NA	276	NA	133
4	212	26	NA	NA	276	NA	154
5	228	26	NA	NA	276	NA	175
6	245	26	NA	NA	276	NA	196

1 Excludes housing, childcare and disability assistance, and maternity allowances and similar support for new parents such as the Parental Tax Credit (New Zealand). Also excludes payments to some particular categories of families such as those for families with multiple births (Australia).

2 All children are assumed to be under 13 years of age. In the case of FTB Part B (Australia), all qualifying children are assumed to be aged at least 5 years. For the CTC (United Kingdom), the higher family element payable in respect of a child aged under one year is omitted.

3 APW is the average production worker. The OECD calculates APW earnings to 2004. They were estimated for Australia (2005) and New Zealand (2007/08) to align with the period in which family benefits examined are payable. The APW is assumed to earn A$55,351 (Australia) in 2005, £21,079 (United Kingdom) in 2004/05 and NZ$46,387 (New Zealand) in 2007/08. The OECD notes that white-collar workers are excluded in calculating APW earnings except for New Zealand. Consequently, the OECD observes that APW earnings for New Zealand are probably increased by 5 to 10 percent.

Notes to table 10 continued.

4 The abatement rates for the FTB Part A and Part B (Australia) are not additive because Part B is only abated against the second income earner's income. Excludes abatement arising from receipt of maintenance (Australia).

5 The calculation shows the level of income at which FTB Part A, including the base rate of assistance, is fully abated.

Benefits conditional on work

Twelve member countries of the OECD provided benefits that were conditional on employment in 2002.[35] The main features of the IWP are compared with in work benefits payable in 2004 in the United States (the Earned Income Tax Credit, EITC) and the United Kingdom (the WTC) in table 11. Information on benefits conditional on employment is taken from a detailed OECD study, which compares such programmes on a consistent basis, but has been updated to incorporate changes made since 2002, particularly the introduction in April 2003 of the WTC in the United Kingdom.[36]

Australia is a notable omission from table 11. According to the OECD, its only in work benefit in 2002 was an Employment Entry Payment, comprising a lump sum payment of A$104 (NZ$113) to people moving into full-time employment.[37]

The United State's EITC began in 1975 as a modest programme aimed at offsetting the social security payroll tax for low-income families with children. Following a series of policy initiatives implemented in 1986 and subsequently, it evolved into the single largest cash transfer programme for low-income families at the federal level. It is expected to cost about US$39.5 billion (about 0.3 percent of GDP) in 2005/06.[38] In comparison, New Zealand's IWP is expected to cost NZ$350 million (about 0.2 percent of forecast GDP) in 2007/08.[39]

There are three regions in the credit schedule of the EITC. In the initial phase-in region, a qualifying family receives a payment equal to the subsidy rate multiplied by its earnings. In the flat region, the family receives the maximum credit payable while in the phase-out region, the maximum credit is abated at a fixed rate. The credit is refundable (ie a taxpayer with no federal tax liability would be paid the full amount of the credit).

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35 OECD (2004a), *op cit*, table 1.1, p 19. The 12 countries comprise: Australia, Belgium, Canada, Finland, France, Germany, Ireland, Japan, Netherlands, New Zealand, United Kingdom and United States. The remaining 16 OECD countries examined (Austria, Czech Republic, Denmark, Greece, Hungary, Iceland, Italy, Korea, Luxembourg, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden and Switzerland) do not provide such benefits. Two countries, Mexico and Turkey, were not examined.

36 The main sources used include OECD (2004a), *op cit*, Internal Revenue Service (2004), *Earned Income Credit (EIC): For Use in Preparing 2004 Tax Returns*, publication 596, www.irs.gov, Inland Revenue (2003), *WTC2 – Child Tax Credit and Working Tax Credit –A Guide*, www.inlandrevenue.gov.uk and *The Tax Credits Up-rating Regulations 2004 (United Kingdom).*

37 OECD (2004a), *op cit*, table 1.11, p 49.

38 Steuerle, Eugene (2005), 'Tax Reform and Fairness for Families: Presentation to the President's Advisory Panel on Federal Tax Reform', unpublished paper, Urban-Brookings Tax Policy Center, March 23, http://www.taxpolicycenter.org/publications/template.cfm. PubID=900795.

39 Dr Cullen's answer to parliamentary question 08406 (2004) and budget 2004 forecast of GDP in 2007/08. The cost is gross of the saving from the abolition of the Child Tax Credit.

The United Kingdom's Working Families' Tax Credit, which was modelled on the EITC, was introduced in October 1999. The WTC and CTC replaced the Working Families' Tax Credit in April 2003.

Table 11: Summary of In Work Benefits United States, United Kingdom and New Zealand[1, 2]

Main Features	**United States Earned Income Tax Credit 2004[3]**	**United Kingdom Working Tax Credit 2004/05[4]**	**New Zealand In Work Payment 2007/08**
Eligibility	The taxpayer must hold a valid social security number entitling the taxpayer to work in the United States. A valid number must also be held for a spouse, if filing a joint return, and for the taxpayer's qualifying child or children. A qualifying child is a son, daughter, adopted child, grandchild, great-grandchild, step child or eligible foster child who at the end of the tax year is under 19 years of age, under 24 years and a full-time student, or of any age if permanently and totally disabled and lived with the taxpayer in the US for more than half the tax year. Only one claim for EITC can be made in respect of each qualifying child. Low-income workers without children who are between 25 and 65 years of age may also qualify. The taxpayer must have earned at least US$1 in taxable wages, salaries or income from self-employment. The annual investment income of the taxpayer must not exceed US$2,650. There are no minimum hours of work required.	The person claiming WTC must usually live in the United Kingdom. Qualifying children are those under 16 years of age or under 19 years of age and engaged in full-time education who are cared for by the taxpayer. The claimant must be an employee or self-employed and must usually undertake at least 16 hours a week of paid work and must expect to work for at least four weeks. The claimant must also be aged 16 years or over and be responsible for at least one child or be disabled and receiving a qualifying benefit, or be aged 25 years and over and usually work at least 30 hours a week. A person without children or a disability aged 50 years or over who was in receipt of certain benefits immediately before taking up work may qualify. A couple must make a joint claim.	The person applying for the IWP must usually be a New Zealand resident and usually resident in New Zealand. Qualifying children are those who are dependent and under 19 years of age. Must work at least an aggregate of 30 hours a week for a couple or 20 hours a week for a sole parent. Recipients of New Zealand Superannuation and similar assistance for people aged 65 and over may qualify provided that they satisfy the work requirement.

Table 11: Summary of In Work Benefits United States, United Kingdom and New Zealand[1, 2] (continued)

Main Features	United States Earned Income Tax Credit 20043	United Kingdom Working Tax Credit 2004/05	New Zealand In Work Payment 2007/08
Maximum level of assistance	For taxpayers (married and unmarried) with one child, the credit is 34 percent of earned income (rounded by income brackets) up to an income of US$7,660. For taxpayers with two or more children, the credit is 40 percent of income up to an income of US$10,750. For low-income workers without children, the credit is 7.65 percent of income up to an income of US$5,100. The credit is refundable. The credit is generally payable annually but may be paid on a regular basis in advance. The level of assistance is adjusted annually for inflation.	The credit includes a basic element of £1,570, a second adult or lone parent element of £1,545 and a 30-hours of work a week element of £640 a year. Additional elements include disability £2,100, severe disability £890 and 50 plus working 16–29 hours £1075, 30 or more hours £1610 a year. The childcare element provides a credit of up to 70% of the maximum eligible weekly costs of £135 for one child and £200 two or more children. The credit is payable weekly, usually through the employer. The level of assistance is reviewed annually.	The payment is NZ$3,120 for 1 to 3 children plus NZ$780 for each additional child. Paid to the principal carer. The IWP may be paid fortnightly or weekly or as a lump sum at the end of the tax year. The level of assistance is to be reviewed every three years.

Table 11: Summary of In Work Benefits United States, United Kingdom and New Zealand[1, 2] (continued)

Main Features	United States Earned Income Tax Credit 2004[3]	United Kingdom Working Tax Credit 2004/05	New Zealand In Work Payment 2007/08
Abatement	For single and married (filing jointly) taxpayers with one child, the credit is abated at a rate of 15.98 percent on annual income over US$14,040 and joint income over US$15,040 respectively. The credit is fully abated at an income of US$30,338 (single) and US$31,338. For single and married taxpayers with two or more children, the credit abates at a rate of 21.06 percent on annual income over US$14,040 and US$15,040 respectively. It is fully abated at an income of US$34,458 (single), US$35,458 (married). For unmarried and married taxpayers without children, the credit abates at a rate of 7.65 per cent on annual income over US$6,390 and US$7,390 respectively. It is fully abated at an income of US$11,490 (single) US$12,490 (married).	Abates at a rate of 55 percent of joint annual income over £5,060.	Abates at the rate of 30 percent of joint income over NZ$27,500 a year. Family Support is abated first, then the IWP and then the Parental Tax Credit.

1 Excludes benefits payable whether the recipient is in work or not, and excludes all housing, childcare and disability assistance provided by other programmes.

2 Foreign currencies may be converted to New Zealand dollars at the following retail rates which prevailed on 1 February 2005: NZ$1=AUD 0.9232=US$0.7171=GB£0.3799.

3 A limited number of states have introduced supplementary programmes. The federal credit only is examined.

An analysis of the EITC, WTC and IWP is presented in table 12. The maximum level of assistance provided relative to APW earnings by the IWP is lower than that for the WTC and the EITC. However, the IWP is substantially less tightly targeted than the WTC and, to a lesser extent, the EITC. The IWP begins to be abated at a higher ratio of income to APW earnings and it is not fully abated until income reaches a much higher ratio than for the other two benefits.

