‘Working for Families’ in New Zealand: Some Early Lessons

Prepared by

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EXECUTIVE SUMMARY

New Zealand's simple tax system has few deductions, exemptions, or credits. Income is taxed from the first dollar, on a simple four-tiered rate structure that is one of the flattest among developed countries. Where the United States and other countries frequently adapt the income tax system to accomplish social (or other) policy objectives, New Zealand generally keeps its social policy tools separate.

But when New Zealand decided in 2002 to pursue a set of social policy goals — reducing poverty, strengthening work incentives for unemployed parents, and improving the delivery of assistance — it did so using a tax-based system. Family Assistance is a set of means-tested tax credits for families with children. Under the Working for Families legislation enacted in 2004 Family Assistance is doubling in size over a four-year period to total 4.4 percent of total government spending. By 2008, when the current changes are phased in, an estimated 61 percent of New Zealand families with children will receive Family Assistance.

This report finds that the Working for Families package is likely to achieve its goals of reducing poverty, making work pay, and improving utilization of family supports by extending tax-based aid.

- The expansion of Family Assistance is likely to reduce poverty and boost the incomes of families with children. The biggest boosts to income will go to working families with relatively low incomes. Middle-income families will also receive income boosts.
- Working for Families will improve incentives for unemployed families now on a benefit to get jobs.
- Working for Families will likely improve utilization of Family Support programmes, as the agencies that administer Family Assistance change how they do business to better serve eligible families.

This report also finds that the expansion of Family Assistance to an increasing proportion of New Zealand's middle-income, two-parent families could have unintended and undesirable consequences for some families with two working parents: high effective marginal tax rates and 'partner penalties'.

- Working for Families increases the incomes of many two-parent families by thousands of dollars per year.
- At the same time, the steep abatement rates in Family Assistance create high 'effective marginal tax rates', or EMTRs, for families that didn't face them before. Unlike New Zealand's standard tax code, which is based on individual income, these EMTRs are based on family income.
- The result is that Working for Families will likely encourage some two-earner households to become one-earner households.
- In addition, it will worsen penalties for parents who become or remain partnered.

The report begins with some comparisons between New Zealand and the United States and concludes with policy recommendations and suggestions for further research.

An American perspective on New Zealand's tax and transfer system

This report is not a formal comparison of U.S. and New Zealand policies, but it is informed by my familiarity with the U.S. tax and transfer system. One significant difference is that in the United States, the tax code has many provisions intended for social policy purposes. By contrast, New Zealand's income tax system is simple, relatively flat, and rarely used for social policy other than Family Assistance.

Another contrast is that means-tested benefits such as the Domestic Purposes Benefit (DPB) in New Zealand for an unemployed parent come closer to meeting actual costs of living than their U.S. counterparts. On the other hand the United States subsidizes the wages of low-income working parents at least as much as New Zealand does. Wages also tend to be higher in the United States. The net result is stronger work incentives.

Working for Families: achieving social policy objectives through tax-based assistance

The goals of the Working for Families legislative package are social policy goals. Working for Families seeks to reduce child poverty which has been higher than in other developed countries despite low unemployment. It seeks to improve the incomes of working families struggling to make ends meet on New Zealand's relatively low wages. It seeks to ensure that paid jobs are more financially attractive than the dole. And it seeks to make it easier for families to access financial assistance.

The designers of the Working for Families package have chosen to increase tax-based assistance through the pre-existing Family Assistance tax credits instead of increasing welfare benefits. However, benefit expenditures are declining slightly while expenditures on Family Assistance are projected to double. By 2008 Family Assistance will outstrip the Domestic Purposes Benefit as New Zealand's largest single programme of means-tested cash aid to families.

Reducing poverty through increased tax-based aid. In 2001, New Zealand's child poverty rate was the 10th highest among the 26 nations of the OECD. By increasing the incomes of most families with low incomes through increased Family Assistance, Working for Families is projected to reduce poverty rates by one-third to two-thirds.

Increasing incomes and improving tax progressivity. Poor families only receive a portion of the increased assistance from Working for Families. The largest per-child increases in family incomes under Working for Families are likely to accrue to families with incomes somewhat *above* the poverty line. Indeed, by one calculation, some 41 percent of the benefits from Working for Families are estimated to go to the one-fifth of families with incomes in the middle of the income distribution. Still, as a share of income, the biggest benefits accrue to families with below-average incomes.

Making work more financially attractive than welfare benefits. Working for Families boosts the income of a prototypical *non-working* sole parent with two children by 8 percent. A comparable *working* parent in a low-wage job receives an 18 percent income boost.

Improving utilization of public assistance.. No programme of income assistance can work if families lack access to it. The Ministry of Social Development (New Zealand's welfare agency) and the Inland Revenue Department (the tax agency) are taking steps to increase Family Assistance take-up, particularly among families that are not receiving a benefit.

The unintended consequences of Working for Families: High effective tax rates and 'partner penalties' for families with two working parents

Under Working for Families, the number of *two*-parent families with children who qualify for Family Assistance — both legally married couples and those living together as if married — is on the rise. Partnered couples represent about two-thirds of New Zealand families with children, but prior to Working for Families, they represented only about one-third of Family Assistance recipients. The rest were sole parents. By 2008 the MSD estimates that the ratio will be closer to 50-50.

Partnered couples that receive Family Assistance will have higher incomes. However Family Assistance is means-tested with the amount of entitlement declining as total family income rises. So when families increase their income their Family Assistance may decline, an effect that is equivalent to a 30 percent increase in marginal tax rates.

These rising marginal tax rates for couples with children pose at least two causes for concern:

- Some parents may work less in order to maximize eligibility for Family Assistance. This is particularly likely to affect partnered mothers with young children. Working for Families may be expected to increase the number of non-working parents but the increase will be small — perhaps a few thousand.

- 'Partner penalties' — the difference between Family Assistance received by a partnered couple relative to if they were single — will rise by several thousands of dollars for many families under Working for Families. Besides appearing unfair, the penalties may discourage some working parents from marrying or partnering, or encourage them to separate. The impact will probably be small, perhaps a few thousand, although such effects are difficult to predict. They may also encourage some couples to lie to the tax authorities regarding their partnered status, balancing the risk of getting caught against the heightened reward for deception.

There are policy options to reduce these marginal tax rates, but they are expensive relative to the number of families whose behaviour may be influenced.

Findings and recommendations

The findings in this report have implications both for New Zealand and the United States. Among the key recommendations for New Zealand policymakers:

- *Start considering improvements to Family Assistance now.* Working for Families included a substantial evaluation component and data is expected to emerge from that evaluation in the coming months. It is not too soon now to begin including that data in a formal process of re-evaluation that focuses on two questions: whether Working for Families is meeting its intended goals, and what unintended consequences may be resulting.

- *Monitor carefully impacts on two-parent families.* Fixing the high-EMTR problem for secondary earners and the partner-penalty problem would be costly. The deciding factor should probably be whether there is evidence that the behavioural impacts predicted in this paper do in fact occur.

- *Bring social policy considerations into tax policy decisions.* The distribution of the tax burden has a range of social implications. More careful consideration of exactly how tax decisions affect social policy does not have to undermine the 'broad-base, low rates' philosophy, but could enrich it.

Among the key lessons for U.S. policymakers:

- *Policy choices can reduce child poverty without undermining work incentives.* Working for Families increased incomes for working and non-working families while also strengthening the relative attractiveness of work.

- *Tax simplicity and a tax system that distributes aid to families with children are* not *inconsistent.* As the United States contemplates fundamental tax reform, protecting existing systems of tax-based assistance to poor families will be a priority. New Zealand's experience shows the two can coexist.

- *Make use of emerging New Zealand data.* The Working for Families reforms are expected to yield data that could help researchers from the United States and other countries better understand behavioural responses to changes in tax policy and social policy.

The Introduction to this report describes some of the similarities and differences between the U.S. and New Zealand tax and transfer systems, including a comparison of benefit levels.

Chapter One explains how the initial goals of simultaneously reducing poverty and increasing incentives to work led to the expansion of Family Assistance to many middle-income families, and concludes that this was a reasonable policy approach. It also explores some of the implications of that expansion, for family incomes and for the tax/benefit system as a whole, as well as for the agencies that administer it.

Chapters Two and Three look at the specific implications of Family Assistance for partnered couples with children — the improved incomes as well as the changes in financial incentives. Chapter Two focuses on the employment decisions of partnered couples, in particular 'secondary earners' with children. Chapter Three focuses on the partnering decisions of those couples.

Chapter Four concludes and offers policy recommendations and suggestions for further research.

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INTRODUCTION

An assessment of how New Zealand uses its tax system to provide assistance to low-income families comes at a key moment for policy-making in both New Zealand and the United States.

- New Zealand by 2008 is projected to roughly double its spending on Family Assistance, which is a tax-based aid to low- and (increasingly) middle-income families with children.

  Under the Working for Families legislative package enacted last year Family Assistance will rise to roughly 1.4 percent of GDP or roughly 4.4 percent of total public spending. At that level it will outstrip the Domestic Purposes Benefit — the primary core welfare benefit for parents with children — as New Zealand's largest single programme of means-tested cash aid to families.

  Substantial changes to New Zealand's benefit system are in the works too, with serious consideration to consolidation of several benefit programmes into a 'single core benefit' that emphasizes workforce participation more than the present system. At the same time personal income tax policy — and particularly its effects on middle-income working families — is high on the political agenda for the upcoming national elections in September 2005. Because Family Assistance is related both to benefit policy and tax policy, it plays a role in both their developments.

- In the United States fundamental tax reform is high on President Bush's second-term agenda. At risk in any fundamental tax reform is the U.S. Earned Income Tax Credit (EITC), which, like New Zealand's Family Assistance, provides important income support to low-income families with children. Even if the United States does not enact fundamental tax reform, the EITC remains a high-profile, highly debated topic in tax policy — particularly since, in the wake of U.S. welfare reform in the 1990s, the EITC has become the nation's single most important source of poverty reduction among children. The Working for Families changes provide potentially useful lessons for thinking about EITC reforms.

In short, both countries have embarked on programmes of tax-based assistance as a complement to — and, to different degrees, as a substitute for — traditional 'welfare'. And both continue to explore the implications of that choice.

An American's view on New Zealand's tax and transfer system

To explain my perspective on Working for Families, it may be helpful to map some basic comparisons and contrasts between the policy settings and contexts in the two countries. New Zealand's tax system is not generally viewed as a potential tool for social policy. Born of the economy-wide reforms of the 1980s, the New Zealand system follows the principle of 'broad base, low rates' — a principle so often repeated that it is often abbreviated as BBLR. Nearly all personal income is subject to tax on a simple four-tier rate schedule, levied on an individual basis.[1] There are a few exemptions — not all capital gains are taxed, for instance — but they exist mostly for actual or perceived reasons of administrative efficiency. The Organization for Economic Cooperation and Development ranks New Zealand's income tax as the second-least progressive among its 26 members.[2]

Social policy in New Zealand is not typically conducted through the tax code

Largely because of BBLR, there is relatively little recent tradition of deliberately creating 'tax expenditures' — that is, tax credits, deductions, exemptions, or other special provisions — to achieve social purposes. To be fair, there are a few: New Zealand does allow a tax deduction for child care that costs some $17 million, and a tax deduction for charitable donations that costs some $77 million. Both are capped in their allowable amounts and therefore appear to have little impact either on behaviour or on family or governmental budgets. Together they total well under 1 percent of GDP. Income tax is paid from the first dollar of earnings, with no allowances for children, housing costs, or anything else. The defense of BBLR is that the tax system is designed to raise revenue, and that social policy should be accomplished through the tax code. It also simplifies tax filing. Most taxpayers now have such simple tax returns that they are not required to file annual returns.

New Zealand's 'neutral' approach to income taxation is different from those of many other countries and is particularly striking to an American. The U.S. federal tax code contains hundreds of billions of dollars' worth of tax expenditures benefiting individuals, approaching 10 percent of GDP in the federal tax code alone. Some of these serve to subsidize specific expenditures, such as deductions for charitable contributions, mortgage interest, and state and local taxes. Others are even purer entitlements, such as the personal exemption — essentially a zero-tax bracket for each member of the family, whether they have earnings or not. Some U.S. tax exemptions are means-tested so that very high-income families do not benefit, others are not.

Of particular note to an American is New Zealand's lack of allowances for children in its basic income tax system. By contrast some of the fastest-growing tax expenditures in the U.S. tax system over the last two decades have been those targeting children, in particular those whose families are relatively poor. One of those is the Earned Income Tax Credit which provides a subsidy of as much as NZ$5,600 per year per family to parents with low incomes, which was greatly expanded from 1986 to 1997. More recently the United States created in the mid-1990s a Child Tax Credit (CTC), worth up to NZ$1,400 per child. Only those families with very low incomes (under NZ$14,000) or very high incomes are excluded. Together, the EITC and the CTC are expected to provide some NZ$120 billion in assistance in 2005.

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[1] The first dollar earned is taxed at 15 percent, and rises to 21 percent of income over $9,500. A 33 percent bracket kicks in at income of $38,000, and the 39 percent top bracket takes effect at an income level of $60,000. By contrast, most other countries including the United States, offer personal exemptions, zero-tax brackets, or other mechanisms for reducing taxes on the first several thousand dollars (or more) of income earned. Note however that most other countries also levy payroll taxes starting from the first dollar of income to finance social-insurance programmes, so New Zealand's overall tax burden on low wages is not necessarily much higher than in other countries.

[2] OECD (2005), *Fundamental Reform of Personal Income Tax*, p. 37.

The exception to the rule: New Zealand's Family Assistance tax credits

The major exception to New Zealand's lack of tax expenditures is its Family Assistance programme of aid to families with children, which in many ways closely resembles the EITC and CTC. The four components of Family Assistance are labelled 'tax credits', and they are administered by Inland Revenue. Unlike the United States, where tax-based entitlements are considered an integral part of tax analysis, analysts in New Zealand frequently treat Family Assistance as an adjunct to the benefit system rather than as a part of the tax system. This has been particularly true over the last several years, as the most visible aspect of New Zealand's ongoing welfare-reform process, known as Future Directions, has been a substantial expansion of Family Assistance.

The 2004 Family Assistance changes, known as Working for Families, made Family Assistance into a broader entitlement programme than the country has had since the economic reforms of the 1980s. As Chapter 1 of this report describes Family Assistance, previously a benefit principally for sole parents with relatively low incomes, is becoming available to *higher-income* families, more *non-beneficiary* families, and more *married-couple* families than before. What is happening in New Zealand is that a tax system largely designed to be family-neutral has a large and growing adjunct that is not at all family-neutral.

Tax credits, tax cuts, and tax-based assistance: subtle distinctions

In the United States a change made to a tax-based entitlement programme that benefits a majority of the nation's families with children would have had a short, pithy slogan attached to it: 'middle-class tax cut'. Indeed the 1990s creation and recent expansion of the Child Tax Credit was so labelled. In New Zealand, by contrast, Working for Families' advocates tend to view it as outside of the tax system. Some of its critics depict it as an *obstacle* to a tax cut, presumably because it utilizes funds that could be spent on (more favoured) tax cuts.[3] These subtly different understandings of the role of Family Assistance are essential to any trans-Pacific comparisons.

Some basic comparisons of policy contexts and settings in New Zealand and the United States

This assessment principally considers Working for Families and the Family Assistance programme on their own merits, without specific comparison to the United States. Some initial comparisons of the U.S. and New Zealand tax and transfer systems may be useful however, both to help American readers understand New Zealand policy choices, and to help New Zealand readers understand my own points of reference.

First, some relevant similarities. New Zealand and the United States are both relatively open economies, with fairly flexible labour markets compared with many other countries. Both nations rely heavily on personal income tax as a source of revenue, with consumption taxes, company taxes, taxes on real property and other

[3] See for instance Fleming (2005).

sources of revenue somewhat smaller than many other developed countries. Both nations have experimented, to varying degrees and with different levels of success, with welfare reforms aimed at getting more single parents into employment.

The two nations also share at least to some degree an ethos of egalitarianism and equality of opportunity, reflecting the nations' roots as frontier nations without historical traditions of rigid class structures. At the same time, because of the relatively unbridled capitalism that they foster, the United States and New Zealand share higher levels of income inequality than other developed countries and somewhat less concern about it, a topic discussed further in Chapter One.

The most obvious contrast between the two countries, of course, is size: the U.S. population is roughly 75 times that of New Zealand, and its economy is some 100 times as large. On the other hand New Zealand is roughly the size of the average American state, and it is at the state level that many U.S. policies, particularly income support policies, are implemented.

The design of welfare/benefits policies in the United States and New Zealand

The state-to-state diversity of policy settings is part of another key contrast between the two countries – the U.S. system of supporting the incomes of needy families is probably more complex than New Zealand's. In part this reflects the federal nature of U.S. policy. Some important sources of income support, such as Social Security and the near-cash Food Stamp Programme, are entirely federally financed and have essentially the same design in every state. Others, such as Temporary Assistance to Needy Families, are jointly financed by federal and state governments. Tax-based assistance such as the Earned Income Tax Credit is largely federal, but many states add their own assistance – some 17 states offer state versions of the EITC, for example. To add to the complexity, some forms of income support in the United States, such as Unemployment Insurance, are structured as social insurance, while others like Food Stamps are entitlements financed from the general fund.

New Zealand's system of benefits has its own complexity, but virtually all income assistance is funded and run by the national government. With the exception of the Accident Compensation Commission, New Zealand lacks any social insurance at all – all benefit payments, including superannuation (retirement), are funded from general revenues and bear no relationship to a recipient's past contributions.

Comparing levels of assistance for low-income working and non-working families in New Zealand and the United States

The diversity of arrangements and programmes from state to state in the United States, and the differences in fundamental approaches to income support in the two countries, make any comparisons of benefit *structures* challenging. It is worth trying to make the comparison anyway for at least one, prototypical family.

- An unemployed sole parent with two children in New Zealand can expect a net annual income from benefits plus Family Assistance of roughly $18,000 to

$20,000, compared with perhaps US$10,500 (NZ$14,700) for a comparable family in the United States.[4]

- That same sole parent working full-time at a wage equal to 2/3 of the national median hourly wage for all workers in each country — that is, earning about $10.20 per hour in New Zealand or U.S. $9.10 (NZ$12.70) in the United States — is roughly equally as well-off in the two countries after taxes and benefits are counted, perhaps slightly better off the United States. Net subsidies to the family add 23 percent to the family's income in the U.S. and 24 percent to the family's income in New Zealand, even taking Working for Families into account. Since the underlying wages are higher in the United States, that family is better off.[5]

- Because the returns from being unemployed are better in New Zealand, while the returns from working are roughly the same or better in the United States, it follows that the financial incentives for entering the workforce are stronger in the United States.

- Note that New Zealand has the additional challenge of generally lower wages and lower per-capita GDP than the United States. This is true even though New Zealand has one of the lowest unemployment rates among developed countries, and even though it has a higher minimum wage than the United States. Encouraging parents to work is even more of a challenge when wages are low.

Incentives and behavioural changes in programmes of financial assistance

This brief comparison suggests there is a trade-off between effectiveness in reducing poverty on the one hand, and effectiveness in providing positive incentives for work on the other. This theme will be discussed further in Chapter One. Despite its success in increasing workforce participation among sole parents (due in part to positive financial incentives) and in reducing welfare rolls, the United States still has very high rates of childhood poverty. New Zealand's poverty rates are high too, but as Chapter 1 will show, they are projected to decline.

The United States has placed an emphasis for years on improving various work- and family-related incentives within social policy. So, too, have many other developed countries. This emphasis has its limits. Harvard researcher and former federal welfare official David Ellwood writes:

> All social policies create incentives, and most create at least some that are undesirable in the eyes of policymakers. The Earned Income Tax Credit (EITC) is unusual in that it creates sharply different incentives for different

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[4] Throughout this report, an equivalence of US$1.00 = NZ$1.40 is used. This reflects, roughly, the OECD's Purchasing Power Parity measurement, and is also quite close to current exchange rates between the two countries.

[5] For New Zealand the calculations reflect Family Assistance, Domestic Purposes Benefit, personal income tax, and the ACC earner's premium. For the United States the calculations reflect food stamps, the State of Maryland's TANF programme, the EITC and child care credit, and the employee's share of FICA payroll taxes which finance Medicare and Social Security. It does not reflect Unemployment Insurance, which in the United States is available only to a subset of the unemployed. Housing subsidies are excluded.

> individuals. For some it serves as a strong work incentive; for others, it is a work disincentive. Similarly, the EITC rewards marriage among some and penalizes it among others. In contrast, traditional means-tested benefits usually create unambiguous work disincentives and marriage penalties.[6]

As this report will make clear, the exact same points could be made about New Zealand's expanded Family Assistance programme in the wake of Working for Families.

Tax-cut politics and policies

A final point of comparison. The American 'middle-class tax cut' that created the Child Tax Credit was enacted at a time of substantial budget surpluses in the United States. Over the last several years however, the combination of economic slowdown and large tax cuts both for middle-income and for high-income families have created a large U.S. budget deficit, with even larger budget deficits on the horizon as the baby-boomer generation begins to retire and places additional strain on the nation's retirement and publicly-funded health care systems.

Like the United States several years ago, New Zealand now has the luxury of a substantial budget surplus, although there are different interpretations of the size and longevity of New Zealand's surplus.[7] Whether these surpluses should be distributed to taxpayers in the form of a tax cut, or alternatively retained as a way of keeping down the national debt, is at the core of the current tax-cut debate.

[6] Ellwood (2000).

