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GROUP

Submission on the Budget Policy Statement 2019

To the **Finance and Expenditure Committee**

This submission is from:
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Child Poverty Action Group (CPAG) is an independent charity that strives to achieve the elimination of child poverty in Aotearoa New Zealand. We work to provide evidence about the causes and effects of poverty on children and their families, and to inform the public, policymakers, media and politicians of the changes to policy needed to reduce child poverty. CPAG believes that New Zealand's high rate of child poverty is due to policy neglect and a flawed ideological emphasis on economic incentives. Through research, CPAG highlights the position of tens of thousands of New Zealand children, and promotes public policies that address the underlying causes of the poverty they live in. Our vision is for an Aotearoa where all children can flourish, free from poverty.

We wish to make the following submission to:

The Budget Policy Statement (December 2018)

We request that our submission is heard orally.

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Summary

Child Poverty Action Group (CPAG) is pleased to see that some of the issues raised in CPAG's 2018 submission[1] have been acknowledged:

The new Government is committed to reducing child poverty and has reversed some of the deliberate reductions and neglect of Working for Families (WFF) during the previous decade.

However there are some important issues that were raised by CPAG in its 2017 and 2018 submissions that are yet to be addressed:

- The need for fair indexation of WFF (yearly by the CPI, with a link to wages as is the case for New Zealand Superannuation (NZ Super).
- The need to remove the discrimination in the In-Work Tax Credit (IWTC) eligibility criteria.
- The need to address the harsh cumulative effects of abatement for low-income families.
- Existing student debt.
- The wisdom of restarting contributions to the New Zealand Super Fund (NZSF) and failure to count NZSF assets in the calculations of net debt.
- The complexity of the new changes.
- An immediate and substantial overhaul of the welfare system including a rethink of the purposes and principles section of the Social Security Act - see CPAG Further Fraying of the welfare safety net.[2] In particular the needs of people, especially children, should be at the heart of the system, not paid work. The relationship basis of welfare payments, punitive sanctions, and the definition of what is considered to be income need urgent reform along with attention to benefit levels and the need to increase the allowable extra earned income that is not subject to steep abatements.

In this submission we argue that while the "Wellbeing framework" is a good idea and has long-term potential it must not be at the expense of the obvious improvements to income adequacy that can – and must - be made immediately. We urge the Government not to wait until the Welfare Expert Advisory Group (WEAG) and Tax Working Group (TWG) reports are in before positive action is taken to reduce the worst child poverty[3]

We also raise questions around the continuing use of the fiscal rules framework including the resumed contributions to the NZ Super Fund.

[1] CPAG 2018 Submission on the Budget Policy Statement (2017) https://www.cpag.org.nz/assets/Submissions/180216%20CPAG%20Submission%20on%20the%20Budget%20Policy%20Statement%202018%20FINAL.pdf

[2] CPAG. Further Fraying of the welfare safety net. (2017) https://www.cpag.org.nz/assets/171208%20CPAG%20further%20fraying%20of%20the%20welfare%20safety%20WEB.pdf.

[3] St John S. & So, Y (2018) How effective are 2018 policy settings for the worst-off children? Working paper 18/2, Institute for Governance and Policy Studies, Victoria University of Wellington https://www.victoria.ac.nz/__data/assets/pdf_file/0009/1656351/WP18-02-Child-poverty.pdf

Wellbeing priorities

To begin to tackle the challenges identified in the Wellbeing Outlook, the Government has identified five Budget Priorities for Budget 2019:

• Creating opportunities for productive businesses, regions, iwi and others to transition to a sustainable and low-emissions economy
• Supporting a thriving nation in the digital age through innovation, social and economic opportunities
• Lifting Māori and Pacific incomes, skills and opportunities
• Reducing child poverty and improving child wellbeing, including addressing family violence
• Supporting mental wellbeing for all New Zealanders, with a special focus on under 24-year-olds.

There is very little detail about how these priorities will be achieved. More resources are critical

CPAG noted in its 2018 Submission

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- There was no commitment to annual Consumer Price Index (CPI) inflation adjustments for WFF let alone adjustments to movements in the net average wage as occurs annually to NZ Super. The reduction in WFF tax credits of $97m in the year to June 30 2018 is a direct result of inadequate inflation adjustments.
- This continued erosion arises from delaying implementation of the Families Package to 1 July 2018. This lack of timeliness is unjustified and has compounded the problems families faced in 2018.
- The decline rather than increase in nominal spending on WFF tax credits is projected out to 2021/22. In real terms this is a significant decline.
- The decline in the real value of Best Start is not apparent only because it is a programme that is phased in over this period.
- The Winter Energy Payment is very expensive and poorly targeted so that much of the cost (around 70%) is because older people have it automatically.[4]
- There is no distributional analysis of the extra spending on Paid Parental Leave. This is a tax-funded, non-means tested payment that is not well targeted and has little to do with reducing child poverty.