Table 12: In Work Benefits United States, United Kingdom and New Zealand[1]

Key Parameters	United States Earned Income Tax Credit 2004[2]	United Kingdom Working Tax Credit 2004[3]	New Zealand In Work Payment 2007/08
	%	%	%
Maximum assistance/ APW earnings[4, 5]			
Single 1 child	8	11	7
Single 2 children	12	11	7
Married 1 child	8	11	7
Married 2 children	12	11	7
Abatement rate[6]			
Single 1 child	16	37	30
Single 2 children	21	37	30
Married 1 child	16	37	30
Married 2 children	21	37	30
Abatement threshold/ APW earnings[7]			
Single 1 child	41	15	57
Single 2 children	41	15	57
Married 1 child	44	15	57
Married 2 children	44	15	57
Income at which assistance is fully abated/APW earnings			
Single 1 child	88	44	128
Single 2 children	100	44	128
Married 1 child	91	44	128
Married 2 children	103	44	128

1 Excludes benefits payable whether the recipient is in work or not, and excludes all housing and childcare subsidies.

2 A limited number of states have introduced supplementary programmes. The federal credit only is examined.

3 The WTC and the CTC replaced the Working Families' Tax Credit in April 2003. The WTC only is examined in this table. The CTC was included in table 10.

4 See notes to table 10 for assumptions relating to APW earnings.

5 For the United Kingdom, the person is assumed to qualify for the 'working at least 30 hours a week' element.

6 Abatement rates for the United States have been rounded. The exact rates are 15.98 percent (one child) and 21.06 percent (two children).

7 The income level at which abatement starts ($27,500) first applies in 2006/07. The calculation takes account of the growth in the APW earnings through to 2007/08. If APW earnings for 2006/07 were used, the threshold would increase to 61 percent of APW earnings.

The WTC is the most tightly targeted in work benefit examined. It begins to abate at a low level of income, 15 percent of APW earnings, and is fully abated when income reaches 44 percent of APW earnings compared with 57 percent and 128 percent respectively for the IWP.

The rate of abatement of the EITC is modest (generally 16 or 21 percent) compared to that for the WTC and IWP (37 and 30 percent respectively). Ordinary rates of federal income tax are also lower in the United States than in the United Kingdom and New

Zealand. Other things being equal, the WTC and IWP could be expected to discourage work effort once they begin to abate to a greater extent than the EITC.

Implications for economic efficiency

Economic efficiency focuses on the extent to which scarce resources are used to produce the highest possible levels of well-being. Resource use is distorted when there are wedges between social and private returns to factors of production (for example, land, labour and capital). Income taxes, for example, reduce the private return from an extra hour of work (measured by the after-tax wage) relative to the social return (measured by the gross wage).[40] As a consequence, leisure (non-work) is preferred to work at the margin and output is lower than otherwise.

The efficiency, substitution or incentive effects of WFF need to be distinguished from its income effects. Efficiency effects arise when relative prices are changed. A reduction in income tax increases the return from an additional hour of work and thereby encourages the taxpayer to substitute work for leisure. In contrast, income effects arise when policies alter a person's income but do not change relative prices. A new superannuitant, for instance, may work fewer hours because their income increases, even though the relative price of work and leisure is unchanged because the same level of New Zealand Superannuation is paid to people over 65 years of age who are in work or in retirement.

Policy changes often produce both substitution and income effects. These effects may work in opposite directions. The substitution effect arising from a reduction in income tax on an additional hour of work would encourage additional work, as noted above, while the income effect may discourage work because a person is required to work fewer hours to earn a given level of income after tax. When the substitution and income effects of a new policy work in the opposite direction, the overall impact on output of the policy can only be determined by an empirical analysis.

Substitution effects are associated with efficiency or inefficiency. An increase in one person's income is (other things being equal) matched by a decrease in another person's income. The winner of Lotto, for instance, obtains a large increase in income whereas many other participants incur a small reduction in income (*ex post*). For this reason, income effects are often omitted from an analysis of microeconomic policies, (ie those that do not have economy-wide effects). If they are taken into account, it is important to include both income gains and losses. Income effects are sometimes referred to as incentives or disincentives but this is generally inappropriate.[41]

Work incentives

A main objective of WFF is to encourage work, especially by beneficiaries, and thereby enhance output and growth, and improve social outcomes. *However, WFF does little to make the taking up of work or additional work more rewarding than non-work and is therefore unlikely to have a noticeable (if any) net positive effect on aggregate employment.*

The main WFF programmes, notably Family Support and the Accommodation Supplement, are generally available to families in work or on benefits. Thus the increase

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[40] Taxes paid by residents are treated as a transfer among residents.

[41] Lindbeck, Assar (1986), 'Limits to the Welfare State', *Challenge*, January-February, p 32, Stiglitz, Joseph E (1998), *Economics of the Public Sector*, W W Norton & Company, New York, pp 243–246.

in the levels of such programmes (with two main exceptions discussed below) will not make work more rewarding than non-work and thus encourage continued dependence on welfare.

The measures that are likely to encourage work include the following:

- The IWP (net of the Child Tax Credit). The IWP encourages families with dependent children to participate in work to the extent necessary to qualify for it and discourages families in work from going on a benefit. However, once a family qualifies for the IWP, by working the required hours and satisfying other criteria, it provides no further incentive to increase work effort.

  The IWP, for example, encourages sole parents who are not on a benefit to work for at least 20 hours a week (the minimum hours of work required by sole parents to qualify for the IWP). However, it does not encourage such parents to undertake additional work or to seek promotion.

  As the Department of Labour observed, the IWP provides no encouragement for second income earners to seek employment where one parent works at least 30 hours a week.[42] On the contrary, it may well discourage secondary workers from engaging in paid work.[43]

  Prior to WFF, people on benefits may have received more net income (including income, accommodation and childcare assistance) than if they had a low paid job. This income problem is addressed to some extent. The percentage margin between family assistance provided to families in work and on a benefit is considerably higher than at present but declines as the number of children increases, reaching 43 percent at six children (see table 5).

  The IWP, net of the Child Tax Credit, will cost $228 million in 2007/08 or about a fifth of the cost of WFF.[44] Most spending on WFF will not increase the return from work. Moreover, most of the cost of the IWP will comprise payments to families already in employment, including families that have a strong commitment to work (most low, middle and upper income working families). The additional expenditure on the IWP relating to families that move off benefits is estimated at just $8 million in 2006/07.[45] It is most unlikely that the IWP will have much influence on the level of employment.

- Additional childcare subsidies can be expected to encourage work at the margin by increasing the net private reward from work. Parents in work or training may qualify for up to 50 hours a week of childcare assistance. Other parents are entitled to up to nine hours a week of such assistance. The maximum rate of subsidy will be $3.12 an hour. Childcare assistance is, however, available to relatively few families and much of the additional support is directed at existing recipients and those in employment (eg those families that benefit from the increase in income thresholds).

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42 See 'Department of Labour Comment' in Cullen and Maharey (2004), *op cit*, p 23.

43 See Eissa, Nada and Hoynes, Hilary W (1998), 'The Earned Income Tax Credit and the Labor Supply of Married Couples', Working Paper No 6856, National Bureau of Economic Research, Cambridge.

44 The IWP is expected to cost $350 million gross ($228 million net of the Child Tax Credit) in 2007/08 according to Dr Cullen's reply to parliamentary question 8406 (2004).

45 Dr Cullen's answer to parliamentary question 08998 (2004).

- The lifting of the income threshold for the abatement of family income assistance from a joint family income of $20,356 to $27,500 on 1 April 2006 will encourage recipients of such assistance to earn more market income within that income range. At the current minimum adult wage of $9.50 an hour, the maximum extra work each year is 752 hours (94 days on the basis of 8 hours a day) for each affected family.[46] The increase in the after-tax return from additional work may, however, not be sufficient to encourage most families to raise their incomes to $27,500.

- The proposal not to abate the Accommodation Supplement while people are receiving a benefit, which reduces the effective marginal tax rate on the first $80 of income from work, will encourage those beneficiaries who are in receipt of the Accommodation Supplement and who do not earn at least $80 a week in paid work to engage in limited work (a maximum of about 8 hours a week at the minimum wage of $9.50 an hour and fewer hours at a higher wage).[47]

- Other changes to the benefit system may, at best, have a slight impact on work incentives.

The positive impact on work incentives of WFF discussed above is likely to be offset by adverse effects. In particular, WFF will result in higher EMTRs than otherwise which will discourage employment. Much WFF assistance will have no effect on work incentives because it does not affect marginal returns to work. In contrast, the higher tax rates than otherwise will largely affect work decisions and other choices at the margin. The tax revenue committed to WFF could have been used to reduce high EMTRs, thereby generating much larger efficiency gains than WFF. The top two rates of personal income tax and the company tax rate, for illustrative purposes, could be reduced to 32 percent for about the same cost. (The distributional effects would, of course, be different.)

The Treasury has helpfully prepared an analysis of EMTRs with and without WFF.[48] The analysis focuses on family income assistance and omits the accommodation supplement and childcare subsidies. It takes account of income tax and abatement rates but omits other taxes such as GST.

