

**An evaluation of ‘In Work Benefits’ in New Zealand:  
Use of the In Work Tax Credit to encourage labour  
supply: implications for an ageing population.**

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# 1 Introduction

Population ageing is a worldwide phenomenon. By 1998, in more developed regions, the numbers aged 60 and older had begun to exceed the young. By 2050, the total number of older persons in all regions is expected to exceed the total number of young for the first time in history. In 1950 proportion of older persons in the world population was 8%. By 2050, the proportion will rise to 21% and one fifth of older persons will be 80 years or older. In 2007, the median age for the world was 26 years, ranging from a median age of 15 years in Yemen, to a median age of 41 years in Japan. By 2050 Niger is expected to have the youngest population with a median age of 20 years, and Spain to have the oldest population, with a median age of 55 years (Department of Economic and Social Affairs, 2008).

*The steady increase of older age groups in national populations, both in absolute numbers and in relation to the working-age population, has a direct bearing on the intergenerational and intragenerational equity and solidarity that are the foundations of society. (Department of Economic and Social Affairs, 2008, p. xxix)*

Globally, the potential support ratio (PSR)<sup>3</sup> has fallen from 12 in 1950 to 9 in 2007, and is projected to fall to 4 by mid century. This has important implications for traditional social security systems like that operating in New Zealand and other countries where current workers pay for the benefits of current retirees (Department of Economic and Social Affairs, 2008, p. xxix). In addition, cost pressures are expected in the health sector, including greater demand for long-term care.

An ageing population implies that labour will become relatively scarce. While labour shortages may be offset by advances in labour-saving technology, the labour-intensive services demanded by an ageing population may be less amenable to technological change.

Ageing nations may implement work incentives as one way to encourage an additional labour supply.<sup>4</sup> This additional supply may come from the older population working longer; from the employed population working longer hours, and/or workers working

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<sup>3</sup> The potential support ratio or PSR is the number of persons aged 15-64 years per one older person aged 65 years or older.

<sup>4</sup> Other ways such as increased immigration are not considered here.

more productively; from more women, including those with children, joining the labour market; or from some combination of these.

The objective of this research is to contribute to the international pool of knowledge about the variety and effectiveness of different ‘in work benefits’. This research project details the different approaches that have been used in New Zealand both historically and currently with a view to assessing their relative effectiveness. In particular, the focus is on the controversial *In Work Tax Credit* (IWTC) introduced in 2006 as part of the Working for Families package that was phased in between 2005-2007.

The *Earned Income Tax Credit* (EITC) as used in the US has a long history as a tool to improve labour market participation and address poverty issues among working populations. While New Zealand’s IWTC may on the surface appear similar to the EITC in the US, and to the *Working Tax Credit* in the UK, there are important differences. The use of the IWTC has, among other issues, raised Human Rights concerns in New Zealand and has necessitated complex adjustments in the tax system. In addition, the appropriateness of the IWTC design has been called into question as unemployment grows in the 2009 recession.

This project takes a public policy framework approach that elucidates trade-offs in the IWTC, and evaluates the policy using standard criteria. Results from preliminary evaluations both ex ante and ex post, including an official preliminary evaluation of the IWTC released in February 2009 are briefly described and assessed. Lessons are drawn for the effectiveness of this tool and other tools in ameliorating the pressures of the ageing population through encouraging work effort.

## **2 In work benefits**

Usually the purpose of ‘In Work Benefits’ (IWBs) is couched in terms of the benefits to the recipients themselves, rather than to alleviate the pressures of an ageing population. Their focus may be either the individual or the family unit, and their use is generally explained in the context of social policy that aims to “enhance opportunities for groups at the margins of the labour market” (Pearson & Immervoll, 2008, p. 2). Thus the focus of such policies is on those who have “difficulties in obtaining and maintaining rewarding jobs, and as a result they and their families often face protracted periods in poverty” (Pearson & Immervoll, 2008, p 2).

Importantly, as noted by Pearson & Immervoll (2008, p 2), the major premise is that the IWB should ‘make work pay’ so that an income gap is created between those in paid work and those not in paid work, without making the latter group worse off as that would simply increase poverty.

Increasing the proportion of the population in paid work, whether by returning people to work after a health crisis or the birth of a child or any other major life event, or encouraging low skilled young people to find work rather than rely on a state benefit, may require a complex combination of “stick” and “carrot” policies. It is difficult in any real world analysis to disentangle the impact of any one policy measure when a number of factors, including the economic environment, may change at the same time. This is the case for an analysis of the IWTC in New Zealand as outlined in this paper.

As Lunt, O’Brien & Stephens (2008, p. 4) note:

*A significant number of those receiving social security benefits are there not because of adverse labour market conditions or traditional caring responsibilities, but because they have a raft of other social difficulties, ranging from health and psychiatric conditions through to substance abuse, domestic violence, lack of self-esteem and absence of labour market skills.*

Factors such as “the parenting role” for lone parent beneficiaries; “poor health” for the long-term unemployed; and “employer discrimination” for beneficiaries with disabilities, are often at work alongside financial disincentives to seek and retain work (Singley, 2004, pp. 33-36). A wide variation in work behaviour found among at-risk individuals may reflect differences in social support, in personal and contextual “barriers” and “bridges” to employment, and their interplay.

*While a lack of social support can be named as a barrier to employment, it is perhaps more accurate to name the presence of social support as a bridge to employment that helps individuals overcome the barriers they face. Thus, a key factor distinguishing benefit use patterns among those facing the same cluster of barriers could be access to social support. (Singley, 2004, p. 49)*

In the New Zealand context, employment of sole parents has been found to be affected by attitudes to non-parental care of young children by the sole parents themselves, lack of effective case management, lack of information, low skills transition costs, health of child or parent by the costs of care, and by abatement of benefits (Singley, 2004, p. 47).

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<sup>5</sup> Social security in New Zealand is not social insurance, but more akin to welfare payments.

Financial returns to paid work are but one of the factors that influence the labour supply decision.

### **2.1.1 Spectrum of In Work Benefits**

In work benefits (IWBs) are specific cash transfer programmes, rather than more generic tax reductions or changes to abatements of welfare benefits which reduce Effective Marginal Tax Rates (EMTRs)<sup>6</sup>. Nevertheless they can be seen within a spectrum of means of enhancing returns to labour and encouraging work effort and higher participation. These wider means include use of minimum wage legislation, ‘welfare to work’ case management, and labour market regulations.

IWBs, while a narrow part of this spectrum, may take a wide variety of shapes. Wage related transfers tend to be time-limited, while tax credits are usually not time-limited. They may take the form of tax credits, wage-related transfers or lump-sum payments where the choice of the programme type largely depends on the target group (Leppik, 2006, p. 3).

IWBs may be as simple as a small cash advance to ease the transition from welfare to work, or as complex as family-based, targeted tax credit measures that are also designed to impact on poverty levels. In Australia, for example, the only official in work benefit called the Employment Entry Payment is a one off lump-sum of around A\$100 for sole parents or long-term benefit recipients when they get a full-time job (Pearson et al, 2008). In contrast, New Zealand has a range of minor transitional measures (see section 4.2) and the IWTC which is a full-blown, expensive, time-unlimited, lightly targeted, and child-related tax credit.

Regardless of type, IWBs share some fundamental design and trade-off issues:

- They are supply-side tools and do not directly affect the demand for labour;
- They may reduce the employment of the non-targeted groups;
- They increase the disincentive to work if and when they are abated;
- They can be difficult to administer and evaluate;
- They may be fiscally costly, especially if not targeted and time limited or focused just on the transition to work;

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<sup>6</sup> The EMTR is the combined loss from tax and benefit abatement when an extra dollar is earned. A poverty trap for low income people may occur when earning extra income does not materially increase disposable income.



- If tightly time-limited, and/or of a low value they may be ineffective in achieving the broader labour-market attachment goals;
- Their costs have to be paid for by higher taxes elsewhere or reduced government spending. These effects can also undermine work and distributional objectives;
- They have implications for the support of those in the welfare system.

To summarise these trade-offs: IWBs may be extensive and expensive on the one hand, with offsetting labour market effects elsewhere and implications for those on welfare. On the other hand, they may be inexpensive but then may be ineffective in achieving meaningful behavioral change. This paper suggests that the IWTC is in the first category, but may also fail to achieve meaningful behavioral change.

### **2.1.2 Employment v poverty goals**

IWBs may differ from other labour market interventions such as the minimum wage by having a dual objective: to increase work incentives and employment, and, to redistribute resources to low income families by taking family situations into account. Indeed, one of the political attractions is that it may appear that both employment and distributional goals may be achieved at the same time (Pearson et al, 2008, p 2). A stronger political constituency for the fiscal cost may be possible for supporting people while in paid work as opposed to supporting them in the welfare system.

Child poverty elimination has become a focus of policy attention in many developed countries in recent years. After a dramatic rise in child poverty in the 1990s, the New Zealand government pledged to make it a top priority (Ministry of Social Development, 2002a). The concern about child poverty has clearly been a factor in the choice of design of New Zealand's IWTC, and is explicitly stated as a goal of the Working for Families package (Centre for Social Research and Evaluation, 2007).

Redistribution that favours work may reflect a belief that that work is 'the way out of poverty'. But it is possible here to fall in to the trap of circular thinking. Does work pay only because of the state subsidies? Are these subsidies a benefit in another form? Pearson et al (2008, p. 13) illustrate the circularity when they write :

*[IWBs] provide additional benefits to low-income families, so reduce the incidence of poverty among those families with children. They also increase the incentive to work, and as poverty rates among those in work are lower than those out of work, any increase in the number of parents moving into work would reduce child poverty.*

The conclusion to be drawn may not be that work is the way out of poverty but that if work is 'subsidised' enough then it can be 'made to pay'. However, as discussed below, attachment to the labour force even at the low end of the pay scale may be thought to create future opportunities for more highly paid work that will provide an unsubsidized path out of poverty.

Child poverty elimination has become a focus of policy attention in many developed countries in recent years. New Zealand, Japan and the UK had increasing rates of inequality in the 1980s. This pattern continued in the 1990s for Japan and New Zealand, while the UK inequality figures showed a significant decrease (OECD, 2008, p. 18). The direct attention paid to alleviating child poverty in the UK in the 1990s may help explain this.

If IWBs are used as a major method of addressing poverty, there is a risk of creating and perpetuating an underclass who cannot access the IWB and who thus must remain in poverty. The argument that the 'underclass' are choosing not to access work may become hard to sustain in times of economic downturns or for cases, such as sickness or child caring where paid work is not an option. This aspect is relevant to any overall evaluation of the IWTC in New Zealand as discussed in Section 6.

## **2.2 The effectiveness of use of IWBs**

Recent research has thrown into doubt the value of work incentives for achieving any long-term benefit. A Canadian experiment randomly divided a group of 5,600 welfare recipients in half. One group stayed in the existing welfare regime, the other were put on a self-sufficiency project (SSP) which gave them generous incentives to get full-time work. The SSP group was given a year to obtain full-time employment; and the scheme gave participants an earnings subsidy for up to three years (Card & Hyslop, 2005).<sup>7</sup>

New Zealand-based economist Brian Easton notes that the study's findings about the long-term effects of the SSP are salutary as in effect they were nil (Easton, 2008). Certainly the scheme gave some of the eligible beneficiaries an incentive to get a job earlier than those who had no such incentive. But after the scheme ended, their labour force participation was much the same as those who were not on the programme. More

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<sup>7</sup> The experiment was investigated by David Card of the University of Berkeley, and New Zealander Dean Hyslop of the NZ Treasury. Their paper was published in the journal *Econometrica* and awarded the prestigious Ragnar Frisch prize for the best econometric article published in the last two years' issues.

of both groups were employed than when the scheme started, but those without the incentive took longer to get a job because the net cost of job-seeking was higher for them. The substantial public spending on the incentives to get people off welfare worked in the short run, but gave no long-term employment return.

Even more disappointing, the programme seems to have done nothing to improve the incomes of subsidised workers. One might have expected that getting a beneficiary into a job should trigger an improvement in the long run and because they got their jobs earlier, subsidised workers should have been better paid than the unsubsidised by the time the scheme ended. Card and Hyslop (2005) were unable to find any such effect. Instead, they found that both groups were largely on or near the minimum wage, and there was no significant difference between the two groups. Formally, the study concludes that the incentives had an effect, but only in the short term while they were operating. There were no long-term gains in terms of higher rates of employment or increased earnings. The public spending was a subsidy, not an investment in good quality, long-term jobs (Card & Hyslop, 2005).

Similarly, a study in Minnesota that aimed to “make work pay” by allowing families to keep more of their benefit when they worked, found that the improved earnings of most single-parent families were not maintained. The study also found that for some two-parent families, the scheme reduced employment among second earners, thus did not operate as a work incentive. While the study found some effects, in particular improved primary school performance, may persist for the most disadvantaged recipients, these gains did not come cheaply, with Minnesota spending more money than it would have under the old welfare regime (Gennetian, Miller, & Smith, 2005).<sup>8</sup>

As noted by the OECD, IWBs are not a magic bullet:

*[They are] costly and must be financed by increased taxes elsewhere or cuts in government spending. So they need to be well targeted and implemented carefully and their interaction with social benefits has to be taken into account. The financial incentive should sufficiently large and the duration of the measure long enough to modify behaviour and improve career prospects.* (Pearson & Immervoll, 2008, p. 3)

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<sup>8</sup> The Minnesota Family Investment Program was conducted under the legislation that replaced Aid for Families with Dependent Children (AFDC), which had been in existence since 1935. The new regime, Temporary Assistance for Needy Families (TANF) was designed to encourage parents into work by making welfare less generous and harder to get. Despite the less generous welfare payments of TANF, the Minnesota programme cost more than it would have under AFDC.

## 2.3 Other instruments to encourage the labour supply

As noted above, one of the difficulties of evaluating the effectiveness of any particular in work benefit such as New Zealand's IWTC is that many other factors also affect the ability of target groups to participate. When policies are implemented to address a raft of barriers to employment at the same time it may be impossible to attribute gains to one policy alone.

The mismatch between hours of work, especially in the casualised labour market, and childcare hours, older relatives availability, transportation, tax policy, labour market regulation, and access to care on school holidays, all impact on the work decision. Where, as in the New Zealand case, the focus is on women with children, a crucial policy concerns the quality, affordability and availability of childcare.

In 2004 the New Zealand government announced a comprehensive package "Working for Families" which included an increase in subsidies for childcare for working parents. This paper largely focuses on the part of the package that affects the financial returns to work directly, specifically, the IWTC that was expected to encourage work effort, but as discussed in section 6 is difficult to isolate from other parts of the package including non-financial aspects.

## 3 Tax Credit approaches

### 3.1 New Zealand Working for Families Tax Credits:

The current Working for Families Tax credits programme (WFF) consists of four different types of refundable tax credits available for eligible families with children under 18. These are set out in Table 1 below.

**Table 1. Working for Families Tax Credits**

| <b>Tax Credit</b>         | <b>Abbreviation</b> | <b>Nature of payment</b>                                    |
|---------------------------|---------------------|---|
| Family Tax Credit         | FTC                 | Child-related weekly supplement                             |
| In-Work Tax Credit        | IWTC                | Child-related weekly supplement with work requirement       |
| Minimum Family Tax Credit | MFTC                | Guaranteed Minimum Family income top-up with 100% abatement |
| Parental Tax Credit       | PTC                 | Paid \$150 a week for 8 weeks for new child                 |

Source: IRD, <https://interact1.ird.govt.nz/forms/famcalc2008/>

The Family Tax Credit (FTC), the In Work Tax Credit (IWTC), and the Minimum Family Tax Credit (MFTC), comprise the major WFF tax credits, with the Parental Tax

Credit (PTC) of minor interest for this paper. The FTC is paid to all families on the basis of numbers and ages of children and household income and is not work-related. The IWTC and the MFTC are work-related in that they require that families are not accessing any main welfare benefit and are working at least 20 hours per week if a sole parent, or 30 hours per week if a couple.

Eligible families are entitled to the FTC and if in work, the IWTC. These are paid as one sum to the caregiver for the ongoing costs of the child(ren). The amount paid for FTC and IWTC depends on the combined annual income of the family, the number of dependent children and their age.

The Minimum Family Tax Credit (MFTC) on the other hand is a top-up payment to guarantee a minimum level of income for those in work. The MFTC is a payment for low income families earning up to \$21,860 gross a year (2008/9) and that level is not child-related.<sup>9</sup> Increasing family size is recognized by the FTC and the IWTC. It ensures that these families have a minimum income of \$355 a week after tax or \$18,460 net a year. The amount paid depends on the family's income with an abatement of 100 percent of the MFTC for each extra dollar earned. As for the IWTC, to be eligible for the MFTC, couples have to work a minimum of 30 hours a week between them and sole parents have to work for at least 20 hours.

The IWTC and the MFTC are both designed to improve the returns to working for those with children and are discussed more extensively in Section 5. Sections 3.2-3.5 below provide details of the US and UK tax credits as basis for comparison and contrast.

### **3.2 The Earned Income Tax Credit in the US**

The Earned Income Tax Credit (EITC) was introduced in the US in 1975. It was designed to reduce the burden associated with Social Security taxes in order to supplement income of low income earning families and at the same time strengthen the incentives to seek, take up and retain employment. EITC is a refundable credit, meaning workers can reduce their tax to zero and then receive a refund of any remaining credit. To qualify, taxpayers must meet certain requirements, including earning taxable income.

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<sup>9</sup> This gross income is 44% of the gross average wage of \$957 p.w. or \$49,764 per year (October 2008). 1 NZD = 47.9701 JPY (February 2009).