[7] On a cash basis, which resembles how the U.S. federal government reports deficits and surpluses, New Zealand's current budget surplus of $2.4 billion this year is expected to change to a deficit averaging about $2 billion or roughly 1.6 percent of GDP over the next several years. Those projected cash deficits treat as spending savings and investments, such as government payments to a fund creating to pay for future retirees' benefits and cash payments for capital construction. Excluding those payments, New Zealand is forecasting positive operating balances averaging about $5 billion over the next several years. See The Treasury (2005).

1 SUPPORTING INCOMES THROUGH THE TAX SYSTEM AND THE BENEFIT SYSTEM: CHANGES AND IMPLICATIONS

For nearly two decades New Zealand has used two methods to provide financial support to low-income families with children: benefits and tax-based assistance. The Working for Families package chose the tax system, not the benefit system, as its primary tool for increasing family income. This chapter explores the logic behind that choice and some of the consequences of that choice.

The goals and methods of Working for Families

Working for Families goals are to reduce poverty, boost incomes, increase work, and improve programme participation

The goals of Working for Families, particularly at the outset, were welfare-reform goals. Working for Families was borne out of a multi-year, multi-agency process known as Future Directions. In December 2002 the Cabinet laid out the goals of Future Directions as follows:

- "supporting labour market participation for families with dependent children";
- "reducing child poverty"; and
- "improving take-up of assistance and improving understanding of and access to family income assistance".[8]

Those objectives might typically be viewed as welfare-reform objectives. They responded to two main problems. Child poverty in New Zealand by the late 1990s was high by international standards. Incentives for sole parents to enter the workforce were rather weak, in part due to the erosion of Family Assistance from inflation. In addition it was thought that a useful tool for reducing poverty would be to increase participation in existing programmes. These issues were the topics of discussion within the Ministry of Social Development from the beginning of the current Labour government late in 1999.[9]

The contents of the Working for Families package were mostly developed in 2003 and early 2004 in a complex process involving multiple agencies and multiple government ministers. (The final contents of the package are described below.) The final objectives, as set forth in the Cabinet papers written just before the introduction and enactment of the package, were slightly different than in the original Cabinet minutes. "Improving take-up of assistance" had become "improving access — ensuring that assistance reaches the right people" (this covers issues of simplification, take-up and delivery effectiveness). "Supporting labour market participation" had become

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[8] MSD (2004), *Working for Families Impacts*, citing Cabinet Social Development Committee minutes from December 2002.

[9] The process of developing Working for Families is described in detail in NZIER (2004) and Treasury (2004).

"making work pay — supporting labour market participation and helping people to move into and remain in employment."[10]

The most notable shift in objectives was that "reducing child poverty" was broadened to "income adequacy — ensuring that there is effective social protection". It appears (and interviews with participants in the policy process confirms) that the slightly broader "income adequacy" goal reflects, in part, the growing awareness during development of the package that in order to improve work incentives, a large share of the dollars in the package would have to go to non-poor families, and that in fact many middle-income New Zealand families would benefit. This also was made possible by the fact that the budget for the package grew during the process, from an initial goal of spending perhaps $100 million to $500 million dollars to a final price tag of over $1 billion.

Working for Families goes outside the benefit system to accomplish welfare goals

Working for Families may seem a surprising way to accomplish welfare reform because it achieves most of its goals *outside* of the core benefits system. The key components of Working for Families are as follows:

- An expansion of the maximum amounts of three of the four Family Assistance tax credits, and changes to one of the credits to target it more explicitly to working families.
- An expansion of the income-eligibility guidelines for Family Assistance, so that as a family's income rises it can continue to receive Family Assistance over a greater range of income.
- A cut in core benefits for families with children — not enough to make beneficiaries net losers under Working for Families, but enough to increase the relative gains from work versus not-working.
- Other benefit changes with narrower impacts.
- Expansion of child-care subsidies and the Accommodation Supplement, a payment to families with high housing costs relative to income.
- Administrative changes including changes to how the MSD and IRD work with recipients, and a programme of evaluation.

As shown below, over a three-year period Working for Families roughly doubles the nation's expenditure on tax-based Family Assistance while actually cutting benefits only slightly. As a result, Family Assistance will likely be the largest component of New Zealand's system of income support for families with children when Working for Families is phased-in, exceeding the Domestic Purposes Benefit or any other benefit. This is unlikely to be a temporary shift because for the first time Working for Families locks in the increases by indexing Family Assistance parameters for inflation after 2008.

The use of Family Assistance to address welfare objectives has a number of consequences. After a general description of New Zealand's tax and transfer system, this chapter assesses the use of Family Assistance in reducing poverty and improving work incentives, and finds that targeting assistance to non-poor and even middle-

[10] MSD (2004), *Working for Families Impacts*.

income families is a legitimate way to achieve the tax-policy goals of progressivity and reduced inequality. Finally, this chapter discusses the practical tradeoffs between using the tax system and using the benefits system to administer family income supports.

Income assistance to New Zealand's families with children, pre- and post-Working for Families

Before Working for Families, most assistance to families with children flowed through the benefit system. Now the balance is shifting

New Zealand's financial assistance to needy families is roughly structured as follows:

- New Zealand has no social insurance system, with the exception of the Accident Compensation Corporation. Instead most individuals and families without other sources of income — including the unemployed, retirees, and people with disabilities — are eligible for 'core' or 'main' benefits.
- In addition families with children whose incomes are low — whether or not they receive benefits — are entitled to tax-based Family Assistance.

Working for Families increased the share of assistance delivered through Family Assistance, and reduced the share delivered through core benefits. This section describes both the underlying system and how it is changing under Working for Families. Budgetary impacts are shown in Table 1.2 below.

Core benefits — targeted to the unemployed — are declining in budgetary cost and becoming more oriented toward preparing recipients for work

Core or main benefits are the main source of income for non-working families. These benefits include the Domestic Purposes Benefit, targeted to sole parents; the Unemployment Benefit, mostly for able-bodied non-parents; and the Sickness and Invalids' benefits. New Zealand Superannuation, which provides pensions to elderly New Zealanders, is also considered a benefit but it is not means-tested.

Administration. Benefits are administered by the Ministry of Social Development through its Work and Income unit. Families apply in person at a Work and Income office, of which there are hundreds throughout the country. (In many towns the most salient representation of the national government is the Work and Income office.) Caseworkers work with the client to provide them with the benefits to which they are entitled and to steer them toward training programmes, employment counselors and 'work brokers', and so on.

Amounts. In 2004 a non-working sole parent with two children on the DPB might expect to receive just under $14,000 per year from the benefit. New Zealand's benefits system was designed with the jobless in mind, with some allowances for earnings in order to encourage transition into the workforce. A DBP recipient, for instance, can earn up to $80 per week without losing any entitlement, and earn another $100 per week with a loss of only about 30 cents per dollar of earnings. Earnings above $180 per week have an effective abatement rate that approaches 100 percent.[11] Relatively few beneficiaries work even part-time. The MSD administrative data suggest that last year only about one in four beneficiaries received income from any source other than the benefit. Benefits are subject to New Zealand's personal income tax.

Budget impact and participation. Some 327,000 New Zealanders, including superannuitants — roughly 10 percent of the adult population, were receiving a main benefit as of 30 June 2004. Just over 100,000 of those were sole parents receiving the Domestic Purposes Benefit. In 2004-05, New Zealand spent some $4 billion on means-tested benefits, or about 3.3 percent of GDP. The DPB represented the largest single means-tested benefit at $1.5 billion.[12]

The changing nature of benefits. Two structural changes to benefits are underway. Until April 2005 the amount of money available from the DPB had been based in part on the number of children in the family. Working for Families eliminated those adjustments resulting in a decline in a family's DPB, which is now calculated only on income eligibility and sole-parent status, not number of children. The loss of benefits is more than offset by the increase in the amount of money available from Family Assistance, so that in dollar terms beneficiaries are better off in 2005 than they were in 2004. But in *relative* terms this change means that Working for Families does more for non-beneficiaries than for beneficiaries.

A larger structural change is that by 2007 the MSD intends to combine all the main benefit programmes into a 'single core benefit'. The goal will be to assess each beneficiary's needs and abilities separately, with a particular focus on determining his or her ability to get a job rather than remaining on a benefit; the number of children will continue to be excluded from the calculation. This reform is particularly focused on recipients of Sickness and Invalids benefits —the fastest-growing category of beneficiaries, among whom it is thought there is a substantial number of potential workers who now receive relatively little support or incentive to work — but will also affect DPB recipients. The mechanics of the 'single core benefit' are still being determined.

Tax-based assistance is growing in size and scope, with greatest gains for working families

For low-income families that have jobs and children, cash support is less likely to come from main benefits than from Family Assistance. 'Family Assistance' refers to several related tax credits administered by the Inland Revenue Department, which is the nation's tax agency.

The four components of Family Assistance, described below, are known as 'tax credits', but they are not linked to the amount of tax paid by a family. The amount of Family Assistance for which a family qualifies is based on annual income, but the

[11] Nolan (2003).
[12] Ministry of Social Development, *The Statistical Report 2004*, available at http://www.msd.govt.nz/documents/work-areas/csre/statistical-report-2004.pdf

credits are not claimed on annual tax returns since New Zealand no longer requires taxpayers to file tax returns. Families can claim Family Assistance at any time during the year and ask to receive payments on a weekly, fortnightly, or annual basis. Weekly or fortnightly recipients are subject to an end-of-year reconciliation or 'square-up' of actual payments received with eligibility based on family income for that year.

Amounts. The amount of Family Assistance that a family qualifies for is determined by the number of children in the family, their ages, the family's total income, whether the family is on a benefit, and whether the parents are working full-time or near-full-time. This is because Family Assistance actually consists of four separate tax credits each with its own rules. They are known as the Family Support Tax Credit, the Child Tax Credit, the Family Tax Credit, and the Parental Tax Credit — names which are rather unhelpful in describing their actual functions.

Of the four tax credits *Family Support* is by far the most widely used. There were 264,000 recipients in 2003. Family Support provides money to low- and middle-income families with children, whether or not they are working.

For families with incomes above a specified income level Family Support abates gradually as income rises. Before Working for Families the credit began to abate at an income of $20,356, first at a rate of 18 percent and then (for incomes above $27,481) 30 percent; after Working for Families it does not abate at all until family income reaches $27,500, and then at a rate of 30 percent.

The second most widely used is the *Child Tax Credit*, claimed by some 122,000 families in 2003. This credit provides additional money per-child to low- and middle-income families with children, but only if they are *not* receiving a benefit. This credit will be renamed the In-Work Payment in 2006 at which time it will be further restricted to non-beneficiaries who have paid employment at least 20 hours per week (or 30 hours combined for a couple).[13] It abates in the same way as Family Support.

A much less widely claimed credit is the *Family Tax Credit*. Until a few years ago it was named Guaranteed Minimum Family Income, which is a more apt description. Like the Child Tax Credit, the Family Tax Credit is available only to non-beneficiaries, with an additional requirement – recipients must work at least 20 hours per week (30 hours combined for a partnered couple). It exists solely to bring the after-tax incomes of the lowest-wage full-time workers up to a specified level. As such only a few families claim it — according to IRD data just over 2,000 in 2003, although that number will increase under Working for Families.

The smallest of the Family Assistance tax credits is the *Parental Tax Credit*, essentially a subsidy for parental leave for parents of newborn children.

The Working for Families package expanded Family Support, the Child Tax Credit/In-Work Payment, and the Family Tax Credit.[14] Table 1.1 shows some

[13] It is unclear how (or whether) this hours-worked rule can be enforced.
[14] The timing of the Family Assistance and benefit changes are as follows. In April 2005 Family Support was increased $1,300 per child for the first child in a family and $15 per week for additional children, while benefits were cut slightly. In April 2006, the Child Tax Credit is to be replaced with the

examples of how these programmes affected families before and after the implementation of Working for Families.

Table 1.1. Annual Family Assistance Payments to Some Typical Family Types, Before and After Working for Families

Family type and Family Assistance type		Family Assistance before April 2005 (pre-Working for Families)	Family Assistance after April 2007 (post-Working for Families)
Family with one child, on benefit, no earnings	Family support	$2,400	$4,300
	Child tax credit/In-work payment	Not eligible	Not eligible
	Family tax credit	Not eligible	Not eligible
	Total	**$2,400**	**$4,300**
Family with two children, not on benefit, earning $15,000 per year*	Family support	$4,100	$7,200
	Child tax credit/In-work payment	$1,600	$3,100
	Family tax credit	$2,700	$5,000
	Total	**$8,400**	**$15,300**
Family with two children, not on benefit, earning $25,000 per year	Family support	$3,300	$7,200
	Child tax credit/In-work payment	$1,600	$3,100
	Family tax credit	$0	$1,100
	Total	**$4,900**	**$11,400**
Family with two children, not on benefit, earning $45,000 per year	Family support	$0	$2,000
	Child tax credit/In-work payment	$0	$3,100
	Family tax credit	$0	$0
	Total	**$0**	**$5,100**

* A family at this income level would still qualify for some DPB. Before April 2005 this family actually would be better off receiving the DPB and foregoing the child tax credit and the Family Tax Credit. After Working for Families the family would be better off foregoing the DPB and taking the tax credits instead.
Note: all children are assumed to be less than 13 years old, amounts are slightly higher for older children. Amounts are rounded.
Sources: The Treasury; author's calculations.

Administration. Family Assistance has no local offices and no caseworkers. Inland Revenue has traditionally administered it in much the same way that it administers the nation's personal income tax. Families (specifically those who are not on a benefit) fill out a form and mail it to Inland Revenue to indicate their eligibility for Family Assistance. Inland Revenue uses that self-declaration, in combination with earnings information gathered from employers, to calculate the amount of Family Assistance for which a family is eligible and deposits the appropriate amount in a family's bank account.

Families who are on a benefit may receive Family Support, and they typically receive it in a different way: the MSD rolls their Family Support payments into their benefit payment. The MSD then claims reimbursement from the IRD. When a family moves on or off a benefit the MSD notifies the IRD who can adjust payment amounts. In 2003 IRD data suggest that roughly one-third of Family Support recipients received

In-Work Payment, the Family Tax Credit is to increase, and the abatement threshold is to be increased to $27,500. In April 2007, annual Family Support is to be increased by an additional $520 per child.

all their payments through the MSD, another one-third of recipients were paid directly by the IRD, and the remaining one-third received payments from both at different times of the year.

Budget impact and participation. Altogether, some 300,000 New Zealand families received at least one of the tax credits in 2003, with a total budget impact of $1 billion. Working for Families is projected to increase the budgetary impact to about $1.8 billion, and increase participation to about 317,000.[15]

Core benefits and Family Assistance are supplemented by a range of other types of assistance.

Table 1.2 shows most of the major forms of means-tested cash and near-cash assistance to New Zealand families, particularly those affected by the Working for Families package. Other than benefits and Family Assistance, the largest form of assistance is the Accommodation Supplement, an MSD-administered payment to families with relatively low incomes and high housing costs. Most beneficiaries receive the Accommodation Supplement – fewer non-beneficiaries do, although it is thought that many are eligible.[16]

Working for Families increases both the Accommodation Supplement and child care assistance. Most of Working for Families' expenditures increase Family Assistance, as the following table shows.

[15] This may seem like a small increase. It reflects in part the fact that Family Assistance parameters are not adjusted for inflation between 2003 and 2007. As family incomes grow the number of participants declines by several thousand per year, absent any change to the parameters. The IRD estimates that Working for Families will increase the number of participants by close to 50,000.
[16] The number of non-beneficiary participants in the Accommodation Supplement has risen in the last year faster than would be expected based solely on the expansion of parameters, suggesting that increased outreach funded by Working for Families is improving take-up.

Table 1.2. Major Types of Means-tested Assistance to New Zealand Families Affected by Working for Families

Type of assistance	Administering agency	Estimated expenditure 2004-05	Projected change under Working for Families full implementation
Main benefits:			
Domestic Purposes Benefit – cash assistance to sole parents with children	Ministry of Social Development (MSD)	$1.5 billion	-$123 million
Invalids' Benefit	MSD	$1.0 billion	-$3 million
Sickness Benefit	MSD	$510 million	-$7 million
Unemployment Benefit – mostly to adults without custodial children	MSD	$831 million	-$16 million
Total		*$3.8 billion*	*-$149 million*
Family assistance tax credits*:*			
Family support tax credit (for families with children)	Inland Revenue Department*	$902 million	+$889 million
Child tax credit (to be renamed In-Work Payment) (for non-beneficiary families with children)	Inland Revenue Department	$150 million	+$227 million
Other family assistance: the family tax credit (formerly known as Guaranteed Minimum Family Income) and parental tax credit	Inland Revenue Department	$27 million	+$12 million
Total		*$1.1 billion*	*+1.1 billion*
Selected other supplementary benefits:			
Accommodation Supplement	MSD	$748 million	+$146 million
Income-related rents	Housing New Zealand	$366 million	-$10 million
Disability allowance	MSD	$267 million	--
Childcare subsidies	MSD	$78 million	+$35 million
Special needs grants	MSD	$54 million	--
Student allowances	MSD	$368 million	-$4 million
Special benefit	MSD	$175 million	-$92 million
Widow's benefit	MSD	$88 million	-$2 million
Child disability allowance	MSD	$63 million	--
Orphan's/unsupported child benefit	MSD	$55 million	$8 million
Total		*$2.3 billion*	*+$81 million*
TOTAL – ALL PROGRAMMES		**$7.2 billion**	**$1.1 billion**

* For beneficiaries family support is paid by the IRD to the MSD, which then pays it out.
Note: Estimated actual expenditures are from the 2005 budget presented May 2005. Projected changes as a result of Working for Families were estimated in May 2004 and reflect the impact of the changes on budgets beginning in 2007-08. The two columns therefore are not completely comparable.
Sources: Treasury (2005); MSD (2004), *Working for Families Impacts*; Nolan (2005 forthcoming).

The historical significance of Working for Families is partly reduced when inflation is taken into account, but the shift is important nonetheless

Working for Families significantly increased spending on Family Assistance while cutting spending on benefits. As Table 1.2 shows, last year New Zealand spent nearly twice as much on DPB than on Family Assistance. By 2007-08, that balance is projected to change: New Zealand will spend more on Family Assistance than on the DPB.

The significance of this shift is somewhat undermined by the fact that over the last few years expenditure on Family Assistance has actually declined substantially. This is because — unlike benefits — Family Assistance amounts and thresholds have not been adjusted annually for inflation. As a result, aside from one major increase in the late 1990s, the value of Family Assistance has eroded over time.

Indeed, one major criticism of Working for Families — expressed by critics on both the left and the right of the political spectrum — is that it does little more than adjust Family Assistance for inflation. This criticism is partly correct. A substantial portion — arguably more than one-half — of the $1.2 billion Working for Families budget represents inflation adjustments, that is, bringing the parameters for the various components of Family Assistance up to the levels they were at when initially implemented. In 2007-08 when the changes are fully implemented, the inflation-adjusted level of the Family Support credit will be only slightly greater than what it was when it was first implemented in 1986. And the amount of the Child Tax Credit — to be renamed the In-Work Payment — will be only slightly higher than it was in 1998-99, for some large families, it will actually be lower. Similarly, many of the thresholds that will be implemented under Working for Families approximate real-dollar thresholds in the past.

For beneficiaries in particular, Working for Families falls short of fully compensating for past erosion of Family Assistance due to inflation. There are two reasons for this: first, they do not qualify for the Child Tax Credit or In-Work Payment; and second, their new increase in Family Support is offset by a reduction in benefit. Beneficiaries are better off in 2005 than they were in 2004, but not better off than they were in the late 1980s.

On the other hand, under the changes Family Assistance for beneficiaries and non-beneficiaries alike will be higher than it has been in *typical* years past. In the past a peak year (in real terms) for the credits has tended to be followed by several years of inflation erosion. Family Support, for example, eroded by 15 percent in its very first year of operation because New Zealand's late 1980s inflation rate was so high in the late 1980s. The Working for Families package rectifies this, mandating inflation adjustments starting after 2007-08.

Moreover, for families that have jobs it appears that the *combined* effects of the two credits in 2007-08 will be greater than it would have been at any single year in the past. When the Family Support tax credit was at its highest ever level — in the year it was implemented (1986-87) — the Child Tax Credit did not exist. When the Child Tax Credit was at its highest level (1998-99), Family Support was well below its peak levels. Working for Families brings both of them up to, or near, their historic highs — and keeps them at those high levels with periodic inflation adjustments.

Meeting its goals and beyond: How Working for Families affects poverty, incomes, and work incentives

Working for Families is likely to reduce poverty substantially

One of the headline strengths of Working for Families is its likely impact on New Zealand's poverty rate, particularly its child poverty rate. Statistics from 2001 suggested that New Zealand's poverty rate was high both by historical standards and by international standards. New Zealand's child poverty rate was roughly equal to the OECD average in the mid-1990s. By 2001 it had risen and was tenth highest among the 26 OECD nations.[17]

New Zealand lacks an official poverty line and a single consensus methodology for measuring poverty levels. Two recent analyses attempted to predict the impact of Working for Families on poverty rates. Both estimates are based on TaxMod, a Treasury micro-simulation model which uses the 3,000-household sample contained in the Household Economic Survey for 2001 (scaled forward to 2005) combined with benefit and tax policy parameters. An analysis by Ministry of Social Development researcher Bryan Perry published shortly after the package was enacted, finds that using one common poverty standard — equal to 50 percent of median disposable household income, with adjustments for family size — the rate of child poverty might be expected to decline by more than two-thirds, from 15 percent to 4 percent, by 2007. Using a slightly higher standard of 60 percent of median income — a poverty line that is probably more consistent with what is actually required for a family to get by — Perry found that the rate would decline by nearly one-third, from 29 percent to 21 percent.[18]

A forthcoming Treasury analysis by Melbourne Institute researchers uses a somewhat different methodology, taking into account among other things the increased workforce participation of some sole parents. Similar to Perry's results, it finds that poverty is likely to decline by more than one-third for partnered couples with children, and by more than one-half for sole parents. The table below shows the figures.[19]

[17] See Perry (2005).
[18] Perry (2004).
[19] Kalb et al (forthcoming 2005).