Mean EMTRs for all individual taxpayers with and without WFF are shown in table 13. According to the Treasury, the mean EMTR in 2007/08 will be 1.1 percentage points (3.8 percent) higher with WFF than without it. A higher mean EMTR implies, other things being equal, lower aggregate employment with WFF than without it. The only way that aggregate employment could be expected to increase, given a higher mean EMTR across all individual taxpayers, would be if taxpayers whose employment behaviour is most sensitive to small changes in EMTRs face lower EMTRs while those who are relatively insensitive to such changes face higher EMTRs, such that a change in the mean EMTR is accompanied by a net increase in employment. This is, however, unlikely to be the case. For example, the EMTRs faced by many second earners affected by

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46 The minimum wage was increased from $9 to $9.50 an hour on 21 March 2005. The calculation is ($27,500–$20,356)/$9.50.

47 The abatement of the Accommodation Supplement is presently capped at a maximum of $20 a week ($80* 0.25) until the beneficiary moves off the benefit.

48 Personal communications 22 July and 10 September 2004.

WFF, who are more sensitive to changes in EMTRs, will increase, as the Rod and Barbara example illustrated.[49]

The higher mean EMTR increases deadweight costs at the margin – the loss of output caused by the impact on behaviour of taxes on the next dollar earned – by 7.8 percent in 2007/08, other things being equal.[50] Families are likely to reduce their work effort (for instance, forgo overtime, promotion and training, and secondary workers are more likely not to take up employment, reduce their hours of work or lower their work intensity) when the net return from a dollar of additional gross income is low. This is especially likely where high EMTRs apply over a wide income range as is likely to be the case. These costs are likely to outweigh any positive work incentives provided by the package.

Table 13: Change in Mean Effective Marginal Tax Rate[1] 2005/06 to 2007/08

Year	Mean EMTR		Increase in Mean EMTR With WFF[2]
	Without WFF	With WFF	
	%	%	%
2005/06	28.4	28.8	1.4
2006/07	28.5	29.3	2.8
2007/08	28.6	29.7	3.8

1 Includes all individual taxpayers.

2 Increase in mean EMTR with WFF expressed as a percentage of the mean EMTR without WFF.

Source: The Treasury.

The Treasury also supplied a box-plot of EMTRs. The change in the pattern of EMTRs in 2007/08 for all taxpayers is difficult to summarise and interpret because of the wide dispersion of EMTRs within decile groups between the range of 0 and 110 percent that was examined. In broad terms, EMTRs seem to be somewhat more concentrated over a slightly higher range of taxable income in decile 1 (the lowest income decile), to be more heavily concentrated over a lower income range in decile 2 and to be more widely dispersed in decile 3. In deciles 4, 5 and 6, EMTRs seem to be more tightly concentrated at lower levels but this pattern is reversed in deciles 7 and 8. There is little apparent change in the distribution of EMTRs in deciles 9 and 10.

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[49] The economic literature generally shows that the *hours of work* of 'prime age males' are largely unresponsive to small changes in the after-tax wage. An increase in tax discourages hours of work (the efficiency effect) by making non-work (modelled as leisure) relatively more attractive than work but a desire to increase hours of work to maintain living standards (the income effect) has the opposite effect. The net change in hours of work is likely to be close to zero. The hours of work of secondary workers (eg wives) and those not strongly committed to working (eg young single men and women, those on benefits and older people close to retirement or in retirement) are more likely to change in response to small changes in the level of taxes. Such workers are more likely to be on the margin of deciding whether to work. While much of the literature focuses on hours of work, broader aspects of participation in work and work effort should also be taken into account. They include (among other factors) whether a male or female who is at the margin between participating in paid work or exiting from the labour market is likely to do so in response to small changes in the after-tax wage, and a person's willingness to seek promotion, participate in education and training, and engage in entrepreneurial activity. There is some empirical support for the view that high EMTRs have a more detrimental effect on work effort (broadly measured) than hours of work. See Heckman, James J (1993), 'What Has Been Learned About Labour Supply in the Past Twenty Years', *American Economic Review*, vol 83, issue 2 (May), pp 116–121.

[50] Deadweight costs increase with the square of the tax rate.

The very large increases in the levels of family income, housing and childcare assistance provided by WFF lead to higher EMTRs over a much wider income range than otherwise as assistance is abated. For instance, an additional 23,790 single-income parents (an increase of 41 percent) and 27,060 couples with dependent children based on primary earners (an increase of 51 percent) and 13,700 (an increase of 82 percent) based on secondary earners will face EMTRs in excess of 50 percent in 2007/08 compared with 2004/05. About 50 percent of single people facing an EMTR over 50 percent will be on an income of over $25,000. About 50 percent of couples (primary earner) with an EMTR in excess of 50 per cent will be on a joint income of over $45,000. These data take account of family income assistance, benefit income and forecast income growth but exclude the Accommodation Supplement and childcare assistance.[51]

Targeting enables higher levels of assistance than otherwise to be paid to people who would otherwise face hardship. Targeting, however, leads to higher EMTRs for affected people but lower EMTRs for taxpayers generally than if the same level of assistance were paid on an universal basis. Given reasonable parameters, targeting is generally more efficient than universal assistance. This is a reason why proposals to introduce negative income taxes or to pay a living wage to all citizens have not generally been implemented.

The problem of high EMTRs as assistance is abated is largely unavoidable but it can be better contained. A reduction in the level of assistance would ease the problem. More 'headroom' might also be made if government spending and the hence the overall tax burden were lower.

The detrimental effect on labour market participation by beneficiaries of high EMTRs is well known. *WFF extends high EMTRs much further up the income distribution, while doing little to alleviate the problem of high EMTRs as people transition from benefits to work. Families with dependent children risk being locked into high EMTRs over wide ranges of income, from which many will have difficulty escaping, even in the medium term. This is a key weakness of WFF.*

The situation of a sole parent with one child (aged less than 13 years) on the DPB in 2007/08 illustrates the concern. The parent is first assumed to be ineligible for the Accommodation Supplement. The initial EMTR when market income is earned (ie additional to the benefit) is 22.2 percent (a 21 percentage points marginal rate of income tax plus ACC of 1.2 percentage points) because the DPB is taxable and is not abated until other income exceeds $80 a week.[52] It rises to 52.2 percent when the DPB begins to be abated at 30 cents in the dollar (at a market income in excess of $80 a week or $4,160 a year) and then jumps to 92.2 percent at an earned income of $9,360 when the rate of benefit abatement increases to 70 cents in the dollar. That rate then applies until the DPB is fully abated.[53] Up to about this point there is no change with WFF.[54]

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51 Dr Cullen's reply to parliamentary question 08410 (2004).

52 The analysis contained in this report and the government's analysis assumes that ACC and income tax rates remain at current levels through to 2007/08.

53 The analysis is based on income bands of $5000. It therefore omits the massive reduction in EMTRs that occurs at the point at which a family ceases to be on a benefit and qualifies for the IWP. The IWP will induce some people to forgo a part benefit in order to qualify for the IWP.

54 The change to the child component of benefits does not affect the level of benefit paid to a sole parent with one child on the DPB, SB, UB or IB. However, if an example involving the change to the child component were used (a sole parent with more than one child or a couple), the change would be small. The DPB would be lower than at present as noted above and would be fully abated at a somewhat lower income.

Rather oddly, the EMTR falls briefly to 22.2 percent with WFF when the DPB is fully abated and before family income assistance begins to be abated at the higher income threshold of $27,500.[55] Once family assistance begins to be abated, the EMTR rises to 52.2 percent and then to 64.2 percent when income exceeds $38,000 and the 33 percent income tax rate applies. Family assistance is fully abated between an annual income of $50,000 and $55,000 at which point the EMTR falls to 34.2 percent.[56]

The addition of further children and the Accommodation Supplement would raise the income level at which benefit income and family assistance is fully abated. For example, a sole parent with two children who resides in Auckland City and qualifies for the maximum Accommodation Supplement at the highest rate possible would need to earn an income of almost $70,000 a year before all assistance is fully abated and additional income is subject to standard tax rates only.[57]

A similar problem arises for families in work. A family with two children aged less than 13 years would be eligible for family income assistance of $10,348 (the minimum level payable to a family with two children). Other assistance is omitted. The family would need to earn a joint income of almost $62,000 before such assistance is fully abated. Thus from the income threshold for the abatement of family assistance of $27,500 to almost $62,000, the family's EMTR will comprise the relevant marginal income tax rate (21, 33 or 39 percentage points for the main income earner and 21 or 15 percentage points for the secondary earner) plus ACC (1.2 percentage points) and the abatement of family assistance (30 percentage points) for both earners. If the main earner is on an income between $38,000 and $60,000, his or her EMTR will be 64.2 percent. In this case, the secondary earner's EMTR will be between 52.2 and 46.2 percent. Thus relatively high EMTRs will apply across a broad range of income and to secondary workers. Their employment behaviour is generally more sensitive to small changes in EMTRs than prime age males.

A report by officials attributed some of the employment gains arising from WFF to income effects. Beneficiaries can increase their income by taking up employment. With WFF the income gain from employment is increased. The three indicative examples examined by officials suggest that replacement ratios (the ratio of net income on a benefit to net income in work) would reduce from around 81.7 percent (sole parent with one child), 83.1 percent (couple with two children) or 82.8 percent (couple with four children) in April 2005 to 75.9, 75.4 and 81.1 percent respectively in April 2007.[58] Net income from work in the examples examined is estimated to increase by 5.8 percentage

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55 A similar temporary reduction in EMTRs applies where beneficiaries have larger families.

56 Patrick Nolan illustrates the same issue by examining the pattern of EMTRs applicable to a person on the DPB as their hours of work increase. See Nolan (2004), *op cit*.

