

# Report

**Date:** 15 March 2019

**Security Level:** BUDGET SENSITIVE

**To:** Rt Hon Jacinda Ardern, Minister for Child Poverty Reduction  
Hon Carmel Sepuloni, Minister for Social Development

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## Indexation Budget Bid: Key Policy Decisions

### Purpose of the report

- 1 This report seeks key policy decisions to help the Ministry of Social Development (MSD) and the Child Poverty Unit (CPU) finalise a Budget 2019 bid for changes to the indexation settings of selected income support payments.

### Executive Summary

- 2 In recent advice to the Ministers for Social Development and Child Poverty Reduction, MSD and CPU officials noted that there was a strong case for changes to the way social assistance is adjusted from year-to-year. Changes to indexation would ensure that the incomes of beneficiaries are maintained in relation to the cost of living, and do not progressively fall further behind those of other New Zealanders. Such changes would also support the Government's objectives for child poverty reduction, and make a significant contribution towards the achievement of its ten-year child poverty targets (*DPMC 2018/19-902 and REP/19/2/146 refers*).

- 3 The Minister for Child Poverty Reduction has indicated that she would like to submit a budget bid for the indexation of main benefit rates to wages **s 9(2)(f)(iv)**

- 4 This report provides updated costings, including any implementation costs, and seeks your decisions on the following matters:

- **Confirming which payments are covered by the proposal** – The rationale for changes to indexation for Budget 2019 is strongest for benefit rates **s 9(2)(f)(iv)**

- **s 9(2)(f)(iv)**

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- **Confirming the wage indexation approach used for indexing payment rates** – We are seeking your direction on the methodology used, and whether to introduce an adjustment which links to both inflation and wages, or wages only.
- **s 9(2)(f)(iv)**  
[Redacted]
- **Confirming the approach to legislation** – We are seeking your direction on which elements of the new indexation regime should be set down in primary legislation now, noting that many details of any such legislation can be determined at a later date.

5

**s 9(2)(f)(iv)**  
[Redacted]

### Recommended actions

It is recommended that you:

- 1 **Note** that any changes on indexation for Budget 2019 should be considered as a first step **s 9(2)(f)(iv)**  
[Redacted]
- 2 **Agree** to include a budget bid for changes to indexation settings, with an implementation date for the changes of 1 April 2020.

Prime Minister Ardern	<b>Yes/No</b>	Minister Sepuloni	<b>Yes/No</b>
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- 3 **Agree** that the budget bid will be for **either**:

3.1 wage-indexing main benefit rates only, at an estimated cost of \$314m over the forecast period; **or**

Prime Minister Ardern	<b>Yes/No</b>	Minister Sepuloni	<b>Yes/No</b>
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3.2 **s 9(2)(f)(iv)**  
[Redacted]

Prime Minister Ardern	<b>Yes/No</b>	Minister Sepuloni	<b>Yes/No</b>
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3.3 **s 9(2)(f)(iv)**  
[Redacted]

Prime Minister Ardern	<b>Yes/No</b>	Minister Sepuloni	<b>Yes/No</b>
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3.4 **s 9(2)(f)(iv)**  
[Redacted]

Prime Minister Ardern	<b>Yes/No</b>	Minister Sepuloni	<b>Yes/No</b>
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4 s 9(2)(f)(iv) [Redacted]  
[Redacted]  
[Redacted]  
[Redacted]

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

4.1 s 9(2)(f)(iv) [Redacted]  
[Redacted]  
[Redacted]

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

5 **Agree** that the approach used for wage indexation be **either**:

5.1 growth rate in average wages (recommended); **or**

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

5.2 the higher of the growth rate in average wages or the Consumers Price Index; **or**

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

5.3 a 'wage band' approach, similar to New Zealand Superannuation, where payment levels cannot not fall below or rise above a certain level of average wages.

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

6 **Agree** that the measure of wages used in recommendation 5 above should be net average ordinary time weekly earnings (per full-time equivalent), which is the same measure used for New Zealand Superannuation.