Table 1.3. Estimated Poverty Rates by Family Structure, With and Without the Working for Families Changes

Target Groups	Pre-WfF	Post-WfF	Percent change
Estimates for individuals:			
Children (50% threshold)	15%	4%	-71%
Children (60% threshold)	29%	21%	-29%
Overall (50% threshold)	9%	6%	-41%
Overall (60% threshold)	18%	14%	-22%
Estimates for families:			
Partnered couples with children	8%	5%	-44%
Sole parents	11%	4%	-65%
Partnered couples without children	4%	4%	0%
Single people	23%	23%	0%
Overall	14%	12%	-9%
Notes: The first group of estimates assumes no change in labour supply and no change in the poverty line. The second group of estimates allows for changes in labour supply and a slight increase in the poverty line (since Working for Families slightly increases median income). The two groups of estimates also use slightly different equivalence scales to adjust for family size. Sources: Perry (2004); Kalb and others (2005 forthcoming).			

Another way to think about the impact on poverty is the extent to which Working for Families reduced the aggregate gap between household incomes and the poverty line. This measure is known as the ‘poverty gap’. TaxMod calculations suggest that the total amount by which annual household disposable incomes fall below the poverty line (using the 60-percent-of-median standard) is about $2.24 billion. Working for Families reduces that aggregate poverty gap to about $1.87 billion, a $380 million or 17 percent reduction in overall poverty in New Zealand.

Working for Families goes beyond helping the poor to benefit more middle-income families

The poverty gap measurement has another implication. If $380 million in Working for Families is reducing the poverty gap, then where is the rest of the $1.2 billion package going? The answer is that despite its significant impacts on poverty Working for Families is *not* primarily an anti-poverty package. The biggest increases in cash assistance under Working for Families are not accruing to families with incomes below the poverty line. Rather, families with incomes somewhat above the poverty line receive most of the money in the package.

A March 2004 Treasury-MSD-IRD report predicted that the average New Zealand family with dependent children with a pre-Working for Families income below $25,000 will gain, on average, about $2,900 per year. It found that the average family with dependent children with income between $25,000 and $45,000 will gain some $5,200 per year. In other words, the average benefits of Working for Families are nearly twice as great for families with incomes above the poverty line than those below it. Some 61 percent of all New Zealand families with children will qualify by 2008, up from 50 percent in 2004.[20]

Overall, just 19 percent of the benefits from the Working for Families package accrue to the one-fifth of the New Zealand population with the lowest incomes. It is the middle-income quintile that benefits the most, receiving 41 percent of the benefits. See Table 1.4 below.

Table 1.4. The Distribution of the Working for Families Package

Household income group (based on market income, adjusted for household size)	Increase in assistance ($millions)	Share of total package
Lowest-income quintile	$224	19%
Second-lowest quintile	$219	19%
Middle quintile	$479	41%
Second-highest quintile	$237	20%
Highest-income quintile	$9	1%
All households	*$1,167*	*100%*

Source: Author's calculations from Nolan (2005 forthcoming) and Treasury TaxMod data.

Table 1.5 confirms that on a per-child basis it is the households closer to the middle of the income scale that fare the very best under Working for Families.

Table 1.5. Average per-child benefits from Family Assistance changes

		Average per-child Family Assistance		
Household income decile (disposable income adjusted for family size)	**Average income**	**Without WfF**	**With WfF**	**Change**
Lowest-income decile	$8,600	$2,000	$3,600	$1,600
2nd decile	19,200	1,900	3,800	1,900
3rd decile	22,300	1,500	3,500	2,000
4th decile	25,300	800	3,000	2,200
5th decile	31,300	700	1,900	1,200
6th decile	38,800	100	400	300
7th decile	47,300	300	600	300
8th decile	56,700	200	400	300
9th decile	70,700	100	300	200
Highest-income decile	124,200	100	200	100
All households	*$44,400*	*$900*	*$2,000*	*$1,100*

* Income averages are average equivalized household income for all families within the decile, exclusive of Working for Families changes. Family Assistance averages reflect aggregate Family Assistance received by families within the decile, divided by the number of children within that decile. Figures are rounded and scaled forward to 2007/08.
Source: Author's calculations based on Treasury TaxMod estimates.

Why did Working for Families provide such a substantial share of its benefits to families near the middle of the income scale? One reason sometimes cited is that Working for Families was a political device — a handout to buttress the current Labour Government's support among lower- and middle-income voters to ensure continued electoral support.

[20] MSD (2004), *Future Directions: Working for Families Impacts*, p. 16.

Whether or not this is true there are other plausible, policy-based reasons for structuring Working for Families in this way. One reason is the challenge for a family with children to make ends meet on the wages that are typical of many New Zealand families. The median hourly wage is $15.34 per hour, with low-wage jobs concentrated in occupations requiring relatively low skills. For instance, one-third of New Zealand jobs are for service and sales workers, agricultural and fisheries workers, and 'elementary occupations' (labourers and janitors for instance). Median wages for those three categories of workers in 2004 ranged from $11 to $12.67 per hour.

Bringing the impact of Working for Families into New Zealand's tax debate

As noted in the Introduction New Zealand's income tax policy is unusually flat and therefore not particularly favourable to low-income families. New Zealand also levies a substantial consumption tax and other taxes that are at least somewhat disproportionately burdensome on low-income families. At the same time New Zealand offers some tax breaks that disproportionately benefit families with higher incomes. Capital gains are to a substantial degree untaxed in New Zealand, as are many inheritances. There are favourable tax regimes associated with the ownership of housing. And high-income families can also benefit by establishing 'trusts' to hold a portion of their income, allowing them to be taxed at lower rates than otherwise would apply. These tax breaks are probably small in comparison with, say, the favourable treatment of much investment income in the United States, although New Zealand does not regularly publish a tally of exactly how much each of those tax provisions costs. They appear to result more from ease of administration and economic efficiency than from distributional concerns.

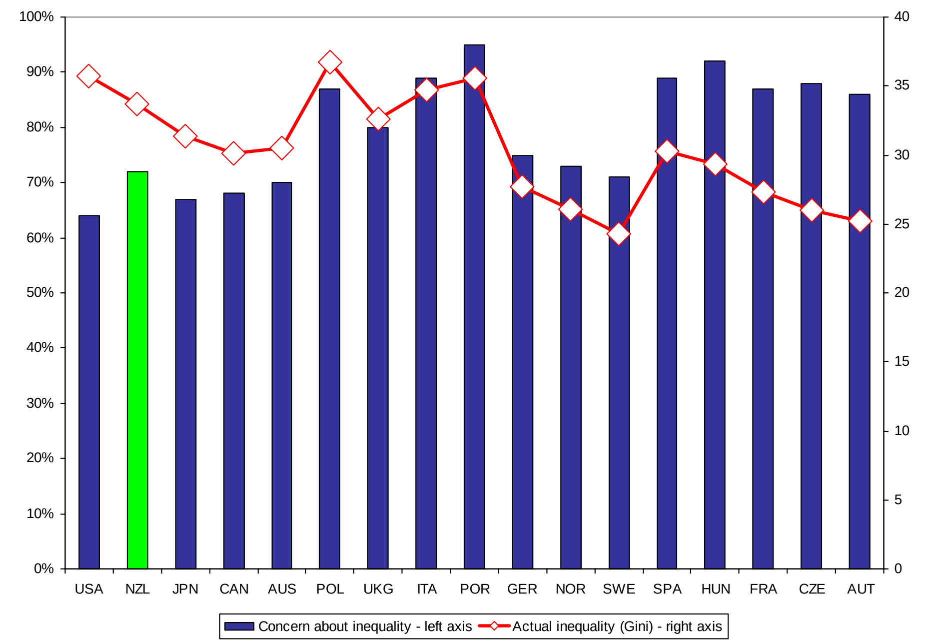
Indeed the flatness of New Zealand taxes is to some extent deliberate. Under BBLR the clear goal has been to maximize revenue collection with minimal disruption to the economy. This philosophy, borne of the economic reforms of the 1980s, is admirable, as far as it goes, because it enables the government to avoid the pressure to create a host of special-interest tax provisions that end up raising rates, distorting economic decision-making, and undermining the basic fairness of the system.

What's missing from the 'broad base, low rates' philosophy is recognition of the role that tax policy plays in shaping a nation's income distribution. New Zealand has historically seen itself as a nation of equals, with relatively little concentration of wealth. Although they are concerned about inequality, New Zealanders appear to be somewhat *less* concerned than residents of other countries — despite rising overall income inequality levels. Data from the OECD on 15 developed countries finds that the gap between *actual* income inequality — as measured by the Gini coefficient — and the level of *concern* about income inequality is larger in New Zealand than anywhere else besides the United States.[21] (See Figure 1.) Recent data from the Ministry of Social Development confirms that income inequality is higher in New

[21] Concern about inequalities in 1998 were measured by the share of respondents who agreed or strongly agreed with the statement "differences in income are too large"; data for Italy refer to 1992. Actual inequalities were measured by the Gini coefficient of inequality in 2000 (1995 in the case of Italy). Förster and d'Ercole, 2005.

Zealand than in most other developed countries. After the increases of the 1980s and early 1990s inequality appears to have been basically flat over the last six years. By at least one measure it appears to be ticking slightly upwards.[22]

Figure 1: Perceived and Actual Inequality in 15 Developed Nations



Source: OECD. Countries are ranked in order of the gap between actual inequality and concern about inequality, with those toward the left having higher levels of inequality and lower levels of concern.

New Zealand policy officials tend not to think of Family Assistance as a provision of the tax code, yet it plays a crucial role in ensuring that on net the overall tax system is progressive.

The middle columns of the following table indicate that personal income tax is not far from being proportional to taxable income. Households with relatively low incomes typically pay 20 percent of their incomes in personal income tax. Households with higher incomes typically pay 25 percent to 30 percent of their incomes in personal income tax.

This table probably overstates the progressivity of New Zealand's personal income tax. The household-income denominator excludes forms of non-taxable income such as capital gains. And the measure of taxes does not reflect consumption taxes, which

[22] Perry, 2005. In recent years the Gini coefficient has been flat, but the ratio of income at the 80th-percentile mark to income at the 20th-percentile mark is rising. A particular challenge when measuring income inequality in New Zealand is that there is almost no available data on capital gains. Evidence from the United States shows that including or excluding capital gains can make a large difference in the calculation of income inequality. Given the large percentage of New Zealanders whose household wealth is vested in real estate, the rapid increase in real estate values over the last several years in most New Zealand cities, and the top-loaded distribution of real-estate wealth, it is at least possible that if capital gains were included in measured income, inequality would be rising.

tend to be disproportionately borne by lower-income families because they spend a higher proportion of their income.

The final two columns of that table, however, show that netting out Family Assistance against income tax liability changes the progressivity of New Zealand's tax code substantially. Family Assistance does not do much to change the average tax burdens on the highest-income households, who continue to pay 25 to 30 percent of their incomes in taxes. However Family Assistance does substantially reduce average tax burdens on households with incomes up to about the median.

Table 1.6. Personal income tax and Family Assistance as a share of pre-tax income, by household income decile

	Average household income excluding taxes and family assistance		**Personal income tax as share of income, excluding Family Assistance**		**Tax net of Family Assistance as a share of income**	
Household income decile	**With WfF**	**No WfF**	**With Wff**	**No WfF**	**With WfF**	**No WfF**
Lowest-income decile	9,577	9,299	24%	26%	-11.8%	5.2%
2nd decile	22,355	21,970	17%	17%	-2.1%	7.8%
3rd decile	19,754	20,883	20%	19%	14.9%	16.7%
4th decile	30,414	31,196	19%	19%	12.8%	17.1%
5th decile	46,280	46,108	19%	20%	15.5%	18.1%
6th decile	56,812	56,800	21%	21%	20.1%	20.5%
7th decile	66,626	66,630	22%	22%	21.6%	21.8%
8th decile	79,675	79,757	23%	23%	23.2%	23.4%
9th decile	103,428	103,627	25%	25%	24.9%	24.9%
Highest-income decile	194,414	194,441	30%	30%	29.7%	29.7%
All households	62,646	62,877	25%	24%	22.3%	23.5%

Note: Household income deciles are based on equivalized disposable income. The somewhat odd results for the lowest income decile may be explained by the fact that benefit income in New Zealand is considered taxable.
Source: Author's calculations from Treasury TaxMod data.

The emphasis on incomes for working families means better incentives for families to enter the workforce

The design of welfare systems poses a deep challenge for policy-makers. How can benefits be made sufficiently generous to lift families out of poverty without undermining incentives to participate in the workforce? If benefits are high relative to wages the result can be high levels of welfare dependency and weak incentives for developing skills that are useful in the workplace. If benefits are low the result can be high levels of poverty, which are associated with poorer outcomes in health, education and other areas.

One key reason that Working for Families is so beneficial for working families with incomes above the poverty line is that policy-makers wanted to give bigger gains to working families than to non-working families. This was in order to ensure that work became more financially attractive relative to non-work.

Working for Families is particularly focused on families headed by sole parents, who represent one-third of New Zealand families with children. Rates of poverty, low living standards, and unemployment are far higher for them than married couples.[23]

Before Working for Families the income of a full-time sole parent working at the minimum wage was only slightly higher than the income of a non-worker. This is because for each additional dollar earned a combination of increased income taxes and reduced benefits (including reduced Family Assistance) wiped out much of the additional income gain. This combination of tax rates and lost benefits attributable to each dollar of earnings is called the 'effective marginal tax rate' or EMTR.

Reducing the high EMTRs, particularly for sole parents, was a key goal of welfare reform. A body of New Zealand and international evidence suggested that sole parents were somewhat more likely to get a job and leave welfare if they would be made financially better off by doing so. High EMTRs spread over a wide range of the potential incomes of sole parents, as was the case before Working for Families, was counterproductive to the MSD's stated goal of helping beneficiaries get jobs.[24]

In this regard Working for Families was a modest success. Figure 2 below provides a graphic illustration of its impact on a prototypical sole parent, with a wage level of $10 per hour, two children, and at varying levels of work. The figure shows that the family's income increases under Working for Families, but the additional income resulting from work increases even more.

- Without the Working for Families changes this sole parent would receive about $27,000 per year in combined benefits and Family Assistance if not working. If working 20 hours per week, total annual income — wages, benefits and family assistance net of income taxes — rises to $30,100. This is a $3,100 increase on $10,000 in pre-tax wages, equivalent to a 69 percent tax rate.

- With Working for Families this sole parent receives roughly $28,100 per year in combined benefits and Family Assistance if not working. If working 20 hours per week total annual income rises to $35,600, a $7,500 increase equivalent to a 25 percent tax rate.

- In other words Working for Families increases the income of the prototypical *nonworking* family by 8 percent but increases the income of the family, when working, by 18 percent.

Figures 3 and 4 show where those additional dollars of income come from. Working for Families increases the Family Support component of Family Assistance but increases the work-contingent components of Family Assistance further while trimming benefits.

[23] MSD (2004), *The Social Report*.
[24] Eissa and Hoynes (2004).

Working for Families creates an expectation that sole parents will work 20 hours per week: no more and no less

The changes increase the return for a sole parent to take a 20-hour-per-week job. Note however that for this typical family, and for some others, there is *no* additional income to be gained by a sole parent moving *beyond* 20 hours of weekly work. This is because the Family Tax Credit (as its old name implies) guarantees a specific income level, which in this case equals the income that can be received at 40 hours of minimum-wage work. In other words, Working for Families rewards the transition from no-work to part-time work far more than it rewards the transition from part-time work to full-time work.

There is some logic here. Juggling a 40-hour-per-week job with the demands of sole parenthood may be simply overwhelming for many parents, particularly for those with younger children. Targeting the biggest incentives toward a part-time job may be an appropriate way of balancing the goal of work with the goal of ensuring that children are well cared for and that a sole parent can balance the demands of work and family.[25]

One of the ways that Working for Families increases expenditures on tax-based assistance and cuts expenditures on benefits is by creating an incentive for a parent to move from the benefit into tax-based assistance at a lower income level than otherwise. Figure 4 shows that this jump occurs right around 20 hours of work where the parent becomes eligible for the Family Tax Credit and the In-Work Payment, but only if they give up benefit participation. As Figure 4 shows it is mostly the Family Tax Credit that causes this bounce.

It is unclear at this point how this transition from benefit to work will be handled. It will be incumbent upon the MSD caseworkers to help explain to beneficiaries the relative benefits of making this move and to help them manage it. More broadly, as discussed further below, the MSD will have to think carefully about what types of assistance sole parents who make this move will need. It may be the case that continued training, job placement, and other forms of support currently limited to beneficiaries may need to be provided to some of these part-time, low-wage sole parents in order to help them continue to improve their families' economic circumstances.

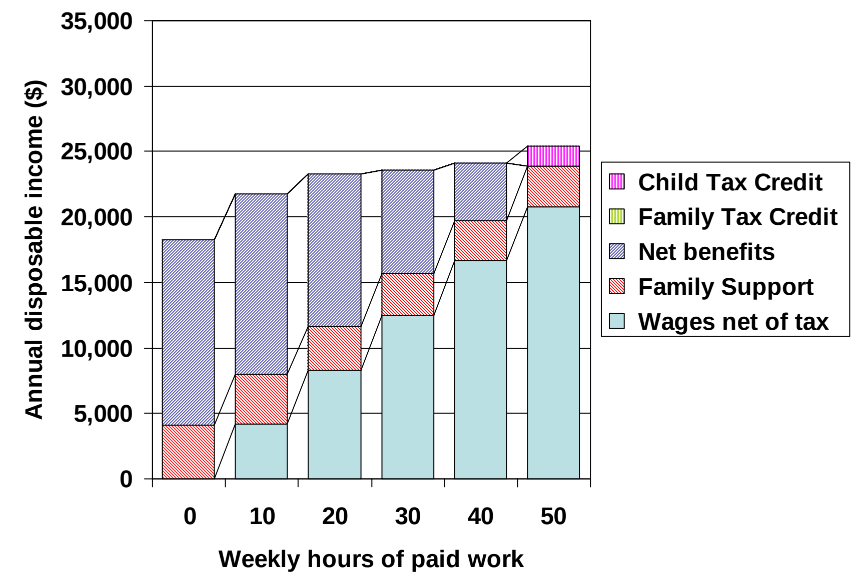
[25] Note that the pre-Working for Families system had fairly good incentives for sole parents to work at least a few hours per week, due to the abatement-free zone and reduced level of abatement for the first few dollars of earnings per week. Most beneficiary parents, however, did not.

Figure 2: Income of a Sole Parent with Two Children by Hours Worked, Before and After Working for Families

Income before and after Working for Families for a sole parent with two children, ages less than 12, receiving Central Auckland accommodation supplement.

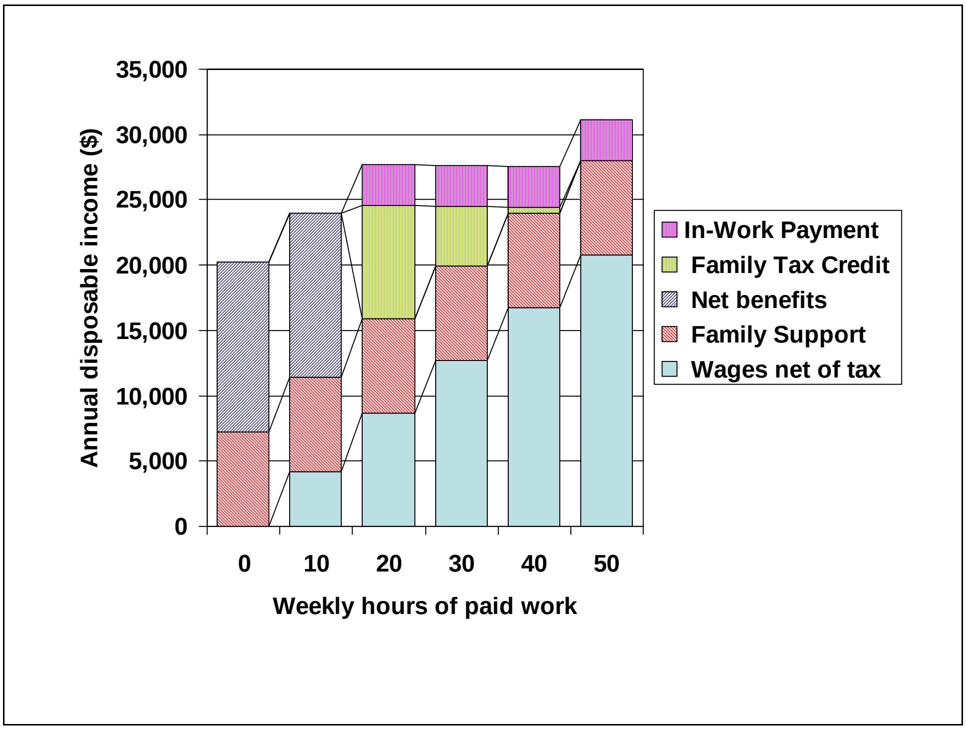
Source: Author's calculations from Treasury TaxMod data.

Figure 3: Sources of income for a low-wage sole parent with two children, pre-Working for Families



Source: Author's calculations from Treasury TaxMod data.