57 The data for the example are taken from Dr Cullen's answer to parliamentary question 07896 (2004).

58 Ministry of Social Development, The Treasury and Inland Revenue Department (2004), *Future Directions – Working for Families Impacts*, Report prepared for the Minister of Finance and the Minister of Social Development and Employment, 15 March, Ministry of Social Development, Wellington, table 10, p 25. The sole parent is assumed to work 30 hours a week at $11 an hour while both couples work 40 hours a week at $12 an hour. The Accommodation Supplement is taken into account. Given the emphasis placed by the government on the income effects of the package, it is surprising that a detailed examination of the impact on replacement ratios of WFF was not included in the paper.

points (sole parent), 7.7 percentage points (couple with two children) and 1.7 percentage points (couple with four children) compared with income on the benefit.[59]

While beneficiaries may increase their employment in response to a higher income from work, their income gains arise, in part, from the redistribution of income. Where this is the case, other workers face lower income than otherwise which may adversely affect their employment.

The Treasury's estimate of the cost of WFF assumes that just 2 percent of sole parents will move off benefits and into work as a result of the family income assistance changes, with no net change for couples. On this basis, it would seem that family income assistance might encourage, at most, 2,160 beneficiaries to move off the DPB at a massive cost of up to $84,600 per beneficiary moved into work.[60] This approach attributes the entire cost of providing income assistance to people on the DPB to the objective of making work pay. It is not possible to allocate the cost of WFF among its objectives.

In answer to a parliamentary question Dr Cullen wrote:

> For the purposes of estimating the out-year costs of the In-Work Payment, it was assumed that 2,700 sole parents will move off [a] main benefit (Domestic Purposes Benefit in most cases) and be in receipt of the In-Work Payment in 2006/07.[61]

This answer confirms that WFF is expected to provide little encouragement for work.[62]

Some commentators have suggested that the Treasury's employment assumptions are conservative. The survey of selected research in box 2 indicates that the impact on employment of similar programmes in other countries varies considerably. While the employment response of single mothers to tax changes is reported in some studies to be moderately large, other studies suggest that Treasury may have underestimated the

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59 The percentages reported are lower than in earlier tables that compared the change in income assistance with WFF rather than the change in net income.

60 The Treasury's analysis was not released with other papers related to WFF. Data for 2007/08 are not available. However, in 2006/07 there are expected to be 106,000 on the DPB. A breakdown between singles and couples is not available. If the number of people forecast to be on the DPB in that year are two percent lower than otherwise, a total of 2,163 ((106,000/0.98)–106,000) will have been moved off the DPB. The cost of providing family income assistance to people on the DPB in 2006/07 is estimated to be $183 million. Thus the cost per person moved off the benefit is $183,000,000/2,163 or about $84,600 in 2006/07. The estimate of the number of beneficiaries may have been rounded. Similar data contained in answers to other parliamentary questions were generally rounded to the nearest 1,000. If that approach had been adopted in this case (the answer to the particular parliamentary question is silent on the point), then the number of beneficiaries moved off the benefit should also be rounded to the nearest 1,000 (ie to 2,000) and the estimated cost would rise to $92,000 per person moved off the benefit. The number of people on the DPB in 2006/07 and the cost of income assistance provided to them are contained in Dr Cullen's answer to parliamentary question 07450 (2004).

61 Dr Cullen's answer to a parliamentary question 08998 (2004).

62 It might be argued that the entire cost of WFF should be taken into account in computing the cost of moving a beneficiary into work on the grounds that other components of WFF are likely to have a minor impact on employment. On that basis, the cost for each beneficiary moved off benefits and into work would be up to $320,000 ($865.2 million/2,700).

adverse impact on the employment of couples. It is not possible, however, to draw a firm conclusion on Treasury's analysis because its assumptions are not known.[63]

The aggregate employment effect is of most interest in evaluating WFF. It is not known whether Treasury's analysis of the employment effects of WFF distinguished between efficiency and income effects and took into account the increase in the mean EMTR.[64] The impact on work effort of beneficiaries of WFF is at best likely to be small and extraordinarily costly. Any additional employment by people who would otherwise be on a benefit is likely to be offset by lower employment than otherwise among other sectors of the population because WFF requires higher EMTRs than otherwise and the incomes of other people are lower than otherwise.

The inescapable conclusion is that WFF will do little to make work pay, which is one of its key objectives. This was acknowledged in an officials' paper prepared for the ministers of finance, and social development and employment. Officials reported:

> The employment effects of the package are expected to be modest, given the priority given to addressing income adequacy objectives.[65]

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63 Some care needs to be taken in interpreting the research results. The percentage change in employment reflects (among other factors) the elasticities assumed or estimated, and the change in the level of the after-tax return from work arising from in work policies.

64 It is understood that Treasury calculated the mean EMTRs with and without WFF after the announcement of WFF at the request of the author.

65 Ministry of Social Development, The Treasury and Inland Revenue Department (2004), *op cit*, p 21.

Box 2: The Employment Effects of Benefits Conditional on Work

Selected international evidence on the employment effects of benefits conditional on work is summarised below.

United States

Stacy Dickert, Scott Houser and John Scholz estimated that the 1993 expansion of the EITC would increase labour force participation of single-parent families by 3.3 percentage points (from 56.4 per cent). Bruce Meyer and Dan Rosenbaum found that EITC changes account for 54 per cent of the increase in the employment rate of single mothers from 1984 to 1996 and 33 per cent of the increase from 1992 to 1996. Their implied labour force participation elasticities are more moderate than those reported by V Joseph Hortz, Charles Mullin and Scholz and for the lowest educated group examined by Nada Eissa and Jeffrey Liebman but still reasonably large at about 0.7.

Eissa and Liebman compared the change in labour force participation and hours worked by single mothers to that of single women without children. They used quasi-experimental methods that were less structured than those applied by Dickert, Houser and Scholz, and Meyer and Rosenbaum. Eissa and Liebman found a labour force participation response of 2.8 percentage points (out of a base of 74.2). Their data also showed no discernible hours of work response.

Eissa and Hilary Hoynes suggest that the EITC may reduce labour force participation among married women. Using quasi experimental methodology, they found that the EITC decreased work effort by second earners, increased married men's employment only slightly (0.2 percentage points) and reduced married women's employment by more than a full percentage point (out of a base of about 50 percent). Overall, family labour supply and pre-tax family earnings fell among married couples eligible for the EITC. Eissa and Hoynes concluded that the EITC effectively subsidises married mothers to stay at home.

In her authoritative survey of research on welfare reform in the United States, Rebecca Blank reports:

> There is unanimous agreement that the growing EITC increased labour-force participation among single parents … The lack of studies that effectively include both welfare reforms and EITC changes [which were implemented contemporaneously] make it difficult to talk about the comparative impact of these two policy changes. Grogger … is unique in trying to explicitly control for both EITC parameters and welfare reform effects. He finds significant effects of the EITC on welfare usage and work behaviour as well as significant policy reform effects. Ellwood argues that the independent effects of these policies cannot be accurately separated …

Box 2: The Employment Effects of Benefits Conditional on Work (continued)

Blank notes that there is a voluminous literature comprising randomised experiments that examine the impact on the behaviour of experimental and control groups of specific welfare to work policies (eg mandatory work requirements and time-limited benefits). She reports:

> Almost unanimously, these studies indicate a significant positive effect of welfare to work efforts on labor market participation, although the size of that impact varies across studies and programs … A best estimate is that welfare reform will increase labor supply among less-skilled women by a little over 1 million workers between 1996 and 2002 … This is a labor supply shock equal to 3.1 percent of employment among all women with less than a college degree.

According to Hotz and Scholz, the relative absence of labour market rigidities in the United States reduces barriers to hiring low-skill workers and presumably enhances the effectiveness of the EITC in stimulating labour force participation.

In a recent paper Eissa, Henrik Kleven and Claus Kreiner comment that the empirical evidence strongly suggests that the labour market entry decision is sensitive to taxes, and is much more sensitive than hours worked. Empirical studies have found extensive margin responses to tax reforms for single mothers that correspond to participation elasticities between 0.35 and 1.7. Almost none of the studies surveyed found any significant hours of work effects. (The extensive margin refers to an increase in participation in paid employment. In contrast, the intensive margin refers to increased work effort.)

Eissa, Kleven and Kreiner examined the labour supply and welfare effects for single mothers following four tax acts passed in 1986, 1990, 1993, and 2001. Those acts provided substantial welfare gains for single mothers. The welfare gains are almost exclusively concentrated along the extensive margin of labour supply.

Eissa, Kleven and Kreiner estimate that the welfare gain per dollar spent was $4.11 (1986 reform), $1.45 (1990 reform), $1.31 (1993 reform) and $1.81 (2001 reform) with hours of work and participation elasticities set at 0.2 and 0.4 respectively. Their analysis included all tax changes affecting single mothers rather than those related to the EITC alone. The results, which are sensitive to the levels of elasticities, suggest that the reforms examined would improve efficiency if they were funded by a non-distorting tax (a gain in welfare per dollar spent greater than $1). However, given that taxes are distorting, most reforms after 1986 are unlikely to have been welfare improving unless their redistributive effect is valued more highly than their efficiency effect.

Hotz, Charles Mullin and Scholz controlled for policy changes at the state level and introduced other methodological improvements. They estimated that the differential EITC expansions increased employment by as much as 3.7 percentage points for families with two or more children relative to families with one child.

Box 2: The Employment Effects of Benefits Conditional on Work (continued)

Overall employment rates increased by 26.6 percentage points for one-child families and by 31 percentage points for families with two or more children. The differential EITC accounted for 12.8 percent of the average increase in employment.

