Article I. Supplementary Analysis Report: Indexing Main Benefits to Inflation

Coversheet

Purpose of Document	
Decision taken:	This analysis has been developed in response to the Government's agreement to index main benefits to inflation (upwards movement in the Consumers Price Index). This will require making a change to the Social Security Act 2018, which currently requires main benefits to be indexed to net average wage growth.
Advising agencies:	Ministry of Social Development
Proposing Ministers:	Minister for Social Development and Employment
Date finalised:	18 January 2024

Problem Definition

The Government has decided to index main benefits to inflation, where inflation is defined as upwards movement in the Consumers Price Index (CPI) over the immediately preceding year to 31 December, from 1 April 2024. This Supplementary Analysis Report considers the impacts, risks and options and elements of the decision to index main benefits to inflation from 1 April 2024. The SAR covers the policy change to index main benefits to inflation and the scope does not extend to the MFTC. This is because the adjustment to the MFTC reflects existing Cabinet policy.

Executive Summary

Cabinet has agreed to index main benefits to inflation from 1 April 2024 and has agreed to amend the Act to give effect to this change [CAB-23-MIN-0490 refers].

This approach prioritises a 2024 implementation but is expected to result in an initial additional cost of $36.049 million over the 2023/2024 and 2024/2025 financial years. This cost will be incurred as the preliminary Half Year Economic and Fiscal Update (HYEFU) forecast indicates that inflation is expected to be higher than wage growth in 2024. However, projected savings of $669.527 million are expected across the forecast period, as HYEFU forecasts indicate inflation is expected to be lower than wage growth in the long-term.

Officials expect that indexing main benefits to inflation will result in main benefit rates being increased more through the 1 April 2024 adjustment than if they remained indexed to net average wage growth. However, main benefit rates will be lower in the long-term, with smaller increases expected from 1 April 2025 adjustment onwards. For example, the rate for Jobseeker 25 years and over is expected to increase by an additional $2.60 per week for the 1 April 2024 adjustment, under CPI indexation. However, by the end of the forecast period in 2028 the rate is expected to be $18.15 less per week than if it was indexed to net average wage growth.

These changes will impact people receiving a main benefit and will have flow on effects to New Zealanders receiving Accommodation Supplement (AS), Minimum Family Tax Credit (MFTC), or social housing tenants paying income related rent.

Main benefits increasing in line with inflation in 2024 will likely result in minor improvements in income adequacy and security for clients from April 2024 to March 2025, along with better maintaining their value relative to the cost of living.

Smaller increases to main benefit rates are expected in the longer term from the 2025 adjustment. This will lead to clients receiving less income than if main benefits were indexed to wage growth, and in isolation may result in slower progress in achieving child poverty targets as set by the Child Poverty Reduction Act 2018. As main benefit rates will differ from the growth in employment income this may increase the financial incentive to work for some clients.

Limitations and Constraints on Analysis

Indexing main benefits to inflation was a manifesto commitment of the National Party for the 2023 General Election. Upon formation of the Government, officials provided advice on options, implementation dates and costings to implement this change in indexation settings.

Because of the time sensitive nature of the proposal, it was progressed through the mini budget in December 2023. Cabinet agreed to proceed with indexing main benefits to inflation and to amend the Social Security Act 2018 to give effect to this change [CAB-23-MIN-0490 refers]. The required legislative amendment must be passed by 8 March 2024 at the latest to meet the Ministry of Social Development annual adjustment process deadlines for implementation on 1 April 2024.

Due to these tight timeframes, it has not been possible to conduct external consultation on this proposal. However, this policy was a manifesto commitment of the National Party and was publicly signalled throughout the 2023 General Election.

The scope of analysis in this Supplementary Analysis Report has been restricted in the commissioning where Treasury advised to only analyse the impacts, risks, and other elements of the Government's chosen way forward for this legislative proposal. Options other than those chosen by Cabinet are not analysed in-depth.

Officials have developed this proposal relying on the preliminary HYEFU forecasts of net average wage and inflation (CPI), of which there is considerable uncertainty. All costs or savings amounts quoted in this report use the preliminary HYEFU forecasts and CPI/wage outlook assumptions. Stats NZ releases the actual figures on 24 January 2024 for CPI and 7 February 2024 for wage growth which will be used for the 1 April 2024 adjustment. These numbers will indicate the true effects of indexing main benefits to CPI for 2024.