The EITC underwent expansion during the 1980s under the Reagan administration, but perhaps the largest expansion occurred in 1993 under the Clinton administration and today it is a very significant redistributive programme costing US\$40 billion in 2007 (Pearson et al 2008, p. 13). One of the stated objectives of the 1993 expansion was to ensure that lone parents in full-time, low wage employment were lifted out of poverty. Estimates for late 1990s show that a lone parent in full-time work with two children would indeed have an income above the poverty line (Pearson et al 2008, p. 31)<sup>10</sup>.

The EITC rates differ for families with 1 child, 2 or more children, and no children. While it does not distinguish between single parent families and two parent families, it treats married and unmarried couples differently. Unmarried couples can file separately and thus each receives the tax credit, whereas the earned incomes of married couples are aggregated. If their aggregate income would put them in the phase-out range, there is a perverse incentive for couples not to marry, or if married, to separate and receive separate EITC credits (Ellwood, 2000).

Rather than an “hours worked” basis as used in New Zealand, the EITC entitlement is assessed on an “earned income” basis. The EITC is designed to offer a subsidy to low earnings and operates over three ranges of income. In the first range, the phase-in, the credit increases as income increases. In the second range, the plateau, the EITC credit remains constant; then over the third range, the phase-out, the EITC credit is abated (Pearson et al, 2008, p. 24).

Table 2 includes the ranges for the Phase-in, Plateau and Phase-out stages for families with a single child, 2 or more children and families with no children. Ranges for married couples are higher than for single adults and are included under each respective category.

A numerical example illustrates the method of determining a family’s total EITC. Take a family with 2 children and one adult in paid employment earning US \$13,000. The EITC credit is at its maximum of 40% of \$11,790 i.e. \$4,716 and will not change unless earnings go beyond \$17,390 threshold, at which point the credit will begin to be abated. Full abatement has occurred by \$39,783 (in 2007, increased to \$41,646 in 2008).

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<sup>10</sup> Quoting Hotz, V.J, and Scholz, J.K. (2003), “The earned income tax credit”, in R. Moffitt, ed., *Means-Tested Transfer Programs in the United States*, University of Chicago Press, Chicago.

When the EITC exceeds the amount of tax owed by the individual, it results in a tax refund for those who claim and qualify for the credit (Internal Revenue Service, 2008). It is also important to note that the EITC has no effect on certain welfare benefits like Medicaid, Supplementary Security Income, food stamps, low-income housing, or most Temporary Assistance for Needy Families (TANF) payments.

**Table 2. The US EITC 2007**

| Number of children: | Benefit: | Phase-in:             | Plateau:      | Phase-out:     |
|---------------------|----------|-----------------------|---------------|----------------|
| 1                   | 34%      | US\$ rates pa in 2007 |               |                |
| single              |          | 0-8,390*              | 8,390-15,390* | 15,390-33,241* |
| married             |          | 0-8,390               | 8,390-17,390* | 17,390-35,241* |
| 2 or more           | 40%      |                       |               |                |
| single              |          | 0-11,790              | 11,790-15,390 | 15,390-37,783  |
| married             |          | 0-11,790              | 11,790-17,390 | 17,390-39,783  |
| no children         | 7.65%    |                       |               |                |
| single              |          | 0-5,590               | 5,590-7,000   | 7,000-12,590   |
| married             |          | 0-5,590               | 5,590-9,000   | 9,000-14,590   |

\* thresholds are indexed for inflation

### 3.3 Evaluation of the US EITC

There is evidence that the EITC has had a positive effect on the labour supply. In particular, this effect is most evident when we look at the percentage change in the labour force participation rate of single women with children. Evidence shows that weekly employment of single women with children has increased by about 6 percentage points, while their yearly employment has risen by almost 9 percentage points (Meyer & Rosenbaum, 2001).

Other findings also indicate that the EITC had a very significant effect on welfare use, for example, Groger (2003) finds the EITC might be the most significant policy measure that explains the fall in welfare use and increase in employment among female-headed families.

Other groups, such as single women with no children, married women and black men, did not experience similar gains in employment. In one study, mothers with young children and mothers with low education levels saw the most significant gains in employment, but there were also some positive changes for primary earners in two-parent families with low incomes, resulting in a small increase in their employment rate (Eissa & Hoynes, 2004). Other studies found a small decrease in the number of hours worked by the secondary earner in married couples.

There is also evidence of a significant impact of the EITC on the distribution of income within the USA. Statistical evidence shows that a large proportion of the people who receive the EITC are below the poverty line, most notably, around 26% of the recipients of the EITC are on food stamps, which is a major indicator that EITC has a strong anti-poverty focus (Liebman, 2000). On top of that, the EITC has been made more generous over the years and in particular after 1993 and there was an increase in the number of people applying for EITC. The combination of the increase in the number of people that receive EITC and the amount that is available to them is attributed to lifting a large number out of poverty in the US.

### **3.4 Criticisms of the EITC**

There are 4 major criticisms of the EITC system:

- Expenditure associated with the EITC programme;
- Error rate of the EITC programme;
- The effect on the average hours of work;
- Timing of the EITC credit.

The level and growth rate of expenditure associated with the EITC since its inception has been a concern. The cost of running the EITC increased from US \$1.7bn in 1986 to US \$18 billion in 1996 to around US \$40 billion in 2007 (Pearson et al 2008, p. 13). This could be an indication that a large proportion of the EITC expenditures is ‘dead-weight’ in a sense that it goes to people who are already adequately employed. However, while expenditure has increased over time, in comparison with other developed nations, US social expenditure between 1980 and 1999 is between 2.7 and 3.6% of GDP, “a far lower level than every other country group” (Scholz, Moffitt, & Cowan, 2008, p. 30).<sup>11</sup>

A second concern is that the EITC has been and continues to be subject of significant error. Payments made in error occur through fraud, and as a consequence of the complex nature of rules surrounding the EITC. The two main avenues for fraudulent gains with the EITC stem from people filing misleading information about the hours

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<sup>11</sup> Between 1980 and 1999, social expenditure in other Anglo countries averaged between 4.8% and 7.8% of GDP, and averaged between 8.1% and 15.3% of GDP in the Northern Europe and the Scandinavian countries (Scholz, Moffitt & Cowan, 2008, p. 30).



they have worked or wages they have received; and secondly, claiming to have children living in the household (Greenstein & Shapiro, 1998; Liebman, 2000). This claim is particularly significant, since the number of children or even the presence of children in the household has a major effect on the amount of the EITC credit received.

It is estimated that around 20.7% of all EITC credit is paid in error. Although this level is very high, it is significantly lower than the 35% error rates reported in the 1980s. Greenstein and Shapiro (1998) also note that not all of the errors associated with the EITC are a result of fraud: a large proportion of errors are a result of complex rules surrounding the EITC. One example given is that of a parent claiming a child under the EITC, but due to the complex nature of the EITC rules, another member of the family should have claimed the child instead, and the actual entitlement was a lot smaller. Errors of this sort amount to nearly a fifth of all errors associated with the EITC (Greenstein & Shapiro, 1998). Changes and counter-measures introduced in order to reduce the error rate of the EITC system include a requirement that individuals applying for the EITC provide a valid Social Security number for the children they claim under the EITC, including the children under the age of 1. There will be no payouts for the claims with lost or invalid Social Security numbers.

Another area of concern is around the total effect the EITC has on the hours of labour supplied. EITC might have a positive effect on employment, due to the increase in the “gap” between those who are working and those are out of work. But on the other hand, there could be an adverse effect on the total number of hours provided by individuals because of the phase-out. Total effect on the number of hours of work provided by the people who are eligible for the EITC credit depends on numbers of people in each of the phase-in range and the phase-out range.

Finally, there is a major issue with the timing of the EITC credit. Most families eligible to receive the EITC credit choose to receive it at the end of the financial year, thereby reducing the probability of having to pay back some of the EITC credit if they received too much of it during the year (Coutts, 1999). This makes the payment less connected with the reward from the immediate work effort.<sup>12</sup>

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<sup>12</sup> As shown by the need to file a tax return to get the full refund, and as shown by the maximum an employer can advance which is less than the maximum possible payout.

Another possible explanation as to why families would choose to receive the EITC credit at the end of the year could be found in the examination of the way in which the family chooses to spend the credit. While most families use the EITC to pay for essentials like food or outstanding bills, some families will choose to invest the money in things that could improve their economic condition, like paying for education, new housing or a new car (Currie, 2006).

### **3.4.1 Use of the couple as the unit**

There are several issues that arise from aggregation of income for families with married adults. Since income is aggregated for the purposes of determining the total credit that the family is eligible for under the EITC, there is a disincentive for the secondary earner to increase the number of hours worked. This effect is observable during the periods of EITC expansion (Pearson et al, 2008, p. 26) and is most pronounced for the families with aggregate income within the phase-out range, where the secondary earner is almost 5% less likely to work (Eissa & Hoynes, 2004).

Another effect of the income aggregation for the purposes of determining EITC credit is that it might discourage parents from getting married if both adults are in low-income employment and have children together. The basic concept is that if their aggregate income would put them in the phase-out range, it is more beneficial for both adults not to marry, or to separate and receive separate EITC credits (Ellwood, 2000). This effect on marriage<sup>13</sup> and cohabitation patterns could have a long term impact that is not obviously quantifiable at present, but could become more apparent in the future.<sup>14</sup>

As the EITC has become the significant vehicle of poverty reduction, out of work benefits have been allowed to slip further behind (Scholz, Moffitt & Cowan 2008, p. 11).<sup>15</sup> Poverty among single mother-headed families has fallen from 35.4% to 24.7%.

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<sup>13</sup> Marriage in the US is legally defined as “taking the vows”, and unlike New Zealand, there appears to be no de-facto category.

<sup>14</sup> “By far, the EITC serves as the largest source of both penalties and bonuses for low-income families. Couples composed of one person with children and low or no earnings typically receive a higher EITC on marriage (because their combined earnings are typically below the EITC thresholds) while couples in which both partners have modest earnings are likely to lose their EITC on marriage because their combined income exceeds that which is eligible for the EITC.” (Maag, 2005)

<sup>15</sup> <http://workforcesecurity.doleta.gov/unemploy/uifactsheet.asp> Each US State administers a separate unemployment insurance program under Federal law guide-lines. Although three States also require employee contributions, benefit funding is usually based on a tax imposed on employers. Benefits are based on a percentage of an individual's earnings (up to a State maximum) over a recent 52-week period,

But while poverty decreased, the number of people in deep poverty (i.e. people below 50% of the poverty line) has increased (Acs & Toder, 2007). Those who are able to find employment do experience the benefits of higher earnings under the EITC, but those who are unable to find employment slide further into poverty, due in part to the reduction in spending on non-work related welfare benefits after 2000 (Scholz et al 2008, pp. 10-16), and to the tighter eligibility criteria.

Although many commentators note that single mothers with dependent children have had the greatest response to the EITC (Pearson et al 2008; Scholz et al 2008), these studies do not go into detail about the kinds of employment the single mothers enter and whether or not it is desirable for single mothers to enter employment when they have dependent children at home. It is also noted that in some cases single mothers would be incentivized to remain in low-wage jobs with little flexibility and reduced overtime pay in order to qualify under the work requirement of the EITC (Herbst, 2008).<sup>16</sup>

Finally, there is an issue in measuring the true effect the EITC has had on employment. While the EITC programme has appeared to increase employment levels in the USA, it is hard to tell how much was due to the strong economic environment that the USA experienced during the 1990s and 2000s (Herbst, 2008).

### **3.4.2 Evaluations in summary**

While only small gains in employment were experienced by groups such as single women with no children, married women, and black men, the positive effects that the EITC has had on the labour supply are most evident in the percentage change in the labour force participation rate of single women with low education levels, and with children. From 1984 to 1996, their weekly employment has increased by about 6 percentage points, while their yearly employment has risen by almost 9 percentage points (Meyer & Rosenbaum, 2001).

There have been some positive changes for primary earners in two-parent families with low incomes, resulting in a small increase in their employment rate (Eissa & Hoynes, 2004), at the same time as there has been a small decrease in the number of hours provided by the secondary earner in married couples with children. The small financial

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and can be paid for a maximum of 26 weeks. Some States provide additional benefits for specific purposes, and additional weeks of benefits during times of high unemployment.

<sup>16</sup> This area is not well addressed in the academic literature, and more information is desirable.

loss caused by this reduction in the hours worked is more than offset by the benefit of an increase in the non-market time (ie at home with the children) of the secondary earner (Orsini, 2007).

The EITC has impacted significantly on the distribution of income within the USA. For example, around 26% of the recipients are on food stamps, a major indicator that EITC has a strong anti-poverty focus (Liebman, 2000). Although US social expenditure is comparatively low, the EITC has regularly been made more generous since 1993, and this, in combination with the increase in the number of people that receive EITC, has lifted a large number of people out of poverty.

### **3.4.3 What we can learn**

The EITC is major redistributive programme that has increased the returns to work for low-paid people. It shows that:

- there may be greater political and public support for such work-based redistribution;
- it may increase attachment to the workforce of sole parents but may decrease that of secondary earners;
- it may perpetuate and even deepen poverty among those not in work;
- there are administrative/fraud problems with the appropriate unit and definition of marriage and presence of children;
- the success of the programme is constrained by the resources, as a percentage of GDP, that are allocated to it; and
- as with other labour market and poverty alleviation programmes, its success may be highly dependent on the prevailing economic environment.

## **3.5 The Working Tax Credit in the UK**

In the UK, although many academic studies on employment effects still refer to the Working Families Tax Credit (WFTC), it was reformed in 2003 when the child-related weekly assistance was separated from the work-related aspect. From this time, the Working Tax Credit (WTC- UK) provided the incentive to work, and the Child Tax Credit (CTC-UK) was the way in which the costs of children were recognized in low income families.

The CTC-UK and WTC-UK are designed to work close together in order to help families with low incomes. Currently, the CTC-UK is available for all families with children that earn income below the threshold level. The WTC-UK is available for all families with low incomes that satisfy the work requirements. In order to qualify, a lone parent must work for a minimum of 16 hours a week, and a person without children must work for 30 hours. Lone parents receive a larger payment than two-adult families.

### 3.5.1 Structure and eligibility:

WTC-UK consists of various elements that combine to determine the total amount of benefit that the person is entitled for. Table 3 below summarises the elements of the WTC-UK (Her Majesty's Revenue and Customs, 2008; Pearson & Immervoll, 2008):

**Table 3. UK Working Tax Credit**

| <b>Family Type: Working Tax Credit Elements</b>  | <b>Rates of credits<br/>(in GBP per year)</b> |
|--|---|
| Basic Element (Paid to all who meet the conditions)  | £1,730  |
| Second Adult Element (For couples)   | £1,700  |
| Lone Parent Element (Single parents)   | £1,700  |
| 30 Hour Element (Minimum 30 hours. Couple, 1 child, can share 30 hours work if one works 16 hours pw.) | £705  |
| Disability Element   | £2,310  |
| Severe Disability Element  | £980  |
| 50 plus Element (16-30 hours)  | £1,185  |
| 50 plus Element (30 hours)   | £1,770  |
| Childcare Element (Up to 80 pence a pound that the family spends on registered or approved childcare)  | 1 child to £175 pw<br>2+children to £300 pw   |

(Based on Pearson & Immervoll 2008, p. 24)

CTC-UK is available for families that are responsible for at least one child or qualifying young person who usually lives with the family. CTC-UK is made up of the following three elements:

- Family element, available for all families with one or more children. A higher rate of family element, usually known as the “baby” element, is paid to families with one or more children under the age of 1. There is only one family element, regardless of how many children live with the family;
- Child element, paid for each child the family is responsible for;
- Disability element.

CTC-UK is paid directly to the person who is mainly responsible for caring for the child or children claimed under the CTC-UK. In contrast the WTC-UK is paid to the person who works for 16 hours a week or more. In case of couples, they are given an option of choosing who receives the WTC-UK payment. WTC-UK starts being abated at

relatively low levels of income. If the income of the individual exceeds £5,220 a year, the WTC-UK is abated at a rate of 37 pence a pound, or 37%.

### **3.5.2 Effects on labour supply:**

A comprehensive statistical study conducted using data collected before the introduction of the previous WFTC and over the existence of WFTC until 2003 compared the labour participation before and after its introduction and found that labour supply of lone mothers increased by about 5.1%. Mothers in couples with a working partner saw a decrease in their labour force participation rate of about 0.6%, while fathers saw an increase in their labour force participation of around 0.8%. The study also concluded that, in absence of any in-work benefit, the labour force participation rate of lone mothers would be 45% instead of the 55% participation rate observed by the study (Brewer, Duncan, Shephard, & Saurez, 2006).

The WTC-UK has a minimum working hours requirement, which means that it creates a “jump” in disposable income when a single person moves from 29 hours of work a week to 30 hours of work a week. This acts as a positive work incentive for low wage workers who work for less than 30 hours a week (Her Majesty's Treasury, 2008).

### **3.5.3 Distributional effects:**

Several studies have found that the WTC-UK and CTC-UK serve a strong distributional role, with most of the benefits going to families in the bottom half of the income distribution. The largest proportion of the benefit goes to families whose income is in the lowest two income deciles. This could indicate that families within this range have both the low level of income to qualify for the WTC-UK and CTC-UK, and at least one adult that works at least 16 hours a week (Her Majesty's Treasury, 2008).

It is also estimated that a person on the minimum wage working full-time has seen an increase in weekly earnings from £43 to £61 as the result of introduction of WTC-UK (Her Majesty's Treasury, 2008).

### **3.5.4 Administrative costs**

Administrative costs associated with WTC-UK and CTC-UK are relatively high when compared to alternative in-work benefit programmes. It is estimated that WFTC costs per family in 2003 were around 4 times as high as costs per family associated with EITC in the US (Brewer, Duncan et al. 2006).

