

# Working for Families Package

## Introduction

How much is the Working for Families package really worth? A number of employees and businesses are asking themselves just that question.

The Working for Families Package (WFF) was introduced just prior to the 2005 election and was a significant factor in winning the Labour Party an historic third term in government. The package comprises two main parts, Family Support and In Work Payment<sup>1</sup>. The Family Support payment recognises the pressures faced by families with children compared to couples or single people with no children. The In Work Payment is designed to encourage people off benefits and into paid employment. Together these payments boost the incomes of families with children<sup>2</sup>.

However, what is now apparent is that receiving WFF payments comes at a price to employees, to business and to the economy generally; in particular,

- Despite what the government says and many people think, WFF is *not* the saviour of low and middle income earners – in fact it has all the makings of a poverty trap.
- WFF potentially reduces incentives for non-working parents to return to or take up work. It may also discourage saving for retirement.
- Thousands of families who receive WFF payments and who live in state houses may end up worse off.
- WFF is creating problems for business, by discouraging people from accepting promotions (because they losing some or all of their WFF payments) or promoting wage inflation to offset WFF abatements
- WFF acts directly counter to the government's economic transformation goal by discouraging low and middle-income earners from increasing their skills and productivity.

## The price to be paid

The WFF is not a permanent subsidy. People in receipt of WFF payments eventually lose them again through reductions in the payments as a WFF recipient's income increases. On average, a single income family receiving WFF payments will receive only 50% of the net value of any pay increase they have been awarded, compared with over 80% for a single income family which is not in receipt of the WFF (see Figure 1 below).

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<sup>1</sup> The examples in this paper assume that both payments are received. Amounts have been calculated using IRD's online calculator.

<sup>2</sup> Families earning up to \$120,000 can receive payments if they have 6 or more children.