Figure 4: Sources of income for a low-wage sole parent with two children, post-Working for Families



Source: Author's calculations from Treasury TaxMod data.

The next several figures map the EMTRs against the disposable income of this prototypical family, pre- and post-Working for Families. They show that the result of Working for Families is to lower EMTRs for a low-wage parent working up to about 20 hours, and then again if a parent works above 40 hours, but to increase EMTRs between 20 hours and 40 hours.

Figure 5: Disposable Income and EMTR Profile for Sole Parent with Two Children, Pre-Working for Families

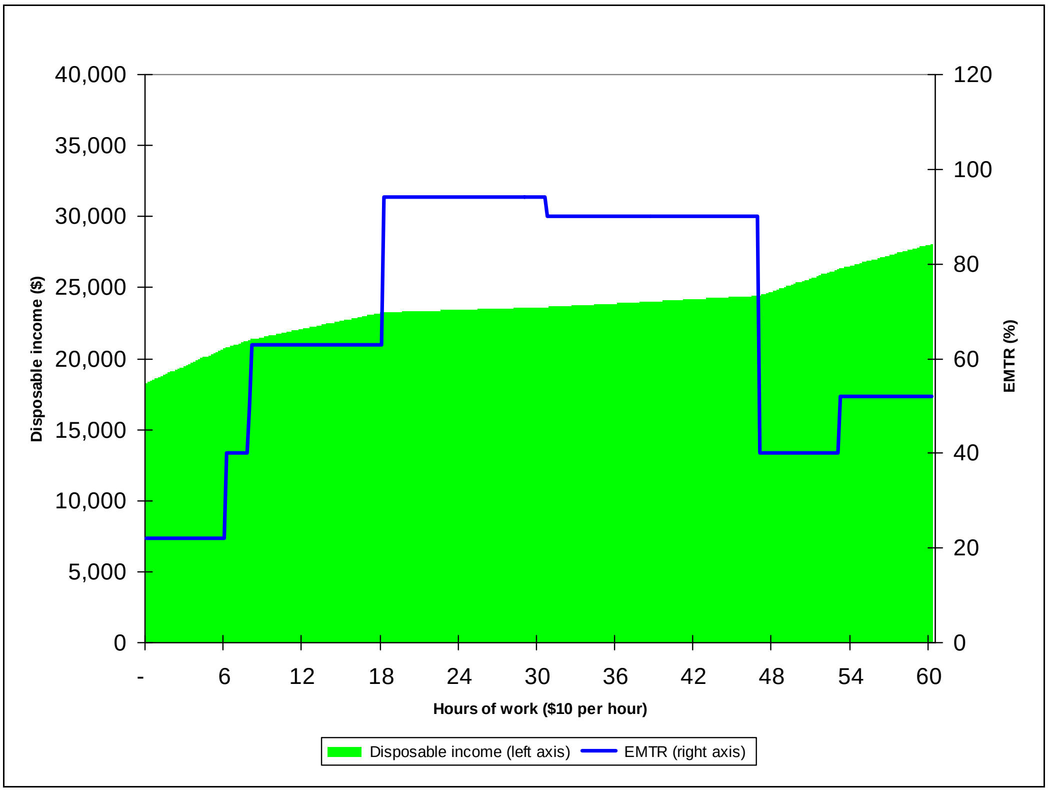


Figure 6: Disposable Income and EMTR Profile for Sole Parent with Two Children, Post-Working for Families

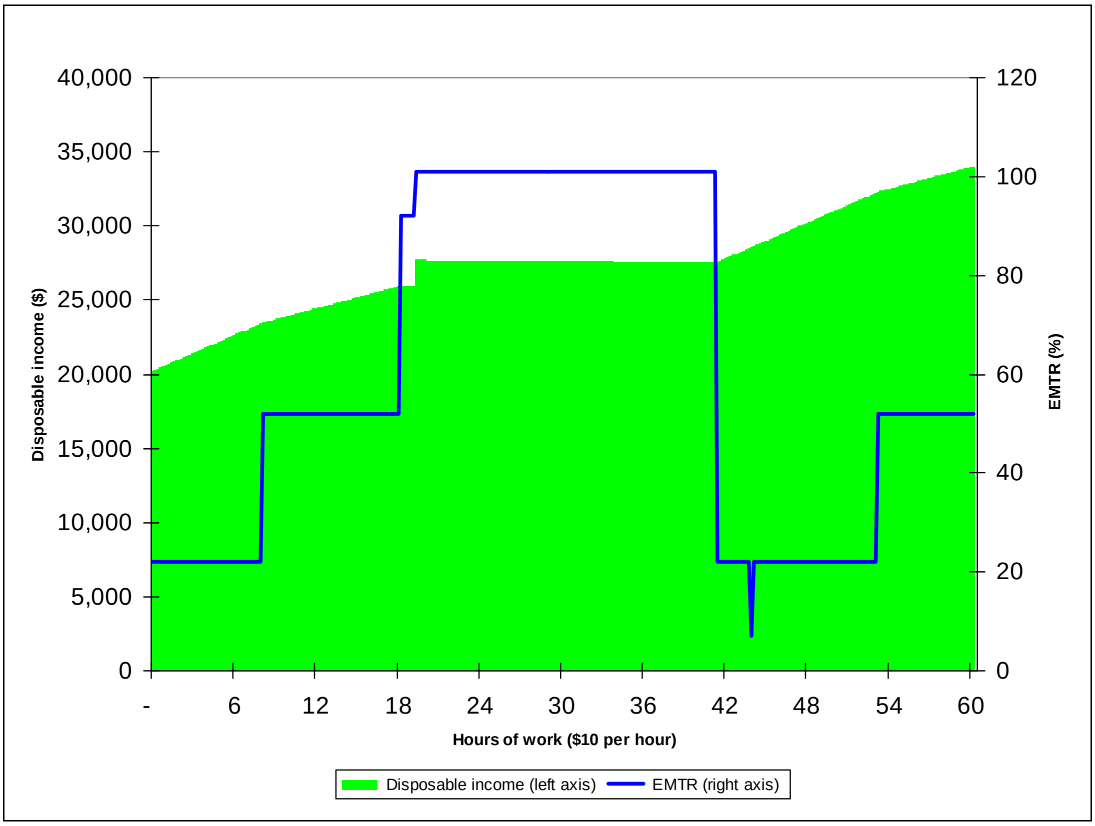
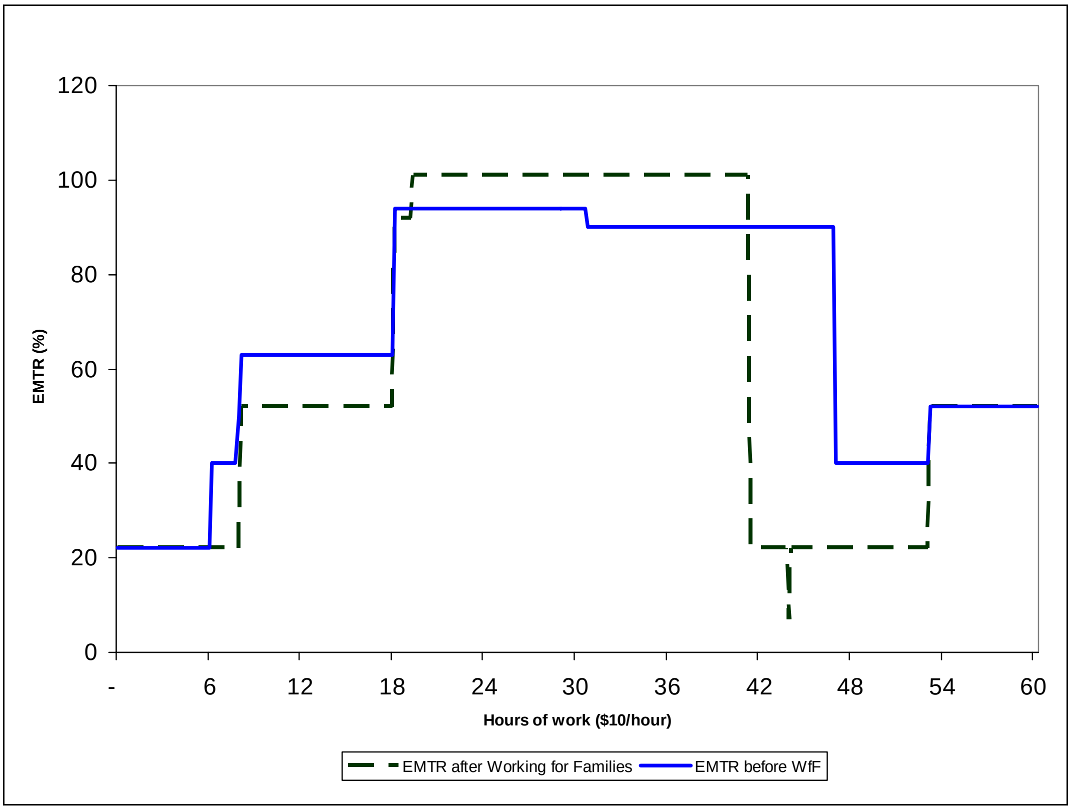


Figure 7: EMTR profiles before and after Working for Families for a Single Parent with Two Children



These profiles are only for one family type. Families with other wage rates, numbers of children, and numbers of earners face different EMTR profiles. For instance, if the family has a wage level slightly above the minimum, then the incentives to work 40 hours rather than 20 hours improve. For a couple the strongest incentive is to work 30 hours rather than 20. And so on.

How will beneficiaries respond to improvements in work incentives?

New Zealand has high unemployment rates among sole parents. The discussion above shows that Working for Families does tend to improve their incentives for work participation, although the improvement is not overwhelming. Indeed compared with the dramatic improvement in incomes for both poor and moderate-income families described in the previous sections, the work-incentives story here is both less dramatic and more muddled. In fact, it is possible that for at least some families the increased income that they receive from Working for Families will persuade them to cut back on their work hours (what economists call the 'income effect'), despite any improvement in marginal work incentives (the 'substitution effect').

With different theoretical effects pushing in different directions, can it be predicted whether more non-working sole parents will actually enter the workforce? Part of the answer comes from the U.S. and United Kingdom experiences where improved financial incentives have in fact encouraged beneficiaries to enter the workforce.

Another part of the answer comes from a new computer model recently commissioned by the Treasury to be constructed by the Australia-based Melbourne Institute. This model, called TaxMod-B, uses actual New Zealand data on the labour force participation rates of working-age people in the 1990s to estimate how changes in tax parameters might affect participation. It was used to calculate the net impact of Working for Families' changes to Family Assistance and the Accommodation Supplement on the labour supply of various groups.

TaxMod-B used relatively conservative assumptions and found that, taking into account both the income and substitution effect, sole parents' work participation is likely to increase by 1.9 percent over the next several years, which works out to an increase of about 2,300 in a population of about 121,900. (See Appendix, Table A-8). Of course, any number of factors — from changes to the labour market to changes in the benefit system — could affect substantially that estimate.[26]

The Practical Pros and Cons of Tax-Based Assistance

In income-support policy, as in architecture, *form* matters as much as *function*. By shifting dollars out of benefits and into tax-based assistance New Zealand is reshaping the form of its income-support policies, with a variety of potential consequences. Some of these consequences, such as easier access for working families and low administrative costs, help explain why policy-makers choose tax-based assistance as

[26] Kalb et al, 2005. The model did not account for changes in child care subsidies, which could increase entry into the labour force.

the channel for increased income suppports. Other consequences are being or may be addressed as part of the implementation of Working for Families.

One key reason that New Zealand expanded tax-based assistance was the simple fact that it was there. Family Assistance was the existing mechanism that provided the most benefits to the target population of working families with children, and so it made sense to put more money into it. However there are additional reasons that might support such a decision.

Tax-based assistance can have higher participation rates than benefits

If a key goal of Working for Families was to make sure that families received the assistance that they needed, then distributing most of the new aid through the tax system made sense. Tax-based programmes typically have high rates of participation. An estimated 80 to 85 percent of eligible U.S. families claim the EITC, for example. Although evidence is slim, officials believe that participation in Family Assistance is quite high. This is partly due to the fact that the MSD distributes a substantial share of it to beneficiaries automatically, but it also reflects the ease of the IRD's mail-in procedures.

Other benefits: less stigma, better data

The availability of data. Tax-based assistance makes sense for a programme whose rules are linked closely to income. The PAYE system allows IRD ongoing access to income data, which it can then feed into the calculations of eligibility for assistance. This can all happen automatically – a taxpayer need not report, for instance, a week in which he or she works overtime or alternatively misses a few days of pay.

Reduced stigma. The Ministry of Social Development report that their market research has found at least some stigma associated with the receipt of benefits in New Zealand. To the extent that tax-based assistance avoids this stigma it may be both more attractive to potential recipients who need the money, and also more politically palatable.

One can foresee a danger here, however. The danger is that Family Assistance, despite its work components, becomes increasingly viewed as just another welfare programme. This is particularly a potential problem for Family Support, which has no requirement that a family have any earnings from employment. As Family Assistance takes up an increasing share of the budget one can imagine it becoming an increasingly popular target over time.

Still, this danger may be some way off. Family Assistance has the political and marketing attractiveness of being associated both with work and with children. And even after Working for Families, Family Assistance will remain smaller than core benefits in aggregate. If the single core benefit strategy succeeds in reducing benefit receipt, however, it is possible that Family Assistance could become the next target.

The challenges ahead for the MSD and the IRD

A greater role for Inland Revenue in providing assistance.. For many years now Inland Revenue has been more than a tax agency. In addition to its revenue-collection role, the IRD collects and distributes child support and has a role in administering New Zealand's student-loan scheme. It has been the administrator of Family Assistance for over a decade.

Inland Revenue's clear strength is its ability to transfer funds among large numbers of people, both businesses and individuals. This it appears to do well. Working for Families however carried with it the expectation that not only would assistance be theoretically available, but that it would actually wind up in the hands of individuals. In response the IRD has moved to improve its outreach to potential FA recipients. Department staff are more likely now than in the past to go to where potential recipient are, such as Work and Income offices or even community events, to hand out forms and encourage families to register for Family Assistance. The agency has also launched an interview-based research programme to understand how Family Assistance recipients view the agency and how interactions can be improved.

Someone needs to be doing this work. In the United States there are a host of institutions other than the federal tax agency — from state and local governments to private foundations to nonprofit community groups — who have picked up the task of ensuring that eligible families know about tax-based assistance programmes. In New Zealand, with relatively less capacity among such institutions, the national government must play a greater role. The IRD recognizes that such outreach requires a different set of skills and capacities than are likely to be easily found within the agency, and it appears to be moving to develop them.

An alternative model would be for IRD to retreat to its traditional role of gate-keeper of family benefits and allow a different agency — perhaps the MSD, with support from independent non-profit organizations operating under MSD or IRD grants — to perform the outreach function. Close scrutiny of the IRD's success in this area will be merited.

A changing role for the MSD. Even assuming the IRD successfully expands its role, the limits are clear. The IRD presumably will never have caseworkers whose job it is to develop some level of knowledge and understand about each family's situation. 'Social development' — helping families improve their economic and social conditions through a range of tools — remains the MSD's goal.

As part of Working for Families, the MSD was authorized to allocate 100 caseworkers specifically to work with non-beneficiary families. A major task of those staffers is to promote child care assistance and the Accommodation Supplement, which remain the MSD's two major pieces of assistance for working families. Publicizing Family Assistance was part of the job assignment as well.

This may be only part of the task. Low-income families, even those with jobs who are no longer on benefit, may need more than just a straight income transfer. It would take a large, costly army of caseworkers to provide every Family Assistance recipient with the kind of personalized help that the MSD strives to provide to beneficiaries. And many such families may not need the same level of assistance as beneficiaries.

Yet the mere fact that a family has been transferred off of a benefit does not necessarily mean they will no longer be in need of help in finding and accessing services such as job training and placement. Indeed the MSD will need to continue to explore new models of working with low-income populations — beneficiaries and non-beneficiaries alike — if the promise of Working for Families is to be realized.

The MSD has another strength that it must find a way to use in the Working for Families era. While the IRD is good at administering an ongoing programme with relatively stable rules, the MSD may be a more appropriate agency for making programmatic changes on the fly, in response to changing family situations, regional labour markets, or other factors. The MSD's increased devolution of responsibility to its local offices should improve this capacity further. The Work and Income unit has hundreds of offices around the country and thousands of employees. In many communities, Work and Income is the most visible representative of the national government.

Say, for example, that there is a major regional economic slowdown that leads to a large number of working families falling below the 20-hour-a-week threshold for receipt of the Family Tax Credit and In-Work Payment. In that case, the MSD may need to step in to support the incomes of families that are not typical beneficiaries but nonetheless in need of assistance.

The timing of benefit receipt. A family that receives Family Assistance from the IRD is allowed to request that the entitlement be deposited in its bank account on a weekly or fortnightly basis. Alternatively, the family can request that their Family Assistance be received at the end of the tax year as part of the annual reconciliation with Inland Revenue of taxable income and income tax liability. In 2003 about 77,000 families received up-front, regular Family Assistance payments from the IRD. Some 45,000 families instead were paid at year's end. (Most of the remaining families were on a benefit for at least part of the year and therefore received their FA up-front.)

One view among social-policy analysts and advocates in New Zealand holds that more frequent, up-front payments of Family Assistance are preferable to end-of-year lump-sum payments. This may be less true for working families as it is for beneficiaries – evidence from the United States suggests that recipients value lump-sum tax credits, like the Earned Income Tax Credit, because they can be matched with lump-sum payments. In addition weekly payments that are based on annual income assessments can lead families into debt if their income increases during the year – the IRD has taken extensive measures to minimize this debt.

Is it advisable to maintain a clear distinction between 'beneficiaries' and 'working families'? New Zealand policy distinguishes between 'beneficiaries' — recipients of a core or main benefit —and 'non-beneficiaries' who don't receive a *main* benefit but may be eligible for Family Assistance, the Accommodation Supplement, child care subsidies, and other types of aid. The difference seems arbitrary, and is illustrated by the MSD's attempt to come up with a better phrase for 'non-beneficiaries'. The MSD chose 'working families', which is a problematic choice because a substantial share of beneficiaries (roughly one in five) are themselves workers.[27] Some non-beneficiaries probably get more money from the state in the form of Family Assistance, housing subsidies, and other forms of cash aid than do some beneficiaries.

But while the distinction may be arbitrary, it has practical import. Beneficiaries, whether they are working or not, are excluded categorically from three of the four tax credits that make up Family Assistance. Because those tax credits become more valuable under Working for Families the consequences of that distinction grow. At the same time non-beneficiaries do not receive the training and job-hunting assistance that beneficiaries receive through local Work & Income offices.

A further practical concern relates to the '20-hour rule'. Under Working for Families a family with 19 hours of weekly employment is eligible for a core benefit. With 20 hours of weekly employment the family is best-off if it foregoes its benefit payment, because then it qualifies for the Family Tax Credit and the In-Work Payment. This 20-hour rule is arbitrary and is likely to prove difficult to enforce, particularly because neither the IRD nor the MSD have a practical way to measure hours of work. (In practice, the 20-hour rule presumably will be enforced as if it were a $190-rule: the IRD will likely screen out only those workers earning less than the equivalent of 20 hours at the minimum wage, currently $190.)

As noted above, the MSD is working to expand its work with families not on a core benefit. A good next step — perhaps doable as part of the 'single-core-benefit' work — would be to seek to integrate policies aimed at beneficiaries with those aimed at families not in receipt of a benefit. For instance, the In-Work Payment and Family Tax Credit could be made available to beneficiaries who work, perhaps on a sliding scale related to income. Under this approach a family with $95 of weekly earnings might be eligible for half of the assistance for which it would be eligible under $190 or 20 hours of work.

The policy development and evaluation feedback loop. For a variety of reasons, benefit policy decisions are made very differently from tax policy decisions. For starters, data collection practices are different. The MSD collects a great deal of data on beneficiaries and much of it is available (or could be made available) in near real-time, since benefits are distributed on a weekly basis. The IRD, by contrast, collects less data on individual families, and much of its data are on a tax-year basis rather than a weekly basis. In addition New Zealand tax-privacy rules can make the IRD's data more challenging for policy analysts to acquire and use.

These data-collection differences map onto the timeline of policy choices. In the world of tax policy, stability and predictability are core values. A tax system that looks pretty much the same year in and year out is a good thing. It is also appropriate that tax policy look pretty much the same for all New Zealanders wherever they live. The IRD's goal is to make sure that financial obligations are met. As long as financial obligations are met there may be relatively little reason to change policy parameters.

[27] Of the 109,526 DPB recipients at 30 June 2004, 26,087 declared some other income – presumably mostly earnings. Ministry of Social Development (2004), *The Statistical Report 2004*.

For benefit policy, by contrast, the hoped-for outcome is arguably more ambitious. For instance, the MSD's goal of 'social development' implies a mandate for behavioral change. If benefits are not helping a family 'develop', then benefit policy should change. Moreover, where a one-size-fits-all is desirable from tax policy, it is probably undesirable from benefits policy, because low-income, jobless families typically face many barriers to full social inclusion.

Universality versus targeting. As described above the default-option of tax policy is to treat taxpayers equivalently, adjusting only for a finite and well-defined set of characteristics (income, family structure, etc.) The default-option of benefit policy is to deliver benefits in a way that allows for adjustments based on personal circumstances.

The implication of this is that tax policy tends to become more universalized. In the absence of universalization, even well-meaning targeting distinctions can be viewed as 'unfair'. The 'penalties' for secondary earners and for partnered couples that exist as a result of Family Assistance are consequences of the failure to universalize; and are discussed at greater length in Chapters 2 and 3.