### 3.6 How does NZ’s IWTC design compare?

New Zealand’s IWTC is very unlike its counterparts in the US and the UK. Table 4 highlights the critical differences.

**Table 4. Comparing In Work Benefits: UK, US, and NZ**

| <u>UK- WTC</u>  | <u>US EITC</u>   | <u>NZ- IWTC</u>                            |
|---|--|--|
| Minimum hours worked required, Adult based                    | No minimum hours, Adult based                            | Minimum hours worked required, Child based |
| Paid to worker  | Paid to worker   | Paid to carer                              |
| Abates from very low income level. Affects transition to work | Phased in over low income and phased out over transition | Abates from level above transition         |
| Abates quickly  | Abates moderately  | Abates slowly                              |

## 4 The use of ‘in work benefits’ in New Zealand

As noted previously, the IWTC was introduced in New Zealand in 2006 as part of the WFF package. This section provides a brief overview of the nature of that welfare and tax system, and documents the nature of in-work benefits and other labour market interventions since the mid 1980s. The IWTC is then discussed in the context of the economy and benefit system.

### 4.1 Background<sup>17</sup>

In 1984, a foreign currency and economic crisis were used by the newly elected Labour government to justify introducing wide-ranging, free market reforms including later labour market deregulation. The new framework included “a monetarist macroeconomic strategy, general liberalization of regulatory control over markets, regressive taxation reform, and public sector reform” (Roper, 2008, p. 14). Fragmentation and inefficiency in the delivery and administration of welfare payments had been the subject of several Treasury papers throughout the 1980s. Treasury economists had also stressed the problems of overlapping income tests, and the work disincentives of the high EMTRs that are implicit in such tests.

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<sup>17</sup> This section draws on St John and Rankin (2009), detailing the Labour government’s policies of the late 1980s, those of the National government in the 1990s, and Labour again in the 2000s. Remarkably few changes in policy directions were made in this area as these political transitions occurred.

Treasury's 1990 briefing papers to the incoming National government noted that more people faced higher EMTRs over longer ranges of potential income implying greater costs to society and a greater probable loss of output:

*An indication of the effect of such scales is the fact that very few people are in jobs with an income at the level where the maximum rate of benefit abatement applies; instead they tend to have no job at all, rather than work for little gain. This is worrying since it discourages part-time work, which may be the most appropriate employment for some beneficiaries. (The Treasury 1990, p. 110)*

The 1991 Budget document "Welfare that Works" (Shipley, 1991) put forward a vision of a seamless, global system of abatement of all social assistance. The mechanisms were described with the aid of 3-dimensional diagrams that showed that a single-family income test and a single phase-out rate were to apply across all forms of social assistance (Shipley 1991, p. 43). The Treasury had also identified high levels of benefits as a major factor preventing a more gradual abatement system, and it was announced late in December 1990 that benefits would be cut significantly. Reducing benefits to very low levels can be seen as the policy approach to "in work benefits" in this period.

In brief, these changes involved making virtually all social assistance targeted by income testing and included:

- Significant benefit cuts;
- Lengthened stand down periods and tighter eligibility rules for welfare benefits;
- No change to rates of abatement of benefits for other income, the level of exempt income was held at 1986 levels;
- All 'per child per week' family assistance became targeted using the test of combined parental income. ( St John and Rankin, 2009)

High EMTRs are required if targeted payments are bled out as quickly as possible and thus the poverty trap problem is confined to as few people as possible. As St John and Rankin (2009) note, "the more that is included for abatement, the longer the income range over which abatement applies, and the more people are affected." Even using a single bleed out rate, the rate of abatement would need to be high because lower rates would prolong the abatement range unrealistically.

*Unfortunately, a clawback of 50% coupled with marginal tax rates of 21% or 33% gives rise to effective marginal tax rates of 71% or 83%. And, even with*



*a 50% abatement rate, the range of income over which a couple or an individual might be affected is wide. (St John and Rankin 2009, p. 5)*

Despite the highly integrative view stated in “Welfare that Works”, family accounts were unworkable and eventually abandoned (St John and Rankin 2009, p. 6). This left a highly targeted welfare system with overlapping income tests and the work disincentive effects of high EMTRs.

In 1996, The Tax Reduction and Social Policy Programme (Birch, 1996), announced three critical policy changes to ease the inherent disincentives in the welfare system:

- lower statutory rates of tax;
- the introduction of the Independent Family Tax Credit (IFTC) (later renamed the child tax credit (CTC)); along with increases in Family Support, especially for older children; and
- increased earning allowances for some beneficiaries.

Some of these changes lacked a consistent basis of agreed principle.

*Thus, in contrast to the previous policy that treated all children of low-income families the same for weekly income support, the CTC discriminated against the children of parents regarded as dependent on the state. And, while the claimed intent was to strengthen families, the new claw back procedures for those on benefits discriminated against intact marriages with children. (St John and Rankin 2009, p. 6)*

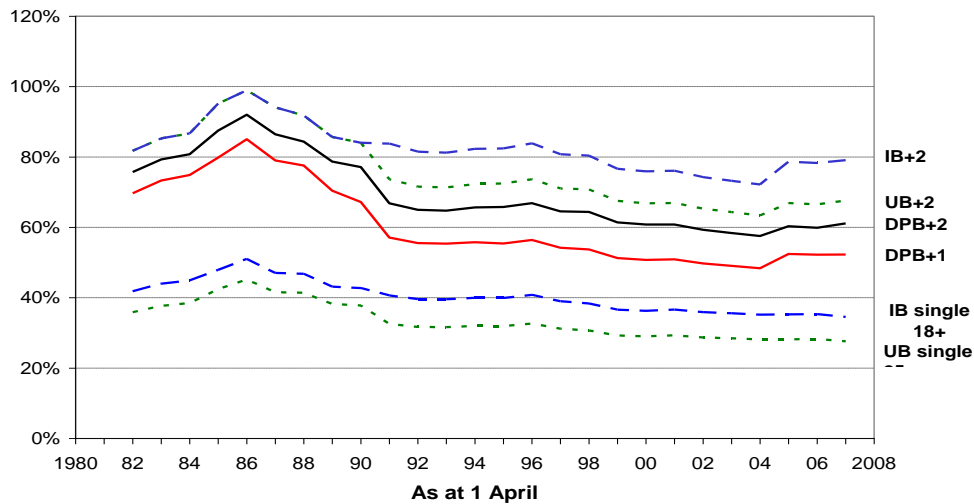
It was planned that by 2008 the system of entry into social security based on unemployment, sickness, disability and sole-parenting would be replaced by a single core benefit, with entry on the basis of income insufficiency. While the core benefit has not been implemented to date, as Lunt, O’Brien & Stephens (2008, p. 3) note: “Rules of eligibility and entitlement have been altered to make explicit the work-first nature of benefit delivery for all income-tested beneficiaries.”

Much of the welfare system as developed in the 1990s remains in force in 2009. In family assistance, the CTC has been replaced by the IWTC discussed in detail below. Benefits remain at historically low relative levels (except for the state pension, see Section 8.2). Benefits are income-tested against joint income for a couple, and a couple and an individual have exactly the same threshold of allowable earnings before abatement occurs. This threshold of \$80 a week has not been adjusted for inflation since

1986.<sup>18</sup> This provides a severe disincentive to engage in part-time work with EMTRs of 92.3% for earnings above \$80.

Figure 1 below shows the drop of value relative to after-tax wages of representative welfare benefits: UB (Unemployment Benefit), IB, (Invalids Benefit) and DPB (Domestic Purposes Benefit), including family assistance. For a sole parent with 1 and 2 children, Working for Families in 2005 slightly reversed the downward relativity trend. Not shown in Figure 1, by 2008 and 2009 this downward trend had reasserted itself as tax cuts improved net average earnings but did not affect net benefits which are only adjusted for prices.

**Figure 1. The value of benefits relative to the net average earnings**



IB+2 : a couple in receipt of the Invalid's Benefit, with two children

UB+2 : a couple in receipt of the Unemployment Benefit, with two children

DPB+2 : a sole parent in receipt of the Domestic Purposes Benefit, with two children

DPB+1 : a sole parent in receipt of the Domestic Purposes Benefit, with one child

(Source: Perry (2008, p. 40)

## 4.2 Other work-related benefits<sup>19</sup>

As noted above, any assessment of the IWTC must take into account other policy changes that also impact on the decision to work. For example, child care is a critical cost of working and the state-related payments for child care increased under WFF.

<sup>18</sup> This \$80 is just over 8% of the gross average wage of \$957 (October 2008). In 1986, it was 21% of the average wage of \$379 p.w. Between 1986 and 2008, the minimum wage increased from \$5.25 to \$12.00. By 2009, the \$80 threshold should be \$210, and it is in fact being raised to only \$100 from 1 April 2009.

<sup>19</sup> Section 4.2 draws on the Centre for Social Research and Evaluation's 2007 report: *Receipt of the Working for Families Package: 2007 Update*.

#### **4.2.1 Childcare subsidy:**

The Childcare subsidy programme aims to assist low and middle income families by providing assistance with the costs of any licensed childcare, family day care, home-based care and chartered Te Kohanga Reo<sup>20</sup>. It is paid directly to the childcare provider and is available to any families with children under the age of 5. Childcare subsidy is usually paid for 9 hours per week. In order to qualify for up to 50 hours of paid childcare per week, the main carer of the eligible child must be either in paid employment, training, job-seeking activity, attending a course of study in a tertiary or secondary institution or be involved in a rehabilitation programme.

The amount paid depends on the weekly income of the care-giver and the number of children who are eligible for the childcare subsidy. In October 2004 and again in October 2005, the income limits entitling families to receive Childcare subsidy were raised under the Working for Families package. In July 2007 the government also introduced 20 hours of free daycare for 3 and 4 year olds.

There has been an increase in the number of childcare subsidies granted each year for the last three years. This reflects the combined impact of changes in the number of children aged under 5, increased employment of sole parents, and broadened eligibility of low-income working families under Working for Families.

#### **4.2.2 Out of school care**

An OSCAR (Out of School Care) Subsidy assists low and middle income families with the costs of approved before- and after-school care and holiday programmes for children between ages 5 and 13. Parents are eligible to receive an OSCAR subsidy for 20 hours a week in term time and up to 50 hours a week during school holidays if they work or study, or if they or their child have a disability or a serious illness.

In 2004, the Working for Families package raised the income limits for families to receive an OSCAR subsidy. The hourly subsidy rates were also increased from October 2004 to equal Childcare Subsidy rates, as well as being raised in line with inflation from April 2005. Hourly rates were raised again from October 2005.

There has been an increase in the number of children covered by an OSCAR subsidy since 2003. This reflects a combination of the Working for Families package (which

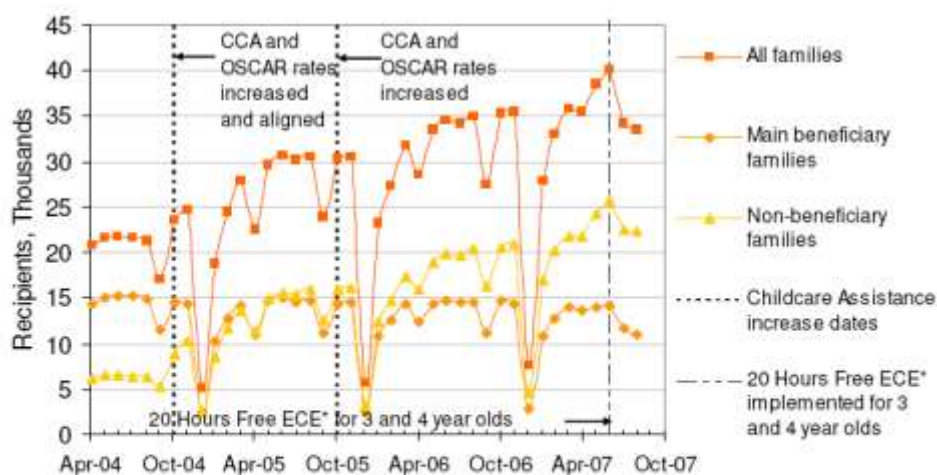
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<sup>20</sup> Maori language preschool.

widened eligibility and increased subsidy levels) and increased use of subsidies by the carer’s benefit recipients who are in education, training or employment.

There has also been a change in the mix of caregivers who receive the OSCAR subsidy. The widening of eligibility to low-income working families under the Working for Families package (see Figure 2) is shown by the changes between 2004 and 2007. In 2004, around 52% of the children covered by an OSCAR subsidy had caregivers who received no pension or main benefits, but in 2007 around 80% of the children covered by the subsidy had a caregiver who did not receive a pension or main benefit (Centre for Social Research and Evaluation, 2007, p. 21).

**Figure 2. Number of families receiving Childcare and OSCAR subsidies at month end, 2004-2007.**



<sup>1</sup> The number of families receiving Childcare Assistance declines during school holidays, with large drops in particular over the Christmas / New Year school holiday period.

\* ECE=Early Childhood Education

Source: MSD Information Analysis Platform (IAP).

(Source: Centre for Social Research and Evaluation, 2007, pp. 21, Figure 10)

The large increase in expenditure on Childcare and OSCAR subsidies since 2003/2004 is largely attributed to the impact of Working for Families, extending the range of incomes eligible for assistance.

#### 4.2.3 Hardship Assistance

Temporary Additional Support (TAS) is available in cases of hardship. Amongst these costs that may affect working people are:

- Repayment for previously purchased vehicles in situations where there is no suitable public transport available and the vehicle is required for employment reasons or because of disability in the family;

- Employment related costs (e.g. childcare, public transport or vehicle costs).

The Recoverable Assistance Programme, introduced in 1996, provides non-beneficiaries with financial assistance that is non-taxable, interest-free, and recoverable, so they can meet essential, immediate needs for specific items or services.

#### **4.2.4 Accommodation Supplement**

The Accommodation Supplement is available to assist people with limited income and limited cash assets to meet their accommodation costs.

The Working for Families package increased the income limits for the Accommodation Supplement, and also changed the abatement regime. Under these abatement changes, beneficiaries receiving an Accommodation Supplement and earning additional income no longer have their Accommodation Supplement abated while they remain on a benefit. Once people enter paid work, however, their Accommodation Supplement is abated at 25% above a base level of income. This adds to the EMTR and thus to work disincentives for recipients.

#### **4.2.5 Transition to Work Grant**

Transition to Work assistance is paid in order to assist people from benefits to employment and to remain in employment. As well as meeting essential costs for job search and entering employment, Transition to Work Grants may be available to assist with costs related to relocation and safety equipment and to assist with covering living costs between the last benefit payment and the first pay from a new job. A maximum of \$1,500 in Transition to Work Grants is available in any 52-week period.

To qualify for the Transition to Work grant, requirements include, among other things:

- Be seeking paid work for a position of 30 hours or more per week;
- Have a verified job interview for a position involving at least 30 hours of work per week, or have a verified job offer involving at least 15 hours of work per week (excluding self-employment);
- Have an essential cost because of the job interview or job offer;
- Be unlikely to make the transition into paid work or to be able to attend the interview without receiving a Transition to Work Grant.

People seeking work involving less than 30 hours per week may access Transition to Work Grants if it is reasonable and appropriate (e.g. if there is no full-time work available, the client is working with the Department of Work and Income (DWI) to progress towards full-time employment, the person is unable to work full-time but is able to work limited hours).

#### **4.2.6 New Employment Transition Grant:**

A new Employment Transition grant, introduced in January 2009, is available to people with one or more dependent children during the first six months after take-up of employment and cessation of their main benefit. To receive the grant, these people must be temporarily unable to meet their work commitments because their partner or child is sick and there is no sick leave available, or they have exhausted their entitlement to paid sick leave. Similarly, the grant can be available if there has been a breakdown in childcare arrangements, and the parent either has no paid leave available or has exhausted their paid leave entitlement.

#### **4.2.7 Course participation assistance**

This programme provides non-taxable, non-recoverable financial assistance towards the actual reasonable costs for people participating in a short-term (generally less than 12 weeks) employment-related training course or programme.

#### **4.2.8 Welfare to work policy 1998-9**

The Community wage, introduced in 1998 and abolished shortly after the 1999 election, was a policy instrument used to move people from welfare into training and employment. The Community wage replaced the unemployment benefit and contractually obliged the unemployed to accept community work as and when offered. Individuals were also required to undertake training and organised activities as specified by the DWI. It was hoped that increased participation in work-related activities would reduce the “benefit dependency” associated with long term unemployment.

Since 1999 the community wage policy has been replaced by a case management approach (Humpage, 2007).

### 4.3 Minimum wage in New Zealand

A number of different approaches have been taken historically to reduce unemployment and encourage more people into work. Perhaps one of the most prominent instruments of government intervention in the labour market is the Minimum Wage Act, 1983. Minimum wage legislation provides protection for workers by creating a wage “floor” for all workers, union and non-union.