### Effect of 5% Pay Increase on Family with 3 Children Receiving Family Support

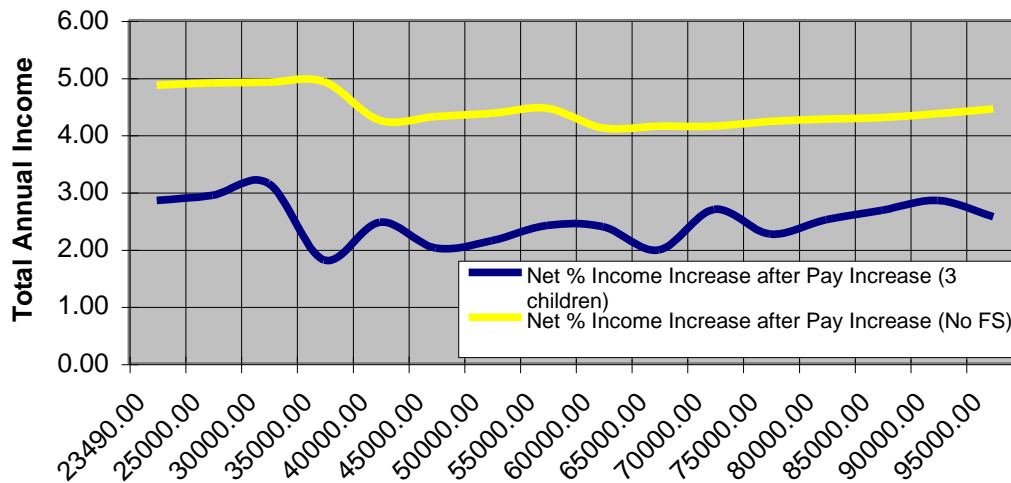


Figure 1

*How does this happen?*

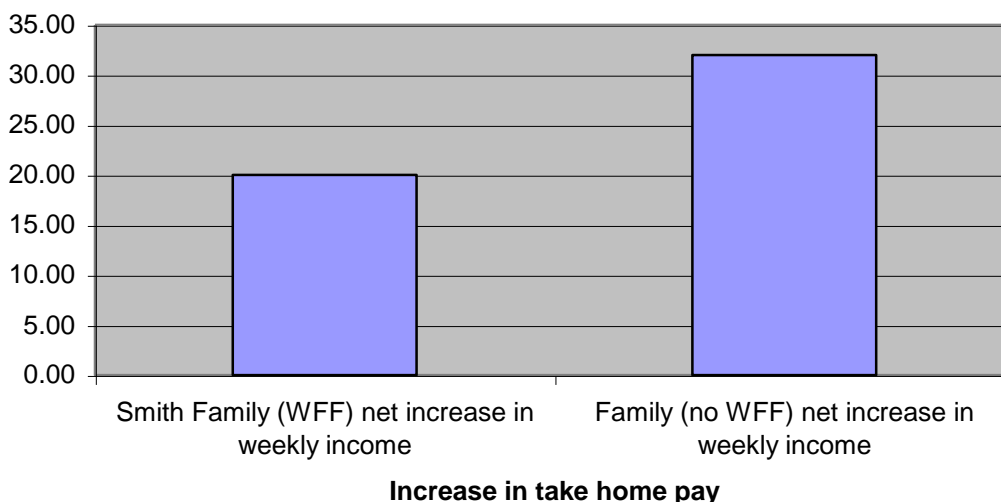
The following 2 examples illustrate the dampening effect that the WFF abatement process has on subsequent pay increases.

#### *Example One<sup>3</sup>*

A single income family with three children under 13 and earning the average national household income of about \$50,000 per year (\$729 per week after tax) can receive a WFF payment of \$198 a week, taking their total weekly income to \$927 per week.

If the income earner gets a 5% pay increase, the WFF payment reduces to \$186 per week, for a new total weekly income of \$946 per week. The reduction in WFF payment effectively reduces the value of the 5% wage increase; i.e., the net value of the 5% pay increase is \$20.00 per week in the hand, instead of the \$32.00 per week it would have been if the income earner were not in receipt of WFF payments. In percentage terms, the income earner in this example receives only 2.14% of a 5% increase instead of the 4.37 % they would have achieved if they were not on the package (taxes account for the gap between 4.37 and 5%).

<sup>3</sup> Values in the examples have been rounded to the nearest \$0.50.



### *Example Two*

A double income family with 3 children under 13 has both earners receiving \$30,000 per year for a net weekly income of \$916.50. Based on the total family income of \$60,000, the family is entitled to WFF payments of \$157 per week bringing their total weekly income to \$1,073.50. One earner gets a pay increase of 3%, the other is offered a new job paying \$34,500 (15% more). Based on their new incomes, the family's WFF payments reduce to \$134 per week, delivering a new total weekly income of \$1,131. The net value of the combined 3% and 15% pay increases is \$57.50 per week in the hand, instead of the \$80.50 per week it would have been if the family were not in receipt of WFF payments. In percentage terms, the family in this example receives an overall 5.37% increase instead of the 8.8% they would have achieved if they were not on the package.

While families who receive WFF payments receive a short-term boost to their incomes, their incomes' increase at a much lower rate than do the incomes of those who do not receive WFF payments.

### **A disincentive for the lower paid?**

The abatement process is especially significant for the low paid since WFF payments can be a substantial proportion of weekly income (as much as 41% for someone on the minimum wage of \$11.25 per hour). Two thirds of New Zealand income earners earn \$35,000 or less per annum.<sup>4</sup> This means New Zealand's low paid all earn less than \$35,000 per year, the point at which the abatement process commences. Under present WFF rules, families earning substantially less than this amount can pocket pay increases without losing any of their WFF payment. As illustrated by Example Three below, their earnings will increase by the full value of any pay increase.

<sup>4</sup> 2006 Census: Statistics NZ

### *Example Three*

A family earning \$25,000 per year (\$384 in the hand per week) with three children under 13, is eligible to receive WFF payments of \$256 per week, boosting their total weekly family income to \$639.50 (an increase of 40%). The abatement process does not start until total family income reaches around \$35,000. A 5% pay increase would therefore not abate the \$256 WFF payment and the new total weekly income would be \$658.50 of which 38% would be the WFF payment. The net value of the 5% pay increase is \$19 per week in the hand (the same as it would have been if the family were not in receipt of WFF payments). However, in percentage terms, the family in this example receives an overall 2.94% increase instead of the 4.9% they would have achieved if they were not on the package<sup>5</sup>.

However, once a family crosses the abatement threshold, the effect is drastic, as evidenced by Example Four.