The rule for an inflation adjustment only when cumulative inflation passes 5% was not eliminated by the Families Package in 2018.

While the Families Package effectively brought the date for inflation adjustments forward nine months to 1 July 2018, and at the same time reset the indexation clock to 1 July 2018,

[4] See St John, S (2018) Use of Nudge theory: The Winter Energy Payment. https://thedailyblog.co.nz/2018/01/17/use-of-nudge-theory-the-winter-energy-payment/

the latest inflation forecast from Treasury also indicates that the next 5% breach (following the 1 July 2018 reset) is likely to occur in March 2021. This means there will be no adjustment until April 2022.

The 5% cumulative rule is very disadvantageous to low-income families in times of low-inflation and has no justification except as a cost-saving measure. Politically it can be manipulated by governments to claim credit for what looks like a big increase when the adjustment is finally made - but that is only because families have had to wait so long for the overdue inflation catch-up.

It is unclear why the Government has chosen to use the CPI (less tobacco) series. This is far from easy to use on Statistics New Zealand's Infoshare site[5].

The indexation affects not just the real spending power of the maximum WFF tax credits, but lack of adjustment to the thresholds means an additional serious erosion of WFF for low-income working families.

The Government raised the threshold from its projected value in 2018 of $35,000 under National to $42,700 helping low-income working families retain more of their entitlements. CPAG welcomes this as an essential change but points out that $42,700 is well below the threshold applying in Australia (A$52,000) and represents only a partial catch-up. The threshold was first set at $35,000 in 2005 and a CPI adjustment means that it should be around $46,000 in 2019. Ideally it should be adjusted annually in line with movements to net average wages.

Without proper annual price (and, where relevant, wage) indexation of most forms of social assistance sustained reductions in child poverty/material deprivation, will not be achieved.

Removal of the discrimination of the In-Work Tax Credit

Far too many children are on incomes under the 40% poverty line and will remain there (St John & So, 2018). It will prove too expensive to tackle this deep poverty with the FTC as any increase goes a long way up the income scale unless draconian and damaging abatement rates are imposed.
CPAG is pleased to see less 'third way' rhetoric that sees social inclusion in terms of paid work only. But policies based on a certain kind of paid work like the In-Work Tax Credit (IWTC) remain anachronistic and damaging. If the Government is serious about lifting the lowest-income families out of poverty, the most cost-effective way is to add the IWTC to the Family Tax Credit (FTC).

The Families Package missed the opportunity to remove the extra per child payment of $15 week of the IWTC for families with four or more children. The very significant rise in the second and subsequent child's FTC risks over-compensating working large families while ignoring the light of those poorer smaller families who do not qualify for the IWTC.

[5] Statistics New Zealand. Infoshare. http://archive.stats.govt.nz/infoshare/Default.aspx

Harsh cumulative effects of abatement for low-income families

CPAG is alarmed at the lack of attention to Effective Marginal Tax Rates (EMTR). While Labour has acknowledged the need to increase the threshold for abatement of WFF, it has not adjusted the tax thresholds and has compounded the EMTR problem by increasing the rate of abatement of WFF to 25%. In addition, it has placed more emphasis on the Accommodation Supplement (AS) that abates alongside at 25%. It has ignored the effect of student loan repayments from a very low level of income.

A family earning another $5000 over the new threshold of $42700 may lose:

Tax + ACC	(18.7%)
Student Loan Repayment	(12%)
KiwiSaver:	(3%)
Loss Working for Families	(25%)
Loss Accommodation Supplement	(25%)

A total loss of nearly 84% of that extra $5000 leaving only around $800 in the hand. There may be other losses incurred as well such as the loss of the community services card and child support payments, and child care subsidies that can leave the family worse off than before they earned the extra.

A family earning an extra $5000 over $48,000 could face an EMTR of 95% because the tax rate is 30%.

In the short-term CPAG suggests an immediate return to a 20% abatement for WFF. Longer term, a move away from use of AS is required, and a complete overhaul of student debt policy. Then abatement of Best Start from incomes of over $79,000 adds another unnecessary and overlapping layer.

The need to increase the core benefit.

Since the 1980’s the value of core benefits in New Zealand compared to average wages have been steadily eroded, at times by design (“Ruthanasia”) but also to a large extent to the fact that they are indexed to inflation and not average wages. During this time the basic job seekers benefit has fallen from 40% of the average wage to 16% whilst the sole parent benefit has fallen from 50% of the average wage to 25%

There is an urgent need to restore at some of these substantial fall in core benefits compared to the average wage. CPAG calls for an immediate increase of at least 20% to all core benefits pending an overall assessment of adequacy of the welfare system.