Benefits policy, on the other hand, seems likely to lead toward more client-specific policies. The 'single core benefit' that is now under development at MSD provides a good illustration. Its name implies a universal programme of benefits. But a review of the policy development to date suggests that in fact the 'single core benefit' will be a relatively complex framework in which beneficiaries will be differentiated based on their needs and abilities.

Does it have *to be this way?* To some extent, it is feasible and appropriate to blur the lines between tax and benefit policy. The MSD can, should, and probably will get better at some of the things the IRD is good at, like interacting with working families (for instance, by establishing national call centers to handle more work that otherwise might have been done in local offices). And of course benefits should not be doled out on an entirely discretionary basis by caseworkers, because it is hard to figure out how to hold the caseworkers accountable for unwise expenditure of funds.

The IRD also can and will do some things that the MSD otherwise might do, like strategizing for increased participation in Family Assistance. Moreover, up to a point, the tax code can be tweaked to be a bit more customized to the individual needs of taxpayers.

Nonetheless, it is tempting to speculate that there are fundamentally different expectations from a tax system and from a benefits system. How much do we want our tax system individualized, and how much do we want a benefits system that is universal? Tax systems typically get *bad* publicity when they are administered in a way that treats individual taxpayers differentially — for instance, when 20 different accountants, working off the same basic information, calculate 20 different tax liabilities. But it is increasingly considered a *good* thing when individual welfare offices adopt different strategies for helping clients, recognizing that there is no right way to 'fix' poverty.[28]

The following table provides a potential framework for thinking about the fundamental difference between the role of a tax agency and the role of a benefits agency.

Table 1.7. Some comparisons of providing assistance through the benefits system and through the tax system

	Benefits policy	**Tax-based assistance and tax policy**
New Zealand administering agency	Ministry of Social Development/Work and Income	Inland Revenue Department
Typical agency clients	Beneficiaries	Families with earnings
Overall goals of agency	'Social development'	Meeting financial obligations
Amount of face-to-face contact with recipients	Extensive	Minimal
Per-recipient administrative cost	High	Low
Intended outcomes	Identification/alleviation of barriers to workforce participation; 'social development'; income support/poverty reduction	Income support/ redistribution; reasonable marginal tax rates; ease of administration
How often does agency make payments with recipients?	Weekly	Weekly to annually
Data timing	Regular	Limited by tax-privacy laws and by annual receipt
Importance of consistent treatment of families versus acceptability of experimental approaches	Experimental approaches more likely to be acceptable, with some limits	Consistency important

Conclusions and recommendations

The policy changes made in Working for Families emerged from welfare-reform *objectives* but mostly took the *form* of changes to tax-based assistance. A major impact of the changes will likely be an increase in the incomes of a range of low- and middle-income families, thereby reducing poverty, improving the distribution of income, and increasing income-tax progressivity. The changes also slightly improved incentives for non-working families to enter the workforce. Working for Families also changes to some degree the roles of the MSD and the IRD, resulting in (among

[28] Some useful research in this area is emerging from the field of behavioral economics. Research shows, for instance, that something labeled a 'tax' is viewed very differently from a 'user fee', even when they are assessed identically. (This seems to be related to a well-known principle of cognitive psychology known as 'penalty aversion', under which people typically have a greater desire to avoid penalties than to receive bonuses. Perhaps taxes are viewed as penalties, while user fees are in the user's mind netted out against the benefits of the service.) See McCaffery and Baron (2005), for example.

other things) an increased level of Family Assistance expenditures for the IRD and an expanded community-outreach role for the MSD.

Going forward New Zealand is likely to consider policies that break down the artificial distinction between ‘beneficiaries’ and ‘non-beneficiaries’/‘working families’ to recognize that low-income families, whether working or not, may need a range of types of assistance. Rules limiting the In-Work Payment and the Family Tax Credit to non-beneficiaries who work at least 20 hours per week could be eliminated, perhaps in favour of providing wage subsidies on a sliding scale, to reflect increasing movement of people in and out of work.

It will also be important to monitor closely the roles of the IRD and the MSD in administering the programmes for which they are responsible. Additional research on the institutional functions of the two agencies as Working for Families goes forward will be useful.

2 WORKING FOR FAMILIES AND THE WORK OF TWO-PARENT FAMILIES

A consequence of Working for Families is that a larger number of *two*-parent families with children than before will qualify for Family Assistance. Sole-parent families in New Zealand tend to have relatively low incomes, and most of them were receiving Family Assistance prior to the Working for Families changes. By contrast most two-parent families have somewhat higher family incomes, not only because they can combine two incomes but also because the average wages of partnered couples are higher. For the purposes of Family Assistance calculations as well as for benefits, partnered couples include both legally married couples and couples who live together.

Partnered couples represent about two-thirds of New Zealand families with children, but prior to Working for Families they represented only about one-third of Family Assistance recipients (the rest were sole parents). By 2008 the MSD estimates that the ratio will be closer to 50-50.[29]

However, even as it reaches more couples Family Assistance will remain a means-tested benefit. Any middle-income family who receives Family Assistance will be in the position that as their total family income rises the amount of Family Assistance for which they qualify will decline. For every additional $1,000 income, they will lose $300 worth of Family Assistance. In economic terms this is equivalent to a 30 percent marginal tax rate, and it will lie on top of statutory marginal tax rates that for most middle-income New Zealand families equal 15 to 33 percent.

So Working for Families will have two impacts on many middle-income New Zealand families. Their disposable incomes will rise by anywhere from a few hundred to a few thousand dollars. And their effective marginal tax rates (EMTRs) will also rise by 30 percentage points, to somewhere between 45 and 63 percent. EMTRs could go even higher if the family participates in another means-tested programme such as the Accommodation Supplement, means-tested student loan repayment, or child care subsidies. Of the families facing the 30 percent Family Assistance abatement rate after Working for Families is fully implemented roughly two-thirds will be partnered couples.

There are at least two reasons for potential concern about these high EMTRs for two-adult families. One is that they might discourage some parents from entering the workforce or increasing their hours of work, or encourage them to reduce their work, even if in the absence of the high rates the parents would choose to work. For reasons described below this is likely to particularly affect partnered mothers with young children. The relatively low participation of young mothers in the paid labour force is already causing concern among some New Zealand policy-makers.

A second reason for high concern about high EMTRs is that they might discourage working parents from marrying or partnering, or encourage them to separate, even if in the absence of the high EMTRs they might choose to partner. This second reason is discussed in Chapter 3.

[29] MSD (2004).

This chapter begins by describing the extent of high EMTRs in the middle class in the post-Working for Families era, then turns to the first concern mentioned above: the impact of those high EMTRs on secondary earners. It asks specifically:

- Will Working for Families cause partnered parents to cut back on their workforce participation?
- If so, what are the consequences? And what are the solutions?

Family Assistance: family neutral, not partner neutral

New Zealand levies income taxes on an individual basis not a family basis, which means that primary earners and secondary earners in a family are taxed identically and without regard to their marital status. Individual income taxation is the most common method of taxation among developed countries. In 1999, 18 OECD countries either levied income taxes individually or allowed couples the option of filing individually, while only the United States and four other countries levy income tax on a family basis.[30]

In other words, each partner pays taxes separately on his or her own income, according to the same tax scale used by single individuals: 15 percent of the first $9,500 in annual income, 21 percent of income between $9,500 and $38,000, 33 percent of income between $38,000 and $60,000, and 39 percent of income over $60,000. A person's tax is not calculated with regard to his or her partner's income at all. Two schoolteachers with the same salaries are taxed at the same marginal rates, even if one is married to a high-income heart surgeon and the other is married to a low-income labourer. In fact for purposes of income tax calculation the Inland Revenue Department does not even inquire as to whether a person is partnered or not.

The downside of this approach is that New Zealand's basic income tax, while *marriage*-neutral and *partner*-neutral, is not *family*-neutral. Two families with the same total incomes can pay quite different levels of taxes if the earnings are divided among two workers. For example, a family where one worker earns $60,000 pays $14,670 in taxes; and a family with the same total income split evenly between two workers pays $11,460 in total income taxes.

The Family Assistance tax credits, on the other hand, are *family*-neutral but not *partner*-neutral: that is, they treat families with equal incomes equally, but levy partner penalties on families. So the calculations of Family Assistance takes into account both parents' earnings. The upside of doing this is that it targets assistance to needy families in order to keep the budgetary impact under control. Were Family Assistance simply abated on an individual basis then families with much higher total incomes would qualify, at a significant additional cost to the government.

[30] Kleven and Kreiner (2002).

The growing prevalence of high EMTRs among secondary earners

For a secondary earner using family income to calculate Family Assistance abatement means that the first dollar of earned income may force abatement of Family Assistance if total income is within the abatement zone. The problem is that as it turns out, the abatement zones in Family Assistance coincide with a very common income range among New Zealand families.

The table below shows the income ranges over which Family Assistance will abate beginning in 2007-08. One-child families with incomes between roughly $33,000 and $52,000 wouldn't have received Family Assistance without Working for Families but will receive it now. Families with four older children with incomes between $68,000 and $94,000 wouldn't have received Family Assistance without Working for Families, but will receive it now. By comparison, pre-tax median household income in New Zealand in 2004 was about $46,000, so many middle-income families who previously would have qualified for little or no Family Assistance will now fall quite squarely within the abatement range.[31]

Table 2.1. Examples of range of family incomes over which Family Assistance is abated, pre- and post-Working for Families

Number of children and ages	Abatement range before WfF	Abatement range after WfF	Range of incomes newly affected by WfF
One child under 12	$20,000 to $33,000	$27,500 to $52,000	$33,000 to $52,000
Two children under 12	$20,000 to $42,000	$27,500 to $61,000	$42,000 to $61,000
Two children, one 13, one 16	$20,000 to $45,000	$27,500 to $65,000	$45,000 to $65,000
Three children under 12	$20,000 to $50,000	$27,500 to $71,000	$50,000 to $71,000
Four children, 13, 15, 16, 18	$20,000 to $68,000	$27,500 to $94,000	$68,000 to $94,000

Note: Abatement rate pre-Working for Families was 18 percent for incomes between $20,000 and $27,500 and 30 percent above $27,500. Abatement rate post-Working for Families is a flat 30 percent for all incomes above $27,500. Thresholds will be adjusted for inflation after 2008. Amounts are rounded.

In other words more families are affected by Family Assistance abatement than before. And the impact on many families is greater because the high EMTRs apply across a broader range of potential incomes for that family.

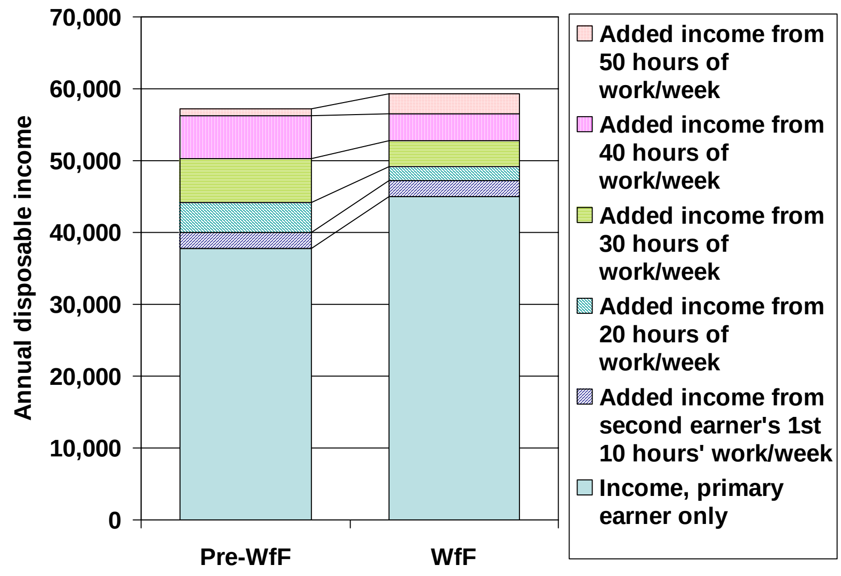
The rate of FA abatement is of particular concern because it lies atop of other sources of high EMTRs in the New Zealand tax and transfer system. Other sources include the Accommodation Supplement, which is also being expanded further up the income scale; the abatement of benefits; and statutory tax rates.

Figures 8 and 9 show the twin effects of the Working for Families changes: increasing incomes but also increasing EMTRs across at least a portion of the second earner's

[31] See Perry (2005). The comparison between this figure and the income ranges shown in Table 2.1 is imperfect for two reasons. First $46,000 is the median income for all households; families with children are likely to have slightly higher incomes than other households. Second, $46,000 is a 2004 figure; the post-Working for Families ranges will not be adjusted for inflation until after 2007-08, so rising incomes will likely move some families above the abatement range by then if for no other reason than inflation. Nonetheless many or most middle-income New Zealand families will still have incomes in the abatement range.

potential income range. This example shows a couple with three children, receiving an Accommodation Supplement at Central Auckland levels, in which one parent (the 'primary earner') is assumed to earn $40,000 per year. The graphs show how disposable income rises and how EMTRs change as income changes.

Figure 8: Income of a Two-Parent Family with Three Children by Secondary Earner's Hours Worked, Before and After Working for Families



Income before and after Working for Families for a two-parent family with three children, ages less than 12, receiving Central Auckland accommodation supplement, assuming one parent earning $40,000/year and second earner's wages at $15 per hour.

Figure 9: Disposable Income and EMTR for a secondary earner, without Working for Families

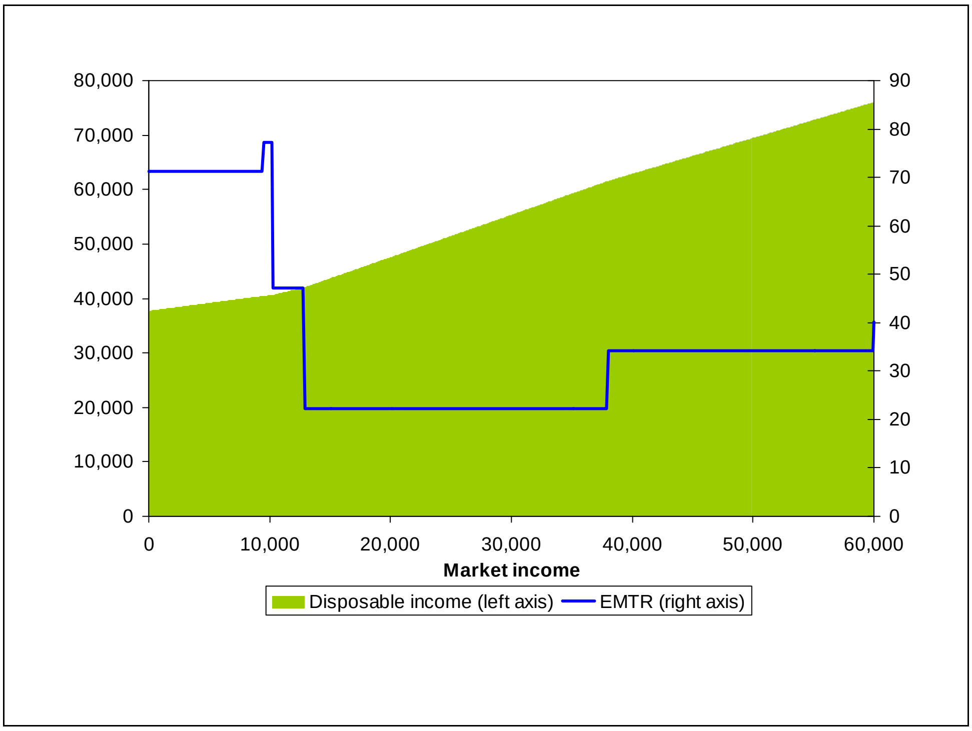
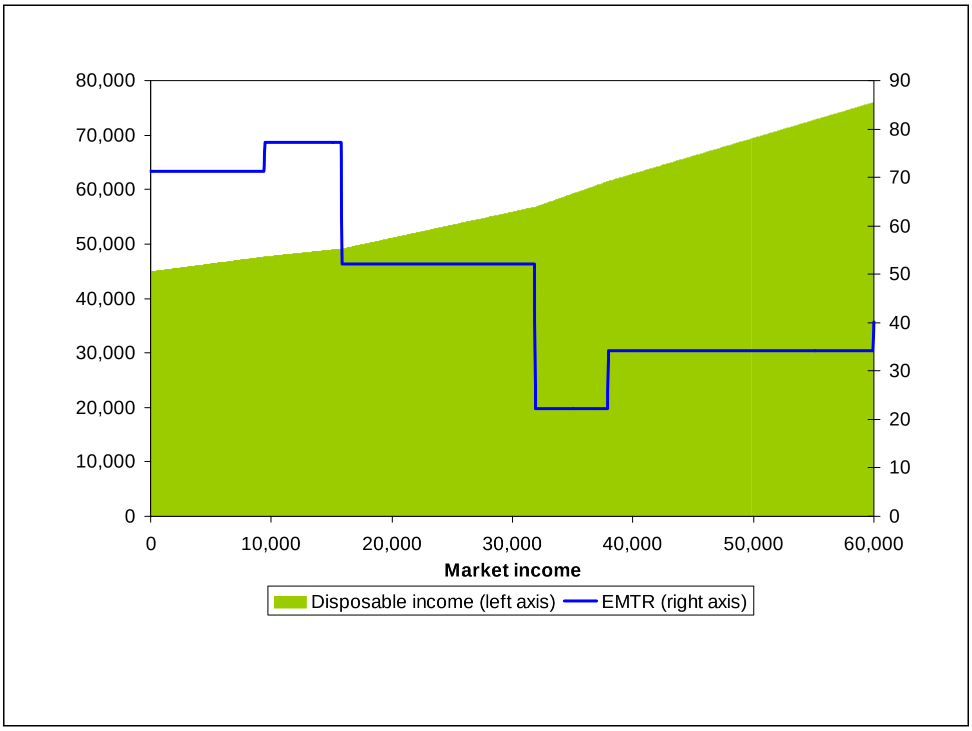


Figure 10: Disposable Income and EMTR for a secondary earner, after Working for Families



Note: Both figures are for a partnered couple with three children in which one parent (the 'primary earner') is assumed to earn $40,000. Maximum Central Auckland accommodation supplement is assumed.
Source: TaxMod.

These figures show that either pre- or post-Working for Families the first $10,000 or so of earnings by the secondary earner have an EMTR of about 70 percent — that is, those $10,000 result in only about $3,000 increase in disposable income.

The big difference is that Working for Families reduces the increase in disposable resulting from the *next* $25,000 in earnings. Those additional earnings yield roughly $19,000 before Working for Families but only about $11,000 post-Working for Families.

The family shown in these graphs is not entirely typical. Most working families in New Zealand neither live in Auckland nor receive the maximum Accommodation Supplement, so this example slightly exaggerates for purposes of illustration the actual impact of EMTRs. On the other hand an earnings level of $40,000 is quite typical.

Using TaxMod it is possible to estimate how the distribution of high EMTRs in New Zealand is shifting. The details are shown in the Appendix to this report.

- Before Working for Families, over half of New Zealand families facing EMTRs of 41 percent or above were headed by sole parents. Such high EMTRs were less common among married couples.

- After WfF, the balance shifts. By increasing the income levels at which Family Assistance credits abate, Working for Families will double the share of two-parent families facing high EMTRs. At the same time, WfF slightly reduces EMTRs faced by sole parents, principally because sole parents typically have lower family incomes.

- The numbers are significant. When Working for Families is fully implemented an estimated 19 percent of secondary earners with children — roughly 93,000 families — will face EMTRs in excess of 41 percent, according to the TaxMod estimates. That is an increase from 8 percent or 38,000 without Working for Families.

Despite the substantial number of families with EMTRs above 41 percent, few of those families face EMTRs greater than 55 percent. To be sure, some families' EMTRs are much higher, even approaching 100 percent. Other than beneficiaries however, these families appear to be relatively few and far between. TaxMod estimates suggest that only about 10,000 married couples with a full-time worker face EMTRs greater than 55 percent.

The 30 percent abatement rate for family support payments is the single largest factor driving high EMTRs. New Zealand has many means-tested programmes, none of which (other than basic benefits) by themselves have EMTRs over 40 percent, but can in combination reach much higher levels. For most secondary earners considering whether to work full-time, part-time, or not at all, high EMTRs are most attributable to the combination of a Family Support abatement of 30% and statutory tax rates that typically range from 15% to 33%.

Will higher EMTRs lead some women to exit the paid workforce?

As a rule there is broad economic consensus that most men and women make their decisions about whether to work and how much to work based on factors *other* than marginal tax rates. But international studies suggest that women, specifically partnered mothers, are different: their labour force participation is quite responsive to financial incentives, including marginal tax rates. A study of the U.S. Earned Income Tax Credit expansion from 1984 to 1996 — which resulted in a 21 percent increase in the EMTRs of some married women — found that it reduced the labour participation rate of low-wage married women by a full percentage point (the increase for married men was much smaller). Married women facing the highest EMTRs as a result of the EITC expansion were most likely to exit the labour force, with an overall reduction in labour supply of about two percentage points.[32]

For any family, a whole host of reasons can affect workforce participation. For two-parent families the decision can be particularly complex. Factors can include the long-term economic consequences of staying out of the workforce, the relative psychological benefits of staying home and going to work, the short- and long-term impacts on child well-being and on the relationship between the parents, and so on. But an obvious first-order question for a couple to consider is how much economically better off the family will be if both parents work.

Those first-order financial calculations include, but are not limited to, high EMTRs. They also include the wages that the secondary earner might be able to command and the costs of going to work, such as child care and transportation. Even before Working for Families increased EMTRs for middle-income families, the trade-off between wages and the costs of working were clearly significant.