### *Example Four*

A family earning \$35,000 per year (\$533 in the hand per week) with three children under 13, is also eligible to receive WFF payments of \$256 per week, boosting their total weekly family income to \$788.50 (an increase of 32%). However, a 5% pay increase would abate the \$256 WFF payment to \$244, delivering a new total weekly income of \$803. The net value of the 5% pay increase is \$14 per week in the hand, instead of the \$26 per week it would have been if the family were not in receipt of WFF payments. In percentage terms, the family in this example receives an overall increase of only 1.8% instead of the 4.9% they would have achieved if they were not on the package.<sup>6</sup>

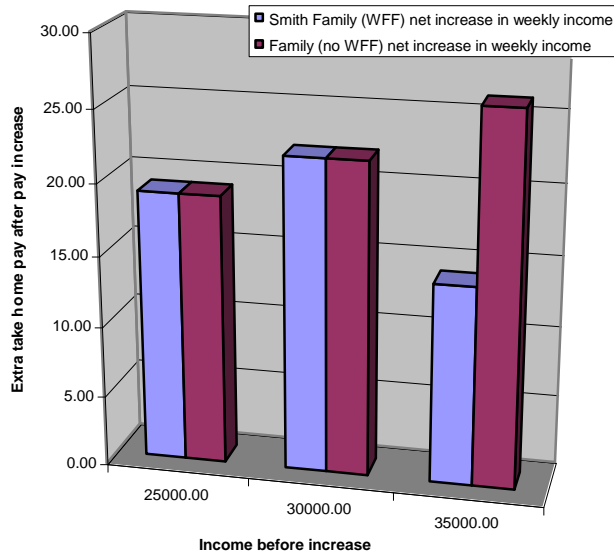
The difference in the effect of abatement on those who remain below and those who cross the abatement threshold is clearly illustrated in the following graph.

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<sup>5</sup> Even though WFF does not abate, the total % increase is a factor of total income including WFF and therefore is a smaller % than if no WFF is included.

<sup>6</sup> By comparison, a family on \$25,000 would have received a 3% increase

### Increase in take home pay after a 5% pay increase



Equally clear is that setting the threshold in this way creates a potentially significant disincentive to those earning below the \$35,000 threshold to accept increases that raise their income above the threshold.

Low-income earners can receive up to a 41% subsidy of their incomes if they remain below the abatement threshold, but the proportion of the subsidy drops rapidly after abatement threshold is crossed (see Figure 2 below). The message to low income earners is not a helpful one. It says that low-income earners maximise the relative benefits of the WFF *if they remain low-income earners*.

### WFFP Payment as Percentage of Total Weekly Income

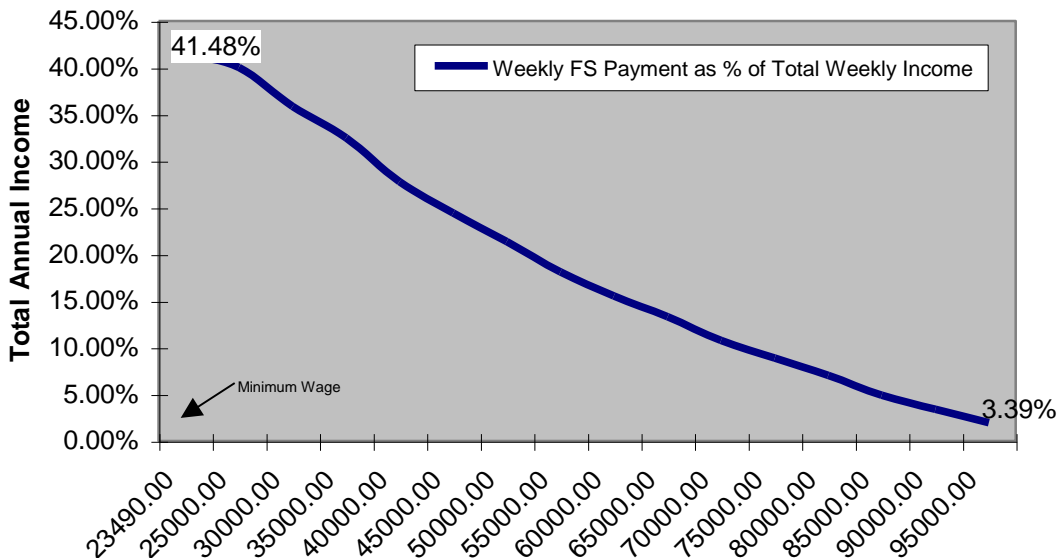


Figure 2

## Headaches for business

The disincentives created by the abatement process are beginning to emerge in business. In one case during 2006, an employee offered promotion to a bigger branch in a nearby town turned the offer down, “because the effect on my family income wasn’t worth it.” The business concerned was unable to further increase their offer to the employee, as this would have had flow on effects through the other branches of the business. Instead the business started the process for recruiting a new branch manager from scratch.