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

7 s 9(2)(f)(iv) [Redacted]  
[Redacted]  
[Redacted]

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

7.2 s 9(2)(f)(iv) [Redacted]  
[Redacted]

Prime Minister Ardern      Yes/No      Minister Sepuloni      Yes/No

[BUDGET SENSITIVE]

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

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

8.2 s 9(2)(f)(iv) [Redacted]  
[Redacted]  
[Redacted]

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

8.3 s 9(2)(f)(iv) [Redacted]  
[Redacted]  
[Redacted]

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

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

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

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

11 Indicate whether you would like any indexation changes to main benefits s [Redacted]  
[Redacted] to be incorporated into primary legislation. 9(2)  
(f)

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

12 Note that if you wish to make legislation amendments, officials will provide more detailed advice on process and timeframes, and how this relates to the legislative process for the other welfare overhaul initiatives proposed for Budget 2019.

13 s 9(2)(f)(iv) [Redacted]  
[Redacted]

Prime Minister Ardern Yes/No Minister Sepuloni Yes/No

**[BUDGET SENSITIVE]**

14 **Note** that should you wish to proceed with a budget bid, officials will provide you and relevant portfolio Ministers with further advice which:

- summarises the key decisions made
- provides final advice on the short and long-term fiscal implications and poverty impacts
- depending on your decisions in this paper, provide any further necessary advice to finalise the bid – for example, on the proposed legislative process
- provides a letter from relevant portfolio Ministers to the Minister of Finance to submit a Budget Bid.

15 **Forward** this report to the Ministers of Finance, Revenue, Housing and Urban Development, and Children.

Prime Minister Ardern

**Yes/No**

Minister Sepuloni

**Yes/No**

Kristie Carter  
**Director**  
**Child Poverty Unit**

...../...../2019

Rt Hon Jacinda Ardern  
**Prime Minister**  
**Minister for Child Poverty Reduction**

...../...../2019

**s 9(2)(a)**  
**Policy Manager**  
**Income Support Policy**  
**Ministry of Social Development**

...../...../2019

Hon Carmel Sepuloni  
**Minister for Social Development**

...../...../2019

## Background

- 6 On 1 March 2019, officials from MSD and DPMC provided the Ministers for Child Poverty Reduction and Social Development with a briefing on potential options for changes to the indexation regime of income support payments. The options were consistent with the indexation recommendations of the Welfare Expert Advisory Group (WEAG) and considered the potential implications of the broader recommendations of the WEAG (DPMC 2018/19-902 and REP/19/2/146 refers).
- 7 As noted in previous advice, there is a strong case to be made for wage indexation of payment rates, especially for main benefits s 9(2)(f)(iv) [REDACTED]. Such an approach would ensure the living standards of low-income families are broadly maintained relative to the living standards of broader New Zealand society.
- 8 On the basis of this advice, the Minister for Child Poverty Reduction has indicated that she would like to submit a Budget bid for the indexation of main benefit rates to wages s 9(2)(f)(iv) [REDACTED].
- 9 These changes are able to be implemented from 1 April 2020 as part of the MSD Annual General Adjustment (AGA) process and Inland Revenue's annual updates. There are no implementation costs for MSD as the changes will be incorporated into existing AGA processes. There are no additional systems cost for Inland Revenue and any additional operational costs are expected to be minor.

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

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

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

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

13 s 9(2)(f)(iv) [REDACTED]

## Confirming which payments are covered by the Budget 2019 bid

14 We are seeking your decisions on whether the indexation changes would cover main benefits, § 9(2)(f)(iv) [redacted]  
[redacted]  
[redacted] Benefit rates § 9(2)(f)(iv)  
are the payments that have the biggest impact on income adequacy of the lowest-income individuals and families, § 9(2)(f)(iv) [redacted]  
[redacted]

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

█ [redacted]  
[redacted]  
[redacted]  
[redacted]

█ [redacted]  
[redacted]  
[redacted]  
[redacted]

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

17 Wage indexation of main benefits may also impact on relativities in the broader social assistance system. For example, if Student Allowance rates continue to be CPI adjusted, benefit rates may become higher than student allowance rates over the long-term, creating a disincentive for beneficiaries to enter study. § 9(2)(f)(iv) [redacted]  
[redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted]  
[redacted]

18 It is also important to note that, because of interdependencies within the welfare system, changes to income support settings such as indexation can have automatic flow-ons to levels of support for other assistance (such as the Minimum Family Tax Credit and Temporary Additional Support). This means certain payments will automatically increase at the same time, in line with the intended purpose of these payments.