An analysis conducted for the Treasury by the Melbourne Institute in 2003 found that non-working married mothers tended to have substantially lower market-earning power than their working counterparts, as measured by qualifications and years of work experience. They also tended to have children under 5, suggesting that child care costs were factors in the decision.

The apparent sensitivity of young mothers to adverse financial incentives has caused particular alarm in New Zealand. Even before Working for Families was fully implemented, the current government expressed concern about the rate of women's labour force participation in New Zealand. OECD studies, backed up by Treasury analyses, have found that New Zealand men, including fathers of young children, have quite high levels of workforce participation. So do most categories of New Zealand women. But of New Zealand women with a child under six years old, just under one-half (49 percent) have jobs. The labour force participation rate among young mothers places New Zealand in the lowest one-third of OECD countries. By contrast the U.S. figure is about 60 percent.[33] Based on these figures, the OECD has

[32] Jaumotte (2003), Kleven and Kreiner (2002), and Eissa and Hoynes (2004).

[33] Johnston (2005). It is not entirely clear why this pattern occurs in New Zealand more than in other countries. The pattern of dropping out of the workforce upon the birth of a child and later returning to the workforce appears to exist across levels of educational qualifications and ethic backgrounds, although the pattern is not quite as strong today as it was 30 years ago.

suggested that New Zealand could close one-third of the per-capita GDP gap between itself and other developed countries by boosting women's participation in paid work. Treasury CEO John Whitehead has quipped, "That short statement has probably occasioned more policy work than any other OECD statement that I'm aware of."[34]

High EMTRs are probably not to blame for this low participation, because those statistics reflect the pre-Working for Families environment, in which EMTRs for second earners were not particularly large. Prior to Working for Families, the OECD found that New Zealand's tax treatment of secondary earners was pretty close to the international average.[35]

Nonetheless the Melbourne Institute's 2003 analysis and other descriptive analyses of New Zealand's non-working mothers are helpful in understanding the importance of high EMTRS, because those non-working mothers probably have counterparts in the workforce —mothers who have chosen to work but could easily exit the paid workforce given a modest change in financial circumstances such as Family Assistance changes.

Like some of their already non-working counterparts these working mothers may have relatively low wages and high child care costs, and for those reasons (as well as perhaps other, harder to quantify reasons) they may be ambivalent about working or not working, at least while their children are young. New Zealand women, particularly young parents, are already moving quite fluidly between workforce and home at different times in their lives. By substantially changing the relative incentives to work Working for Families seems likely to affect the choice of at least some mothers of young children whether or not to work in those years.

In other words, whatever pre-Working for Families factors were pushing down women's labour force participation — and there is at least tentative reason to finger child care costs and child care availability as potential explanations — the post-Working for Families EMTRs are likely to compound those problems for many secondary earners, and may push some of them out of the workforce.

How big might the impact be?

One very rough way to predict the impact in New Zealand might be to take international estimates of the responsiveness of married women's labour-market participation rate to tax changes and apply it to the changes in EMTRs under Working for Families. One survey of the literature reports that a one-percent increase in marginal tax rates is typically associated with a 0.5- to 1.0-percent decline in married women's labour force participation. Applying the low-end of that range to the changes in average EMTRs under Working for Families yields an estimate that

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[34] Remarks to Treasury workshop on labour force participation, April 14, 2005. Whitehead's remarks were actually delivered by another Treasury official. A detailed assessment of the OECD calculation suggests a somewhat lower figure, reflecting the fact that the new entrants into the labour force probably would have lower productivity levels. See Bryant et al (2004).

[35] Jaumotte (2003).

perhaps 9,000 secondary earners with children might change their workforce-participation decision.[36]

A more conservative result emerges from TaxModB, the Treasury's recently acquired model of labour supply described in Chapter One. Considering both the income effects and the substitution effect of Working for Families on all married women, TaxModB suggests that the net labour-force participation rate is likely to decline by 0.43 percentage points. Those rates are small but taken against the national population of nearly 900,000 married women it suggests a potential decline in labour force participation of about 3,600 women plus another several hundred men.[37]

It is important to take these estimates carefully. TaxModB's developer suggests that it could take four years or more for these behavioural suggestions to show up. Given the phased-in nature of Working for Families, it could be 2010 or later when the impacts take effect.

Moreover the numbers are rather small relative to the overall labour market, which already includes some 230,000 working mothers. They are also small relative to the pre-existing 'problem' of non-participation by some secondary earners. Treasury analyst Grant Johnston calculates there are about 110,000 non-working secondary earners with children in New Zealand.[38]

Discerning any Working for Families-induced changes will prove challenging because they might well be very hard to measure as they will be swamped by other factors: changes in the overall demand for labour, changes in productivity and wage rates, changes in parents' preferences, and so on.[39] It does nonetheless seem reasonable to associate Working for Families with a potential reduction in married women's labour force participation in the thousands.

Assessing potential policy solutions

The problem of high EMTRs for secondary-earners was recognized before Working for Families was adopted. Briefing papers prepared before the release show that it was not an accidental oversight but rather a recognized, if undesired, side-effect from what were viewed as other important policy choices: to expand Family Assistance, to improve work incentives, and to target it to needy families. If it could have been fixed cheaply and easily, the briefing papers indicate it probably would have been.[40]

[36] The elasticity estimate is from Kleven and Kreiner (2002). The calculation is based on findings, reported in the Appendix to this paper, that under Working for Families the 107,800 secondary earners in couples with two full-time workers are facing an increase in their EMTRs averaging 4 percentage points, and 183,600 secondary earners in couples with one full-time worker are facing an increase in EMTRs averaging 7 percentage points; (107,800 * 0.04 * 0.5) + (183,600 * 0.07 * 0.5) = 8,600.
[37] Author's calculations based on data in Kalb, Cai and Tuckwell (forthcoming 2005).
[38] Johnston (forthcoming 2005).
[39] From 1986 to 2001, for instance, the total labour force participation rate of all women aged 25-54 rose by 10 percentage points (from 66 percent to 76 percent), which is equivalent to more than 60,000 people – ten times the size of the impacts discussed here. See Johnston (2005).
[40] Before it was unveiled publicly, the Working for Families proposals were submitted to a small number of outside commentators. MSD (2004), *Working for Families Impacts*, pp. 36-40, discusses the concerns raised by those commentators and the policy developers' responses.

Targeting a fix

If the EMTR problem *is* tackled, what should a solution look like? There are probably four principles that should be followed in order to address the problem as directly as possible.

First, any solution should be targeted first and foremost to families with two earners. It may be appropriate to assist sole parents as well, but a solution that benefits a family with one working parent and one non-working parent will not change behaviour. This rules out such broader policies as income splitting, a zero-tax bracket, or reductions in marginal tax rates.

Second, any solution should tackle EMTRs, rather than trying to create a policy 'offset' somewhere else. Since the problem is the increased EMTRs and resulting workforce participation declines resulting from Working for Families, then the solution should address the parameters within Working for Families. This rules out, for instance, policies aimed at increasing the supply of child care, which may be good policy for other reasons but will not address the high EMTRs in Working for Famlies.

This second principle does not rule out policies that somehow take child care costs into account. It is the *interaction* of high EMTRs with other financial aspects of workforce participation, like child care costs, that are most likely to reduce participation.

Third, solutions should target those parents for whom EMTRs are most likely to change behaviour. These include parents with young children; parents who have relatively low wages; and those facing high child care costs.

Fourth, to the extent possible, any solution should take aim at the EMTRs facing secondary earners at their *initial* level of workforce participation. Research suggests that it is the fundamental decision of whether to work or not-work that is most susceptible to high EMTRs, the numbers of hours worked is less susceptible.

One option that meets those principles is to allow the first several thousand dollars — perhaps $10,000 — of a secondary earner's wages to be exempt from the family income calculation for purposes of abatement. For a secondary earner considering entering the workforce this would reduce the cost of taking a job by as much $3,000 (that is, 30 percent of $10,000).

An even better-targeted option would be to allow work-related child care costs to be deducted from the family income for purposes of abatement, up to a specified amount (perhaps $5,000 per child). For a secondary earner considering entering the workforce who faces child care costs, this would reduce the cost of taking a job by as much as $1,500 per child (that is, 30 percent of $5,000).

A less well-targeted, but more comprehensive, approach would be to make Family Assistance entirely universal, that is, to eliminate means-testing for all families or perhaps all but the most affluent. To keep the cost within reason, it could be limited to families with children under six years.

Those options would all work by expanding Family Assistance. There are options that work in the opposite direction, such as scaling back Family Assistance so that it covers a smaller swath of two-income families, or scaling it back only for families without two earners (in essence, the mirror image of the policies above). Such options would probably undermine the anti-poverty and income-adequacy objectives of Working for Families as a whole.

Conclusions: Would a cure be costlier than the disease?

The first option described above might cost between $100 million and $150 million per year. The second option might cost substantially less, the third option much more.

Some simple mathematics suggests that seeking to change the behaviour of a few thousand individuals at a cost of over $100 million per year is equivalent to expenditure in the tens of thousands of dollars per behaviour-changing individual. Most of the benefit from the policy change would accrue to families that are not changing their behaviour at all. And most of those beneficiaries would be families with incomes somewhat above the poverty line and in some cases above the national median. Indeed, if the goal is simply to reduce EMTRs and improve labour supply, it may make more sense to target additional expenditures on sole parents in the benefit system since they continue to face high EMTRs.

Additional data on the characteristics of families affected by high EMTRs would help to make this judgement, such work is presently underway at MSD. So, too, would additional evidence on the responsiveness of parents to high EMTRs – a study that used the 1996-98 expansion of family assistance to measure changes in workforce participation might prove useful, for example. Going forward, the additional data that will be generated from the Working for Families evaluation will prove helpful.

It is also worth noting that the problem described in the following chapter stems from exactly the same roots as the secondary-earner problem. Any policy solution will need to address both problems at once.

The bottom line is that any solution to this problem will involve a large distribution of unfettered funds to middle-income families. In the current policy context of large budget surpluses and some political impetus for tax cuts for ‘middle New Zealand’, it is worth considering that the policy options described above would be a way to distribute the surplus back to middle-income taxpayers in a way that resolves a policy problem.

3 PARTNERING PENALTIES IN THE TAX AND BENEFIT SYSTEMS

In addition to the high marginal tax rates for secondary earners, the Working for Families package has another flaw: it treats many partnered couples less favourably than they would be treated if they were not partnered. This chapter examines the sources of partnership penalties in the New Zealand tax and benefit systems, their size and growth under Working for Families, and the extent to which these growing penalties might be expected to affect basic equity, behaviour, tax compliance, and custodial and child-support choices.

For want of a better term this essay uses 'partnering penalty' to describe the difference between taxation of partnered and unpartnered parents. As this analysis will discuss, the most salient aspect of New Zealand's partnering penalties may not be their actual economic effects but the way in which they are framed. That is, the term partnering penalty — or even more its close cousin, marriage penalty — has significant demagogic potential which I don't mean to endorse.

Declining marriage rates, rising rates of sole parenthood, and the public concern often expressed about these changes — whether that concern is legitimate or not — mean that the combination of 'marriage' and 'penalty' may have significant political implications. 'Partnering penalty' is a more accurate choice than 'marriage penalty' because Family Assistance calculations are based on the income of partnered couples, whether or not they are legally married. As noted in the previous section, *both* married and unmarried couples can claim Family Assistance as long as they are living together. From the perspective of an unmarried couple living together the Family Assistance penalty is for cohabitation.

But even the phrase 'partnering penalty' is a loaded term. An equally accurate term might be 'unpartnered-parent bonus', since the penalty only exists in relation to how a partnered couple might be treated if they were living separately. The branch of cognitive psychology known as 'behavioral economics' teaches us that bonuses and penalties are not typically viewed as the inverse of each other. Most people's aversion to penalties exceeds their attraction to bonuses. As a general rule therefore, bonuses may be viewed as 'fairer' than penalties.[41]

Nonetheless concerns about partnering penalties are more than mere spin. Partnering penalties raise genuine issues of equity, behavioural distortion, and tax compliance, which are addressed below.

Family Neutrality and Partnership Penalties

Like the high tax rates on second earners partnership penalties in New Zealand result from the fact that, while the basic personal income tax scale taxes on an individual basis, Family Assistance amounts are 'family neutral' — calculated based on total family income.

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[41] McCaffery and Baron (2005).

The partnering penalty occurs if two people each have their own income from market sources — for instance, wages—then when they partner, their combined income is higher than either's income separately. This, in turn, is likely to reduce their eligibility for Family Assistance.

Consider, for example, a sole parent of two children with an income of $30,000. When Working for Families is fully phased in this taxpayer can claim family assistance of about $9,500 per year. Under Family Assistance rules every additional dollar of family income results in a loss of 30 cents of family assistance. Therefore an additional $30,000 of family income would wipe out $9,000 of that Family Assistance payment. So if that sole parent partners with someone earning at least $30,000, there is a loss of $9,000 per year of disposable income.

This is a significant increase relative to 2004. Before Working for Families was enacted this family might expect a much smaller penalty. The changes are discussed below.

Note that Family Assistance is far from the only programme that means-tests family income. Other forms of assistance to families abated based on family income include Accommodation Supplements, child care subsidies, and major means-tested benefits such as Domestic Purposes Benefit and Unemployment Benefit. Although this chapter focuses on the new partner penalties created under Working for Families, a reassessment of the existing partner penalties under the benefit system may also be in order.

The Consequences of Partnering Penalties

Partnering penalties can be problematic for at least four reasons. The first is that they may be viewed as inherently unfair. The widely recognized tax policy principle of 'horizontal equity' holds that similarly situated taxpayers should be treated similarly. It may be expressed as simply as the words of one U.S. Senator: "We believe people should be treated the same if they get married".[42] The problem, discussed below, is that horizontal equity is difficult to achieve because it runs into alternative principles of equity that may be at least equally valid.

The second reason is the possibility of *behavioural* responses. There is reason to believe that large partner penalties could distort families' decisions about whether or not to cohabit or marry. Such distortions would reduce the number of two-parent households with potential implications for child development, social policy, and economic efficiency. The size and importance of those responses, however, are open to some debate – the section below provides some discussion and international evidence.

The third reason for concern about partnering penalties is the possible *compliance* issues that they raise. Penalties that can range into the tens of thousands of dollars can encourage couples to lie about or fudge their partner status. One result of the Working for Families package is that a higher share of partnership penalties will fall

[42] Kay Bailey Hutchison, July 18, 2000, found at http://hutchison.senate.gov/speec117.htm.

under the jurisdiction of the Inland Revenue Department who typically rely on self-reporting of partner status, with relatively minimal audit and enforcement activities.

The fourth reason for concern about partnering penalties is that under some circumstances they may affect the economic support of children and the way that partners 'negotiate' their family choices.

Whether partnering penalties are 'fair' depends on the preferred definition of fairness

The concept of partner penalties or marriage penalties often evokes strong responses, because it may run afoul of one or more deeply held values. One such value is that marriage or partnering is a fundamentally private or personal decision, which government should neither reward nor punish financially. That is, the state should be entirely neutral toward marriage. In an article discussing in general terms the best forms of public policies toward married couples one New Zealander writes, "The onus is on individuals to develop functional relationships and to maintain them, rather than to have to accommodate pressure coming from outside".[43] Although the writer was not referring to financial incentives, the existence of large disincentives to partnering might indeed be viewed as "pressure coming from outside".

This view of the decision to partner as essentially private partly explains the choice by New Zealand — and by a majority of other developed countries — to levy taxes on an individual basis. In this way, there are no partner penalties.

In tax policy terms the principle of horizontal equity holds that similarly situated taxpayers should be similarly taxed. In other words, small differences between taxpayers should not lead to big differences in their treatment under the tax code. This begs two questions: How important are the differences between partnered couples and their unpartnered counterparts? And is there a fair way to reflect these differences in the tax code?

Partnering can clearly have positive economic consequences. Since a married couple can buy in bulk they have greater purchasing power, which in effect makes them better off than unpartnered couples. The challenge here is figuring out *how much* better off a partnered couple might be. The Revised Jensen Scale — which is used by the Ministry of Social Development in a variety of contexts to adjust data for family size and structure — suggests that a couple with two children are approximately 25 percent better off partnered than unpartnered.[44]

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[43] Pryor (2005).

[44] The Revised Jensen Scale, developed by Ministry of Social Development researcher John Jensen, states that in order to have purchasing power equivalent to a single adult living alone, a family with one adult and two children would require income that is 1.75 times as great as the single adult, and a family with two adults and two children would require income 2.17 times as great as the single adult. By this approach a single-person household with an income of $20,000 may be said to have roughly the same purchasing power as a two-adult, two-child household with a total income of $43,400. See discussion in Bryan Perry, "Working for Families: The Impact on Child Poverty," *Social Policy Journal of New Zealand*, July 2004. Note that Treasury's TaxMod microsimulation model does not use the Jensen scale but the similar Whiteford scale, which (for instance) assumes that in order to have purchasing power equivalent to a single adult living alone, a family with one adult and two children would require

One conclusion that might be drawn from that rough calculation is that public policy should compensate fully for this 25 percent differential, in order to ensure that a parent with a given income level is roughly as well off with a partner as without a partner. A broad body of evidence suggests that family income, holding everything else constant, is a key determinant of child outcomes. It may be plausibly argued that the state should subsidize sole-parent families to a greater degree in order to avoid a situation where children of sole-parent families systematically have worse outcomes than married-couple families. As it turns out, and will be shown below, Family Assistance may have the effect of roughly equivalizing the incomes of sole-parent and two-parent couples.

The potential problem is that this is economically equivalent to taxing-away all of the economic benefits that a couple might realize from partnering.

A crucial aspect of partner penalties is that they exist chiefly as a function of two other concepts of fairness. One of these is vertical equity or progressivity, which is essentially what causes Family Assistance to be means-tested in the first place. Another is the principle of family neutrality: two families with equal total incomes should be treated equally regardless of whether there is one parent or two. Indeed, this argument could even be extended to the principle that a two-parent family should be taxed *less* than a sole parent family with the same level of income because the two-parent family has more human resources to share the burdens of parenting.[45] The problem with these dueling conceptions of equity is that it is difficult for most citizens, many lawmakers, and even many sophisticated government officials to reconcile them.[46]

In short, the fairness argument — which on its surface may seem the most compelling reason for concern about partner penalties—is at least somewhat undermined by the simple logistical challenge of reconciling with other important issues of fairness. There are two other potential reasons to be concerned about partnering penalties, however, their impacts on actual family structure and their impacts on compliance.

Rising partner penalties may split up families, with potential social and economic consequences

Marriage rates have been falling, and divorce rates have been rising in New Zealand, as in other countries, for several decades. (See Figure 11.) To some extent marriages have been replaced by informal partnering arrangements and unions, but the increase in unmarried partnerships does not fully account for the decline in marriage, including among parents. The decline in marriage and the rise in divorce have been

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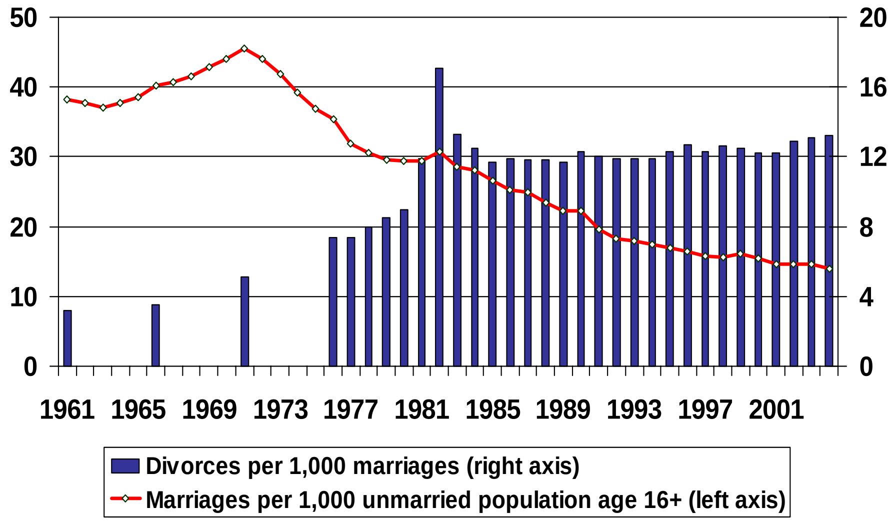
income that is 1.72 times as great as the single adult, and a family with two adults and two children would require income 2.16 times as great as the single adult.

[45] Another potential critique of partner penalties is that the state should, if anything, structure policies in ways that endorse marriage as an institution. This principle holds that marriage is *not* a fundamentally private or personal decision but rather a public institution that the government should support. This argument supports recent policy changes in both tax policy and welfare policy in the United States whose goals are to support marriage, described later in this chapter. It is less relevant in New Zealand because cohabitation, not legal marriage, is the cause of penalty.

[46] McCaffery and Baron (2004) use experimental techniques to show the difficulty that subjects have in reconciling tax progressivity and various forms of tax-neutrality in the context of family structures.

accompanied by an increase in sole parenthood. In 1986, 15.7 percent of children lived with a sole parent; by 1996 that figure had risen to nearly 25 percent. Slicing the numbers a slightly different way, of the roughly 600,000 families with children in New Zealand some 30 percent now are headed by a sole parent. Some recent evidence suggests these trends have eased, but not reversed.