In several other cases, businesses have reported employees demanding higher increases to offset the reduction in family support payments. These employees felt aggrieved that their net income would increase by only a fraction of the ostensible value of the increase offered (see Figure 3 below). In most of these cases the employees saw their remuneration as being separate from the WFF payment despite the fact that the WFF had boosted their overall family income. Some employees in single income families regard the WFF as income for their partner rather than for themselves, further separating remuneration and WFF in their mind.

In a recent, and innovative, approach, a North Island manufacturer received a union claim in collective bargaining to convert overtime payments into time in lieu entitlements. The union claimed that the historically generous overtime opportunities were translating into higher annual incomes that reduced working for family payments and impacted overall family incomes.

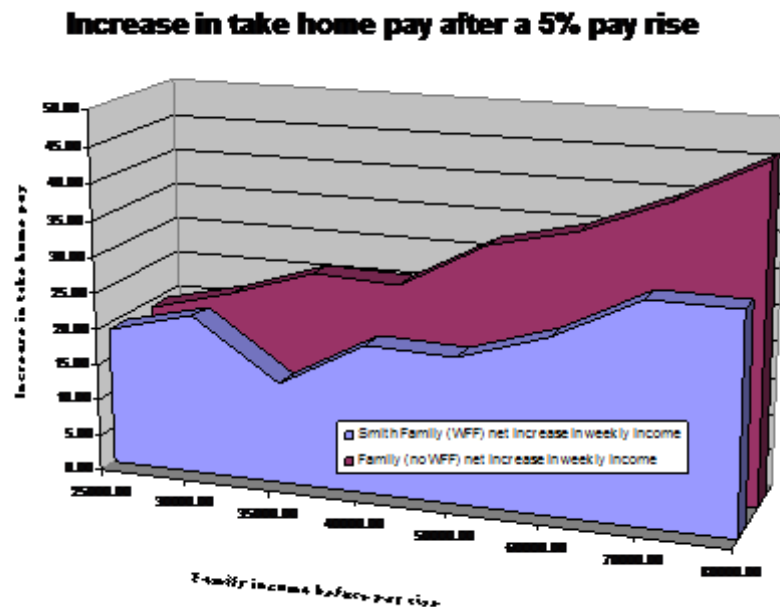


Figure 3

Affected businesses are concerned that these perceptions will become more prevalent, and may flow into unsustainable wage claims from unions during collective bargaining and from employees generally. The inflationary effects of such pressures

will not help businesses, nor will the inevitable industrial conflict. Only time will tell if this proves to be the case.

### **Not good for the economy**

Nor are the disincentives arising from the abatement process good in the longer term for the economy in general and the Economic Transformation process in particular. Economic Transformation is the Labour government's cornerstone strategy for improving the economic productivity and well-being of New Zealand's economy and citizens. Success depends in no small part on the willingness of New Zealand income earners to "lift their game"; to take on new skills, new technology and new ways of doing things. However, given that the majority of New Zealanders earn under the abatement threshold of \$35,000<sup>7</sup>, the disincentives identified in the preceding paragraphs may lead to less willing participation of the majority of the workforce in improving the nations productivity. This can only make successful economic transformation an uncertain proposition.

### **So who is the package helping?**

As mentioned earlier, two thirds of all income earners in New Zealand earn less than \$35,000.<sup>8</sup> Incomes of \$85,000 and over are in the top 10% of incomes. The vast majority of New Zealand's income earners therefore are eligible for a WFF payment if they also have children under 18.

The disincentives for lower paid earners to raise their incomes above the abatement threshold mean that while the package has short-term benefit as a cash boost to incomes it has marginal if not negative benefits over the medium to long term.

Evidence is mounting to suggest that the Working for Families Package is ultimately a hindrance to economic transformation and its intended consequence of a lifting of incomes, skills and living standards in New Zealand.

### **A disincentive to retirement saving?**

Not only does the WFF possibly discourage low paid employees to upskill, it may also discourage savings for retirement.