Table 6 shows the relationships between youth rates and the minimum wage in 2008. Youth workers aged under 18 years were initially paid at 60% of the minimum wage, but in two steps over 2001 and 2002, this was increased to 80%, and the age of eligibility for the adult minimum wage was lowered from 20 to 18 years (Pacheco & Cruickshank, 2007). The Act specifies a review of the minimum wage in December of each year, and minimum wage rates have been increased every year, rising from \$7.55 in 2000 to \$12.00 in 2008 (Department of Labour, 2008). Then in February 2009, the Prime Minister announced a further increase to \$12.50 per hour, effective 1 April.<sup>21</sup>

**Table 5. Increases in Minimum Wage, 2000 to 2009 (nominal \$)**

| Year | Hourly rate<br>(before tax) | Weekly rate<br>(40 hours, before tax) | Percentage<br>Increase |
|------|-----------------------------|---------------------------------------|------------------------|
| 2000 | \$7.55                      | \$302.00                              |                        |
| 2001 | \$7.70                      | \$308.00                              | 2%                     |
| 2002 | \$8.00                      | \$320.00                              | 6%                     |
| 2003 | \$8.50                      | \$340.00                              | 6.25%                  |
| 2004 | \$9.00                      | \$360.00                              | 5.8%                   |
| 2005 | \$9.50                      | \$380.00                              | 5.5%                   |
| 2006 | \$10.25                     | \$410.00                              | 7.9%                   |
| 2007 | \$11.25                     | \$450.00                              | 9.75%                  |
| 2008 | \$12.00                     | \$480.00                              | 6.6%                   |
| 2009 | \$12.50                     | \$500.00                              | 4.17%                  |

(Source: various, including Department of Labour website: [www.dol.govt.nz](http://www.dol.govt.nz))

Because of strong economic conditions during the early 2000s, it is hard to gauge the full effect of minimum wage increases on employment in New Zealand. While there is little convincing evidence that a minimum wage has a negative effect on employment, there are arguments that minimum wage could lead to reduced flexibility for employers and may cause a percentage of the low skilled labour force to remain in long term unemployment (Pearson & Immervoll, 2008, p. 14).

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<sup>21</sup> The increase to \$12.50 represents a 4.2 per cent rise. Consumer prices rose 3.4 per cent and the average wage increased by 5.4 per cent in the year to December (Collins, 2009).

**Table 6. Minimum wages as at 1 April 2008**

| Category                  | Per Week (40 hours) |            | Per hour     |
|---------------------------|---------------------|------------|--------------|
|                           | <i>Gross</i>        | <i>Net</i> | <i>Gross</i> |
| New Entrants Minimum wage | \$384               | \$326      | \$9.60       |
| Minimum Training wage     | \$384               | \$326      | \$9.60       |
| Minimum Wage              | \$480               | \$402      | \$12.00      |

## **5 The New Zealand “In Work Tax Credit”**

### **5.1 Background**

The IWTC was introduced in April 2006 as part of a broad package of tax credits called Working for Families. New Zealand is one of only six countries to use a child-related work incentive. The others are Austria, Belgium, Ireland, South Korea, the Netherlands, and the Slovak Republic (Human Rights Tribunal, 2008, p. 10). While the IWTC is designed to provide a work incentive, it is important to understand its place in the overall pattern of family assistance payments in the New Zealand system.

The presence of children requires special recognition in the assessment of the ability to pay tax. In New Zealand, tax exemptions have not been used since the 1970s. By 1986 there was a simple system in which children, whether in families on benefits or in work, were all treated the same. Assistance for children comprised Family Support, a refundable tax credit that reduced against joint parental income, and Family Benefit, a universal cash payment of \$6 per child per week. In 1991 the Family Benefit was added to Family Support, so that all child financial assistance became a single refundable tax credit that was abated above a threshold of joint parental income.

Family Support was paid to the caregiver for the children, regardless of whether the families of the children concerned were on benefits or earned low incomes. Unlike welfare payments, however, there was no automatic adjustment for inflation and income thresholds were rarely increased. Over the 1990s the real value of Family Assistance was eroded at the same time as child poverty emerged as a major social issue (St John & Craig, 2004).

In 1996, the weekly per-child Family Assistance was increased by \$20 per child per week, but \$15 of this increase was separated off from Family Support, and only paid for children whose parents were not on a benefit. Rather than an explicit work incentive, it was a reward for not being “dependent” on the state. This payment of \$15 per week per child was initially called the Independent Family Tax Credit (IFTC), reflecting that role.



In 1996 the IFTC was renamed the “Child Tax Credit” (CTC), and became part of a raft of similar tax credits called Family Plus, available only to families not on a benefit. The renaming indicated recognition that it was a payment to help with the costs of children rather than primarily a work-related payment, but its design ensured that it was paid only to those parents in work.

In practice, the CTC denied beneficiary families an overdue inflation catch-up in 1996; meanwhile the purchasing power of their Family Support continued to fall (St John & Craig, 2004). The Labour Government, elected in 1999, acknowledged that child poverty had become a major social problem, and in 2002 vowed to eliminate it (Ministry of Social Development, 2002b). The 2004 budget announced “Working for Families” (WFF) would be introduced with a two-year phase-in beginning in 2005 for increased financial family assistance.

WFF was initially a package worth over a billion dollars.<sup>22</sup> It included a range of improvements such as increased Accommodation Supplement and childcare subsidies. The major thrust, however, was a very significant increase in financial assistance for children in “working families”. The clear intention was to encourage and reward attachment to the labour market and by doing so reduce child poverty.

The package on the surface appeared to increase Family Support (now called the Family Tax Credit (FTC) significantly for all, but the government had taken the opportunity to use this extra assistance to offset a range of cuts to benefits, so that some families were left only ‘no worse off’. In addition, these same families were excluded from the new In-Work Tax Credit (IWTC) that replaced the CTC from 1 April 2006. The IWTC was much more generous than the CTC, at \$60 a week for families with up to three children and an additional \$15 a week for the fourth and subsequent children.

Criticism of the WFF package in 2004 stressed that the poorest of poor children had been left out but the government claimed to have no money left to help beneficiaries further. Then, in a surprise move pre-election in 2005, it was announced that from 1 April 2006, an additional \$500m per year would augment the WFF package. However, the additional money went only to families earning more than \$27,500, well above welfare benefit levels.

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<sup>22</sup> WFF was expected to absorb 4.4% of total government spending between 2004 and 2008.

The threshold for the IWTC’s joint parental income test was raised to \$35,000, and the rate of abatement was reduced from 30 percent to 20 percent. These moves could reasonably be justified, as the previously higher effective marginal tax rates on low incomes were seen to counter the work incentive thrust of the government’s intentions. But if work incentives were the objective, the opportunity was not taken to revisit the design of the In-Work Tax Credit, or its ongoing relevance as a work incentive.

There now appeared to be no clear connection between the original rationale for the IWTC and the final form in which it was enacted. Because the IWTC is like the FTC in every respect, the two tax credits are added together for abatement purposes. The FTC abates first and then the IWTC. The end result, and seemingly unintended consequence of the 2005 changes, is that the IWTC is paid to families a long way up the income scale where “a gap between wages and benefits is not relevant” (Fletcher, 2009, p. 34). The legitimacy of this payment has also been challenged by child advocacy groups on grounds of discrimination as outlined in Section 7.

**Table 7. WFF weekly and annual support from 1 October 2008**

| <b>Weekly payments:<br/>Age and number of children</b>                           | <b>Rate<br/>1 October 08</b>    |
|--|---------------------------------|
| First child if under 16  | \$86.29                         |
| First child if 16, 17 or 18  | \$99.96                         |
| Subsequent rate if child under 13  | \$59.98                         |
| Subsequent rate if child 13 to 15  | \$68.40                         |
| Subsequent rate if child 16 or over  | \$89.44                         |
| <b>Lump sum, annual end of the year payments:<br/>Age and number of children</b> | <b>Annual rate<br/>for 2009</b> |
| First child if under 16  | \$4,376                         |
| First child if 16 or over  | \$5,069                         |
| Subsequent rate if child under 13  | \$3,042                         |
| Subsequent rate if child 13 to 15  | \$3,469                         |
| Subsequent rate if child 16 or over  | \$4,536                         |
| Abatement Threshold  | \$35,914                        |
| Rate of abatement  | 20%                             |

By 2007 the full Working for Families package was implemented, with parameters as set out in Table 7. The extra income received by low- and middle-income working families has impacted positively on child poverty measures among working families, (Perry, 2008) but left other non-working families behind (St John & Wynd, 2008). While the overall WFF package reduced the rate of child poverty from 30% to 22%

(Perry, 2008, p. 78),<sup>23</sup> the remaining poverty is largely concentrated in families that are ineligible for the IWTC. Child Poverty Action Group (CPAG) estimated that approximately 185,000 children live in families not eligible for the IWTC, and remain in some degree of hardship, with about 150,000 of them in severe and significant hardship (St John & Wynd, 2008): For this group little respite is in view, only exhortations for their parent or parents to get a job, regardless of how inappropriate or impossible that might be.

## **5.2 The Carrot: The In-Work Tax Credit**

The In-Work Tax Credit was the “carrot” of the government’s welfare reforms. It was designed to boost the rewards for parents moving from benefits into paid work, that is, to “make work pay”. At \$60 per week for up to three children, plus an additional \$15 per week per child thereafter, it is a generous payment, and would appear at first glance to be an incentive to re-attach to the workforce.

Policy on the IWTC appeared to have been influenced by the UK tax credit system; but as outlined in section 3.5, since 2003 Britain’s child-related assistance has not differentiated between working and non-working families (St John & Craig, 2004). The UK per-week, child-related payments comprise a universal child benefit and a child tax credit, paid for all children on the same basis, regardless of the source of their parents’ income. As Table 4 shows, the UK Working Tax Credit is quite different to New Zealand’s IWTC – it is aimed at the transition to work and abates from a low level at a high rate. It is not related to the numbers of children; it is available to all low-income workers; and it is paid to the worker, not to the principal caregiver of the child.

Like the CTC before it, New Zealand’s IWTC conflates policy goals of child-related income security with adult workforce participation. It is a child-related payment first and foremost. In every respect except as to who gets it, it is just an addition to the Family Tax Credit, adding on top of it, and abating after the FTC has disappeared. Perhaps in an attempt to reinforce the message that the IWTC is more clearly a work incentive, claimants must now meet the weekly work criterion of 30 hours for a couple and 20 hours for a sole parent, a condition not required for the CTC.

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<sup>23</sup> Using the poverty line of 60% current after housing costs equivalised median household income.

The “work incentive” is paid to the caregiver of the child (who may not be “in work”), not the worker. The irony is that, once in receipt of the IWTC, many families in two-parent households can afford for the primary caregiver, or both parents, to work less. While anecdotal, a case cited in a recent MSD newsletter illustrates the point. Setoga (Toga) and Liz Tofilau live with their three children aged six, three and one, in Petone. Toga works for the Salvation Army centre in Wellington as a youth worker. Liz is an early childhood teacher in Lower Hutt.

*Tax credits and some childcare assistance have made it possible for Toga to reduce his working week from five to four days, and spend one day a week studying towards a degree in health and psychology at WelTec...The extra funds make it possible for Liz to spend more time with the children while they're young. This year, the whole family went to Samoa. It was the first time in years they had been able to go anywhere as a family. (Ministry of Social Development, 2007)*

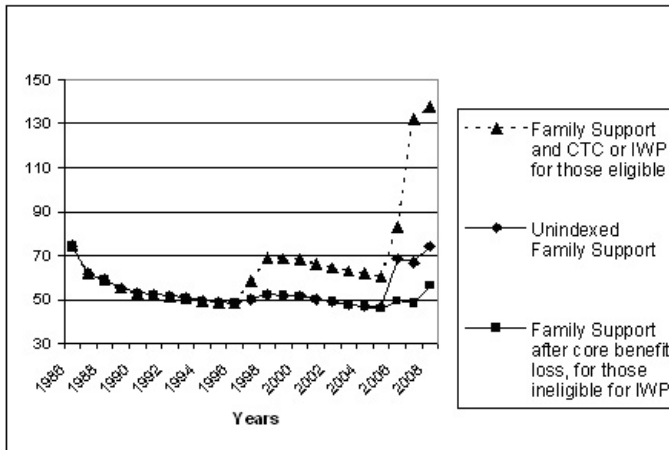
While improved family work-life balance for 2-parent families due to fewer hours worked may be applauded, the intent of the IWTC was to increase, not reduce, labour market participation. The target of the policy was clearly sole parents for whom the 20 hours paid work criterion is particularly harsh compared to the two-parent 30 hour requirement. Sole parents are already doing the job of two parents. Participants in a recent study noted that the sheer relentlessness of doing everything on their own, felt most acutely by those with two or more children, was a contributor to rising stress levels, deteriorating mental and physical health, and in some cases hospitalisation or suicidal thoughts (The Rotorua Peoples Advocacy Centre (RPAC) Inc., 2007).

The rules of independence from the state for the IWTC require that parents cannot receive any main social welfare benefit or student allowance. Anomalies abound in this requirement. Thus if caregivers receiving the state pension, New Zealand Superannuation, also meet the paid work requirements, they may also qualify for the IWTC, as may some parents receiving accident compensation payments even if they do not work. A partnered women who works 20 hours, but whose partner is unemployed, does not qualify for the IWTC. On the other hand, even though her actual hours of work are zero, a partnered woman whose partner works for 30 hours may receive the IWTC.

Because of the IWTC and other changes introduced as part of the WFF package, a much bigger gap has opened up between families “in work” and those not “in work”. Using the one-child low-income family to illustrate, Figure 3 shows how the changes in 1996 and in 2005 with WFF affected the real spending power of family assistance for those

families who qualified for the CTC/IWTC, and those that did not. Figure 3 also shows how the core benefit cuts which accompanied WFF have made the gap even larger. Overall, the cuts to benefits and other hardship provisions for the worst off group was estimated to save \$237m per year.

**Figure 3. 1-child maximum real per week family assistance 1986-2008 (\$2004)**



(Source: St John & Craig, 2004)

Despite the intent of IWBs internationally not to create the gap by reducing the relative income of those out of work, (see section 2.1.2) this has been the effect in New Zealand with implications for the achievement of the other goal of the IWTC, that of child poverty reduction. In defending these changes, the government argued that “...great care was taken in developing Working for Families to ensure that nobody was worse off as a result of the changes” (Mallard, 2004). In a time of improved real redistribution to working low-income working families, to be “no worse off” in nominal terms increased social exclusion and entrenched the relative poverty of the poorest children.

The inclusion of the poorest children in the IWTC would cost approximately NZ \$450m per annum (St John & Craig, 2004).<sup>24</sup> Because they have a younger demographic structure and a lower socio-economic status than the general population, New Zealand’s Māori and Pacific Island populations are disproportionately disadvantaged by their exclusion from the IWTC (Wynd, 2006). These ethnic groups have already experienced a much larger decline in their living standards between 2000 and 2004 than the rest of the population (Ministry of Social Development, 2006). It can be argued that the IWTC in effect, treats children of different races differently. This discrimination is being

<sup>24</sup> In contrast in 2005 the government extended family assistance to families well up the income scale

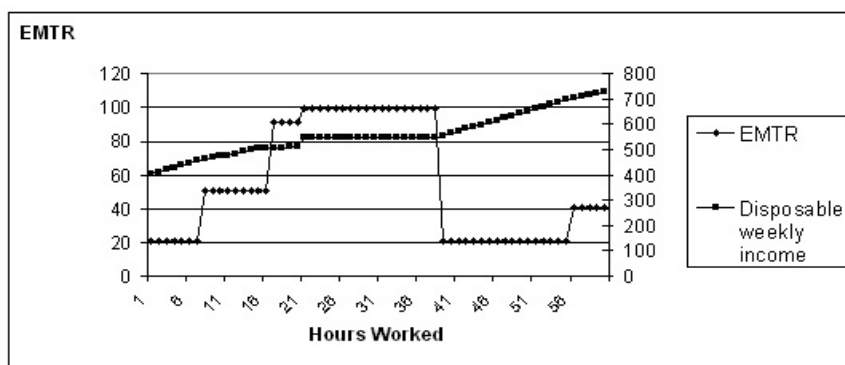
debated politically under Treaty obligations to the indigenous peoples and illustrates another vulnerability of the IWTC policy (see section 7.2).

In 2008, as the recession began to impact, many families experienced a sharp drop in living standards. The low benefit levels were accompanied by a loss of the IWTC for the children of the newly unemployed. In the past, when parents needed to go on to a benefit, Family Support could be expected to increase as a result of their lower income. Now, because the IWTC is tied to employment, family assistance lowers when income falls for all income under the family assistance threshold, and thus fails to provide a cushion to protect the income needs of children when their parents' work income falls.

### 5.3 The Minimum Family Tax Credit

The minimum family tax credit (MFTC) is not child-related, but is designed to provide a guaranteed minimum family income for those working the required number of hours. The level in 2008 is \$22,119 before tax (\$18,044 net), regardless of the composition of the family, with Family Tax Credit (the old Family Support) and the In-Work Tax Credit paid on the top of the net guarantee. The MFTC is a top-up that is reduced by one dollar for each additional dollar of disposable income earned. Thus it resembles a welfare benefit. Use of this top-up increased under Working for Families.

**Figure 4. Disposable weekly income 2007 (RHS axis) and effective marginal tax rate (LHS axis) for single parent with two children**



Source: S. Poletti, (2008), based on sole parent 2-children working at the minimum wage

Families coming off benefits may need to access the MFTC to attain a level of income comparable to that of a benefit plus part-time work. Figure 4<sup>25</sup> shows the disposable income and the effective marginal tax rates faced by a single parent on the minimum

<sup>25</sup> This calculation updates Johnson (2006) using current data from Inland Revenue.

wage as a function of the number of hours worked.<sup>26</sup> It shows that moving from on-benefit and 19 hours per week work at the minimum wage; to off-benefit working 20 hours and getting the MFTC, increases disposable income by around \$30 a week. There is no incentive for a single parent to work more than 20 hours a week until they can work around 38 hours, because MFTC abates at 100 cents for each additional dollar of net income, resulting in no increase in income for the additional 17 or 18 hours worked.

It is also important to understand that, while the move from being employed for just below 20 hours a week and being in receipt of a benefit, to being employed for 20 hours and not receiving a benefit, is technically a move off welfare to “independence,” in reality it is no such thing. The amount of assistance provided by the state in each case is almost exactly the same, if not more, for being in work. The main difference is that the name for the assistance from the government has changed, avoiding the stigma which may be associated with “welfare”.

The way tax credits are structured is illustrated in Figure 5. The tax credits above the minimum family income line are the means by which additional children are recognized. As earned income increases, the MFTC reduces dollar for dollar.