Figure 11: Marriages and divorces in New Zealand, 1961-2003



Source: Statistics New Zealand. Divorce data not available for 1962-65, 1967-70, and 1972-75. Pre-1991 figures include visitors from overseas; post-1991 figures include residents only. The spike in divorces and marriages in 1981 reflects the introduction of no-fault divorce in New Zealand in that year.

For at least some couples, economics — including the change in net tax liability or benefit eligibility — may play a role in the decision to become, or to remain, partnered. As noted earlier the partner penalties described in this paper could be described as sole-parent bonuses, because they function as rewards to parents who choose to separate or not to partner in the first place. This, in turn, may have any number of implications for child development, for general social welfare, and for overall economic efficiency.

- At the most basic level, the practice of heavily subsidizing parents for living separately is equivalent to publicly subsidizing the increased costs of living separately. In other words, parents may be making a costly decision on living arrangements because the [government] is picking up the cost. In economists' terms, this causes a 'deadweight loss': society is spending money on something, in this case housing and other costs, on which individual actors wouldn't choose to spend their own money.

- Moreover, there is at least some evidence that partnering and marriage are good for children, good for parents, and (by extension) good for society as a whole.[47] Married people earn more, live longer, and have healthier lives

[47] See for instance Wilson and Oswald (2005).

than their unmarried counterparts. Their children may also fare better, although the evidence is mixed and there are many complicating factors.

If New Zealand's partnering penalty were to actually reduce the number of two-parent families, then it might be bad for society. If, on the other hand, parents' partnering decisions turn out to be almost entirely independent from financial incentives, then there is less cause for concern.

Over the next few years, as Working for Families is implemented, it may be possible for researchers to measure whether patterns of family formation are changing in response. This topic is among the items that are to be studied under MSD's evaluation of Working for Families. The evaluation will include a longitudinal study of Family Assistance recipients from which it may be possible to measure any changes in family formation resulting from the changes.

In the meantime the U.S. tax code offers a good laboratory for studying the effects of taxes and tax credits on marriage decisions, because different families face different penalties and bonuses for marrying under various provisions of the U.S. code and because those provisions have changed over time. A series of studies have shown that U.S. marriage penalties can reduce the likelihood of marriage and increase the probability of divorce.[48] (A broader discussion of the U.S. marriage-penalty debate is appended to this chapter.)

Studies that focus on the U.S. Earned Income Tax Credit can be particularly helpful. Like Family Assistance the EITC generally is limited to low- and moderate-income families with children. It has also been one of the principal sources of marriage penalties in the U.S. tax code because while a single parent with full-time low-wage earnings can qualify for an EITC of more than US$4,000, until recently most married couples with two workers qualified for much less if anything.

A 1999 U.S. study by two California university researchers found that a US$1,000 (NZ$1,400) increase in the EITC translated to a 1.3 percentage point reduction in the probability of marriage. A 2001 study by Syracuse University economist Stacy Dickert-Conlin and a colleague found that a US$100 increase in the EITC might translate to a decline of 0.2 to 1.0 percentage points. Harvard University economist David Ellwood finds that any impacts may be simply too small to measure.[49]

It is not entirely clear that these studies are applicable to New Zealand. The U.S. marriage penalty, after all, is just that: a penalty for legal marriage, not for cohabitation. A parent who lives with her child and with a partner can typically claim the EITC, as long as the partner is not the child's father. Different factors play into a decision to cohabitate rather than marry, and different factors play into a decision to live separately rather than divorce.[50]

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[48] Leslie A. Whittington, "Marriage Penalty," *Encyclopedia of Taxation and Tax Policy*, Urban Institute, 1999, http://www.urban.org/pubs/taxation/whittington.html.
[49] Dickert-Conlin and Houser (2001); Ellwood (2000).
[50] On the other hand, this could *increase* the impact of the partnering penalty on the actual partnering decision. There is some evidence to suggest that non-married partnered relationships are less long-lasting than married relationships which may mean they are more susceptible to increases in the economic incentive to separate.

Yet the sheer size of the increased New Zealand partnering penalty, and the extent to which it will affect couples that it did not affect before, makes it more difficult to ignore the possibility of at least some behavioural impacts. Even excluding the higher-end U.S. estimates, the U.S. results suggest that marriage-penalty increases in the range of several thousands of dollars *could* result in a decrease in the number of two-parent families — and therefore result in an increase in sole parents — numbering in the thousands or even tens of thousands. But the U.S. evidence is sufficiently mixed, and its applicability to New Zealand sufficiently unclear, that it is hard to say with any certainty whether there will be any noticeable impact at all.

Partner penalties may reduce taxpayer compliance

There is another kind of behavioural change that New Zealand families might make in response to partner penalties. They may choose not to disclose their status to the IRD. The increase in partner penalties carries with it an increased risk of non-compliance.

New Zealand's individual-based income tax system makes it fairly easy to both administer and comply. The IRD tracks each individual's earnings throughout the year and levies tax through the PAYE system. There is no need to file a form or return. Indeed, administrative simplicity is probably an even stronger argument for individual taxation than marriage neutrality.

By contrast, in order to receive Family Assistance a parent must fill out Form FS-1, 'Family Assistance Registration'. The form asks for information about one's partner (specifying that "partner means a husband, a wife, or someone with whom you have a relationship similar to marriage") as well as about children and earnings.

Once a parent begins to receive Family Assistance no further filings are required. Just as annual tax returns are no longer required, so there is no affirmative process that a parent must go through on a yearly basis to reassert the right to Family Assistance. The IRD does seek to regularly confirm eligibility, but it would be relatively easy for a taxpayer to ignore those efforts.

The form of the deception that a family might undertake could vary quite a bit, from flat-out tax evasion (probably pretty rare) to mere tax avoidance or something in-between — 'tax avoision'. A parent could choose to lie; a parent could choose simply not to report a change in partner status; or a couple could choose to adopt a form of relationship that confers on them most of the benefits of partnering while seeming to remain just shy of the definition of a formal partner. For instance, a person in a relationship might spend a very large share of waking hours with a significant other and her children but maintain a legal residence with other family members. A $9,000 penalty may be sufficient to offset any costs associated with such a flexible arrangement. A substantial share of non-compliance with the U.S. EITC rules is related to the marriage penalties that it creates.

This problem has existed in the benefit system for some time. However, there is a level of personal contact between beneficiaries and the agency that can help prevent such deception. Moreover, the MSD maintains a 'benefit fraud unit' a part of whose job it is to investigate reports of cohabitation. The IRD's enforcement unit is, quite reasonably, more focused on the 'big fish' in the tax system: high-income taxpayers and large businesses for whom each dollar spent on enforcement is most likely to yield the best returns.

There is another reason that some level of non-compliance is inevitable: it is part of the cost of having a system that is both inexpensive to administer and accessible to legitimate beneficiaries. Family Assistance by most accounts appears to have relatively high rates of participation by eligible families,[51] and the IRD's budget for administering it is relatively modest.

Arguably, non-compliance may even be seen as a third-best solution to the partner-penalty problem. In essence, partnered couples may legislate their own partner-penalty relief. But this argument essentially abandons the notion that the rules for tax-based assistance reflect careful and deliberate policy design. If it contributes to general public skepticism about the fairness and appropriateness of taxes and transfers, then it could reduce compliance even more broadly.

If we bear in mind that Family Assistance is a provision of the tax code, then the IRD's decision to concentrate resources on higher-yield enforcement work seems justifiable. It is hard to justify chasing a small number of low-wage mothers and fathers for a few thousand dollars each, when there are probably much larger enterprises to chase.

Nonetheless the expansion of Working for Families creates a changing compliance environment. Studies in the United States have shown that expansions in the EITC have led to even greater increases in rates of non-compliance. Although EITC noncompliance remains a small share of the total gap between taxes paid and taxes owed, the visibility of the issue has led to increased political pressure on the IRS to develop new compliance strategies. Some of those strategies, such as increased audits and increased demands for documentation, have adversely affected legitimate EITC recipients.[52]

Partnering penalties may affect how families negotiate partnering status and the support of children

The decision of whether to partner or not is a complicated one. One complication is that the two potential partners may have different incentives or barriers to partnering. The existence of partnering penalties may be felt in different ways by the two parents. Partnering penalties are typically conceptualized as if they are borne *jointly* by a partnered couple. But it is worth remembering that the decision to partner is negotiated between two individuals. That is, if the partner penalties affect the individuals differently, it may affect their relative desires to be partnered.

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[51] Nolan (2005).

[52] See discussion at Burman (2003). On the other hand, a very recent Internal Revenue Service study finds that income tax non-compliance in general costs the federal government over $250 billion per year, an amount equal to about 15 percent of revenue, with some aspects of the income tax associated with far higher non-compliance rates, a finding which provides useful context for the few billions of dollars lost due to non-compliance in the EITC. See U.S. Internal Revenue Service (2005).

The partnering penalties in New Zealand are entirely child-based because they are based on Family Assistance. It is important to note that for an unpartnered couple, there may be another factor in the income of sole-parent families with children: child support.

Child support in New Zealand is typically determined according to a fixed, means-tested formula based on the number of children and the non-custodial parent's income. For two children child support equals 24 percent of pre-tax income, subject to a minimum and maximum. Child support is payable to the custodial parent or, if the custodial parent is a beneficiary, to Inland Revenue.

Working for Families increased the incomes of parents with dependent children, but it did not change the child support formula. One consequence is that while Working for Families increased the net disposable incomes of custodial parents — and thereby reduced the financial burden of supporting children — it did not affect the incomes of non-custodial parents, even those who also bear a portion of the financial burden.

So even as Working for Families is *decreasing* incentives to be partnered, it is *increasing* incentives to be a custodial parent. The actual measurement of these incentives is discussed in the following section.

Measuring the Size and Extent of Partner Penalties in New Zealand

Measuring the size and extent of partner penalties is not entirely straightforward. The simplest illustration is to use prototypical couples, varying incomes, family size, and eligibility for benefits to illustrate the range and variation in penalties. A challenge in either case is that a mode of comparison is not always clear. Take a partnered couple with individual earnings of $50,000 and $30,000 and two children. We want to compare their current treatment under the tax system to how they'd be treated if unpartnered, but we cannot know which parent the children would live with, or whether one would live with each.

This section uses the prototypical method to show both the *size* and the *extent* of partnering penalties for typical families. The assumptions here present a reasonable picture of the new partnering penalties; a microsimulation analysis would present a richer and more detailed picture.

The size of partnering penalties: an example of a couple facing a $9,000 penalty

To illustrate the changing magnitude of partnering penalties it is helpful to spotlight one prototypical couple whom we will call Pat and Kim. Both have market earnings of $30,000. If they are not partnered, Kim has custody of their two children (both aged 12 or less) and Pat lives alone. If they are partnered, they share custody of those two children.

Table 3.1. An Example of a Partnering Penalty Pre-Working for Families

	Pat alone	**Kim, custodian of two children**	**Total of Pat and Kim, unpartnered**	**Pat and Kim, partnered with two children**
Wages	$30,000	$30,000	$60,000	$60,000
Income taxes	-5,730	-5,730	-11,430	-11,430
Family Assistance	0	3,630	3,630	0
ACC wage tax	-360	-360	-720	-720
Disposable income	23,910	27,540	51,450	47,820
Partnering penalty relative to unpartnered sum:				3,630
Partnering penalty as share of total market income:				7%

The table above shows that by partnering Pat and Kim lose $3,630 in family assistance, or seven percent of their disposable income. In this case there is a single cause of the penalty: Family Assistance. Under pre-Working for Families rules a family with total income of $30,000 qualifies for $3,360 in FA; a family with total income of $60,000 qualifies for none, hence the partner penalty.

The next table shows how this partnering penalty changes for Pat and Kim under Working for Families. It shows that the increase in Family Assistance has the consequence of increasing the family's income, but also increasing the couple's partnering penalty.

Table 3.2. An Example of a Partnering Penalty Post-Working for Families

	Pat alone	**Kim, custodian of two children**	**Total of Pat and Kim, unpartnered**	**Pat and Kim, partnered with two children**
Wages	$30,000	$30,000	$60,000	$60,000
Income taxes	-5,730	-5,730	-11,430	-11,430
Family Assistance	0	9,598	9,598	598
ACC wage tax	-360	-360	-720	-720
Disposable income	23,910	33,508	57,418	48,418
Partnering penalty relative to unpartnered sum:				9,000
Partnering penalty as share of total market income:				16%

Note: Tax calculations shown do not reflect the adjustments to income tax thresholds scheduled for 2008.

Adding Accommodation Supplements to these calculations further increases the partnering penalty. The table below shows that the partnering penalty rises again, to $16,395 or 27 percent of market income. These calculations assume Central Auckland rents of $300 for each family type, so they represent a high-end rather than a typical penalty even for Accommodation Supplement recipients. In addition, the table is based on the assumption that housing costs are flat for all family units. In fact housing costs will normally vary by family size. Larger families will spend more on housing than smaller families although the increase is not proportional.

Table 3.3. An Example of a Partnering Penalty Post-Working for Families, With Accommodation Supplements

	Pat alone	**Kim, custodian of two children**	**Total of Pat and Kim, unpartnered**	**Pat and Kim, partnered with two children**
Wages	$30,000	$30,000	$60,000	$60,000
Income taxes	-5,730	-5,730	-11,430	-11,430
Family Assistance	0	+ 9,598	+ 9,598	+ 598
ACC wage tax	-360	-360	-720	-720
Accom. Supp.	+ 4,135	+ 6,083	+ 10,218	2,823
Disposable income	28,045	39,591	64,426	48,031
Partnering penalty relative to unpartnered sum:				16,395
Partnering penalty as share of total market income:				27%

Note: Assumes Auckland rents of $300/ month in all cases.

Because of the relatively heroic assumptions about actual accommodation costs that partnered and unpartnered families would face, and because many non-beneficiary families do not receive the Accommodation Supplement, the rest of the tables in this chapter do not assume receipt of an Accommodation Supplement. It is worth bearing in mind, however, the significant *upward* pressure they can place on partnering penalties.

The distribution of partnering penalties within the couple

Which individuals within a family are most affected by partnering penalties? One way to think about these partnering penalties is to assume that Family Assistance specifically benefits the children. This would suggest that children bear 100 percent of the partnering penalty, that is, Family Assistance works specifically to offset the negative economic consequences of the lower income that family experiences in the absence of one parent.

In fact, even if it is intended to assist children, Family Assistance affects the economic circumstances of parents as well. The availability of Family Assistance might influence the extent to which sole parenthood is seen as acceptable. On the other hand, as discussed above, the custodianship of children has significant economic costs.

Table 3.4 shows equivalized and unequivalized income for Pat and Kim, with and without a child-support relationship.

Table 3.4. An Example of a Partnering Penalty in 2008, Taking Into Account Child Support

	Pat alone	Kim, custodian of two children	Pat and Kim, partnered with two children
Without child support:			
Disposable income ($)	23,910	33,508	48,418
Equivalence ratio	*1*	*1.75*	*2.17*
Equivalized income* ($)	23,910	19,147	22,312
With child support:			
Disposable income ($)	19,779	37,639	48,418
Equivalence ratio	*1*	*1.75*	*2.17*
Equivalized income* ($)	19,779	21,508	22,312
* relative to single adult			

Without child support, Kim's equivalized family income unpartnered is lower than it would be if they were partnered, while Pat's equivalized family income is higher. This formulation suggests that it is in Kim's economic interest to partner but not in Pat's interest.

Child support, however reduces Pat's income and increases Kim's income. Table 3.4 shows that, in equivalized terms, both of them now are slightly better off partnered than unpartnered.

One conclusion drawn from the calculations in Table 3.4 is that adjusting for the economies of scale realized by Pat and Kim roughly offsets the partner penalty. In other words, Family Assistance compensates this couple for the economic cost of separating or failing to partner. If Pat is the biological parent child support can distribute income in such a way as to ensure that neither parent is substantially better off unpartnered than partnered.

It may be tempting to consider Table 3.4 an obviation of the partner-penalty issue. If neither Pat nor Kim is better off unpartnered than partnered, then what is the problem? The apparent neutrality displayed in Table 3.4 is entirely a construct of social policy. In the absence of state intervention, partnered couples would be economically better off than unpartnered couples – a deadweight loss results.

The extent of penalties among New Zealand's partnered couples

An initial way to measure the extent and size of partnering penalties is to adjust the example of Pat and Kim to reflect diverse incomes that roughly range across the most common New Zealand income levels and family types.

Tables 3.5 and 3.6 make one such adjustment varying the wages of both custodial parents. The receipt of core benefits (the DPB and UB) is assumed, but not other benefits such as the accommodation supplement and child care. For families eligible for either core benefits or for the Family Tax Credit and In-Work Payment, it is assumed they choose the better deal.

Interestingly, for a few families with relatively low incomes, the increases in Family Assistance for low-wage working families have *reduced* partner penalties. A couple in which both parents earn $20,000 faces lower partner penalties under Working for Families than they did previously. This is largely because before Working for Families a sole parent with $20,000 income would likely have chosen to remain on benefit, and then would have had to forego that entire benefit upon partnering (with almost no replacement with Family Assistance).

For most couples Working for Families has extended the reach of partner penalties up the income scale and made them larger for middle-income households than they were before.

Over the 81 households depicted here the number of families facing partner penalties rises under Working for Families from 53 to 67. The average increase in partnering penalties is $2,109.

Table 3.5. Partner penalties by wages of parents, pre-Working for Families

	Yearly wages of custodial parent								
Wages of non-custodial parent	**0**	**10,000**	**20,000**	**30,000**	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**
0	9,387	10,800	10,640	8,517	8,536	8,536	8,536	8,536	8,536
10,000	9,757	13,285	8,396	7,115	4,764	4,134	4,134	4,134	4,134
20,000	12,510	11,309	7,261	3,610	630	-	-	-	-
30,000	14,668	14,309	7,891	3,610	630	-	-	-	-
40,000	17,668	14,939	7,891	3,610	630	-	-	-	-
50,000	18,298	14,939	7,891	3,610	630	-	-	-	-
60,000	18,298	14,939	7,891	3,610	630	-	-	-	-
70,000	18,298	14,939	7,891	3,610	630	-	-	-	-
80,000	18,298	14,939	7,891	3,610	630	-	-	-	-

Source: Author's calculations.

Table 3.6. Partner penalties by wages of parents, post-Working for Families

	Yearly wages of custodial parent								
Wages of non-custodial parent	**0**	**10,000**	**20,000**	**30,000**	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**
0	9,316	13,090	11,700	8,536	8,536	8,536	8,536	8,536	8,536
10,000	9,572	15,198	5,986	7,134	7,134	7,134	4,732	4,134	4,134
20,000	11,948	9,752	4,852	6,000	6,000	3,598	598	-	-
30,000	10,636	12,752	7,852	9,000	6,598	3,598	598	-	-
40,000	13,636	15,752	10,852	9,598	6,598	3,598	598	-	-
50,000	16,636	18,752	11,450	9,598	6,598	3,598	598	-	-
60,000	19,636	19,350	11,450	9,598	6,598	3,598	598	-	-
70,000	20,234	19,350	11,450	9,598	6,598	3,598	598	-	-
80,000	20,234	19,350	11,450	9,598	6,598	3,598	598	-	-

Source: Author's calculations.

Among families with one child these penalties would be smaller and less widespread. Among families with more than two children, most of these penalties would be larger more widespread.

The next step in analysis will be to apply this methodology to a statistical cross-section of the New Zealand population based on a survey such as the Household Economic Survey. It would be relatively straightforward to calculate partner penalties for each partnered couple in the HES. TaxMod could be used to measure the size of partner penalties both before and after Working for Families.

As noted above, it will be more of a challenge to ascertain the extent to which these changing partner penalties actually change behavior. A longitudinal survey such as the new Survey of Family, Income and Employment (SoFIE) recently launched by Statistics New Zealand, or the survey that is being developed as part of the Working for Families evaluation, is likely to prove useful.

Reducing partner penalties: a costly proposition

The policy options discussed in Chapter 2 as solutions for the problem of high EMTRs for secondary earners would also address the partner-penalty issue for middle-income families. (Partner penalties would remain in the benefit system.) Universalizing Family Assistance would essentially eliminate it, since per-child payments would follow a child no matter the income of the household. Allowing a portion of a secondary earner's income to be exempt from family income for the purposes of calculating abatements would also reduce partner penalties: a $10,000 exemption, for instance, would reduce the partner penalty by up to $3,000.

A particularly *poor* way to reduce partner penalties would be to introduce income-splitting, that is, to allow couples with unequal market incomes to split their earnings equally for tax purposes. Table 3.7 shows the impact of income splitting on marriage penalties. It shows that of the 81 families studied 43 would have lower partner penalties as a result of income splitting. But 11 families would receive *new* partner *bonuses* – and only one of those family types faced a penalty before. Meanwhile, some 17 families would find their penalties unaffected, because their earnings are already relatively equal.

Table 3.7 shows that under income splitting, larger reductions in penalties (as well as the new bonuses) would accrue to families with high incomes than to families with lower-incomes. Families with incomes higher than those shown on this table would also benefit substantially, whether or not they presently face penalties. The distribution of benefits from income splitting, shown in Table 3.8, is quite different from the distribution of current-law penalties. This is because income splitting favours higher-income families with different levels of earnings, while the penalties predominantly affect lower- and middle-income families with more similar earnings.

Moreover, since the benefits from income splitting are unrelated to number of children, net bonuses would be most likely to accrue to childless couples and to couples with fewer children: larger families would be most likely to still face partner penalties even after income splitting is applied.[53] In other words, income splitting

[53] Income splitting proposals may be limited to families with children under a specified age. See for instance New Zealand Institute for Economic Research (2005), which describes the United Future Party's income-splitting proposal.

would tend to subsidize a rather *different* cohort of couples than are penalized under current law.