The KiwiSaver scheme comes into being on 1 July 2007. New employees will be automatically enrolled, but may opt out. Existing employees will not automatically be enrolled but may opt in. The additional effect of Kiwisaver contributions on families in receipt of WFF payments may act as a disincentive to savings, possibly reducing take-up of the KiwiSaver Scheme.

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<sup>7</sup> 2006 Census National Highlights: Statistics NZ

<sup>8</sup> 2006 Census: Statistics NZ

### *Example Five*

A family earning \$35,000 per year (\$533 in the hand per week) with three children under 13, is eligible to receive WFF payments of \$256 per week, boosting their total weekly family income to \$789 (an increase of 32%).

If the family contributes 4% of income to KiwiSaver, net pay reduces to \$512 per week and total take home income, including the \$256 WFF payment, reduces from \$789 to \$768 per week. However, a 5% pay increase would abate the \$256 WFF payment to \$244, delivering a new total weekly income of \$781. The net value of the 5% pay increase is \$13 per week instead of the \$14 per week without KiwiSaver, or instead of the \$26 per week it would have been if the family were not in receipt of WFF payments and KiwiSaver.

As can be seen, there is a further reduction in take home pay when KiwiSaver contributions are added to the factors governing WFF payments. While this reduction is not large, it will be significant to low-income families in particular. They therefore are unlikely to see short or medium term benefits in savings. Coupled with the already mentioned incentives to keep earnings below the \$35,000 WFF abatement threshold, it becomes possible that the two thirds of New Zealand income earners earning less than \$35,000 will have little inclination to take up the Kiwisaver option.

### **A disincentive to quality flexible work?**

Another group affected is parents who want to return to work after full time childcare.

Parliament is currently considering the Employment Relations (Flexible Working Hours) Amendment Bill a private member's bill. If passed the bill would give employees a right to request more flexible working arrangements to fit with their work/life balance needs. A decision on the Bill has been delayed to permit research into ways of providing quality flexible work opportunities without the need for legislation.

The government is supportive of initiatives that increase the flexibility of workplace working arrangements, for instance supporting more part time work. Such arrangements are of particular benefit to parents who wish to return to work after full time childcare.

However, the effect of abatements on WFF payments will not assist the motivation of parents to take this step. Why? A parent returning to paid work will increase the family income. If the family's existing income is over \$35,000, any WFF payment will abate. On top of the abatement will often be childcare fees. The total cost of a parent returning to the workforce therefore will be the reduction in WFF payments plus the cost of childcare. This could easily be sufficient to dissuade many parents from returning to the workforce.

### *Example Six*

A single income family earning \$35,000 per year (\$533 in the hand per week) with three children under 13 is eligible to receive WFF payments of \$256 per

week, boosting their total weekly family income to \$789 (an increase of 32.46%).

The non-earning partner decides to return to work part-time, placing the 3 children in childcare for 5 hours per day, three days a week, at a cost of \$200 per week. The part time remuneration is \$20 per hour for 15 hours per week (\$15,637 per year and \$244.00 in the hand each week). However, since the family's income has increased (now \$50,637) WFF payments will reduce from \$256 per week to \$192 per week and the total family income will be \$969 per week. When the childcare fees are deducted the family's new disposable income is \$769.00 per week. This is a reduction of \$20.00 per week from the income received by the family before the non-earning parent returned to work.

### *Example Seven*

A single income family earning \$35,000 per year (\$533 in the hand per week) with three children under 13 is eligible to receive WFF payments of \$256 per week, boosting their total weekly family income to \$788.50 (an increase of 32%). When the youngest child starts school the non-earning partner decides to return to work full time, placing the 3 children in after school care for 2 hours per day, five days a week, at a cost of \$150 per week. Remuneration is \$30,000 per year (\$458 in the hand each week). However, since the family's income has increased (now \$65,000) WFF payments will reduce from \$256 per week to \$140.00 per week and the total family income will be \$1131 per week. When the after school care fees are deducted the family's new disposable income is \$981.00 per week. While this is an increase of \$192.50 per week from the income received by the family before the non-earning parent returned to work, the WFF abatement process also contributes to a 42% reduction in the value of the take home pay earned by the partner returning to work! When child care fees are also taken into account, the partner returning to work effectively retains only \$142 per week or 31% of their take home pay! This may be of only marginal overall benefit to the family.