**Figure 5. Structure of tax credits**

|  |
|--|
| <b>Parental tax credit</b>                         |
| <b>In-Work tax credit</b>                          |
| <b>Family tax credit (formerly Family Support)</b> |
| <b>Minimum Family Tax Credit</b>                   |
| <b>Net earned income</b>                           |

It is difficult for families receiving family assistance to understand the impact of earning more income because they are given a total WFF tax credit amount on their tax reconciliations, even though different credits are treated differently for abatement purposes. The severe abatement of the MFTC is of concern, as families may find at the end of year that they have to repay, dollar for dollar, any unanticipated income.

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<sup>26</sup> The Minimum Wage rose to \$12 an hour in April 2008, and \$12.50 in April 2009. For higher wages the figure would be more compressed towards the left.

Data for 2006 shows that nearly a quarter of families who were getting the MFTC had to repay some at the end of the year. The MFTC was received by only 863 families in the year ended March 2006, but this had jumped to 2,727 in the year ended March 2007, showing the increased importance of this benefit for those moving off the DPB (updated Inland Revenue, 2007).<sup>27</sup>

#### **5.4 Theoretical justifications for the IWTC**

In general a wage subsidy has income and substitution effects. Work is made more attractive by the increase in the marginal return so there is a substitution in the positive direction, while the income effect makes the worker better off, and so may be encouraged to work less. In the low wage, low income areas in which in work benefits usually operate, the substitution effect is expected to dominate. In the phase out period, the substitution effect works to discourage extra hours of work. In so far as the phase out applies to joint income for the couple, there may be a strong disincentive for the secondary earner who would face the EMTR of the couple. The overall impact on hours worked will be a subtle balancing of these effects.

The IWTC is a lump-sum payment and as such can be expected to have income effects. There is an incentive to work the required number of hours to receive it in full, but once it is received it does not increase the marginal returns to extra work effort. Eventually the IWTC abates at 20 cents in the dollar, so that for additional hours of work there is a substitution effect away from work effort.

For sole parents, the incentive operates in a complex way. To receive the IWTC a sole parent must work 20 hours but must also come off the benefit. If she stays on the benefit, she can work 20 hours and receive a part benefit but no IWTC. If she comes off the benefit and still works only 20 hours it is unlikely at low wages that she will have enough to live on. The WFF package then adds the MFTC to her disposable income to guarantee her family a minimum income level. As described in section 5.3, MFTC has a 100% abatement so that any income earned above the income from the 20 hours is effectively confiscated, providing a very strong work disincentive for those in that income band.

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<sup>27</sup> See section 6.4 for more detail.



For couples, the hours of work requirement is less onerous at 30 hours a week and only 8% of couples do work less than these hours. For most secondary earners the income and substitution effect work in the same direction which should unambiguously reduce her/his hours of work.

The theoretical justification for the IWTC must be that the work incentive aspects for sole parents outweigh the disincentives for secondary earners in couples with children. Additionally there may be some social benefit from ‘making work pay’ for those already in low paid work.

Other a priori considerations:

- If there is an increase in subsidised work by mothers with children, there may be a corresponding decrease in unsubsidised work elsewhere;
- The IWTC has to be paid for by higher taxes which have disincentive effects;
- Encouraging low wage employment may keep wages low.

There are also particular issues associated with the IWTC and IWBs generally in an economic downturn. As Fletcher (2009, p. 34) points out: “In a situation of falling employment and rising benefit dependence it would be preferable to remove the in-work tax credit and transfer the expenditure to an increase in the core family tax credit.”

## **6 Evaluation of the IWTC**

### **6.1 Methodologies for evaluating IWBs**

Methodologies for evaluating IWBs are set out in Pearson et al (2008, p 25) as follows:

1. Experiential. Pilot studies allow for a control group not affected by policy.
2. Simulation. Projection of likely effects before policy put in place based on characteristics of the population.
3. Statistics approach. Difference-in-Differences approach eliminates other effects by use of statistics and is most generally used.

New Zealand is a small country without regional or state differences in policy. There was no pilot study for the IWTC, a national programme. This rules out method 1 as an evaluation methodology. The other two approaches are discussed below.

## 6.2 Expected results

A March 2004 paper to Government Ministers on the expected impacts of Working for Families reached the following conclusions about the anticipated key effects of the original package on employment:

*As a result of the reforms there may be a small increase in labour market participation amongst both beneficiaries and non-beneficiaries who decide to enter the labour force. Depending on the skills of these new entrants and general economic conditions, this may lead to a small increase in employment. Needless to say, the package has been developed against the background of strong economic growth. In the event of an economic downturn, employers are less likely to absorb any increase in labour supply generated as a result of improved work incentives. Families already engaged in work are not generally responsive to financial work incentives and may, depending on the structure of assistance, reduce the work effort of second earners in dual-income households. These findings are confirmed by preliminary micro-simulations applied to the labour market in NZ. (Ministry of Social Development, 2004, paras 89-92)*

The micro-simulation the Ministers refer to is a study based on the second methodology. The Kalb, Cai, & Tuckwell (2005) study by the New Zealand Treasury prior to the introduction of WFF predicted the impacts of the first version of IWTC based on labour supply elasticities derived from 1990-2001 data (Kalb & Scutella, 2003). The simulation assumes a perfectly elastic demand for labour (Kalb, Cai, & Tuckwell, 2005, p. 10). The changes that were modelled were decreased benefit rates, increased family assistance partly dependent on the labour supply, and the accommodation supplement. The effects of the latter were expected to be small and can be ignored for the purposes of this paper.

Sole parents were the only group for whom a positive labour supply effect was expected as a result of the WFF policy changes. According to this 2005 research, around 1.8 percent of single parents were expected to enter the labour force as a result of the WFF package. About 2.4 per cent of all sole parents were expected to work less and about 1.9% were predicted to prefer longer working hours with an overall average increase of average 0.63 hours a week. The tax revenue for the group as a whole would decrease, due to negative supply responses for those already working full-time, who are more likely to earn more than new entrants in the labour force. The authors found an increase in the probability of working was largest for one-child families as would be expected because the increase in IWTC over the previous CTC is largest for the 1-child family (Kalb, Cai, & Tuckwell, 2005).

Only 8% of couples in the sample observations worked less than 30 hours a week and for these, higher incomes “may actually induce a reduction in labour supply of one or both partners” (Kalb, Cai, & Tuckwell, 2005, p. 13). The results showed the labour supply of married men and women was predicted to decrease by 0.22 and 0.23 hours per week respectively. “For married women, the most popular choice is to reduce labour supply to zero” (Kalb, Cai, & Tuckwell, 2005, p. 13). All effects by the number of children are negative. It was also noted that the abatement of family assistance post reform applies further up the income scale, providing a higher EMTR for some women in higher income families.

The microsimulation was based on the Household Economic Surveys (HES) which did not include the increased childcare subsidies of WFF. These can be expected to increase work participation of parents with young children. The authors note “the effect is probably largest for low-wage families where the price of childcare might otherwise cancel out nearly all additional earnings to be obtained from additional working hours” (Kalb, Cai, & Tuckwell, 2005, p. 24).

Other qualitative analyses include a report published by the Business Roundtable which concluded that the WFF package was unlikely to have a noticeable, if any, net positive effect on aggregate employment. It noted that the WFF package provided no encouragement for secondary income earners to seek employment where one parent was already working 30 hours a week (Dwyer, 2005). Analysis by Nolan (2004) and St John & Craig (2004) drew the same conclusions.

In summary, prior to the IWTC becoming payable in 2006 and prior to the unexpected extension announced pre-election 2005, it was expected that there would be only a modest effect on movement of sole parents from benefits to work (in other words large numbers would remain reliant upon benefits). The employment of couples, in particular secondary earners (usually mothers) was likely to decrease.

The analysis ignores the role of childcare subsidies and of the MFTC and its importance to sole parents who are moved off benefit, discussed below and assumes that the demand for labour is perfectly elastic. The effect of cuts to welfare benefits for the target group is not easily disentangled from the effects of the IWTC alone.

Ministers expressed concern that the policies might have consequences for other labour market policies:

*On balance, we expect the increase in labour market participation as a direct result of Future Directions – Working for Families reform to be modest. Should there be an increase in labour supply, any downward pressure on wages would reduce the returns to work for people without children and make these workers increasingly reliant on minimum wage provisions.* (Ministry of Social Development, 2004, paras 89-92)

### **6.3 Statistical studies**

Using the third methodology, there was some preliminary research on the impact of tax credits using a difference-in-differences approach (Fitzgerald, 2008). This report found small labour market gains and other small impacts such as the effect on partnering. It concluded that

*... we provide some evidence of employment increases and more solid evidence of work hour increases for those working due the family assistance policy [tax credits] changes. Evidence on partnering is more elusive but there are certainly no large impacts currently* (Fitzgerald, 2008, p. 48)

This study did not provide a policy analysis, nor did it answer critical questions such as whether tax credits are appropriate labour market tools; whether they are well-designed; whether they are worth the cost; and what their unintended consequences may be.

It would appear that the statistical approach employed by Fitzgerald et al (2008), while problematic, largely confirms the earlier results from microsimulation. They show however that partnered women increased their hours of work, an outcome that may reflect the positive incentive effect of the reduced of abatement of family assistance and higher threshold than originally intended that were introduced with the pre-election 2005 changes.

### **6.4 Official reviews of the In Work Tax Credit**

The IWTC is a very new policy and official assessments have been preliminary to date. There was a statutory requirement for the review of the level of the IWTC by the 30 June 2008 (Inland Revenue Department, 2008) and for ongoing evaluations (Centre for Social Research and Evaluation, 2007; Ministry of Social Development & Inland Revenue Department, 2009 forthcoming) Other evaluations of timeliness etc provide some additional information (Inland Revenue, 2008).

The first IRD evaluation of WFF acknowledged the difficulty of assessing the work incentive aspect of the IWTC. While it found that “nearly two thirds of families agreed that the In-Work Tax Credit is a good incentive to stay off a benefit”(Centre for Social

Research and Evaluation, 2007, p. 38), this is a long way from proving that it is a sensible and effective work incentive. On the contrary, it may simply serve to illustrate the gap between those who are able to work and those who cannot.

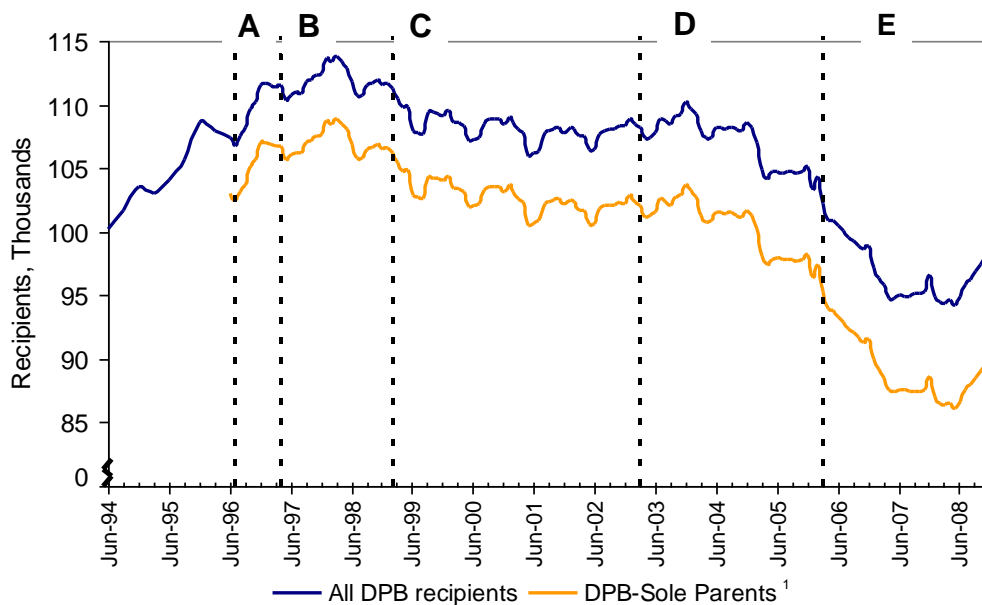
As Fetcher (2009, p. 34) notes: the IWTC is not well-targeted as a “make work pay” measure, since most of the expenditure goes to those higher up the income distribution, for whom the gap between wages and benefits is not relevant

#### 6.4.1 Sole parents

The reduction in DPB numbers since the introduction of the IWTC has been taken as evidence that “the in-work tax credit ... appears to be making a difference” (Inland Revenue & Centre for Social Research and Evaluation, 2007, p. 39). In support of that claim figure 6 shows the actual numbers of benefits in force to July 2008.

*...since WFF has been implemented, New Zealand has experienced the largest fall in numbers receiving DPB since the benefit was introduced in 1973 – the number of families receiving the DPB has fallen by 12,500 (from 109,700 at August 2004 to 97,200 at August 2007). (Centre for Social Research and Evaluation, 2007)*

**Figure 6. Domestic Purposes Benefit recipients, all classes 1994 – 2008**



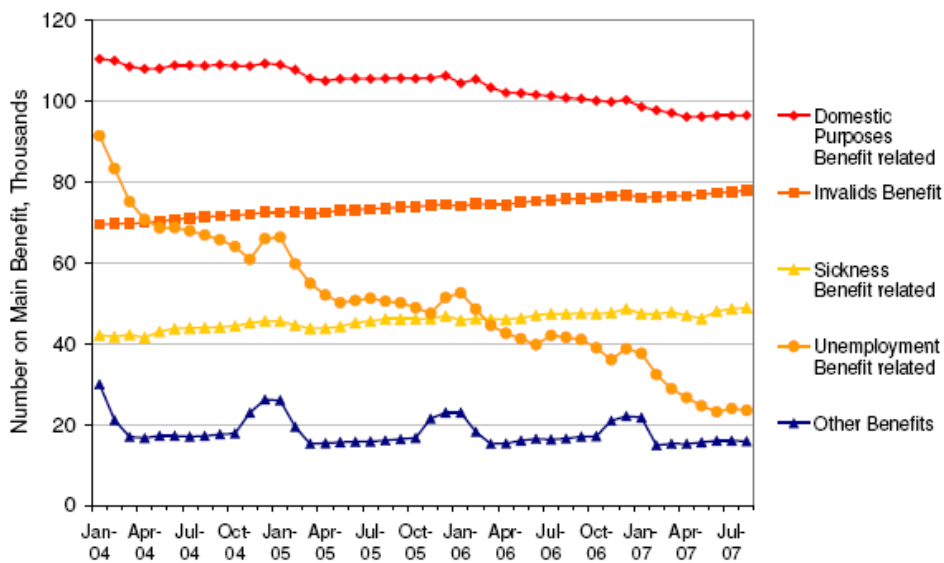
(Source: Ministry of Social Development & Inland Revenue Department, 2009 forthcoming)

This sharp fall however needs to be seen in the context of overall trends in sole parent numbers on the DPB. As also shown in Figure 6 these had fallen since the peak in 1998. Figure 6 also shows the sharp cyclical nature of the numbers with the rise in the

early 1990s reflecting poor economic conditions; and after the recovery from the downturn in 1999, unemployment benefit numbers fell to record low levels when the economy was particularly strong in the 2000s. More recent economic events are reflected in the upward trend in the last 12 months of 2007-2008 shown in Figure 6.

Other confounding factors are the growth in those on disability benefits such as the sickness and invalids, reflecting in part the ageing of the population and changes in conditions for the unemployment benefit.

**Figure 7. Total Working Age Clients by main benefit, January 2004 to August 2007**



Working age is 18 to 64.

DPB related include sole parents, caring for sick or infirm person, and women alone.

Transitional Retirement Benefit is included in the group 'Other Benefits' and only for the time period January 2004 to February 2004 as it ceased to exist in March 2004.

(CSRE, 2007, p.7, Figure 1, MSD Information Analysis Platform (IAP))

Figure 7 makes clear that exits from the DPB were indeed occurring at a faster pace between 2004 and 2007 but this is not evidence of the efficacy of the IWTC because

- The labour market was exceptionally tight and unemployment itself was falling rapidly until 2007. Demand for unskilled labour was high;
- Child care subsidies and supply also increased markedly;
- Minimum wage was lifted each year see Table 5;
- Case management can be expected to have helped;
- Exits may not have entailed a significant increase in hours of work;
- The role of the MFTC is ignored.

As the economy worsened during 2008, as might be expected the downward trend in to 2007 shown in Figure 6 began to reverse sharply. The latest figures for all benefits (Table 8) including the DPB, show that from December 2007 to 2008 there was a sharp rise in unemployment benefits and an increase of around 2,000 in DPB numbers.

It was suggested in the 2007 report that:

*...WFF is having a positive impact on incentives to work and is contributing to movement off benefit into work, particularly for sole parents who already had some labour market attachment. Specifically: The in-work tax credit is being received by a large and growing number of families. One year after its implementation the number of recipients is continuing to increase and 184,700 families received in-work tax credit in the tax year ending March 2007. (Centre for Social Research and Evaluation, 2007, p. vi)*

**Table 8. Trends in the number of working aged recipients of main social security benefits (quarterly series - December 2003 – December 2008)**

| End of quarter | Unemployment Benefits <sup>2</sup> | Domestic Purposes Benefits <sup>3</sup> | Sickness Benefits <sup>4</sup> | Invalid's Benefits | Other main benefits <sup>5</sup> | All main benefits |
|----------------|------------------------------------|---|--------------------------------|--------------------|----------------------------------|-------------------|
| December 2007  | 22,748                             | 98,154                                  | 49,093                         | 80,082             | 19,655                           | 269,732           |
| December 2008  | 30,508                             | 100,282                                 | 50,896                         | 83,501             | 20,989                           | 286,176           |

(Source : MSD <http://www.msd.govt.nz/documents/about-msd-and-our-work/newsroom/factsheets/>)

An overlooked point here is that the eligibility for the IWTC was widened considerably to higher income people by the time the IWTC was implemented in 2006. As this tax credit must be applied for it could be expected that over time, the numbers would increase as high income families realized their eligibility. At growing cost to the tax base, 36% of the total number of families with children are recipients.