Table 3.7. Partner penalties (and bonuses) by wages of parents, post-Working for Families, with income splitting allowed

	Yearly wages of custodial parent								
Wages of non-custodial parent	**0**	**10,000**	**20,000**	**30,000**	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**
0	9,316	13,060	11,130	7,966	7,726	6,526	5,326	3,526	2,206
10,000	9,542	15,198	5,986	7,134	6,894	5,694	2,092	174	- *426*
20,000	11,378	9,752	4,852	6,000	5,760	2,158	- *1,562*	- *2,760*	- *3,360*
30,000	10,066	12,752	7,852	9,000	6,358	2,638	- *362*	- *1,560*	- *2,160*
40,000	12,826	15,512	10,612	9,358	6,598	3,598	598	- *600*	- *1,200*
50,000	14,626	17,312	10,010	8,638	6,598	3,598	598	- *600*	- *600*
60,000	16,426	16,710	9,290	8,638	6,598	3,598	598	-	-
70,000	15,224	15,390	8,690	8,038	5,998	2,998	598	-	-
80,000	13,904	14,790	8,090	7,438	5,398	2,998	598	-	-

Note: Underlined cells are those with reduced partner *penalties* due to income-splitting.
Shaded, italicized cells are those with *new* partner *bonuses* due to income-splitting.

Table 3.8. Distribution of benefits from income splitting

	Yearly wages of custodial parent								
Wages of non-custodial parent	**0**	**10,000**	**20,000**	**30,000**	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**
0	-	30	570	570	810	2,010	3,210	5,010	6,330
10,000	30	-	-	-	240	1,440	2,640	3,960	4,560
20,000	570	-	-	-	240	1,440	2,160	2,760	3,360
30,000	570	-	-	-	240	960	960	1,560	2,160
40,000	810	240	240	240	-	-	-	600	1,200
50,000	2,010	1,440	1,440	960	-	-	-	600	600
60,000	3,210	2,640	2,160	960	-	-	-	-	-
70,000	5,010	3,960	2,760	1,560	600	600	-	-	-
80,000	6,330	4,560	3,360	2,160	1,200	600	-	-	-

Conclusions and recommendations.

As with high marginal tax rates for second earners, partner penalties are relatively straightforward to spot but can be costly to fix. Analysis of this issue could benefit from expanded measurement of the extent of the problem through the microsimulation described above, as well as careful study over time of whether the Working for Families changes do in fact affect partnering. The threshold question of whether partnering or marrying conveys social goods also merits additional study. Tax compliance, in particular, seems worthy of additional study. There does not appear to be much analysis of levels of compliance with existing partner-reporting rules in Family Assistance.

Even without additional research the existence of partner penalties may be viewed as additional justification for some of the options described in Chapter 2 as solutions to the problem of high marginal tax rates for second earners. In particular, these partner penalties suggest yet another reason why, if a policy goal emerges of distributing New Zealand's budget surplus back to middle-income taxpayers, a carefully designed expansion of Family Assistance could be a sound way to accomplish it.

Appendix to Chapter 3: Lessons from the U.S. Marriage Penalty Debate for New Zealand

In the United States reducing the so-called ‘marriage penalty’ was a major goal of the very large tax cuts enacted in 2001 and 2003. Marriage penalties in the United States result in part from the fact that individual income taxes are levied on a family basis. That is, income taxes, as well as eligibility for means-tested tax credits, are calculated based on the total income of a married couple. (Couples that are not legally married are taxed as separate units. There are specific and complicated rules on how to allocate children for tax purposes between cohabitating, unmarried parents, but for the most part cohabiting parents do not face penalties akin to those in New Zealand.)

Although married couples face a slightly different set of income-tax thresholds and parameters from those faced by single individuals and unmarried heads of household, the tax system for many decades in the United States has been structured in a way that required married partners *with roughly equal incomes* to pay more income taxes as a couple than they would pay together if they were not married. This is because married couples faced tax-bracket thresholds that were only slightly higher than those of single people. In addition the US Earned Income Tax Credit, like New Zealand’s Family Assistance, abated based on total household income.

Note however, that many married partners with very *unequal* levels of income pay less total income taxes than they would pay if not married — in effect, a ‘marriage bonus’. By marrying someone with a low income or no income, a high-income person can reduce his or her tax liability by taking advantage of the preferential marriage brackets. A 1997 Congressional Budget Office Study found that roughly half the married couples in the United States faced marriage penalties, most of the rest received marriage bonuses.[54]

Among the large and costly tax changes enacted in 2001 in the United States were reductions in taxes paid by married couples. Tax brackets and standard deductions were adjusted upwards for married couples, and the Earned Income Tax Credit was also slightly changed to increase the thresholds for married couples. By 2008, when the changes are fully phased in, the number of married couples receiving bonuses will exceed the number facing penalties.

The marriage-penalty story from the United States may have implications for New Zealand. It seems likely that the size of the partnering penalties that will result from Working for Families are roughly comparable to U.S. marriage penalties, and perhaps even smaller. The CBO study found that among the U.S. married couples that could be said to face a marriage penalty through the tax system the average penalty in 1996 was US$1,750, equivalent to a current NZ$3,000. Looking specifically at the U.S. Earned Income Tax Credit and the Child Tax Credit, which are roughly comparable to Family Assistance, the maximum U.S. marriage penalty for a couple with two children is about NZ$6,300. These are comparable or even modest compared to the partnering penalties described in this paper.

[54] Congressional Budget Office (1997).

One lesson from the U.S. experience is that these penalties can be quite difficult and costly to fix, particularly when they relate to low-income credits. The marriage penalties in the EITC have turned out to be far more difficult to fix than those in the bracket structure. In order to fully eliminate marriage penalties in the EITC without cutting benefits for sole parents eligibility would have to be extended to married couples with quite high incomes. This extension would water down the anti-poverty targeting efficiency of the credit. Instead U.S. policymakers chose a more modest NZ$5,200 extension of the abatement threshold for married couples. This is closely analogous to the New Zealand Family Assistance situation, and suggests that any solution to the partner penalty problem may need to be partial.

A second implication of the U.S. experience is that the debate about marriage penalties can quickly become sidetracked into a more general debate about support of marriage as an institution. Marriage penalties in the U.S., like partner penalties in New Zealand, are mostly borne by couples in which the partners have relatively equal incomes. But the solutions in the United States are not targeted to two-earner couples — as could have been done in a variety of ways — but rather benefit all married couples regardless of the division of income within the couple, even if they already received bonuses. In other words, the response to the marriage penalty problem was to increase bonuses for marriage generally — a clear case of policy misdirection.

The equivalent scenario in New Zealand relates to income splitting. As proposed by some New Zealand political parties income splitting would allow a couple with unequal earnings to reallocate their incomes in order to take advantage of the lower-earning partner's lower tax bracket. In effect, this would allow the creation of marriage bonuses, predominantly for couples with unequal levels of earnings. Supporters of income splitting have suggested income splitting as a response to the partner penalties described in this paper presumably on the theory that it would support marriage as an institution. In fact income splitting would mostly create new partner *bonuses* for couples that now face no penalty, while leaving unaffected many now-penalized partners.

4 CONCLUSIONS AND RECOMMENDATIONS

This report has reviewed New Zealand's tax-based assistance for families and its expansion under the Working for Families programme. It has considered both the good things that are expected to result from the package — reduced poverty, improved work-participation incentives for sole parents, and stronger roles for both the agencies involved in Family Assistance — as well as the institutional challenges posed by implantation. It has also discussed the policy implications of extending Family Assistance to more partnered couples than in the past.

Implications of this report for New Zealand

The coming years will yield more information about how Family Assistance is working, but it is not too soon to think about making changes where warranted. The American public management expert Robert D. Behn describes the ideal policy development process as a three-step process: "Aim, Fire, Ready". Under this formula, the first step is to choose the objective; the second step is to implement; the third step is evaluation and, if necessary, rejiggering of policy to meet objectives; and then the sequence repeats.[55] For better or worse, the Working for Families gun has been fired. As data emerge to allow measurement of impacts changes can be contemplated.

Fortunately measureable impacts are already starting to emerge, and more data should come soon. The next couple of years could be good ones for researchers and policy analysts interested in understanding Family Assistance and the Working for Families changes. The Working for Families budget includes $7.6 million over five years to finance an evaluation project that should improve the quality and availability of data on the provision, delivery, and impact of both benefits and tax-based assistance to families in New Zealand.

The evaluation project plan contains a host of important potential questions to ask about Working for Families – about its impacts on poverty and incomes, on workforce participation, on programme participation, and about family structure – broken down in a variety of ways in order to present as complete a picture as possible. Two overriding questions will hang over the project:

- Is Working for Families delivering what it intended?
- What *unintended* consequences are resulting?

If Working for Families works as intended poverty rates will decline further than they otherwise would have, income inequality will be reduced, the work participation of sole parents will increase, and more eligible non-beneficiary families will receive assistance through the MSD and the IRD. Moreover the added income and reduced inequality may be expected to improve the lives of low- and moderate-income families with children in New Zealand in a variety of ways. Measuring those effects is a major goal of the Working for Families evaluation.

[55] Behn (1991).

At $1.2 billion Working for Families is a big enough programme that it almost inevitably will have unintended and perhaps undesireable side effects. Two of those effects are predicted in this paper: a decline in the labour supply of married mothers, and a decline in partnered couples. As this report showed fixing those problems is costly. Whether they are 'worth' fixing may depend largely on whether it can be shown that Working for Families in fact distorts family behaviour including tax compliance, as well as family formation and workforce participation.

What is crucial is that the evidence on Working for Families' impacts — good and bad — contribute to a broad and public debate. A priority should be placed on making raw data from the evaluation widely available to independent researchers in a user-friendly form.

A larger question emerges from the Working for Families process. What do New Zealanders want from their tax system, and what do they expect in the way of income supports for families? As of June 2005 New Zealand is in the middle of an election campaign in which tax cuts have emerged — somewhat suddenly — on the public agenda. The rhetoric of tax cuts not surprisingly centers on putting money back into families' pockets. Yet Family Assistance, perhaps New Zealand's best-targeted way of doing so, is curiously absent from the public discourse around taxes — except as a targeted example of the spending that would be reduced in order to finance tax cuts.[56]

For example, a programme of tax cuts that lives by the BBLR framework will have one set of social implications. It will not improve New Zealand's income distribution, which worsened in the 1980s and 1990s and has yet to substantially improve.

A programme that focuses on strengthening Family Assistance, on the other hand, could have different social implications. It could break down the distinctions between 'beneficiaries' and 'working families', recognizing that most New Zealand families work at some point in their lives and thus have a legitimate claim on tax-based assistance. It could further focus on reconciling the family-neutrality of the Family Assistance system with the marriage-neutrality of the individual tax system, perhaps creating a hybrid system that allows reduced abatement of Family Assistance for secondary earners.

Implications of this report for the United States

The New Zealand experience should remind Americans how hard it is to design social policies and tax policies that simultaneously reduce poverty, improve work incentives, and stay neutral on family-formation decisions, all within a reasonable fiscal framework. But the New Zealand experience also reminds us that it can be done: a policy change by itself can make major inroads on such challenging problems as child poverty without bankrupting a country that is smaller and poorer than the United States.

New Zealand also illustrates that a super-simple income tax system designed on the BBLR principle can still distribute tax-based aid to families with children. The

[56] See, for example, Fleming (2005).

tensions between a broad-base-low-rates framework and the use of the tax code for social policy purposes can, in fact, be overcome.

Lastly, because of the data that is coming online from the Working for Families evaluation, New Zealand over the next few years could be something of a laboratory for understanding the relationships between tax policy, social policy incomes, workforce participation and family formation.

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APPENDIX: DATA ON EFFECTIVE MARGINAL TAX RATES.

This Appendix contains a series of tables that provide a broader look at the impact of Working for Families on the financial incentives facing secondary earners. In order to simulate the impact across a range of family types Treasury's micro-simulation model, TaxMod, was used. TaxMod is based on the 2001 Household Economic Survey, a sample of 3,000 New Zealand households weighted to reflect actual populations and participation in benefit programmes, scaled up to 2005 levels. It allows direct calculations of family incomes and EMTRs under a variety of possible programme designs.

The Appendix tables provide basic detail on the New Zealand population, broken down by family type and presence of children, as estimated by TaxMod. All families are included, including retirees. Some key findings:

- Two-parent families account for roughly two-thirds of New Zealand families with children. On average they have slightly more children and much higher market incomes (that is, excluding taxes and government transfers) than sole-parent families. Note that the average incomes shown here are *mean* incomes, not median incomes, and therefore are somewhat skewed by a small number of families with quite high incomes.

- Couples with one full-time worker have average incomes nearly as high as couples with two full-time workers. This may be explained by the fact that there are a small number of families with one worker who has very high earnings; in such families, it may be the case that there is minimal economic need for the second parent (usually a woman) to work at all, and the economic gains seem to be outweighed by the advantages of taking care of children.

- Families with only one full-time worker have more children than families with two workers, and they are more likely to have at least one child under six years old. Again, there may be an economic explanation: more and younger children mean higher child care costs if both parents work.

'High' EMTRs were defined as those exceeding 40.5 percent, which is the highest statutory tax rate facing New Zealand workers, reflecting the top tax rate of 39 percent plus the ACC earners' premium of 1.5 percent. 'Very high' EMTRs were defined as those exceeding 55 percent. For two-parent families, the EMTR shown is that for the lower-earning parent. (For the higher-earning parent, the EMTR would be the same or higher, depending on statutory tax bracket.)

The TaxMod estimates here are static, meaning that no behavioural changes are assumed post-Working for Families. One implication of this is that reductions in EMTRs are probably overestimated and increases in EMTRs are probably underestimated. This is because at least to some extent, family incomes tend to congregate at places in the income scale where EMTRs are high. So even a random movement in abatement schedules could appear to reduce EMTRs, simply because the static model does not allow for families recongregating at high-EMTR spots.

Table A.1. Characteristics of families in TaxMod

	Number of families	Percent with female primary earner	Average number of children	Average age of youngest child	Share with at least one child under 6	Average market income
Couples with children						
Two full-time workers	107,800	28	1.8	8.6	31%	$98,865
One full-time worker	183,600	11	2.1	5.8	54%	86,702
No full-time worker	29,800	45	2.2	5.9	49%	22,289
Total	321,100	20	2.0	6.8	46%	84,813
Sole parents						
Full-time work	34,100	79	1.8	8.5	36%	29,221
Part-time work	26,500	98	1.7	8.4	26%	7,975
No work	96,700	93	1.8	4.8	64%	2,101
Total	157,300	91	1.8	6.2	51%	8,967
Total, families with children:	478,400	43	1.9	6.6	48%	59,875
Couples, no children						
Two full-time workers	147,600	33	n/a	n/a	n/a	104,904
One full-time worker	152,400	26	n/a	n/a	n/a	71,550
No full-time worker	168,500	27	n/a	n/a	n/a	20,704
Total	468,500	28	n/a	n/a	n/a	63,770
Single, no children						
Full-time work	547,200	38	n/a	n/a	n/a	40,866
Part-time work	80,100	64	n/a	n/a	n/a	10,838
No work	594,300	59	n/a	n/a	n/a	7,644
Total	1,221,700	50	n/a	n/a	n/a	22,735
Total, all families	2,168,600	44	n/a	n/a	n/a	84,813

Notes for all tables: For couples full-time work is defined as 30 or more hours of work. The secondary earner is the one with lower total market earnings; EMTRs shown are those of the secondary earner. For sole parents full-time work is defined at 20 or more hours of work. These definitions match the definitions of work used for eligibility for the work-based components of Family Assistance, including the new In-Work Payment. Income amounts are totals for families.

Cells with a * indicate a category for which TaxMod contains fewer than 10 observations.

Source for all tables: TaxMod.

Table A.2. Average incomes and EMTRs by family structure, before and after Working for Families

	Number of families	Average statutory tax rate	Without Working for Families: Average income	Without Working for Families: Average EMTR	After Working for Families: Average income	After Working for Families: Average EMTR
Couples with children						
Two full-time workers	107,800	26	73,165	28	74,045	32
One full-time worker	183,600	18	63,626	25	65,965	32
No full-time worker	29,800	17	30,788	29	34,440	29
Total	321,100	21	63,784	27	65,755	32
Sole parents						
Full-time work	34,100	24	28,929	51	33,572	55
Part-time work	26,500	21	20,970	55	23,652	50
No work	96,700	21	18,384	24	21,599	23
Total	157,300	22	21,105	35	24,539	35
Couples, no children						
Two full-time workers	147,600	27	77,597	28	77,615	28
One full-time worker	152,400	19	54,132	23	54,191	23
No full-time worker	168,500	20	33,042	28	33,207	28
Total	468,500	22	53,938	27	54,023	27
Single, no children						
Full-time work	547,200	27	30,932	29	30,993	29
Part-time work	80,100	19	11,065	32	11,161	32
No work	594,300	20	15,155	22	15,375	22
Total	1,221,700	23	21,954	26	22,095	26
TOTAL, all families	2,168,600	23	34,996	27	35,634	28

Notes and source: See Table A.1.

Table A.3. Change in average incomes and EMTRs by family structure resulting from Working for Families

	Average change in income	Average change in EMTR
Couples with children		
Two full-time workers	880	4
One full-time worker	2,339	7
No full-time worker	3,652	0
Total	1,971	5
Sole parents		
Full-time work	4,643	4
Part-time work	2,682	-5
No work	3,215	-1
Total	3,434	0
Couples, no children		
Two full-time workers	18	0
One full-time worker	59	0
No full-time worker	165	0
Total	85	0
Single, no children		
Full-time work	61	0
Part-time work	96	0
No work	220	0
Total	141	0
TOTAL, all families	638	1

Notes and source: See Table A.1.

Table A.4. Distribution of EMTRs before WfF implementation, by family type

	Low EMTRs (below 25%)	Moderate EMTRs (25-41%)	High EMTRs (41% to 55%)	Very high EMTRs (over 55%)	Total	*High and very-high EMTRs combined*
Sole parents:						
Full-time workers	4,400	13,500	5,300	10,900	34,100	16,200
Part-time workers	*	*	*	16,000	26,500	16,000
Not working	89,900	5,300	*	*	96,700	1,500
Secondary earners:						
In families where both partners work full-time	59,600	43,000	*	*	107,800	5,200
In families where one partner works full-time	130,900	23,900	*	*	183,600	28,800
In families without a full-time worker	18,200	7,200	*	*	29,800	4,400
Total families with children					478,400	72,000

Notes: The ‘high and very-high EMTRs combined’ column omits some families due to the need to omit some cell data.

Notes and source: See Table A.1.

Table A.5. Percent distribution of EMTRs before WfF implementation, by family type

	Low EMTRs (below 25%)	Moderate EMTRs (25-41%)	High EMTRs (41% to 55%)	Very high EMTRs (over 55%)	Total	*High and very-high EMTRs combined*
Sole parents:						
Full-time workers	0.9%	2.8%	1.1%	2.3%	7.1%	3.4%
Part-time workers	*	*	*	3.3%	5.5%	3.3%
Not working	18.8%	1.1%	*	*	20.2%	0.3%
Secondary earners:						
In families where both partners work full-time	12.5%	9.0%	*	*	22.5%	1.1%
In families where one partner works full-time	27.4%	5.0%	*	*	38.4%	6.0%
In families without a full-time worker	3.8%	1.5%	*	*	6.2%	0.9%
Total families with children					100.0%	27.4%

Notes and source: See Table A.1.

Table A.6. Distribution of EMTRs with full WfF implementation, by family type

	Low EMTRs (below 25%)	Moderate EMTRs (25-41%)	High EMTRs (41% to 55%)	Very high EMTRs (over 55%)	Total	*High and very-high EMTRs combined*
Sole parents:						
Full-time workers	7,300	4,200	8,200	14,300	34,100	22,600
Part-time workers	*	*	15,400	*	26,500	15,400
Not working	94,700	*	*	*	96,700	*
Secondary earners:						
In families where both partners work full-time	47,500	39,600	*	*	107,800	20,600
In families where one partner works full-time	96,500	17,700	60,900	8,400	183,600	69,300
In families without a full-time worker	20,400	*	*	3,000	29,800	3,000
Total families with children					478,400	130,900

Notes and source: See Table A.1.

Table A-7. Percent distribution of EMTRs with full WfF implementation, by family type

	Low EMTRs (below 25%)	Moderate EMTRs (25-41%)	High EMTRs (41% to 55%)	Very high EMTRs (over 55%)	Total	*High and very-high EMTRs combined*
Sole parents:						
Full-time workers	1.5%	0.9%	1.7%	3.0%	7.1%	4.7%
Part-time workers	*	*	3.2%	*	5.5%	3.2%
Not working	19.8%	*	*	*	20.2%	*
Secondary earners:						
In families where both partners work full-time	9.9%	8.3%	*	*	22.5%	4.3%
In families where one partner works full-time	20.2%	3.7%	12.7%	1.8%	38.4%	14.5%
In families without a full-time worker	4.3%	*	*	0.6%	6.2%	0.6%
Total families with children					100.0%	27.4%

Notes and source: See Table A-1.

Table A-8. Labour supply responses to Working for Families

	Married men, with and without children	Married women, with and without children	Single childless men	Single childless women	Sole parents
Share of population that enters workforce	0.29	0.20	0.06	0.12	1.94
Share of population that exits workforce	0.38	0.63	0.23	0.06	0.03
Change in average number of hours of work/week	-0.09	-0.18	-0.09	-0.02	0.71
Total population	846,860	846,860	400,043	399,615	121,878

Source: Calculated from Kalb and others (forthcoming 2005).

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