Even though childcare costs will vary from the examples, the impact is clear. There is a significant risk of low take up of flexible work opportunities if the net gain to the family is marginal or negative. This risk can only harm the effectiveness of the government's flexible work initiatives.

### **In a state house? More bad news!**

Tenants in state houses pay income related rents up to a threshold level<sup>9</sup> and market related rents thereafter. For a family earning less than the market rate threshold for state house rents and over the WFF abatement threshold of \$35,000, any increase in family income will lower WFF payments and increase rents.

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<sup>9</sup> This level is 25% of net family income up to the NZ Superannuation married rate. If the income is higher than the married super rate 50% of the difference between the married super rate and actual income is added. Maximum rent payable is the market rent for the property. Currently the married super rate is \$426.24 per week after tax.

### *Example Eight*<sup>10</sup>

A single income family, living in a state house, earned \$35,000 per year (\$533 in the hand per week) and with three children under 13 received WFF payments of \$256 per week. This boosted their total weekly family income to \$789 (an increase of 32.46%). They also paid income based rent of \$160, making their effective family income \$629 per week<sup>11</sup>. The market based rent for this property would have been \$230 per week. Early in 2007 the non-earning partner returned to work 15 hours per week and, until 1 April 2007, received the minimum wage of \$10.25 per hour (\$8016 per year and \$129.00 in the hand each week). The addition of the part time income increased the family income to \$43,016 but reduced WFF payments from \$256 per week to \$221 per week and increased the income related house rent to \$225 per week, making the effective family income \$659 per week. On 1 April 2007, the minimum wage increased to \$11.25 an hour raising the part timer's income to \$8,799 per year (\$141 in the hand per week). While the family income increased to \$43,799, the WFF payment remained at \$221 per week. The bad news came when the family was told that their income had crossed the threshold dividing income related rents from market related rents. Their rent rose to the market rate of \$230 per week reducing the effective family income to \$665 per week. This is just \$6 per week more than the effective family income received before the 1 April 2007 increase in the minimum wage.

This example (and examples *Six* and *Seven*) illustrates a lack of integration between various government assistance programmes. The combined negative effects of the rules governing these assistance programmes on people who access more than one form of assistance can in effect negate the overall value of all assistance. And as the following example shows, it is not easy to escape from these effects.

### *Example Nine*

The family in *Example Eight* initially were relieved when the partner working part time was offered a 100% increase in working hours, to 30 hours per week (\$17600 per year or \$273 in the hand each week). Family income would be \$52,600 but the WFF payment would reduce from \$221 to \$186 per week. Being market related, rent fortunately would not change. The effective family income would be \$762, which is \$103 a week more than if the part time partner remained on 15 hours per week. But... the family would keep only \$103 (38%) of the \$273 net wage created by the doubling of the part time partner's hours. Perhaps unsurprisingly, the family turned down the offer of the extra hours.

### **Tax changes would be better**

There is a clear need for a short-term review of the income related assistance schemes. In respect of the WFF Package there is a particular need to minimise the disincentives on the lower paid before they become reliant on the package. This could be achieved quickly and simply by commencing the abatement process at the

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<sup>10</sup> Based on an actual case.

<sup>11</sup> Effective family income is the total of net incomes and WFF less the cost of rent.

bottom, removing the income “nest” currently in place for those families earning less than \$35,000 per year. Another interim solution may be to remove the hours based criterion for receipt of the In Work Payment.

The real issue though is to avoid the complications of abatement regimes in the first place. If it is determined that the government should intervene in the process of improving national incomes it should do so in a way that is effective in the areas of need, is administratively simple, and does not create perverse incentives that contradict other policy initiatives. Currently the administration of state social assistance programmes requires monolithic government infrastructure, complex and cumbersome administrative processes, and ever increasing costs.

An obvious means of addressing this issue is to leave the value of government assistance in people’s pockets in the first place. This means adjusting tax rates and thresholds rather than introducing new ways of distributing the tax take. Except for those genuinely unable to work, this would act as a primary incentive to work; it would also mean that increases in net income would need to be achieved through effort and productivity.

Taking a tax adjustment approach would simplify administrative issues and reduce government social spending (and its associated administration and compliance costs). It would largely remove disincentives attached to WFF or the cross over effects into other assistance programmes. Reduction in government spending would contribute significantly to funding some of costs of reducing state assistance in favour of a reduced tax take.