## Confirming the wage index used for adjusting rates

### *Indexation of New Zealand Superannuation*

19 New Zealand already has an existing approach to wage indexation, used for adjusting rates of New Zealand Superannuation and Veteran’s Pension (NZS/VP). Legislation sets out a two-step process that must be followed for the annual adjustment of rates of NZS/VP:

§ 9(2)(f)(iv) [redacted]

## [BUDGET SENSITIVE]

- the net weekly rates must be adjusted on 1 April each year in line with any annual percentage increase in the CPI for the year ending the previous 31 December
  - the net weekly amount payable to a married/civil union/de facto couple must not be less than 65%, or more than 72.5%, of the net average wage<sup>2</sup>.
- 20 Further, the Government has made a commitment to ensure that the net married rate of NZS is not set below 66% of the net average wage. This approach is also known as a 'wage band' approach, where payment rates cannot fall below or rise above a certain wage level. Since 2007, NZS has been at the bottom of this 'wage floor', which means that rates have moved with average wages for the past decade or so.
- 21 One of the benefits with a wage band approach is that it protects the real incomes of NZS recipients if inflation is ever higher than wages. If this situation occurs, NZS rates would increase in line with inflation and move above the wage floor. It is worth noting that net wage growth has consistently been higher than CPI growth over the past decade.

### *A wage band approach*

- 22 You could consider using a similar 'wage band' approach for main benefit rates s 9(2) (iv) This would involve further consideration of what an appropriate wage band might be, as well as determine what the relativities 'should be' between different rates for various family types.
- 23 NZS has a relatively simple rate structure compared to the benefit system. The benefit system has significantly more payment rates because different rates are paid depending on family and benefit type.
- 24 Determining such an appropriate level would be challenging, particularly for Budget 2019. We do not recommend progressing with such an approach for Budget 2019 ahead of the response to the WEAG's recommendations, particularly given they recommend significant changes to the level of main benefits and relativities between the rates.

### *A wage growth approach*

- 25 As indexing payment rates to wages is primarily about maintaining relative changes over time, an alternative approach is to simply adjust payment levels by the growth rate in net average wages (i.e. no wage band is applied). Such an approach is currently used for Paid Parental Leave.
- 26 This would likely have the same outcome over the long term as the wage band approach. There is a small chance of small year-to-year differences when the CPI is higher than wage growth (as the wage band approach protects real incomes), but this is unlikely, and it is also arguable that this is appropriate, if your objective for indexation is to maintain relativities of standard of living.

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<sup>2</sup> The single living alone and single sharing rates must be adjusted to be 65% and 60% of the net married couple rate respectively



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27 The benefits of using the growth rates are:

- Ministers can decide to make separate decisions around the levels outside of indexation decisions, without having to change the underlying indexation settings
- Stats NZ frequently make methodological improvements to their data, which is more likely to impact on the level of wages (and prices) themselves rather than growth rates (due to revising historical data to maintain consistency in the series). Under a wage band approach, methodological changes would have an impact on social assistance levels and can have significant financial implications.

*A higher of wage growth or inflation approach*

28 Because of the risk of higher inflation than wage growth, you could require that rates be adjusted by whichever is higher out of CPI or wages. However there are issues with such an approach because:

- This can result in ratcheting of payments - because the higher growth rate of wages or inflation is used, it can result in the increases to payment rates being higher than both inflation and wage growth over the long term.
- Because of the above, it is possible that benefits could increase faster than NZS in the years following higher CPI growth than wage growth. However, as noted earlier such an approach is unlikely as wages generally grow faster than CPI.

29 Irrespective of the approach used, we recommend that the measure of wages should be net average ordinary time weekly earnings (per full-time equivalent), which is currently the measure used for NZS. It is important to note that because net wages will be used, this will mean any personal income tax changes will also automatically flow through to beneficiaries (unless rates are deliberately adjusted to avoid this). Personal income tax changes may be considered as part of the Government's response to the Tax Working Group's report.

s 9(2)(f)(iv)

30 s 9(2)(f)(iv)

31 s 9(2)(f)(iv)

32 s 9(2)(f)(iv)

s 9(2)(f)(iv)

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

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

35 s 9(2)(f)(iv) [Redacted]

36 s 9(2)(f)(iv) [Redacted]

37 s 9(2)(f)(iv) [Redacted]

38 s 9(2)(f)(iv) [Redacted]

**Confirming your approach to legislation**

39 There are options for you in terms of legislative change, which are in part dependent on which payments you wish to index. It also comes down to whether you wish to require successive governments to make these adjustments, or whether you simply want to commit to these proposals via Cabinet decisions.