United Kingdom

Richard Blundell *et al* used a structural simulation model to evaluate the expected impact on employment and hours of work of the United Kingdom's Working Families' Tax Credit. They estimated that it would increase employment of single parents (assuming a 100 percent take-up) by 2.2 percentage points but reduce employment of married women with employed and unemployed partners by 0.6 and 1.3 percentage points respectively. Full-time employment was affected to a greater extent than part-time employment in all three cases.

Mike Brewer and Andrew Shephard surveyed six studies of 'make work pay policies'. Only two of the studies isolated the effect on employment of the Working Families' Tax Credit. Those studies found that employment by lone mothers increased by 3.4 percentage points. Employment by couples fell by 0.4 percentage points in one study and by 0.3 and 0.9 percentage points for women and men respectively in the other. The same model was used in both studies and this may account for the similarity of the results reported.

Marco Francesconi and Wilbert Van der Klaauw used longitudinal data collected between 1991 and 2001 to evaluate the effect on single mothers of the Working Families' Tax Credit. They compared changes in the employment behaviour of lone mothers with those for single women without children. Francesconi and Van der Klaauw found that the introduction of the Working Families' Tax Credit led to an average increase of about 7 percentage points in the fraction of lone mothers who worked 16 or more hours per week by 2001, with almost all this increase being in full-time employment (30 or more hours per week). It was necessary to work at least 16 hours a week to qualify for the Credit.

The reported employment growth was due to both an increase in the rate at which single mothers remained in the labour force and an increase in the rate at which they entered it. The average employment effect, however, conceals considerable disparity in responses, which varied between 12 percentage points for lone mothers with one pre-school child to essentially no effects for mothers of multiple older children. The childcare tax credit component of the Working Families' Tax Credit was believed to have played a key role in explaining the estimated employment responses. Francesconi and Van der Klaauw did not examine the effect on the employment of couples of the Working Families' Tax Credit.

The Francesconi and Van der Klaauw estimates are much higher than those of most other studies in the United Kingdom and the United States. Their comparison of lone parents with single women without children is subject to bias because the employment behaviour of both groups is affected by different factors that were not controlled for.

Box 2: The Employment Effects of Benefits Conditional on Work (continued)

Despite this serious weakness, Hon Steve Maharey cited the study in reporting "recent UK research suggests similar reforms [to WFF] … have increased sole parent employment by seven percentage points."

OECD

In an editorial in the *OECD Employment Outlook 2000*, the OECD reported the effect on employment of 'make work pay' policies was uncertain:

> Large numbers of people are now covered by some existing MWP [make work pay] schemes (at any given time, 1 in 6 of the Dutch working population; 1 in 5 of Belgian workers; 1.5 million British households; and about 1 in 6 American families). But of course many – probably most – of these people would be working even in the absence of the schemes. Assessments of how many of these jobs would not exist were the schemes to be abolished suggest that the initial employment effect is not enormous – perhaps 5 to 10 per cent of those covered …
>
> MWP policies are, of course, not "free". They must be financed by increased taxes elsewhere and/or cuts in public spending, which themselves might have negative effects on employment. The net costs of such programmes may be positive as the increase in benefits to those already working will likely be greater than the reduction in benefits to those who enter work …
>
> In sum, the evidence is that, if they can overcome … administrative difficulties at reasonable cost, a number of, but not all, OECD countries should consider introducing MWP policies. If they did so, they might expect to increase employment by a moderate amount, at the same time as narrowing the distribution of family income or wages.

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Box 2: The Employment Effects of Benefits Conditional on Work (continued)

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Organisation for Economic Cooperation and Development (2000), 'Rewarding Work', *OECD Employment Outlook 2000*, Organisation for Economic Cooperation and Development, Paris, pp 7–10.

The incentive to have children

The incentive to have children is increased by making families better off according to the number of dependent children they have. The increase in the level of Family Support increases the incentive to have children. The IWP also encourages families in work to have a first child. However, it has no direct effect on the decision to increase the size of a family beyond one child to three children, but beyond three children it reinforces the effect of Family Support.

The effect on family size (beyond having a first child) of WFF for families in work is likely to be modest because the additional income provided is small relative to the annual cost of caring for children. The maximum additional family income assistance for the first child in a working family is $4,160 a year.[66] The maximum additional income increases as the number of children rises to reach $7,800 for five children. However, the maximum additional family assistance for an increase in family size (ie the marginal increase) after the first child is $520 a year between one and three children and $1,300 a year beyond three children. These levels of additional support may be compared with the additional $8,000 ($6,400) that is reported to be required to provide a sole parent (couple) with one child with an income, adjusted for family size, equivalent to an income of $20,000 without children.[67]

The incentive for beneficiaries to have additional children is somewhat different from that of families in work because of the change in the child component of benefits and because the IWP does not apply. The change to the child component of benefits differs depending on whether a sole parent or a couple is affected. For a couple, the maximum additional income from family assistance for the first child is about $832 a year. Thereafter it is $1,300 a year for each child. For a sole parent, the additional income for the first child is $1,820 a year. The additional income for a second child is around $66. However, for the third and subsequent children it is $1,300 a child.

Family breakdown is an important source of child poverty and adversely affects the development of children leading to heightened risks of educational failure, teenage pregnancy and participation in crime. An increase in income assistance based on the number of children may lead to some increase in the number of sole parents as the WFF

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[66] This comprises additional Family Support for the eldest child of $1,820, the IWP of $3,120 and the loss of the Child Tax Credit of $780.

[67] Perry, Bryan (2004), 'Working for Families: The Impact on Child Poverty', *Social Policy Journal of New Zealand*, issue 22 (July), table 1, p 26.

provides a higher income for families on benefits with dependent children. WFF also provides limited additional encouragement for sole parents to have additional children while dependent on benefits. Government papers relating to the development of WFF suggest that no attention was directed at addressing the underlying causes of family breakdown.

Other effects on incentives

The prevalence of relatively high EMTRs on low to middle and, in some cases, upper incomes will encourage tax avoidance and evasion, thereby making the tax system more complex, and will tend to reduce confidence in the tax system. People on low incomes generally do not have the resources to engage in tax avoidance, although tax evasion arising from undeclared earnings, such as 'cash jobs', is perceived to be a problem at most income levels. The position is different for people on middle and upper incomes. Such people often have greater scope to engage in avoidance activities because they have a higher level of discretionary income, the potential saving in tax may make it worthwhile and they may have greater control over the form of their income. They may, for example, be able to take income in a form that is not taxed at their true EMTR such as fringe benefits and income earned through a superannuation fund. People on middle and upper incomes may also be in a better position than those on low incomes to buy 'tax efficient' investments.

Over time, middle and upper income earners will seek to lower the impact on additional earnings of high EMTRs. Investment choices will be distorted, resources will be wasted in developing and maintaining tax avoidance schemes, and confidence in the tax system will be impaired. The government will come under pressure to alleviate the impact of high EMTRs. It may be tempted to do so by introducing further tax concessions (eg for saving) rather than addressing the underlying problem.

Impact on growth objective

Dr Cullen and Mr Maharey reported to the Cabinet Policy Committee that "Improving New Zealand's economic performance is our top priority."[68] After noting certain strategies that the government is pursuing to further that objective they observed that "we need to bring our social assistance system up to date so that *it no longer acts as a barrier to people moving from benefit to employment* and actively supports families in work."[69] However, the package does little to reduce such barriers as noted above. There is little analysis in the paper on how and to what extent the package would contribute to improved economic performance. That objective was not addressed, other than superficially.

An officials' paper on the package observed that "The modest employment effects of Future Directions – Working for Families may have a small positive impact on GDP per capita in New Zealand over a period of time."[70] As discussed above, such employment effects are small, costly and likely to be offset by lower employment than otherwise elsewhere in the economy. Officials also observed that "the size of the package will limit future fiscal flexibility and constrain the range of future policy options without revenue increases."[71]

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68 Cullen and Maharey (2004), *op cit*, p 1.

69 *Ibid* (emphasis added).

70 Ministry of Social Development, The Treasury and Inland Revenue Department (2004), *op cit*, p 3.

71 *Ibid*.

WFF will do little to improve overall economic performance. In the quotation noted at the start of this report, Robert Lucas observed that economic growth is the key to raising the living standards of poor people. *The opportunity to use up to $1 billion to pursue pro-growth policies, including reductions in high EMTRs, will be lost if WFF is fully implemented as announced.*

Administration and compliance costs

The government has allocated $131 million between 2004/05 and 2006/07, and almost $28 million a year thereafter, to the administration of the programme. Other costs will be incurred by recipients in applying for assistance and notifying Work and Income or the Inland Revenue Department of changes in personal circumstances (although the obligation to do the latter is understood to be often ignored).

Family income assistance is paid during the year to beneficiaries by Work and Income. People in work and not on a benefit may elect to receive Family Support on a fortnightly basis from Inland Revenue (with an end of tax year square-up) or receive it as a lump sum after the tax year has ended. The circumstances of a considerable number of people change during the year. Children may move among carers. A family may move off a benefit and into work and then back on to a benefit. As a consequence, responsibility for the payment of family assistance shifts from Work and Income to Inland Revenue and *vice versa*. There has been a growing debt problem in respect of families who receive too much family assistance during the year. Some such debt has been written off.[72]

Steps are to be taken to enhance the delivery of WFF. They are intended to address administrative problems with existing family assistance. Families moving off benefit and into work, for example, will not be required to apply to Inland Revenue for family income assistance, although Inland Revenue will ask them to confirm or correct certain details relating to their eligibility for family income assistance within the initial eight weeks. Moreover, Work and Income will advise Inland Revenue electronically when families move on to a benefit. These and related improvements in administrative arrangements are desirable.