Responsible Manager(s) (completed by relevant manager)

Bede Hogan

Policy Manager

Income Support Policy

Ministry of Social Development

Quality Assurance (completed by QA panel)

Reviewing Agency:	Ministry of Social Development and the Treasury
Panel Assessment & Comment:	A Quality Assurance Panel including membership from the Ministry of Social Development and The Treasury has reviewed the Supplementary Analysis Report: Indexing Main Benefits to Inflation prepared by the Ministry of Social Development and considers that the information and analysis summarised in the SAR **partially meets** the quality assurance criteria. The analysis of options in the SAR has been constrained to the option chosen by Cabinet. Given this, the panel considers that the information in the SAR is as complete as could reasonably be expected in the timeframes and it identifies the main benefits and impacts of the options given the stated policy objectives. The SAR notes that consultation has not been possible given time constraints.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The Social Security Act 2018 has required main benefits to be adjusted by net average wage growth since 2020

1. Indexation settings for main benefits are an important tool for determining the rates of main benefits.
2. Historically, from 1989 to 2010, main benefits were adjusted by Cabinet agreement each year (except in 1991) without any legislative requirement. In 2010, the Government legislated for annual adjustments of main benefits to inflation. Since 2020, main benefits have been indexed to net average wage growth as required by primary legislation. Section 452A of the Social Security Act, 2018 (the Act) states that MSD is to adjust the specified main benefit rates[1] annually according to upwards changes in the net average wage. The annual adjustment occurs on 1 April each year.
3. Main benefit rates have a significant impact on clients in terms of providing an adequate income to meet the cost of living. Whilst it is not the sole factor affecting work incentives, main benefit rates can affect financial incentives to engage in work. If rates do not keep pace with employment income, there can be greater incentives to work.
4. In 2022 the increase in CPI was higher than the increase in the net average wage. In response, the previous Government decided to provide a one-off discretionary top-up to increase main benefit rates to meet the percentage increase in the CPI for the April 2023 adjustment.

Forecasting indicates that wage growth will be lower than inflation for the 2024 Annual Adjustment, but higher over the remaining forecast period

5. The Treasury's Half Year Economic and Fiscal Update (HYEFU) shown in Table 1 indicates that inflation (upwards movement in CPI) is likely to be higher than wage

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[1] The specified rates are: Jobseeker Support, Sole Parent Support, Support Living Payment (except specified rates), Youth Payment and Young Parent Payment, Widows' Benefit, Domestic Purposes Benefit for sole parents. The maximum rate of Emergency Benefit will also be increased to that of the equivalent specified rate of main benefit.

growth for the 1 April 2024 adjustment. HYEFU modelling estimates a notable difference in rates if main benefits are indexed to inflation, compared to net average wage. However, we will not know for certain until Stats NZ releases the official figures on the 24 January 2024 for CPI and 7 February 2024 for net average wage.

Table 1. Half Year Economic and Fiscal Update forecast of CPI and net average wage growth from April 2024 to April 2028.

Inflator	April 2024	April 2025	April 2026	April 2027	April 2028
CPI	5.13%	2.89%	2.25%	2.09%	2.02%
Net average wage growth	4.74%	4.59%	3.77%	3.15%	2.91%

6. If indexation settings remain linked to wage growth for the 1 April 2024 adjustment, clients are likely to receive a lower increase in their main benefit rate in comparison to indexing main benefits to CPI. This would lead to savings for the 1 April 2024 adjustment in comparison to indexation to inflation.
7. However, the forecast indicates that, from the 1 April 2025 adjustment onwards, average wage growth will be higher than CPI. Therefore, if the status quo is maintained, it is expected to result in beneficiary incomes being higher in the long-term, increased benefit expenditure and less government savings in comparison to indexation to inflation.

What is the policy problem or opportunity?

Cabinet has agreed to fulfil the National Party's manifesto commitment to change main benefit indexation settings in 2024

8. Indexing main benefits to inflation, through the CPI, maintains benefit rates relative to the cost of living. This will allow beneficiaries to maintain their purchasing power relative to the growth in costs. Indexing main benefits to wage growth, through net average wage growth, allows main benefit rates to keep relative pace with the income of wage-earning New Zealanders.
9. The appropriate approach to indexation depends on which objective the government wants to prioritise whilst balancing overall cost. In 2019, indexation settings of main benefits were changed to be indexed to wage growth as the percentage increase was historically greater than that of the Consumer Price Index (CPI). Therefore, it was expected that indexation to wage growth would ensure that the living standards of beneficiaries broadly keep pace with other New Zealanders, to a greater degree than indexation to CPI. It was also intended to deliver additional support for beneficiaries relative to indexing to CPI, including by achieving greater progress in meeting child poverty targets as set by the Child Poverty Reduction Act 2018. Due to the size of the population receiving a main benefit (approximately 362,000 people as of September 2023), a small change in main benefit rates through the 1 April 2024 adjustment can have a large fiscal impact. Indexing main benefits to inflation presents an opportunity to generate fiscal savings in the longer term, leading to a more sustainable cost to the government.
10. However, during periods of high inflation, the status quo setting of indexing main benefits to net average wage growth is not guaranteed to maintain the living standards

of beneficiaries relative to the cost of living. This may provide less income adequacy to low-income New Zealanders.