**Table 9. Number of DPB recipients with and without income in addition to benefit**

| DPB Recipients at end of August | No other income | With other income (\$ per week) |                |                |                |              | Total         |
|---------------------------------|-----------------|---------------------------------|----------------|----------------|----------------|--------------|---------------|
|                                 |                 | All with other income           | \$1-80         | \$81-180       | \$181-300      | >\$300       |               |
| 2005                            | 80,000          | 26,400                          | 8,900          | 9,000          | 5,900          | 2,600        | 106,400       |
| 2006                            | 78,000          | 23,600                          | 8,200          | 8,200          | 5,200          | 2,000        | 101,500       |
| 2007                            | 75,600          | 21,600                          | 7,300          | 7,500          | 4,800          | 2,000        | 97,100        |
| Change                          |                 |                                 |                |                |                |              |               |
| 2005-2006                       | -2,000<br>-3%   | -2,800<br>-11%                  | -700<br>-8%    | -700<br>-8%    | -700<br>-12%   | -600<br>-25% | -4,800<br>-5% |
| 2006-2007                       | -2,400<br>-3%   | -2,000<br>-8%                   | -900<br>-11%   | -700<br>-8%    | -300<br>-7%    | 0<br>-1%     | -4,400<br>-4% |
| 2005-2007                       | -4,400<br>-6%   | -4,800<br>-18%                  | -1,600<br>-18% | -1,400<br>-16% | -1,100<br>-18% | -700<br>-25% | -9,200<br>-9% |

Source: MSD Information Analysis Platform (IAP).

Note: Numbers may not sum due to rounding. Percent change calculated on unrounded data.

(Source: Centre for Social Research and Evaluation, 2007, p. 40)

*Legislation passed in November 2005 gave effect to earlier commitments to further enhance the WFF package by raising the income threshold and lowering the rate of abatement for income in excess of the threshold. These enhancements were expected to provide additional WFF Tax Credits to an estimated additional 160,000 families, including 60,000 newly eligible families. These families have higher incomes than the previous target group. By 1 April 2007 nearly all families with children earning under \$70,000, many earning \$70,000 to \$100,000, and some earning more, qualified for WFF. (Centre for Social Research and Evaluation, 2007, p. 2)*

It was claimed that the IWTC “appears to be contributing to the decrease in the numbers of DPB recipients” (Centre for Social Research and Evaluation, 2007, p. 36) and in support the report cited the work of Fitzgerald et al (2008) as discussed above.

The 2007 report acknowledged that the fall in numbers was greatest among those with other income, that is, people who had an *existing* attachment to the labour market (see Table 9 above). Of these, “some would have been already working sufficient hours (20 a week) to qualify.” (Centre for Social Research and Evaluation, 2007, p. 40) Between 2005 and 2006 the biggest fall in numbers was for those already working in some way with a large drop for those earning over \$300 a week ( -25%).

The IWTC started in 2006 and between 2006 and 2007 of the reduction of 4,400 only 2,400 were not working at all and most would not have gone into full-time work. Between 2007 and 2008 the numbers on the DPB increased sharply by 2,128 and while



these may not be the same people, it suggests that overall the IWTC was not operating to help DPBs retain jobs in the downturn.

In conclusion, a close analysis of the composition of the numbers is required. But it can be inferred that of the total reduction in DPB numbers a very small number had no connection to the labour market already, and of those who had left the benefit it is not clear how many would be working more than 20 hours as discussed below.

Another confounding factor not addressed in any analysis is the role of child support (payment from the non-custodial parent). This payment may be large enough to sustain a sole parent off benefit and may have profound work incentive implications. While on the DPB the child support payment is used to offset her benefit and many sole parents prefer to stay on a part-benefit even when working so that this payment is secured.

#### 6.4.2 Role of the MFTC

This report does not detail the number who would have moved off a part benefit on to the MFTC, but the figures above suggest that many have done so. The latest figures for the MFTC confirm this as between 2006 and 2007 the numbers of sole parents on the MFTC jumped from 621 to 2,167. The number was similar for 2008. The average entitlement for MFTC in 2008 was \$2,801. The MFTC can in fact result in sole parents receiving more from the state off the DPB than on a part benefit (Gray, 2008).

**Table 10. Data for the receipt of the MFTC**

|                                    | 2004           | 2005           | 2006           | 2007            | 2008            |
|------------------------------------|----------------|----------------|----------------|-----------------|-----------------|
| Numbers entitled to MFTC (year)    | 1,412          | 1,007          | 863            | 2,727           | 2,397           |
| % Couple                           | 29%            | 30%            | 28%            | 21%             | 16%             |
| % Sole                             | 71%            | 70%            | 72%            | 79%             | 84%             |
| <b>Entitlement Mean</b>            | <b>\$2,274</b> | <b>\$2,298</b> | <b>\$2,325</b> | <b>\$2,748</b>  | <b>\$2,801</b>  |
| 25 <sup>th</sup> percentile        | \$625          | \$827          | \$786          | \$985           | \$881           |
| 75 <sup>th</sup> percentile        | \$3,418        | \$3,427        | \$3,493        | \$3,945         | \$4,139         |
| Total WFF tax credits: <b>Mean</b> | <b>\$7,618</b> | <b>\$7,650</b> | <b>\$9,632</b> | <b>\$10,914</b> | <b>\$12,025</b> |

(Source: Ministry of Social Development & Inland Revenue Department, 2009 forthcoming)

In February 2009, the results of a further difference-in-differences study using the Household Labour Force Survey and Income Survey (June Quarters), and a Survival analysis of recipients of DPB-Sole Parent using MSD and IRD linked data was partially

released (Ministry of Social Development & Inland Revenue Department, 2009 forthcoming).

The estimated employment rates allowed the conclusion that WFF had resulted in another 8,100 sole parents in employment for pay of at least one hour or more a week by June 2007 and that this could be attributed to the changes. The effect was due to the whole of the WFF package, not the IWTC alone. The authors also report that the percentage of sole parents working 20 hours or more increased by 12 percentage points to 48%, with three-quarters of this attributed to the changed financial incentives and support. A technical report is to be released later in 2009.

The “difference in differences” approach compares the employment rates of unemployed matched single persons with that of sole parents. While the methodology is clearly the best that can be done with the data, the comparator group in a time of very low unemployment is questionable. It is also likely that there are some displacement effects between the two groups. It has been mentioned above that some of these 8,100 would now have exited employment as the recession makes an impact on low-wage, casualised work.

While it may contribute to the goal of “making work pay” overall, it is hard to see that the IWTC has been successful in achieving its goal of increasing paid work for sole parents. Moving off a benefit does not necessarily equate to moving to full-time employment or even significantly increased hours, because of the use of the MFTC, which is arguably just a benefit in a different guise. It has a 100% EMTR and provides a very strong work disincentive to those working 20 hours to increase hours beyond that.

#### **6.4.3 Young people and the IWTC**

The Social Security Amendment Act 2007 targets young people through close monitoring and by making it more difficult for them to obtain benefits, but offers no tax incentives to work. There may be minor “in work payments” as outlined in section 4.2

In 2003, officials from the Treasury and IRD suggested to the Minister of Finance, Michael Cullen, that there was merit in increasing incentives amongst those without dependent children because: sustained employment can enhance future earnings potential, thereby improving individuals’ capacity to support themselves and any children they may have in the future. Providing in-work assistance solely to those with children may be perceived as discriminatory and using a single individual without

children as the baseline makes the construction of in-work assistance clearer ie which parts of the payment relate to work incentives and which parts relate to family formation (Ministry of Social Development, 2004, para. 13).

In addition there was some recognition that work incentive measures aimed solely at parents could have adverse effects on single people. For example, the effect of the IWP could be to reduce pressure on employers to pass on wage increases, thus preventing wage rises for single people as well as parents (Ministry of Social Development, 2004, Para. 132). Financial inducements to parents to enter the labour market may increase their chances of employment at the expense of adults without children (Bryson, Evans, Knight, La Valle, & Vegeris, 2007).

## **6.5 Policy assessment against criteria**

Using standard public policy criteria the IWTC may be assessed against equity, efficiency, and simplicity criteria, and for its cost effectiveness in meeting specific goals. Confounding the analysis is that the IWTC is part of a complex package; the policy is relatively new; and the macro environment, minimum wage and tax policies have also been changing.

The IWTC was introduced on 1 April 2006, and has been running for less than 3 years. In this period, the minimum wage has gone up; thresholds for Family assistance abatement have gone up; the rate of abatement has come down; benefits for those with children have been reduced; unemployment has fallen from record low levels, then risen; and tax rates have changed.

### **6.5.1 Equity**

In horizontal equity terms, the IWTC can be seen to recognise the effect of family size on ability to pay tax and to provide some horizontal equity even well up the income scale for those with children. The converse argument is that it fails to recognise the need for extra assistance for those on benefits as family size increases.

This feature has made the IWTC vulnerable to criticism. Because the IWTC has two objectives, work incentive and income adequacy, it fails to achieve the second for those who do not access it by the appropriate attachment to the labour market. The hours worked requirement also creates inequity for those who just miss out.

The 2005 changes were not rationalised in terms of their work incentive effects, but largely seen as a way to deliver a tax cut to families and not to others. This inequity in turn has led to an entrenchment of child poverty and the need for complex compensatory policies (St John & Rankin, 2009), (see also section 6.6).

### **6.5.2 Efficiency**

The use of a fixed-amount, targeted, child-related payment such as the IWTC to reward paid work effort is problematic because, once a family qualifies, it provides no extra incentive to work more. As discussed above, it may eventually provide a disincentive to work, through high effective marginal tax rates abating against extra income (Nolan, 2002).<sup>28</sup> Universal payments, unfashionable and long since abandoned, have the advantage that they do not reduce as extra income is earned, so they are more work-friendly than targeted payments.

Moreover as the analysis above has shown, the IWTC is not a stand-alone work incentive and once it is coupled with the MFTC whose EMTR is 100%, there is strong incentive to work only the required number of hours and no more unless the leap to well-paid, full-time work can be made.

The overall efficiency effects must be the balance between the slight improvements in incentives for some sole parents to increase hours of work to 20 hours a week versus the disincentives to work more than 20 hours, and the disincentive effects on a large increased group of higher income secondary earners.

Less easily quantified, there is also the social value placed on certainty of income by sole parents. In CPAG V Attorney General, the Deputy Chief Executive of Social Policy, Ministry of Social Development, acknowledged that where work has been precarious people may choose to stay on a benefit (Gray, 2008, p. 105). Churning and unstable employment can lead to income insecurity for some people, with high risks of debt and may lead some to return to the benefit (Ministry of Social Development, 2004). Sole parents who may have to rely on uncertain child support from ex partners may prefer the state collects this and uses the money to help pay for their benefit. These effects can be expected to increase as hours of work are cut in the current recession.

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<sup>28</sup> Work incentives linked to the care of children also exclude the childless, who may be more in need of a work incentive than parents with young children.

### 6.5.3 Simplicity

The IWTC is a complex intervention in family assistance. It has necessitated other complex discriminatory policies to redress the problems. It has made family assistance much harder for people to understand especially now the IWTC, the FTC, and the MFTC have different criteria and abatements. It might be better to have a work incentive that does not try to do so much.

### 6.5.4 Cost Effectiveness

In 2003, the Treasury suggested that an appropriate policy solution should distinguish between groups of sole parents. For sole parents with low wage earning potential and costly child-care challenges, the policy aim should be to encourage only a moderate amount of work to supplement benefit income, while encouraging child and personal development. The intention would be that over time, full-time work would be more viable as childcare requirements became more manageable and the sole parent's wage earning potential rose. According to the Treasury, until that point was reached, attempts to heavily subsidise the return from longer hours of low paid work seem relatively pointless. There should be greater work expectations of sole parents for whom full-time work is a reasonably attainable goal eg because their children require little direct supervision or they can command a good wage in the labour market (Hurnard, 2007).

A Treasury document also noted that proposals to lift labour force participation amongst young women aged 20-34 should be evaluated carefully because early childhood education is expensive and there is a risk of low value for money from spending in this area. The document states: "It is also not clear to what extent increased participation by young women leads to real increases in output, if in part it substitutes paid for unpaid work." (The Treasury, 2005, Para. 7)

**Table 11. Joint Income, Number of Families, Millions paid in IWTC**

| <b>Joint Income</b>  | <b>Number of Families</b> | <b>Amount IWTC paid (\$m)</b> |
|----------------------|---------------------------|-------------------------------|
| Under \$15,000       | 14,660                    | 27.8                          |
| \$15,000 to \$25,000 | 23,420                    | 45.3                          |
| \$25,000 to \$35,000 | 28,650                    | 74.6                          |
| \$35,000 to \$45,000 | 34,890                    | 103.6                         |
| \$45,000 to \$55,000 | 28,690                    | 87.0                          |
| \$55,000 to \$65,000 | 26,370                    | 73.8                          |
| \$65,000 to \$75,000 | 18,180                    | 45.5                          |
| \$75,000 to \$85,000 | 8,620                     | 14.4                          |
| Over \$85,000        | 4,390                     | 8.3                           |
| Progress Total       | 187,870                   | 480.3                         |

Figures obtained recently from the Crown Law Office, shown in Table 11, break down numbers of families and total amount spent on the IWTC specifically in \$10,000 income brackets for the 2006/2007 year. The estimated cost of the IWTC is approximately NZ \$500m per annum. In 2008, if the number moved into equivalent full time work is 2,000, the cost per beneficiary moved into work is \$250,000 (see Table 8). In the extreme, if all the extra employment disappears in the recession, the cost still remains. This calculation however 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.

The OECD report, *Economic Survey of New Zealand, 2007*, stated:

*No matter what strategy is selected, a number of distortions within the present tax bases should be reviewed. First, the government has increasingly used the tax system as a tool to deliver on other policy objectives. This has complicated the tax system and has had some adverse effects on individual economic behaviour. The Working for Families package provides assistance to families with children. The package has increased the incentives for some of those on welfare to move towards work and for some to increase their hours of work. But changes in the last Budget [2005] extended the income range over which assistance is withdrawn, which has raised the numbers of families for whom additional hours of work becomes less attractive financially because of higher effective marginal tax rates. Alternative ways of supporting families without these negative effects on incentives to work could do more to raise living standards and should be investigated further. Shifting the balance of funding towards more generalised assistance with childcare costs for working parents could be one option. (OECD, 2007, p. 10)*

## **6.6 Employer perspectives**

There has been little empirical analysis of possible labour market distortions. An ‘hours of work’ requirement can create perverse incentives to overstate hours, while the work subsidy implicit in the MFTC can be appropriated by the employer. The guaranteed income floor for those who meet the hours of work requirement may allow the employer to reduce the hourly rate, constrained only by the minimum wage legislation. Lower wages for subsidised workers may create an unfair bias against unsubsidised workers.

## **7 Unintended consequences and Human Rights considerations**

### **7.1 New consequential policy developments**

One of the consequences of the IWTC has been the need for compensating policy elsewhere. Workers who got nothing out of Working for Families were effectively denied a tax cut in 2005 when the WFF programme was extended well up the income scale, increasing the original cost by 50% (\$0.5 billion).

The new National-led Government has acknowledged the problems faced by unusually high levels of taxation of some categories of lower-income people, and the inequities that arise with Working for Families when New Zealand's economy endures a period of contraction and rising unemployment. Two new compensating policies: a new tax credit for workers who had received nothing under the WFF package, and a package to support newly redundant workers, have been introduced as described below.

#### **7.1.1 The Independent Earner Tax Credit**

Table 12 gives the current and future income tax scales for individuals in New Zealand. WFF tax credits substantially offset income tax for middle and low income families, while others have had very little tax relief. The Independent Earner Tax Credit (IETC) is a tax credit to the maximum of \$520 a year for the year 2009-2010, rising to \$780 per year by 2010-2011. The tax credit is aimed at working residents not in receipt of any income-tested benefit, New Zealand Superannuation, or WFF assistance. For employees who qualify, this tax credit will reduce the amount of PAYE deduction from their salary or wages. Self-employed or non-PAYE workers would also be able to access this tax credit provided they qualify and fill out a tax return or request a personal tax summary from the IRD. The IETC is available for people earning \$24,000 per year and it will abate at 13 cents per dollar for every dollar over the yearly income of \$44,000.

**Table 12 Income tax scales 2009-2011**

*From 1 April 2009*

| <i>Income tax rates</i> |       |
|-------------------------|-------|
| \$0 – \$14,000          | 12.5% |
| \$14,001 – \$48,000     | 21%   |
| \$48,001 - \$70,000     | 33%   |
| \$70,001 and over       | 38%   |

*From 1 April 2010*

| <i>Income tax rates</i> |       |
|-------------------------|-------|
| \$0 – \$14,000          | 12.5% |
| \$14,001 – \$50,000     | 21%   |
| \$50,001 - \$70,000     | 33%   |
| \$70,001 and over       | 37%   |

*From 1 April 2011*

| <i>Income tax rates</i> |       |
|-------------------------|-------|
| \$0 – \$14,000          | 12.5% |
| \$14,001 – \$50,000     | 20%   |
| \$50,001 - \$70,000     | 33%   |
| \$70,001 and over       | 37%   |

Since the threshold of \$24,000 a year is less than the full-time income of someone earning the statutory minimum wage, it was intended to supply an incentive to expand the number of hours supplied by an individual in order to reach the threshold (New Zealand Government, 2008). The EITC however introduces yet more complexity to overcome the perceived anomalies created by the IWTC. It also takes New Zealand further from the path of tax reform adopted in the late 1980s of simple low rate broad base comprehensive income taxation (St John, 2007 ).