Despite those steps WFF is likely to add some complexity to family income assistance arrangements for the following reasons:

- More people are to be brought within the family income assistance net.
- The amount of money payable for each child is larger and thus the potential debt problem is greater (other things being equal). Fraud is also likely to be a greater problem.
- A new weekly payment option is to be made available to people in work who are entitled to family income assistance.
- Payments made to beneficiaries are to separately identify family income assistance and benefit payments.
- Unlike other income assistance programmes, the IWP has a minimum required hours of work criterion. Hours of work will need to be monitored for all people in work who claim the IWP. This is likely to be problematic in the case of self-

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72 Australia addresses the potential for overpayment by providing an element of family assistance that can only be claimed at the end of year.

employed people such as those engaged in activities on the margin between hobbies (eg life style farms) and a genuine business. It is also likely to prove troublesome where people work variable hours (eg seasonal, relief and shift workers). They may qualify for the IWP in some weeks but not in others unless special rules are applied. The criterion relates to the combined hours of work of couples. Thus checks on the eligibility of couples for the IWP will require the hours of work of both people to be examined where neither works at least 30 hours a week.

- The calculation of family assistance payable to certain families on a benefit has been complicated by a decision to ring fence such assistance from the impact of subsequent changes in income.[73] The level of family assistance payable to beneficiary families with annual income above the abatement threshold for Family Support will be increased. For the purposes of the square-up and abatement, separate calculations would seem to be required for the periods within the tax year that a family is, or is not, on a benefit. It is understood that the details of how this proposal is to be made to work have yet to be developed. It may prove to be too costly.

Child poverty and the distribution of income

The government's main justification for WFF is to address the issue of poverty, especially child poverty, and to ensure income adequacy.

Child poverty

Bryan Perry of the Ministry of Social Development provides the best information that is available on the impact on child poverty of WFF.[74] His analysis focuses on changes to family income assistance only. All income data are stated in 2005 (inflation-adjusted) dollars.

According to Perry, 14.7 percent of households with dependent children will have had an equivalised disposable income below 50 percent of household median disposable income in March 2005 (ie before the relevant policies are implemented).[75] This rate is estimated to fall to 4.3 percent once WFF is fully implemented in 2007/08. Using 60 percent of median household income as the poverty line, the measured level of child poverty is forecast to fall from 29 percent to 20.5 percent.[76]

The expected reduction in poverty may have been higher than forecast by Perry if the increase in the Accommodation Supplement and childcare assistance, and the change in Special Benefit, had been taken into account. The Accommodation Supplement and childcare assistance is available to beneficiaries and other people on low to middle incomes.

The striking reduction in forecast poverty arises because the incomes of many families are presently just below the lower poverty benchmark or between both poverty lines, as Perry notes. Thus modest increases in the incomes of such families have a large effect on the forecast level of poverty. WFF provides a significant increase in income for

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73 Cullen and Maharey (2004), *op cit*, Appendix 7, p 35–39.

74 Perry, Bryan (2004), *op cit*, pp 19–54.

75 An equivalised disposable income is income after taking into account benefits and other income assistance and deducting tax, and adjusting for the size and composition of the household or family.

76 Perry (2004), *op cit*, table 3, p 35.

families with dependent children on low to middle incomes (an average increase in net incomes of between 10 and 20 percent from additional family income assistance alone is forecast by the government) but has a relatively minor effect on the median income for the entire population (ie the poverty benchmarks are little changed).

Perry's analysis also shows that there are substantially more economic family units without dependent children who are in poverty than those with dependent children.[77] [78] The estimated reduction in measured poverty among all households is less than for families with dependent children. It is forecast to reduce from 9.3 percent to 5.5 percent (lower poverty line) or from 17.8 percent to 13.9 percent (higher poverty line).[79]

The government's focus on families with dependent children reflects a perception that such families face greater hardship than other groups. There was also a concern that inadequate resources may unduly harm the prospects of children. These views are persuasive, despite Perry's finding that most economic family units in poverty do not contain dependent children. However, unless the underlying causes of child poverty are addressed, the life chances of children are likely to continue to be at risk.[80]

Income distribution

WFF increases the incomes of many families with dependent children who are not presently deemed to be in poverty. The largest increase in family income in 2006/07, when the IWP is implemented, accrues to those with an equivalised disposable income of around $18,000, which is well above both poverty lines ($10,750 and $12,900).[81] [82] An equivalised income of $18,000 is equal to an actual income after tax of about $39,000 for a couple with two children. As a consequence, there is a significant increase in the number of families with an equivalised income between $15,000 and $22,000. The upper end of this range exceeds the pre-reform median disposable income for all households.

The extent to which family income assistance will benefit families well up the income distribution when it is fully implemented is shown in table 14. About half of the cost of the assistance is allocated to families with an (actual) income *after tax* of more than $25,000. Such households are likely to be in household gross income deciles 4 and above (ie 30 percent of all households would have a lower gross income).[83]

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77 An economic family unit comprises a couple, a two-parent family with dependent children, a sole parent with dependent children or a single adult. A child over 15 years of age who is in full-time employment or on a benefit would be classed as a separate economic family unit (an adult). All individuals over 18 years of age are treated as separate family economic units.

78 Data supplied by Perry show that there are about 359,600 economic family units below an equivalised disposable income of $10,500, which is somewhat below the 50 percent poverty line. Of these units, 64,740 include dependent children. They are forecast to fall to 19,952 units when WFF is fully implemented.

79 Perry (2004), *op cit*, table 3, p 35.

80 Morgan, Patricia (2004), *Family Matters: Family Breakdown and its Consequences,* New Zealand Business Roundtable, Wellington.

81 Relatively large increases in equivalised family incomes are also reported for families with an equivalised family income of between $4,000 and $6,000.

82 It would be preferable to report the increase in family income once the package is fully implemented. However, such data are not reported by Perry.

83 This assessment is a judgment. The translation from family income after tax to gross household income depends on the composition of the household and how household income is distributed among household members.

A third of the cost arises from assisting families earning over $35,000 a year after tax, including middle and upper income households. About 17 percent of the cost of family income assistance ($170 million) is allocated to families with a net income over $45,000 and up to $80,000. Some such families may also benefit from additional housing and childcare assistance.

A single-income family with one child on a net income over $45,900 would earn over $60,000 (before income tax, ACC and family assistance), the level at which the top marginal rate of personal income tax (39 percent) applies. The government's justification for introducing the 39 percent rate was that few taxpayers would be affected (forecast by Labour Party before the 1999 election to be 5 percent of all individual taxpayers) and those affected could afford to pay more tax. About 10 percent of individual taxpayers are expected to have earned a gross taxable income of over $60,000 in 2004/05.[84]

Table 14: Distribution of Additional Family Income Assistance 2007/08

Net Family Income	**Average Increase in Net Income**[1]		**Families that Benefit**[2]		**Estimated Cost**[3]		**Cumulative Cost**
$/year	$/week	%	No	%	$m	%	%
Under 15,000	61.89	21	12,000	100	39	4	4
15,000–25,000	53.99	14	164,000	100	460	45	49
25,000–35,000	100.97	18	36,000	100	189	19	68
35,000–45,000	95.97	12	30,000	100	150	15	83
45,000–60,000	67.70	7	38,000	86	134	13	96
60,000–80,000	57.00	4	12,000	18	36	4	100
Over 80,000							
Total	66.03		292,000	61	1,007	100	

1 Net income is assumed to be evenly distributed over each income range. The percentage increase for the lowest income range assumes an average income within that range of $15,000 and is therefore the minimum possible percentage increase.

2 Rounded to the nearest 1000.

3 Author's calculation.

Source: Cullen and Maharey (2004), Appendix 1, p 8, and author.

Mr Maharey recently stated that:

> Working for Families is a $2.75 billion package spread over four years.
>
> All the money will go to low to modest income households. Some 300,000 families will benefit.[85]

This statement is not true, unless households that could be expected to be in the top two or three deciles by gross income are regard as being on a "modest income".

Table 14 also highlights the high average percentage increase in the net incomes of families earning up to $45,000 a year. All such families benefit from WFF. The increase is especially high for those on the lowest net family incomes. The incomes of families

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84 Cullen, Michael (2004b), *op cit*.

85 Maharey, Steve (2004), 'National's Criticism of Working for Families Publicity Exposes True Agenda', press statement, Office of the Minister for Social Development and Employment, 2 September, Wellington.

that earn under $15,000 a year increase by an average of at least 21 percent. Most families in the first two income ranges shown are likely to be on benefits or New Zealand Superannuation.[86] Many are also likely to be assisted by increases in subsidies for childcare and housing.

The additional income may lead to a higher number of welfare beneficiaries with dependent children than otherwise. The government is expecting that the prospect of a higher income still from employment will prove to be a more powerful influence. The question of which income effect will prove to be the stronger will depend on factors such as preferences of beneficiaries to care for their children and the value that they place on the loss of time for non-work activities that would be entailed in moving off the benefit and into work.

A further indication of the extent to which WFF distributes income beyond those on low incomes is given by the level at which a single-income family will be in a net zero tax position (ie the level of income before tax at which family income assistance equals income tax and ACC that would otherwise be payable). All children are assumed to be less than 13 years of age. The income levels given are therefore the lowest possible, given the number of children. They are $31,043 (one child), $36,721 (two children), $41,577 (three children) and $47,409 (four children).[87]

Families with dependent children on upper incomes and households without dependent children will predominantly pay net income tax. There is a risk that perceived vertical inequities could undermine trust in the income tax system. Moreover, if relatively few people pay income tax, net of family income assistance, while many people benefit from public spending, politicians may be unduly encouraged to promise additional spending that is not in the national interest to obtain the support of favoured groups that do not bear the direct cost.[88]

Is an emphasis on redistribution warranted?