What objectives are sought in relation to the policy problem?

11. The objectives sought are to:
    - fulfil the manifesto commitment to change indexation settings of main benefits to inflation from 1 April 2024
    - generate savings over the forecast period.

Section 2: Deciding upon an option to address the policy problem

What scope are options being considered within?

12. Officials developed the options while balancing both the commitment to a 2024 implementation with maximising savings over the forecast period, in order to achieve the objectives of the manifesto commitment.
13. The scope of the analysis of the options was restricted in the commissioning for this Supplementary Analysis Report. Treasury advised to only analyse the impacts, risks, and other elements of the Government's chosen way forward for this legislative proposal. Therefore, other options not chosen by Cabinet are not analysed in-depth.

What options were considered by Cabinet?

Option 1: to index main benefits to inflation from 1 April 2024

14. This option reflects the National Party's fiscal plan, which committed to indexing main benefits to inflation by 1 April 2024. This requires repealing the current requirement to adjust main benefits by net average wage growth and insert main benefits into section 453 of the Social Security Act 2018, which will index main benefits to CPI. Cabinet must agree to make this amendment under urgency to meet the 1 April 2024 adjustment timeframes.
15. This approach will fulfil the manifesto commitment by changing the indexation mechanism for main benefits from wage growth to inflation. This option incurs an initial cost of $36.049 million in the first two fiscal years and higher base rates for main benefits for future adjustments (compared to a net average wage growth adjustment in 2024). The total net savings over the forecast period comes to $669.527 million.

Option 2: to maintain the status quo setting of main benefits being indexed to net average wage growth

16. This option would retain the status quo of indexing benefits to wage growth but would not fulfil the manifesto commitment made by the National Party to index benefits to inflation. This option is already in place in legislation under section 452A of the Social Security Act 2018.

A further option to index main benefits to inflation from 1 April 2025 was proposed by officials but was not considered by Cabinet

17. Indexing main benefits to inflation from 1 April 2025 would have fulfilled the commitment a year later than the manifesto commitment intended. This option avoided the need to pass legislation under urgency, however, the legislative process would likely have still been truncated.
18. Implementation on 1 April 2025 would have been expected to achieve greater savings of $925.019 million over the forecast period, as inflation is expected to track lower than

wages from 2025 only. However, this option was not progressed to Cabinet as it did not align with the manifesto commitment of implementation in 2024.

What was the Government's preferred option, and what impacts will it have?

Cabinet has agreed to option 1: for main benefits to be indexed to inflation from 1 April 2024

19. This approach will maintain main benefit rates relative to the cost of living and prioritises a 2024 implementation, which incurs an initial cost and achieves savings in the long-term. A legislative amendment will need to be passed under urgency to meet 1 April 2024 adjustment process deadlines.

Table 2. Preliminary Half Year Economic and Fiscal Update forecast of main benefit rates under indexation to CPI or Net average wage growth from April 2024 to April 2028.

	Apr-23	Index	Apr-24	Apr-25	Apr-26	Apr-27	Apr-28
Jobseeker Support Single, 25+ years	$337.74	Wages	$353.73	$369.77	$383.74	$396.00	$407.72
		CPI	$356.33	$366.32	$374.32	$381.96	$389.57
Jobseeker Support Married, civil union or de facto couple without children (Total)	$574.70	Wages	$601.92	$629.22	$652.98	$673.84	$693.78
		CPI	$606.32	$623.32	$636.94	$649.94	$662.88
Jobseeker Support Married, civil union or de facto couple with children (Total)	$606.86	Wages	$635.60	$664.42	$689.52	$711.56	$732.62
		CPI	$640.26	$658.22	$672.60	$686.32	$700.00
Sole Parent Support	$472.79	Wages	$495.18	$517.63	$537.18	$554.34	$570.75
		CPI	$498.81	$512.80	$524.00	$534.69	$545.34
Supported Living Payment Single, 18+ years	$384.92	Wages	$403.15	$421.43	$437.35	$451.32	$464.68
		CPI	$406.10	$417.49	$426.61	$435.31	$443.98
Supported Living Payment Married, civil union or de facto couple without children (Total)	$654.04	Wages	$685.00	$716.06	$743.10	$766.84	$789.54
		CPI	$690.04	$709.40	$724.90	$739.68	$754.42
Supported Living Payment	$686.20	Wages	$718.70	$751.28	$779.66	$804.58	$828.40