40 s 9(2)(f)(iv) [Redacted]

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

41 s 9(2)(f)(iv) [Redacted]

[Redacted]

[Redacted]

42 You could also make an initial commitment to annually increase benefit rates s 9(2) via a Cabinet decision, s 9(2)(f)(iv) [Redacted]

43 You may prefer, however, to 'bed in' the indexation changes through legislation as part of the Budget 2019 bid, to ensure that the change occurs and endures into the future. While it would be useful for you to signal your broad preference for whether you want to include these arrangements in primary legislation for the Budget 2019 changes, the specific details of any such legislation would not need to be settled now.

44 Officials recommend that you begin developing legislative proposals as part of the Budget 2019 bid. Officials will consider the process for this as part of broader advice on the legislative process for the other welfare overhaul initiatives.

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

[Redacted]

[Redacted]

[Redacted]

46 s 9(2)(f)(iv) [Redacted]

## Updated financial implications

47 The table below provides revised cost estimates of these options, both individually and in combination. The estimates used in the previous advice were based on Treasury’s TAWA model; we have now obtained more refined estimates which incorporate MSD administrative data for the payments primarily administrated by MSD.

Net fiscal cost	2019/20	2020/21	2021/22	2022/23
Main benefits to wages	\$13m	\$61m	\$103m	\$137m
§ 9(2)(f)(iv)				

48 In the estimates above, we have also separated out the additional cost of two key decisions in this paper § 9(2)(f)(iv)

49 Appendix One includes further information on expected impacts of the change, including the likely impact of wage indexation on benefit rates and the impact of different options on the before-housing-cost primary measure of child poverty.

50 As noted in previous advice, over time the difference between wage growth and inflation accumulates, and means that the fiscal costs will grow significantly outside of the budget forecast period. § 9(2)(f)(iv)

Indexation options	2028/29
Benefits/wages	\$0.8b
§ 9(2)(f)(iv)	

51 We note that if payment rates are subsequently lifted it will have an impact on the costings above, and even more so on the fiscal costs over a longer time horizon. The fiscal impact of this will be considered as part of the broader response to the WEAG recommendations.

## Next Steps

52 Should you wish to proceed with a budget bid, officials will provide you and relevant portfolio Ministers with further advice which:

- summarises the key decisions made to date
- provides final advice on the short and long-term fiscal implications and poverty impacts of the budget bid
- depending on your decisions above, provide any further necessary advice to finalise the bid – for example, on the proposed legislative process/timeframes
- provides a letter from relevant portfolio Ministers to the Minister of Finance to submit a Budget Bid.

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**APPENDIX ONE: Additional information on the impact of indexation changes**

*Impact on payment rates*

- The table below shows the additional increases that would result from wage-indexing main benefits, over and above the expected increases that would result from CPI adjustment under the current status quo.

Description	2020	2021	2022	2023
Job-seeker Support - Single 25 and over	\$3	\$5	\$7	\$10
Job-seeker Support - Married - no children	\$4	\$9	\$12	\$16
Job-seeker Support - Married - with children	\$5	\$10	\$13	\$17
Sole Parent Support - 1 child	\$4	\$8	\$11	\$15
Supported Living Payment - Single 18 years and over	\$3	\$7	\$9	\$12
Supported Living Payment - Couple rate (each)	\$3	\$6	\$8	\$10

*Modelling of impact on child poverty BHC50 measure*

- The table below shows TAWA modelling of impacts of the initiative on the BHC50 measure over the forecast period, assuming an implementation date of April 2020. As noted in previous reports, however, the impact on rates of poverty are more likely to be seen over a much longer time horizon, which means that indexation is much more relevant to the long-term targets.
- Modelling is not available on the After-Housing-Cost primary measure (AHC50), which significantly constrains our ability to understand the impact of different changes s 9(2)(f)(iv)

	2019/20	2020/21	2021/22	2022/23
Benefits/wages	-	-	-	5,000
<span style="color: red;">s 9(2)(f)(iv)</span>				