While WFF is expected to substantially reduce forecast poverty among families with dependent children and increase the income of such families on low to middle incomes, the following broader points are relevant to an assessment of the efficacy of the policy:

- Although similar poverty benchmarks to those adopted by Perry (and other researchers on poverty in New Zealand) are commonly adopted overseas, they are, to a large extent, arbitrary. They reflect a relative measure of poverty. There are grounds for arguing that an absolute real threshold (adjusted occasionally rather than annually as median income changes) is more appropriate. Such a threshold emphases the alleviation of hardship rather than the doubtful objective of making incomes more equal.[89]

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86 The two lowest income ranges are also likely to include families that earn a low market income or incur losses from business activities.

87 Dr Cullen's reply to parliamentary question 07899 (2004).

88 For further analysis see Davidson, Sinclair (2005), *Personal Income Tax in New Zealand: Who Pays, and Is Progressive Taxation Justified?*, New Zealand Business Roundtable, Wellington.

89 See Green, David G (1996), *From Welfare State to Civil Society: Towards Welfare that Works in New Zealand*, New Zealand Business Roundtable, Wellington, especially pp 46–50 and Buchanan, Cathy and Hartley, Peter (2000), *Equity As A Social Goal*, New Zealand Business Roundtable, Wellington, pp 109–156.

In the interests of alleviating hardship, income assistance for families that would otherwise be in the lowest two income deciles might generally be warranted. The case for generally increasing the incomes of families in deciles 3 and above on hardship grounds is weak. Some such families would, however, receive some support as assistance is abated.

- The poverty measures used by Perry are based on income whereas spending is generally acknowledged to provide a better indication of material living standards, especially for people on low incomes. Their spending levels are typically higher than their reported income.[90]

- It is arguable that the level of benefits reflects the minimum acceptable standard of living in New Zealand. The poverty lines used in the study are set above those levels. Around 29 percent of dependent children are brought up in households that earn up to $10,000 a year in market income (ie up to an average of 20 hours work a week at the current minimum adult wage of $9.50 an hour). Thus up to 29 percent of children will be reported to be in poverty if the poverty line is drawn above the level of benefits, together with a small margin for market income, unless supplementary assistance such as Family Support is provided.

  The position is much the same in other comparable countries. The OECD reported that in the majority of 23 OECD countries examined, benefits of last resort available to single adults of working age (excluding unemployment benefit) are generally set below the poverty thresholds. If benefits conditional on rental expenditure are not available at all (which is broadly comparable to the assumption in Perry's analysis) then social assistance incomes are less than half the median income in all countries. They are close to or above the lowest poverty threshold examined (40 percent of equivalent median household income) in only seven countries (Australia, Belgium, Czech Republic, Netherlands, New Zealand, Norway and Poland). In seven other countries, incomes are close to or below 20 percent of the median income, regardless of whether housing-related benefits are available.[91]

  When different types of family were examined, the OECD found that incomes for families with children in a "sizeable majority of countries" are still below the 40 percent poverty threshold. Incomes in two-children families (sole parent and couples) appear somewhat higher relative to the poverty thresholds than in families with no children.[92]

  In most OECD countries the level of in work earnings required to escape income poverty are found to be around 50 to 60 percent of the earnings of the APW in the case of single-person households (no children). For families with two children in New Zealand and Australia, one person earning "significantly less than 50% of [the wage of the] APW" is sufficient to ensure income above the poverty line while the required earnings, relative to APW earnings, are "two to three times as large in a considerable number of countries" including the United States, Sweden, Spain and Hungary.[93]

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90 See Green, David (2001), *Poverty and Benefit Dependency*, New Zealand Business Roundtable, Wellington, especially pages 17–43.

91 OECD (2004a), *op cit*, pp 81–85. The OECD reports that in most countries where benefit entitlements can potentially lift income close to the poverty line, overall entitlements depend critically on the level of housing costs that qualify for housing-related cash support.

92 *Ibid*, p 84.

93 *Ibid.*

- The same families are not usually persistently in poverty, although some families remain on very low incomes for extended periods. People who are temporarily down on their luck and are therefore reported to be in poverty often rise above it over time. Peter Saunders observes that, "Throughout the western world, longitudinal surveys consistently find that between half and two-thirds of those who appear under any given 'poverty line' in one year are no longer there just a year or two later."[94]

- The government's income adequacy objective is imprecisely defined and unable to be monitored against actual outcomes. The risk is that more redistribution is always viewed as desirable. The ultimate limit to redistribution might not be reached until a much more equal distribution of incomes is achieved.

- Redistribution from single people and families without dependent children to families with children on low to middle incomes largely transfers income between different stages in people's life cycle. Single people largely consist of the young and the surviving spouse of a former couple. Similarly, income redistribution between families with children on high incomes and those on lower incomes tends to reallocate income between younger families and older families. Much of the WFF package is likely to constitute such redistribution. The grounds for redistribution, beyond the alleviation of hardship, are doubtful.

- The analysis of poverty often implicitly assumes that people are not responsible for the choices that they make and which may have contributed to income insufficiency. Static analysis such as that discussed above generally assumes that people will not change their behaviour in response to government assistance. In this context, the problem of poverty and income insufficiency is to be addressed by redistributing income rather than by changing behaviour. While behavioural changes are not possible in some cases, for instance where serious illness or injury precludes employment, they are feasible in other situations. The vast majority of people can be expected to respond to the incentives that they face (ie they act in their self interest).

  Over 25 percent of children are brought up in low-income households because their parents or, more commonly, their sole parent is dependent on welfare. While income redistribution may alleviate such poverty in the short run, it encourages more people to become dependent on welfare than otherwise and undermines the acceptance of personal responsibility. If income transfers alone could overcome poverty, it would have been eradicated a long time ago.

  In the case of the breakdown of marriage (or a similar relationship), the state largely relieves the non-custodial parent of the obligation to support their children and former spouse. The income support that the government provides, which far exceeds contributions under the liable parent scheme, encourages the breakdown of two-parent families. On average and over time, such families provide the best environment for raising well-adjusted children.[95]

  Unless the underlying problems that lead to welfare dependency, such as family breakdown, inadequate education and skills, the erosion of the work ethic, and ill health caused by the abuse of drugs and alcohol, and other factors that arise from the choices that people make, are addressed, child poverty will remain a serious

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[94] Saunders, Peter (2004), *Australia's Welfare Habit and How to Kick it*, Duffy & Snellgrove and The Centre for Independent Studies, St Leonards, p 19.

[95] Morgan, Patricia (2004), *op cit.*

concern. Increasing the level of redistribution without addressing the causes of child poverty and income insufficiency is likely to accentuate the problem over time.[96]

- The performance of the economy in producing a growing supply of goods and services that consumers are willing to buy and generating jobs for everyone who is willing to work – not redistribution – ultimately determines the material standards of living of citizens. Few families with at least one parent in full-time, full-year work face material hardship.[97]

  Policies that will raise output and incomes, and remove impediments to participation in paid employment, such as improving education and training, would increase average material living standards.

  The impact on child poverty of broader economic trends should not be underestimated. Perry shows that between 1988 and 1994 the proportion of children living in poverty doubled (using the lower poverty line and constant value thresholds).[98] By 1998 the poverty rate had returned to about its 1988 level. Both of these movements were larger than that predicted with WFF (although the data are not entirely consistent). The upturn in poverty from 1988 was accentuated by rigidities in the labour market that led to higher unemployment than otherwise as the economy was restructured. The economy has grown at a solid pace since about 1994, leading to higher employment, lower unemployment and rising wages. These factors can be expected to have contributed to the reduction in poverty but they are obscured by relative measures of poverty.[99]

- Redistribution can make some people better off but only at the cost of making others worse off. Because redistribution is costly (for instance, because raising taxes to fund it adversely affects incentives to work, save, invest and take risks), it necessarily involves a net reduction in output and income. Over the longer term, even groups that are perceived to benefit from redistribution may be disadvantaged if such policies impede the growth in per capita incomes.

- The government's argument that low and middle income workers have not shared in the economic recovery is not credible:

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96 The Child Poverty Action Group has advocated greater redistribution toward families with dependent children on low incomes. It criticised WFF because (among other grounds) "serious design flaws within the package leave around 175,000 of the country’s poorest children with very little help", a goal of eliminating child poverty was not adopted by the government and because WFF discriminates on the basis of the employment status of a child's parents. According to the Group, the "work first" approach adopted by the government to address child poverty is "unacceptable", see St John, Susan and Craig, David (2004), *Cut Price Kids: Does the 2004 'Working for Families' Budget Work for Children?*, Child Poverty Action Group, Auckland.

97 Mead, Lawrence M (1997), 'Raising Work Levels Among the Poor', *Social Policy Journal of New Zealand*, issue 8, March, pp 1–28.

98 Perry (2004), *op cit*, figure 8, p 38.

99 This pattern is not anywhere near as apparent when the poverty line is updated each year to reflect contemporary median income. In that case the rise in reported poverty from 1988 is apparent but the subsequent decline is limited and the forecast decline with WFF is much larger than that recorded in the late 1990s. With a contemporary measure of poverty, an equal across the broad rise in real wages and income support does not alter the reported level of poverty. This requires the incomes of households in poverty to rise faster than that of the median household.

- Total employment increased from about 1.6 million persons in December 1993 to 2.1 million in December 2004, an increase of 31 percent.[100] Increased participation in paid employment is a main way in which many people have benefited from recent economic growth. It is implausible that employment growth was solely among those on high incomes.