Married, civil union or de facto couple with children (Total)		CPI	$723.96	$744.26	$760.52	$776.04	$791.50

20. The HYEFU forecast indicates that inflation is likely to be higher than net average wage growth for the 1 April 2024 adjustment, meaning that if main benefits are indexed to inflation from 1 April 2024, there will be an initial cost of $36.049 million for fiscal years 2023/24 and 2024/25, and savings of $669.527 million over the forecast period.

21. The initial cost of $36.049 million to the government over the 2023/2024 and 2024/2025 period is due to beneficiaries receiving a higher increase in the rates of main benefits in comparison to wage growth. Although this will not generate savings for the first two financial years, it means that people receiving a main benefit may be better off with benefits indexed to CPI from the 1 April 2024 compared to the status quo. Therefore, they will have more income to meet their needs as shown by table 2.

22. A total of $669.527 million is expected to be saved over the forecast period under indexation to CPI due to beneficiaries receiving a smaller increase in their main benefit rates than if status quo settings were maintained. Therefore, main benefit recipients will receive less income in the long-term.

23. The savings generated through indexing main benefits to inflation over the forecast period mean that benefit expenditure is a more sustainable cost to government. These savings will be available to be used to address other Government priorities that support households with a high cost of living, including proposed changes to personal income tax thresholds.

24. It is worth noting there are other types of assistance that are consequentially impacted by changes to how main benefits are indexed, including Accommodation Supplement, Minimum Family Tax Credit and Social Housing.

Changing indexation settings will have a direct impact on main benefit recipients

25. The change in indexation settings is likely to directly affect main benefit recipients, who are low-income New Zealanders. The change in main benefit rates will disproportionately affect people who identify with the population groups of women, Māori, and Pacific peoples, and disabled people, who are overrepresented within the main benefit population.

26. Women make up 55 percent of the people receiving a working-age main benefit whilst only composing approximately 50 percent of the New Zealand population. Māori are overrepresented in the population who receive main benefits in comparison to the wider population. Approximately 39 percent of people receiving a main benefit are Māori, but only make up approximately 17 percent of the general population. Pacific people are also overrepresented in the main benefit recipient population making up 12 percent compared to 8 percent of the general population. As main benefit recipients, the impacts on these groups will be the same as for all New Zealanders but will disproportionately affect these groups.

27. Initially, with benefits increasing more in 2024 under CPI as seen in Table 2, these groups are likely to benefit from the change through having more income to meet their needs. However, in the long-term with benefits likely to increase at a lower rate and therefore receive less income under CPI indexation, these groups are likely to be disadvantaged in comparison to status quo settings.

28. For example, the rate for Jobseeker 25+ years and over is expected to be higher $2.60 per week for the 1 April 2024 adjustment; however by the end of the forecast period on 1 April 2028 the rate is expected to be lower by $18.15 less per week under CPI

settings in comparison to status quo settings. This range based on the best available forecast available when developing advice but is subject to change.

29. Disabled people and people with health conditions will be affected by a change in indexation settings. The difference between the income of people on a main benefit and those in work may lead to a low replacement rate. This may incentivise work-ready beneficiaries to go into work but may potentially disadvantage both work-ready beneficiaries and those with health conditions and disabilities from participating in their community and meeting their essential needs. Beneficiaries that are not able to work will also be impacted by this change, but will have no ability to enter work to change their situation.

30. In isolation, indexing main benefits to inflation may impact progress toward child poverty reduction targets. Preliminary modelling (based on preliminary HYEFU data) shows that indexing main benefits to inflation leads to an estimated increase in the number of children in poverty under the AHC50[2] and BHC50 poverty measures over the forecast period, in the absence of other changes.

31. This is compared to the status quo of indexing main benefits to wage growth. By tax year 2028, there would be an estimated increase of 7,000 (+/- 4,000) children under the AHC50 poverty measure, and an estimated increase of 7,000 (+/-6,000) children under the BHC50 poverty measure (noting that the latter figure is a broad range).

32. Beyond the forecast period we would expect this change may have a particularly significant impact on the primary, before housing costs measure of child poverty. This is because the threshold for defining poverty on this particular measure is updated each year in line with median household income growth, rather than inflation.