### **7.1.2 The redundancy package**

In addition to the IETC, the National-led government introduced a package called ReStart that will continue to pay the In-Work Tax Credit (IWTC) to workers who have been made redundant from full-time work with children for their first 16 weeks of unemployment, thereby softening for some the double blow of unemployment. The In Work Tax Credit is only paid to redundant workers who have children, and is renamed “ReCover”. The policy effectively acknowledges that the IWTC is a payment to assist with the support of children, and not simply or even primarily a work incentive.



The second component of National's ReStart is a plan to raise, for 16 weeks, the maximum Accommodation Supplement payable. This will mainly help people who have overextended themselves with respect to their housing; in particular, people who face the prospect of losing their homes if unemployment causes them to default on their mortgages. It will not help renters with cash assets (eg savings for a deposit on a house) who will therefore be unlikely to qualify for an Accommodation Supplement.

A payment that is supposed to be a work incentive made to those who are not working, and to only a selected group of those who are not working and who meet stringent criteria, is likely to produce a new raft of inequities and inconsistencies. These issues are likely to be brought into sharp focus as the recession deepens in 2009.

## **7.2 Human rights breaches by IWTC alleged**

Another unanticipated consequence of the IWTC has been a sustained attack on it by New Zealand child rights advocates who have argued that the IWTC is unlawful discrimination in terms of Human Rights legislation.

A claim between Child poverty Action Group (CPAG) Incorporated, Plaintiff, and The Attorney-General, Defendant, was brought under the Human Rights Act 1993 and its amendments. This case, CPAG v Attorney General was heard in the Human Rights Review Tribunal in June/July 2008. The case had originally been filed in 2002 against the CTC which became the IWTC in 2006. The history, documents and decision of this protracted and expensive exercise can be accessed at [www.cpag.org.nz](http://www.cpag.org.nz).

The plaintiff argued that the IWTC is a part of weekly family assistance to help meet the needs of low income children. Yet children can miss out on this payment solely because of the work status of their parents. It was claimed that the IWTC constitutes unlawful discrimination under Part 1A of the Human Rights Act 1993 (HRA) and breaches New Zealand's obligations under the United Nations Convention on the Rights of the Child (UNCROC). The fall in the rate of child poverty in New Zealand, as a consequence of the IWTC and attributed to the WFF package, was, it was alleged, achieved by reducing the poverty only of those children whose parents are in work.

This case is of considerable international interest as it is the first time the government's own policies have been challenged under Human Right legislation in a class action. In a 100 page judgment, the judge upheld the claim of discrimination against 230,000 of the

poorest children in New Zealand who do not benefit from the part of their family assistance called the IWTC. In particular, Paragraph 192 stated:

*We are satisfied that the WFF package as a whole, and the eligibility rules for the IWTC in particular, treats families in receipt of an income-tested benefit less favourably than it does families in work, and that as a result families that were and are dependent on the receipt of an income-tested benefit were and are disadvantaged in a real and substantive way. (Human Rights Tribunal, 2008, p. 72)*

The Tribunal expressed concern at the lack of human rights considerations in the IWTC policy formation and in its extension in 2005:

*... we have significant concerns about the decision to make the WFF tax credits available to families with incomes in the mid to high range. (Human Rights Tribunal, 2008, p. 4 footnote).*

OECD witnesses for the defendant also questioned the inappropriateness of having an IWB apply so far up the income scale (Human Rights Tribunal, 2008, p. 27). Despite these criticisms, and the strong finding of discrimination, the Tribunal did not, in the end, uphold the claim that there had been a breach of Part I A of the Human Rights Act, finding the discrimination to be “of a kind that is justified in a free and democratic society” (Human Rights Tribunal, 2008, p. 4). The justification arguments related to the intention of the policy, but there was no attempt to quantify either the total costs or total benefits to society from the work incentive aspect. The decision has been appealed and is likely to be heard in 2010.

The IWTC as a work incentive raises important equity and social issues because of its unusual design. It is tied to children, and denied to workers without children although some of these workers may be more in need of an incentive, or more sensitive to the effects of a tax incentive. The Human Rights implications, including its disproportionate impact on the indigenous population (see Section 5.2) have yet to be resolved.

## **8 Other considerations: the ageing population**

### **8.1 Encouraging labour participation by older workers**

Keeping older people in work has a number of potential advantages:

- It provides more opportunities for social connectedness, and is often associated with the experience of greater wellbeing (Ministry of Social Development & Office for Senior Citizens, 2008, p. 18);

- It extends the number of working and saving years for individual accumulation of private savings, thus making the annual saving burden (for a given target retirement income) lower and more affordable during the working years;
- It shortens the number of retired years so that, on average, retirement income will have to last for a shorter period. This also reduces the annual saving commitment required before retirement to achieve a given level of private retirement income;
- Older workforce participants continue making a contribution to the country's economic output and, as well, defer the start of the decumulation period when private savings are run down;
- The demands on taxpayers for the payment of public pensions can reduce if the state pension age is increased;
- It is possible that the demands on current taxpayers for other financial support for older citizens, including health costs, might also be reduced as higher incomes during the early period of old age would allow more self-provision.

It would also be reasonable to assume that older people staying in the work force longer would have a positive effect on national output and productivity. Older workers are likely to have institutional knowledge and experience that is often lost when they leave. Also, as nations move from “smokestack” economies to “information” economies, older workers are well-suited to meet the increased demand for intellectual labour (Purcell, 2004, p. 3).

Improved productivity from increased participation by older workers, and the other advantages listed above, are reliant on local and national economies that are able to absorb extra workers; and an international economy that demands the extra goods and services that are produced. As the current economic downturn continues and possibly deepens, different public policy considerations may increase in importance. Should priority now be given to ensuring employment for younger workers? Should the immediate concern be increasing the age of entitlement to the state pension, thus reducing the tax burden?

## **8.2 Background: state pensions in New Zealand**

In New Zealand from 1940 to 1974 the structure of state pensions remained largely intact with the level of benefits gradually increasing. The pension structure comprised an age pension, means-tested from age 60; and universal superannuation, taxable from age 65. Legislation in 1974 introduced the compulsory New Zealand Superannuation

Scheme from 1 April 1975. After the 1975 election, the scheme was disbanded in 1976, and in 1977 the universal “National Superannuation” from age 60 was introduced.<sup>29</sup>

This pension is now called New Zealand Superannuation and is a universal and individual entitlement paid at age 65. There is a modest residency test of at least 10 years’ residence in New Zealand over age 20 with at least five years over age 50, but there are no eligibility tests based on contributions paid, or on years of work during a potential recipient’s working life.

There are three levels of payment: single person sharing accommodation; single person living alone; and each person in a couple relationship sharing accommodation (each partner in the couple receives their own pension). The annual taxable amount for a single person living alone is currently \$18,084 a year (after tax<sup>30</sup> approximately 45% of the after-tax national average wage). For a married couple, the total annual amount is \$27,494 a year (after tax approximately 66% of the after-tax national average wage). Nearly all New Zealanders over the state pension age qualify for the full amount.

Because of the relative generosity of NZS (OECD, 2008, p. 140),<sup>31</sup> variation in the state pension, whether of age of entitlement, or amount, or abatement conditions, makes a significant difference. Most retired New Zealanders receive most of their retirement income from NZS. In 2006/07, NZS constituted 83.1% of the average of total incomes of those receiving NZS (Preston, 2008, p. 28). Any changes to the annual amount or to the terms on which NZS are payable, including to the eligible age, has a direct impact on the living standards of retired New Zealanders.

New Zealand’s recent history provides two examples that illustrate the potential impact public policy changes can have on individual decisions about retirement: changing the state pension age, and introducing and removing an income test on the state pension.

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<sup>29</sup> The environment for both public and private provision for retirement became highly politicized see (St John, 1992, 1999).

<sup>30</sup> NZS is taxed in full, like salary and wages, as ordinary income.

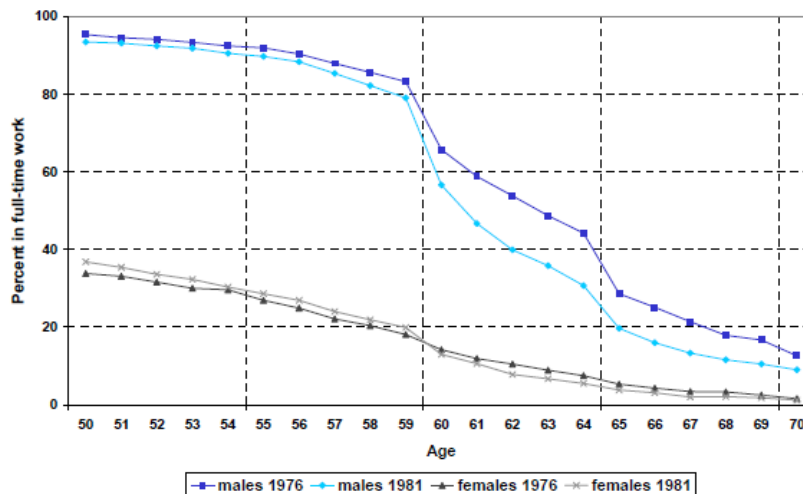
<sup>31</sup> This report shows New Zealand (and Netherlands and Czech Republic) have 2% of retired people in poverty, compared to 10% in the UK, 24% in the US, and 22% in Japan.

### 8.2.1 Changing the state pension age

National Superannuation from 1978 was paid at age 60, as a taxable, non- income tested, universal benefit at a rate of 80% of the average wage for a couple. Figure 8 drawing on Rochford (1985), led Hurnard (1999) to conclude, with respect to the reduction in the state pension age in 1977:

*[Rochford's figure] shows how the proportion of men in full-time employment for the age group most affected by this policy change ... fell much more than those of slightly younger age groups.... It also shows a sizeable response to the income effect of the increase in pension rates among those over 65.... In the case of females the trend towards higher rates of full-time employment evident amongst those aged in their 50s becomes reversed from age 60 in response to eligibility for [NZS].*

**Figure 8. Changes in proportion of males and females in full-time work, 1976-1981**



(Source: Hurnard, 1999)

The universal pension was re-named “New Zealand Superannuation” (NZS) in 1992, and over the 10 years between 1992 and 2002, the state pension age was eventually raised to age 65. It increased to age 61 in 1992, and then increased by three months in every six months to reach age 65 in 2002. The impact of this is compounded by changes to the income test and described below.

### 8.2.2 Introducing and removing the income-test on NZS

A second public policy reform was the introduction of an income test in 1985, the “surcharge”, which was highly controversial and was eventually withdrawn in 1998

(Littlewood, 2008).<sup>32</sup> From 1977 to 1985, NZS was payable without any regard for any other income received, whether from interest on investments or paid employment or any other source. In 1985, the Labour Government introduced a “surcharge” that was in fact an income test. An extra tax of 25% was applied to any other taxable income over a modest amount. The surcharge ceased to apply once it equalled the amount of NZS. In 1992, this abatement regime was tightened by the new National government so that NZS was reduced by 25% of all taxable income in excess of \$4,169 for a single person and \$6,240 for a couple

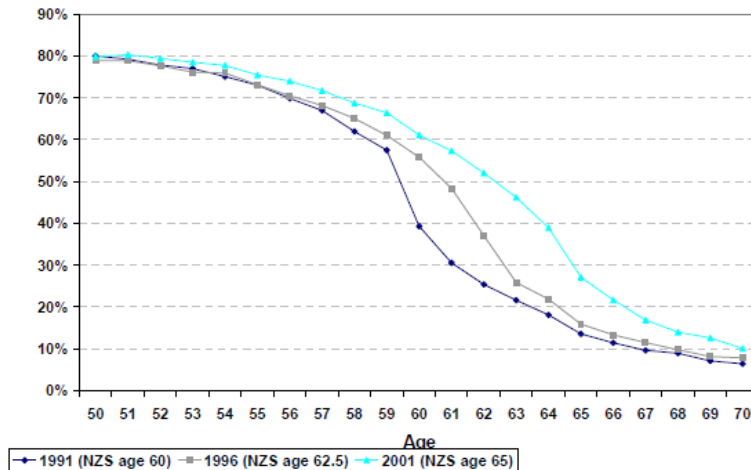
The income threshold from NZS was lifted significantly from 1997 to \$15,400 a year for a couple and \$10,300 for a single person, then abolished in 1998. During its 13 year life the surcharge was politically contentious. Both major political parties broke election promises in connection with its introduction and removal. The advent of the new proportional representation electoral system saw its removal when a minority party used it as a pre-condition for a post-election coalition.

As mentioned above, the state pension age was raised during the 1990s. It appears that the change in the state pension age had a direct influence on the retirement decisions of males as shown in Figure 9. What Hurnard (1999) calls the “maximum rate of exit” (Hurnard 1999, p. 12) was predicted to increase by about five years over the period. He suggests that simply reaching state pension age and therefore becoming entitled to NZS increases the retirement rate of males by 21 percentage points and by 7 percentage points in the case of females (Hurnard 1999, p. 17). More recent research shows that the final removal of the income test in 1998 also seemed to affect participation rates from that time. Figure 9 below shows an increasing labour force participation rate for all New Zealanders over age 65 between 1991 and 2001, after a slight drop between 1986 and 1991.

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<sup>32</sup> Littlewood (2008) is a short history of changes in both public and private provision in New Zealand.

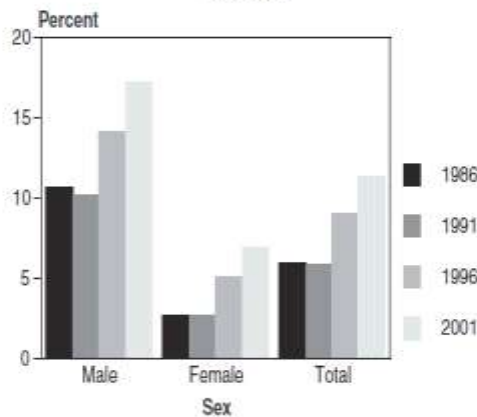
**Figure 9. Changing full-time employment rates of males by single year of age during the transition, 1991, 1996, and 2001**



(Source: Hurnard, 1999)

*The employment rate... has grown steadily since 1986 for people aged 65 and over, rising by 62 percent for men and more than doubling for females ... The growth did not occur evenly throughout the period, with the rate remaining steady between 1986 and 1991, a very different outcome compared with the experiences of the younger population... [where the employment rate remained relatively flat over the 15 years]. (Statistics New Zealand, 2004, p. 9)*

**Figure 10. Employment Rate for People Aged 65 Years and Over, 1986 to 2001**



(Source: Statistics New Zealand, 2004, p. 10)

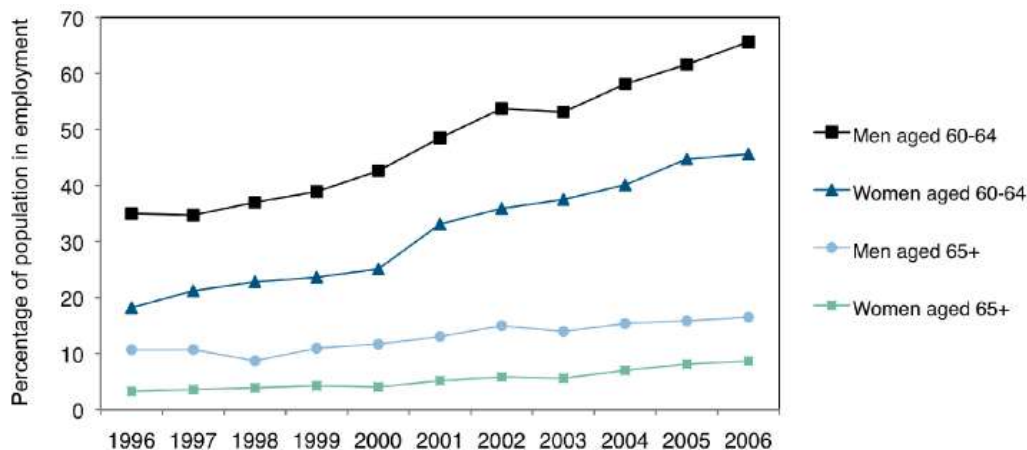
Relating Figure 10 to the history of public changes outlined above, 1991 was the period when policies could be regarded as most discouraging to labour market participation for older workers. The income test was in place and was about to be tightened (from 1992) while the state pension age was 60 but was about to start increasing. By 2001, 10 years later, both of these influences had diminished. The income test was abolished in 1998 and the state pension age was 64½ in 2001 and would reach age 65 in 2002.

### 8.3 Changing participation rates: Human Rights

Changes to the state pension age and the income test described above had an impact on labour market participation rates of older New Zealanders. Another public policy change has affected recent statistics. Before 1999, an employer could insist on retirement at the state pension age, which by then had reached age 63½. A 1999 Amendment to the Human Rights Act 1993 outlawed the retirement of employees on the basis of age.<sup>33</sup>

Making paid participation for older workers legal has made it more acceptable and more expected.<sup>34</sup> However, while some employers actively seek to attract older workers, others maintain misconceptions and see them as less productive than younger people. “An important step towards supporting older workers is reducing the negative stereotyping of older workers and promoting positive ageing.” (Ministry of Social Development & Office for Senior Citizens, 2008, p. 18)

**Figure 11. People aged 60+ in employment, 1996-2006**



(Source: Ministry of Social Development & Office for Senior Citizens, 2008, p. 18)

As Figure 11 shows, the trend of increasing labour force participation continued at least until 2006. In particular, it is worth noting that the Ministry of Social Development and Statistics New Zealand (2007) cite numbers from the *Household Labour Force Survey*, 2007, showing that the participation rate of all New Zealanders over the current state pension age of 65 grew by 69% between 2001 and 2006.