- The effective rate of income tax on income between $9,500 and $34,200 was reduced from 28 percent to 21 percent in two steps implemented on 1 July 1996 and 1 July 1998 and the income band was extended to $38,000 as part of National's 1996 tax reduction and social policy programme. The Independent Family Tax Credit (now the Child Tax Credit) was introduced and the rates of Family Support were increased. These changes were intended to provide proportionately larger tax reductions for low and middle income earners than for those on higher incomes.

- Government spending has increased substantially. Between 1993 and 2003, real current outlays per capita increased by 5 percent.[101] While there are valid concerns about the efficacy of much new spending, low and middle income earners can be expected to have benefited from it to some extent.

WFF significantly increases middle class welfare by transferring a large amount of income to families on middle and upper incomes. At the same time, many such families are paying significant taxes. This churning of income is a feature of middle class welfare. James Cox examined middle class welfare in detail. He observed:

> The churning of income involves a redistribution of resources through government that does nothing for equity. Because the disincentive effects of taxation come into play, society is unambiguously worse off as a result of churning.[102]

Cox noted that New Zealand had generally been successful in reducing government spending on middle class welfare. He recommended further moves in that direction and would no doubt regard WFF as a backward move.

Where to now?

The shortcomings of WFF essentially arise because an inappropriate structure of assistance has been adopted to raise the incomes of beneficiaries with dependent children, especially those on the DPB, and families in paid work with dependent children. WFF is predominantly concerned with income redistribution and does little to make work pay.[103]

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100 Statistics New Zealand (2005), 'Household Labour Force Survey: December 2004 Quarter', Statistics New Zealand, Wellington.

101 Data were supplied by Bryce Wilkinson.

102 Cox, James (2001), *Middle Class Welfare*, New Zealand Business Roundtable, Wellington, p vii.

103 The suggestions outlined in this section draw on studies prepared for the New Zealand Business Roundtable that contain detailed discussion and a wide range of proposals that could be adopted to improve welfare arrangements. They include Buchanan, Cathy and Hartley, Peter (2000), *op cit*; Cox, James (1998), *Towards Personal Independence and Prosperity*, New Zealand Business Roundtable, Wellington and (2001), *op cit*; Green (1996) *op cit* and (2001), *op cit*; and Morgan, Patricia (2004), *op cit*.

The related problems of child poverty and income insufficiency largely arise from welfare dependency. They are to be addressed by boosting the income of beneficiaries. The next difficulty is that work is not sufficiently attractive to encourage beneficiaries with limited skills and patchy work histories to exit from benefits and to discourage new people from becoming beneficiaries. Beneficiaries are able to earn an income after tax, without forgoing leisure, that is not significantly lower than that of people in low paid jobs who are not on benefits. To overcome this problem, assistance for families in work is increased (eg the IWP) and abatement regimes are relaxed. These measures are limited in their effectiveness.

As it is prohibitively costly to provide universal assistance, targeted assistance is unavoidable. However, the level of assistance provided with WFF is too high and too much assistance is poorly targeted. Thus assistance is still being abated at upper incomes, especially for families with three or more children. The outcome is excessively high EMTRs over wide income ranges with little net reward from additional work effort.

The pattern of EMTRs under WFF will be difficult to sustain over time. EMTRs on the main earners and secondary earners in families on low to modest incomes who receive benefit income and family, housing and/or childcare assistance are too high over too wide a range of income.

Middle and high-income earners in receipt of family assistance will also face excessive EMTRs, especially those subject to abatement of family income assistance and housing or childcare support, or both. Dr Cullen admitted as much in the 2004 budget lock-up for analysts. He has indicated that the solution would be to lower the 30 percent abatement rate for family assistance. That would reduce EMTRs as such assistance is abated (perhaps by 5, 10 or 15 percentage points), increase the fiscal cost of WFF and provide assistance even further up the income distribution. Dr Cullen's suggested solution is unattractive.

WFF relies largely on income effects rather than efficiency effects to influence behaviour. As a consequence, aggregate output and employment will be lower than if $1.1 billion a year were spent on policies that enhance growth, including reductions in high EMTRs.

WFF encourages dependence on benefits by making it more attractive to remain on benefits rather than self-reliance and the acceptance of individual responsibility. In particular, it encourages family breakdown, which is detrimental to the long-term interests of affected children. WFF follows the abolition of work tests for the DPB and SB which could also be expected to foster welfare dependency.

In summary, the pattern of EMTRs is seriously distorted by excessively raising income levels for families on benefits and in work through income transfers. The approach is implicitly driven from the bottom up. Beneficiaries, however, are a minority of potential low-paid workers. The tail has wagged the dog.

Similar problems arose when National sought to encourage people on the DPB to engage in part-time work in 1996. However, the difficulties caused by WFF are much larger. Better arrangements are possible and desirable, although a tension between the prevention of hardship and the promotion of economic efficiency is unavoidable.

While it is not possible to outline in detail a more desirable package without considerable analysis, the general direction in which policy should move is as follows:

- The government should focus on broad policies that will generate a sustained increase in output and incomes, including the removal of impediments to employment.
  - A higher rate of economic growth would raise average per capita incomes and increase the scope to provide for those who are genuinely unable to work.
  - Full-time and full-year employment is the key to the avoidance of hardship and welfare dependence. Policies such as those relating to minimum wages (which have been increased substantially since 1999), and undue emphasis on employment protection measures, discourage employment, especially of people with limited skills and work experience.
  - Lower government spending and hence lower taxes should be part of such a strategy. High rates of personal tax and company tax should be reduced. Consideration should also be given to lowering high EMTRs as assistance is abated. This would encourage growth, as the Treasury has noted.[104]
- The government's approach to welfare should, as far as possible, encourage self-reliance and the acceptance of personal responsibility, and support vital institutions such as the family. The government should concentrate on the prevention and alleviation of hardship. The grounds for focusing on income inequality *per se* are weak.
- The problem of welfare dependence should be addressed directly. Reliance on work incentives and income effects, together with 'case management' of beneficiaries by Work and Income, to induce people into work are not sufficient:
  - Eligibility rules for benefits need to be tightened, including the reintroduction of work tests for the DPB and SB, and time limits should be introduced for benefits (other than for those who are permanently incapacitated), with a lower benefit rate applying after the expiry of the limits. More energy needs to be directed at moving people off benefits and into work (not training except, perhaps, for people with grossly inadequate basic skills). Welfare arrangements (including the quality of legislation and court decisions) that, for example, allowed spending on the Special Benefit to blow out need to be addressed.
  - Consideration should be given to contracting out the administration of benefits and employment services, especially for long-term beneficiaries. This might help to sharpen incentives within Work and Income. Taxpayers should be viewed as their 'clients' rather than beneficiaries.
  - Family breakdown should be addressed by requiring non-custodial parents rather than taxpayers to make a much larger contribution to the support of their children and by changes to family law as outlined by Patricia Morgan.[105]
  - The level of the DPB should not be increased when additional children are born more than 12 months after a person first applies for the DPB. The problem of encouraging additional children while on benefits is accentuated by WFF. The suggested approach would require additional Family Support to be denied or an offsetting adjustment to the main benefit.

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104 The Treasury (2003), 'New Zealand Economic Growth: An Analysis of Performance and Policy', unpublished paper, The Treasury, Wellington.

105 Morgan, (2004), *op cit*.

- Schools should give much greater weight to the achievement of at least adequate standards of literacy, numeracy and other basic skills to enable the least talented and socially adjusted young people to be able to participate in paid work and society generally. Remedial programmes outside of the regular schools may be required to bring some people up to the minimum level of education necessary to obtain and retain work.
- More effective policies to combat destructive behaviour among the young (eg crime and drugs) need to be implemented.

- The level of the main benefits should generally determine the minimum acceptable income of people dependent on benefits. Supplementary assistance, such as the Accommodation Supplement, should be available to deal with significant problems that are not addressed by uniform rates of benefits across the country, but such assistance should be tightly controlled.

- The policy of encouraging part-time work and part benefit income should be replaced by an increased emphasis on people exiting entirely from benefits and into work (other than those who are genuinely unable to work because of illness or injury and those whose work capacity is significantly constrained by illness or injury or serious skill deficiencies). Consistent with this policy, income transfers should be abated for the first dollar of income from paid work.

- While a modest increase in family assistance from pre-WFF levels might well be warranted, the levels of family assistance should be reduced from those announced in WFF and be more tightly targeted:
  - At a minimum, the increase in Family Support to be implemented on 1 April 2007 ($520 a year for each child) should be scrapped.
  - The levels of Family Support for both beneficiaries and families in work should be reduced (by, say, $10 a week) when the IWP is introduced in April 2006. This would reduce the level of income provided to beneficiaries relative to WFF but not relative to pre-WFF levels. The incentive to engage in work would be strengthened somewhat and the overall level of family assistance would be reduced.
  - The indexation of family assistance should also be put on hold, at least until the real level of such assistance reduces to a more appropriate level.
  - The new income thresholds for Family Support, childcare assistance and the Accommodation Supplement should be revised downward. The aim should be to target assistance more tightly on families who would otherwise be in hardship. Consistent with this objective, assistance should begin to abate at a low income but, as far as possible, the application of multiple rates of abatement as income increases should be avoided.
  - As a general guide, EMTRs should not exceed 50–60 percent, except perhaps over narrow income ranges or in unusual circumstances. This objective would be difficult to achieve unless the levels of assistance and/or rates of tax are reduced.
  - Lower rates of income tax would provide some benefit to families in work who are on middle incomes.