Changing indexation settings will have indirect impacts on other types of assistance

33. A change in main benefit rates can also cause indirect impacts that affect a population wider than main benefit recipients through minor increases and decreases in client entitlements to other financial assistances. Currently, we do not have actual impacts, but these can be assessed when the new rates of main benefits are set.

34. In the short-term (from 1 April 2024) higher increases to benefit rates resulting from inflation indexation will result in a slight reduction in Accommodation Supplement expenditure.

35. In the longer term, from 1 April 2025, the entry threshold (the minimum accommodation costs that a person must pay before being eligible for the subsidy) will increase at a lower rate, as it is set as a percentage of main social security benefits. Additionally, during this period, the income threshold, above which the AS is abated by 25c for each dollar of additional income, will increase at a lower rate, as it is linked to the income cut-out point for main social security benefits.

36. For non-beneficiaries, these effects will offset, and some will experience an increase and others a decrease to AS. Our modelling estimates that in April 2025:

- 48,000 families have an average increase of $1.07 per week
- 35,000 families have an average decrease of $1.61 per week
- 289,000 families will have their AS unchanged.

37. AS may be unaffected if the client is already receiving their maximum AS entitlement. Further, since AS is rounded up to the closest dollar, small changes may have no effect on entitlement.

38. In the short term (from 1 April 2024) higher increases to benefit rates will result in an increase in the amount Income Related Rent clients will need to pay for their property.

[2] After Housing Costs 50 percent moving line: measures the number of children in households with less than 50 percent of the median equivalised disposable income after housing costs for the financial year.

This will result in reduced governmental expenditure on the Income Related Rent subsidy.

39. However, given that rents are not immediately changed when household income increases or decreases, the impact in the long-term, starting on 1 April 2025 is difficult to estimate. Some households may not have their rent revised until 12 months later, and only if the change is above a certain threshold. Note that people in emergency housing are also likely to see an increase in their required contribution to their housing costs.

40. Approximately 3,200 low-income families are receiving Minimum Family Tax Credit, which is an incentive to ensure low-income working families remain better off financially in full-time work than they would be on a main benefit. Minimum Family Tax Credit thresholds are linked to main benefits. If the lower threshold of the tax credit is not increased in line with main benefit rates, low-income working families are likely to be better off on a benefit than in full time work. Inland Revenue is addressing this, and changes were progressed through the mini budget alongside this proposal.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (e.g., ongoing, one-off), evidence and assumption (e.g., compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
	Additional costs of the preferred option compared to taking no action		
Regulated groups (individuals)	Recipients of main benefits and the flow on affects to other assistances will be affected by the impacts of changing indexation settings.	Medium At the end of September 2023, 362,094 people were receiving a working age main benefit. MSD expects that these clients will be impacted. For the 1 April 2024 adjustment main benefit recipients will have a larger increase to their rate of main benefit compared to the status quo, however over the forecast period, they will likely have a decrease in weekly main benefit rates compared to the status quo. Around 193,600 households receive less than the maximum amount of AS, and around 70,000 working households receive AS, all of whom will be impacted. There are currently around 43,700 social housing tenants receiving a main benefit who will be impacted. Exact impacts will be confirmed when wage and inflation data are released by Stats NZ in early February.	Medium
Regulators (MSD)	The Ministry of Social Development will remain the steward of the Social Security Act 2018,	Minor	High confidence in expected savings and implementation costs. Savings and

	indexation settings and the 1 April 2024 adjustment.		implementation costs rely on preliminary forecasts. These have been forecast to the best of the Ministry of Social Development's ability; however, they are subject to change.
Others (e.g., wider govt, consumers, etc.)	Inland Revenue has progressed a change in MFTC through the mini budget to address the flow on effect of changing indexation.	In the 2022/2023 income tax year there were approximately 3,200 families which received MFTC who may be affected.	Low
Total monetised costs		Overall, $669.527 million in savings over the forecast period.	
Non-monetised costs	N/A		

Section 3: Delivering an option

How will the new arrangements be implemented?

41. Legislative amendments will need to be progressed under urgency to be in place by 8 March 2024 at the latest, in order to meet the 1 April 2024 deadline for entering the new rates of assistance into the model for the yearly adjustment of rates. This process occurs annually and is budgeted for through MSD operating costs.

42. If the change in legislation is progressed later than this date, it will risk implementation for 1 April 2024 not being feasible, as the model requires testing and independent analysis. For example, it may impact the time available for quality assurance and produce additional time constraints upon work to enable the new payment rates to be effective from 1 April 2024.

How will the new arrangements be monitored, evaluated, and reviewed?

43. There is existing data collection regarding clients receiving main benefits. No specific monitoring is planned for the policy change, but future analysis would be possible.