<sup>33</sup> Equivalent to the US Age Discrimination in Employment Act 1967.

<sup>34</sup> A parallel can be drawn with New Zealand’s Smoke-free Environments Act 1990, the anti-smoking legislation that made smoking in work and public places illegal. A down-stream effect was that it made smoking less acceptable behaviour in private ie the legislation had a cultural or “social norm” effect.

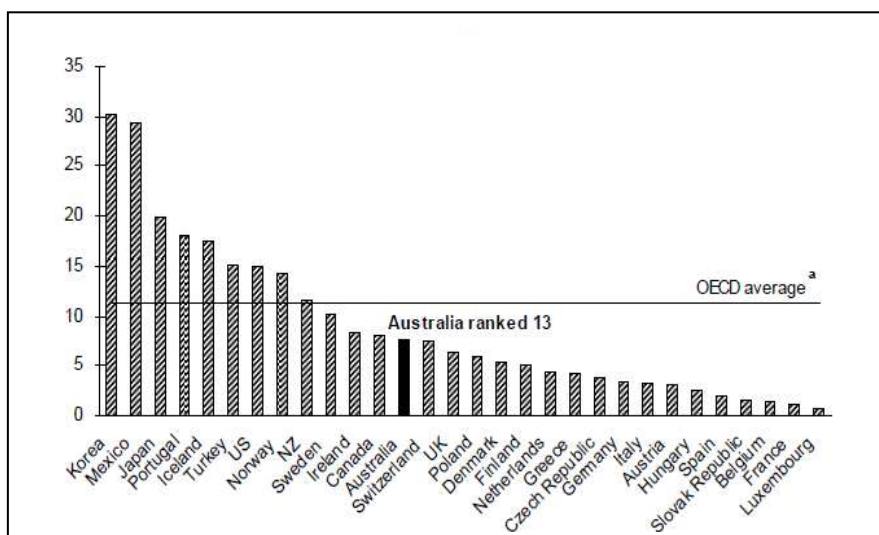


## 8.4 The Australian experience

Australia and New Zealand share some history, and some superficial elements of the design of their age pensions. Their state pension schemes have in common: universality; eligibility age of 65; and a broadly similar annual amount paid.<sup>35</sup> In Australia, the “Age pension” is both income and asset tested in a complex process that produces a potential reduction in the state pension on two bases with the higher one applying. Walter, Jackson, & Felmingham (2008) list the government’s three policies designed to encourage work force participation by older Australians:

- The Pension Bonus Scheme (PBS), introduced in 1998. A direct financial incentive which encourages workforce participation past the age of 65 via a lump-sum tax-free bonus to those who defer claiming (and are entitled to claim) an Age Pension.
- Retirement Transition Measures. From July 2005, an employee, once they reach their 'preservation' age (e.g. for those born before July 1 1960, the age is 55), can reduce their working hours while still maintaining their income by accessing superannuation benefits through an 'income stream'.
- Budget May 2006 Tax changes. These remove the 15 percent tax on superannuation payments for workers retiring after the age of 60.

**Figure 12. OECD Labour Force Statistics by Age and Sex, 2005**



(Source: Abhayaratna & Lattimore, 2006, p. 27)

<sup>35</sup> However, Australia’s approach to retirement and retirement income policies in the last 30 years has been far less controversial than New Zealand’s, where retirement income policies have been referred to as the “ultimate political football” (Clark, 2008).

Australia also has a compulsory retirement saving scheme to which employers contribute 9% of all employees' remuneration. In addition, there are extensive tax concessions on private retirement savings, including the compulsory scheme. Despite Australia's more interventionist overall retirement incomes policy, the difference between Australia's and New Zealand's participation rates for the over age 65s is striking, as the preceding chart demonstrates.

Abhayaratna and Lattimore (2006, p. 27) conclude that, for Australia in 2006:

*65 plus age group ranked well below the OECD average — 7.6 per cent compared with 11.3 per cent (ranking 13th among 30 OECD countries) — and significantly below Korea (30.0 per cent), Mexico (29.2 per cent), the US (15.1 per cent) and New Zealand (11.7 per cent).*

Walter, Jackson and Felmingham (Walter, Jackson, & Felmingham, 2008) suggest that more needs to be done by the Australian government:

*As shown, those most willing to consider deferring retirement are also those most likely to respond positively to policy initiatives, especially incentives, to work longer. As importantly, financial incentives are not the only, or even necessarily the primary, motivating factor for older workers. In this study, non-financial measures such as the opportunity to mentor and train younger workers rated above a financial bonus for older workers or an increase in earnings limits for those on an Age Pension. To maximise the number of older Australian workers deferring their retirement, therefore, other policy options, especially incentives to remain in the workforce, will need to be developed and implemented. And such measures need to move beyond the financial realm.*

## **8.5 Encouraging labour market participation by older workers**

Factors affecting the labour participation rates of older workers include: the rules governing eligibility for social security benefits; the tax code; social norms; and the availability of alternative employment options. Countries with high per capita incomes tend to have lower participation rates of older workers, for example, an average of 21% of men and 10% of women aged 60 years or older are economically active, compared with an average of 50% of men and 19% of women in the less developed regions. This variation is explained on the one hand by the limited coverage of retirement schemes in less developed countries, and the relatively small incomes they provide (Department of Economic and Social Affairs, 2008, p. xxxi), and on the other by other factors such as a shortage of employment opportunities and obsolescence of skills and knowledge (Department of Economic and Social Affairs, p. 34).

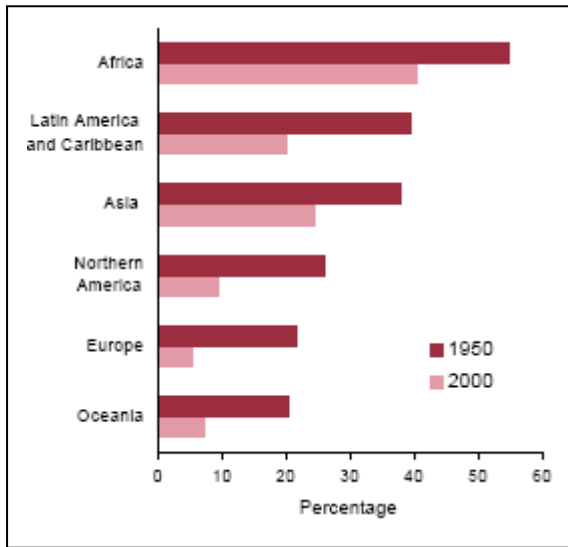
The higher participation rates of older workers in New Zealand when compared with Australia can be partly explained as a consequence of a change in culture or social norms, following a legal change. As noted, the 1999 Amendment to the Human Rights Act 1993 that outlawed the retirement of employees on the basis of age has made it possible for superannuitants to continue their workforce participation. The increased longevity and improved health of older people (Ministry of Social Development & Office for Senior Citizens, 2008, p. 18) also makes their extended participation in the labour market practical and desirable. Higher participation rates in New Zealand can also be explained by the non-abatement of earned income against NZS.

The arguments above regarding the fall and rise in participation rates of New Zealand's older workers is also persuasive when they are compared with the US experience. The US, for example, has followed a more consistent path than New Zealand in retirement policy, and their labour force participation rates (LFPR) have followed a very different trajectory in the last decade. Purcell (2004) draws on Census data showing a drop in the LFPR of men aged 55-64 from 90% in the 1950s to 70% in 2002. Similar to New Zealand's experience, most of the decline occurred between 1970 and the mid 1980s. Among men aged 65+, the decline in the LFPR was larger: from 46% to 16%, and began earlier, but it also ended around 1985. However, unlike New Zealand's experience of increasing participation rates, since 1985, the LFPR for men in the US aged 55 to 64 has remained in the range of 66% to 69% and has only increased slightly for those aged 64+ from 16% to 18% (Purcell, 2004, pp. 3-4). This would suggest that New Zealand's dual policies of non-abatement of pensions against labour market earnings, and making compulsory age-based retirement illegal, appear to be having an effect on the LFPRs of older workers.

## **8.6 Encouraging participation for those over state pension age**

As Figure 13 shows, New Zealand's experience can provide a guide for other countries. More benign public policies have resulted in a 69% growth in the labour force participation rate of all New Zealanders over the state pension age of 65 between 2001 and 2006.

**Figure 13. Labour force participation at age 65 or over, 1950 and 2000**



(Source: Department of Economic and Social Affairs, 2008, p. 30)

Interestingly, Purcell (2004) notes that after the repeal in the US in 2000 of the earnings test for workers at or above the normal retirement age,<sup>36</sup> a higher than average percentage of new benefits were awarded to people aged 65+ (Purcell, 2004, pp. 7-8).

*With this change, workers who had deferred receipt of social security benefits now had an incentive to apply for social security benefits. Workers who delay receipt of benefits until they are beyond the normal retirement age remain eligible for a delayed retirement credit, which permanently increases their benefits, thus creating an incentive for older workers to remain in the labour force. (Purcell, 2004, p. 8)*

Purcell (2004) also reports on the option of phased retirement, a transition phase of working part-time, and receiving some or all of their retirement benefits, prior to full retirement. Although its advocates contend phased retirement would incentivize more, older people to continue in paid employment, under current US law, it can only be offered to employees who have reached a pension plan's normal retirement age. Strategies for firms to retain or attract the services of those eligible for retirement include the options of working fewer days per week; fewer hours per day; job-sharing; and re-hiring as contractors so the work is project-based rather than continuous (Purcell, 2004, pp. 8-9).

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<sup>36</sup> Prior to the repeal, benefits of recipients younger than age 70 were reduced if their earnings exceeded specific thresholds (Purcell, 2004, p. 7).

Other ways of encouraging older workers to remain in the paid or unpaid labour force for longer, or to return to the labour force, in addition to flexible work arrangements, is to ensure the work is meaningful; and to provide them with opportunities to enhance their skills (Ministry of Social Development & Office for Senior Citizens, 2008, p. 18).

The participation rates of older Australians, for example, are likely to increase if the design of the age pension is addressed, particularly if the income and asset tests are removed or reduced. The cost of the change in the Australian state pension entitlement would probably be met by limiting or removing tax concessions for private provision, including the compulsory scheme. If more benefits of labour market earnings are retained, in addition to the pension, then continued participation is well-rewarded. If labour market earnings are abated away, participation carries a penalty in terms of both income and leisure.

## **8.7 Summary**

New Zealand has already adopted what appears to have been effective policies to incentivise work for older workers and those over state pension age. The raising of the age of eligibility for the state pension; the outlawing of a retirement age; and the removal of the any means testing of the pension so the EMTRs remain modest when there is additional income; have been foundational. The state of the economy is likely to be key in outcomes however, as it is for younger workers.

The pension is set at a level that prevents poverty, showing that work incentives do not require poverty among non-workers. In addition, the universal pension may provide the income support basis to facilitate unpaid care-giving services, vital to the outcomes of an aging population.

## **9 Conclusion**

New Zealand has adopted a radical and unusual work incentive programme for the younger working age population of which the IWTC is the centerpiece. There are superficial similarities to the US EITC and the UK WTC but the NZ IWTC has unique design features.

The target of the work incentive is sole parents on benefits, based on the assumption that sole parents are not working because 'work does not pay'. While the IWTC is child-focused it is not nuanced to allow for either age, health and numbers of children,

nor the health status of the sole parent. These factors may critically affect the ability to work. Because the IWTC is a part of family assistance that is only paid to those sole parents who are off benefit and working 20 or more hours a week, it excludes approximately 230,000 children (22% of all children under 18). The effect is that those who cannot respond to the work incentive to work at least 20 hours a week, do not get this child-focused payment and are significantly disadvantaged. The policy has proved vulnerable to challenge on Human Rights grounds.

The overall WFF package was a complex set of measures that are best not seen in isolation. While family assistance was increased for all low income families, benefit cuts facilitated at the time along with the IWTC produced a relative income gap that has perpetuated the poverty of those not in work. This situation is unlikely to be sustainable in the recession when work incentives can no longer operate to keep parents in work. Thus there is a direct conflict between the income adequacy/poverty prevention goal and the work incentive goal. In Section 2.1.2, it was noted how one should not be achieved at the expense of the other.

The empirical results are difficult to evaluate and are at best mixed, with the small improvements in employment attributed to the WFF package not likely to be sustained in the recession of 2009. Empirically, it is difficult to attribute the recorded improved employment results for sole parents to the IWTC alone. Significantly increased child care subsidies and access, and the operation of the MFTC, have both been very important. A stronger economic environment; higher minimum wages; lower tax rates; and changes in the abatement of family assistance, are other factors.

The New Zealand experience demonstrates what can happen when IWBs are not carefully designed and their objectives are not understood. The payment of the IWTC to high income families resulting from the extension (pre-election 2005) cannot be rationalised in either work incentive or 'making work pay' terms. Once introduced, such a payment is difficult to abolish and creates the necessity for other complex compensating policies such as the new Independent Earner Tax Credit and the ReCover payment (see section 7.1)

Other mechanisms to assist the transition in work such as discussed in Section 2.3 may bear more fruit. It is noted also that the less distortionary tools of raising the minimum wage (Section 4.3), raising the threshold, and reducing the rate of abatement for family

assistance, are potent work incentive tools. In this respect, the pre-election 2005 changes had positive work incentive effects for families earning between \$27,000 and the new threshold of \$35,000, and from the lower rate of abatement (20% down from 30%) above \$35,000. This was therefore a missed opportunity to abandon the IWTC as being no longer required.

The IWTC is not necessarily paid to the worker and so is less directly related to work effort than the WTC-UK or the EITC-US. It is frequently paid to the caregiver who may not be in work at all. At the higher income level this payment is more clearly understood to achieve a degree of horizontal equity for families of different sizes. At lower income levels, the vertical equity and child poverty prevention effects suggest that it ought to be available for all.

From a work incentive perspective, paying the IWTC to higher income families unambiguously acts to reduce work effort especially of the secondary earner due to the income effect. It has further disincentive effects as EMTRs rise once the payment is abated at 20 cents in the dollar. The EMTRs for couples in 2009 tax terms range between 32.5% and 58%.

An overall assessment of the IWTC must balance the employment gains against the employment losses and count the full cost to the government revenue. The fiscal costs of the IWTC (approximately \$500m) plus child care subsidies, plus increased MFTC payments, plus case management costs, are offset only minimally by reduced welfare benefits for sole parents. These fiscal costs in turn produce deadweight losses elsewhere as they are paid for by higher taxes or borrowing. The OECD (2008) notes that IWBs are costly; they must be well-targeted; and they must provide both sufficient financial incentive and duration if they are to modify behavior and improve career prospects.

Comparing and contrasting the EITC as it has been adopted and applied in the US and the UK, with the IWTC as it has been adopted and applied in New Zealand provides lessons and guidelines on the effectiveness of these and other tools in ameliorating the pressures of the ageing population through encouraging work effort. The most convincing argument for the IWTC may be that as a lump-sum approach it *may* encourage attachment to the full-time labour market which *may* have long-term benefits. There is little or no evidence that the IWTC can or will operate this way for sole parents especially with young children. If, however, labour market attachment is the intention

there is no reason to exclude the young, single, and childless from it. The policy implication of this research however indicates that the design of the IWTC is inappropriate for meeting the work incentive objective.

The dual requirement of meeting hours of work and being off benefit to qualify for the IWTC makes it difficult to administer and reconcile with income earned on an annual basis. Repayments demanded at the end of the year when incomes are higher than anticipated or work hours have fallen can reverse work incentive effects and create a distrust of accessing such tax credits. An 'hours of work' requirement can also create perverse incentives to overstate hours, while the work subsidy implicit in the MFTC can be appropriated by the employer who then may pay lower wages creating an unfair bias against unsubsidised workers.

The discussion of the nature and objectives of in work benefits outlined in Section 2 does not suggest that their development in western countries has been designed specifically to address the labour shortages associated with the ageing of the population. At best, facilitating attachment to the low end of labour market may improve the opportunities for eventual, well-paid work so that the costs of an ageing population can be more easily met. In the case of New Zealand however, the positive gain for the economy from additional hours of work by low-wage sole parents is at least partially, if not fully offset by the increased costs of childcare services. If more women are working, but many more are working in the commercialised childcare sector, there are few gains for the ageing population.

Yet as the population ages it is clear that labour-intensive, care-giving services demanded by frail older persons will increase. Two questions may arise: First how are low skilled persons to be directly incentivized to supply this labour? To assume that subsidization is necessary to draw forth the required hours of work admits that the social value of this work is not reflected in the net wage rate, and/or it been undervalued and underpaid as a labour market failure.

Second, should the service be regarded as forever low-skilled or has there been underinvestment in the skills actually required? Is the care giving /nursing of the old an activity that can develop the potential and skills of workers, and enhance productivity and quality in this sector? If so how will society pay for that?



It is likely that New Zealand and other countries will have more focused policy debates on these and other issues in the near future. In these discussions the role of the IWTC may be seriously questioned. However once a policy such as the IWTC is implemented it may be difficult to reform. In the case of New Zealand the trade-offs that were possible with the raising of the threshold for family assistance and the reduction of the rate of abatement in 2006; and the redesign of tax rates in 2008 and 2009; are not open to being exploited in the future. This implies that a reform of the costly IWTC may create losers. One possibility is not to index the payment for inflation and allow it to erode over time.

If the poverty objective is to receive due attention, the IWTC could be added to the rest of family assistance so that all poor families receive it as a child supplement, leaving work incentives to come from the non-discriminatory policies of lower taxes, a higher minimum wage, and lower abatement. However, this path would cost more than the existing policies.

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