Existing student debt

The 2018 BBPS states:

> *The Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office. Reducing government debt will give future generations more options and provide a buffer to help manage future risks or shocks. New Zealand has low government debt by international standards but is vulnerable to shocks, such as natural disasters, and household debt has been increasing to record levels.*

CPAG suggests that the Government needs to concentrate on making sure that household debt is reduced—if it generates surpluses to reduce net debt by forcing households to borrow to fund social provision (as has been the case recently) there is little gain.

Housing

New Zealand is in the grip of an extraordinary speculative housing bubble. Numerous studies point to a housing affordability crisis in New Zealand. For example, the recently released Demographia International report finds house prices here are “severely unaffordable” for the country as a whole. When considering major housing markets the report found Auckland to be the second most unaffordable market out of 99 markets in eight countries after Hong Kong (US, Canada, Australia, UK, Singapore, NZ, Ireland and Hong Kong).

The divide between children who thrive and those who don’t is now strikingly along housing lines. Affordable warm housing without overcrowding and with security of tenure is critical to children’s well-being.

There are fundamental problems with the Accommodation Supplement (AS) as a means to assist low-income families. Payments are insensitive to household size and the AS may lead to higher rents being charged by landlords. There is limited security of tenure with low-income families often finding themselves having to move frequently. The private rental accommodation is often not well insulated with cold damp houses. Coupled with overcrowding this has a significant impact on child health for low-income families. Recipients are not allowed to have cash reserves above a certain level which makes it impossible to save for emergencies or a house deposit. For low-income working families the WFF tax credits and AS abatements reduce the extra value of every extra dollar earned by 50% over and above the loss from tax of 17.5% or 30%.The AS is not indexed so it reduces in real value as housing and other costs increase.

CPAG recommends a greatly expanded role for social housing with rents no higher than 25% of income. At a minimum the Government should build or buy 10,000 social houses a year.

As well CPAG would like to see a shift in housing assistance shifted away from the AS into higher Working for Families and other benefits over with time. Furthermore we call an increase in the allowed amount of cash assets parents can have without their AS being affected. The AS is complex and for further information see CPAG forthcoming report 2019.

Health

The Government is to be commended for extending the zero-fees scheme of primary health care and prescriptions to all children under 14. The Winter Energy payments will have some impact on the budgets of low-income families which is a positive. However it is expensive ($450m) and poorly targeted with most of the payments (70%) going to pensioners who are not facing fuel poverty. CPAG believes there are other initiatives such as changing to an opt-in system for those over 65 and extending the IWTC to beneficiary families, which would be much more cost-effective in addressing family poverty.

CPAG has extensively documented the impact the perfect storm of child poverty, low quality housing, overcrowding has on child health.

Recent years has seen a rise of third world diseases in parts of New Zealand that can be directly attributed to the above. The health system is creaking and unable to provide adequate health care to many New Zealanders and particularly the most vulnerable.

Years of underfunding has meant that funding increases in recent years have not been sufficient to maintain services with an aging population and increased costs. Not enough is spent on prevention of diseases such as diabetes. Poverty and diseases such as rheumatic fever very high for developed country. Hospital and ambulance services are stretched. The New Zealand Council of Trade Unions (NZCTU) estimates that to restore the level of health services New Zealand enjoyed in 2010 would need an extra $2.6 billion a year over and above the $800m or so needed to keep health services at the same level as in the previous budget (current spending is a bit over 14 billion). CPAG calls on the Government to increase health spending in the next budget by this amount as a matter of urgency.

Education

Public schooling in New Zealand is contributing to a significant financial burden upon families, especially for those who are already experiencing hardship. This is in part due to the hidden costs of a ‘free education’, which fall to families to spend on items such as ‘voluntary donations’, uniforms, trip costs, examination fees, and the increasing costs associated with a digital curriculum, such as tablets and laptops. The sad reality is that the longer students stay at school, the greater the pressure on their families to bear the financial costs of them being at school.

Reports show that the New Zealand Government’s funding for the education sector is proportionately less than the average across the OECD, and the proportion of household expenditure is much higher. On average across the OECD priority expenditure is on primary education, while in New Zealand, secondary school spending is prioritised. New Zealand childcare costs are amongst the most expensive in the OECD at nearly 30% of net household income and undergraduate student fees are also amongst the most expensive compared with other OECD countries.

All children, no matter what their home circumstances, deserve a rich, fulfilling and challenging education which helps them reach their potential.

There is a compelling need to markedly increase funding for public education to ensure that expenditure on education becomes less of a household burden, and introduces systems to ensure that a genuinely free public education in New Zealand can be guaranteed.

Furthermore early childcare education is crucial for providing young children with foundations for learning and life.

CPAG calls on the Government to ensure that high quality, culturally-responsive early childhood education is available for all children in early childhood care and education (ECCE) by requiring 100% degree-qualified teachers in all teacher-led, centre-based ECCE centres.

Use of the fiscal framework

The Government has signed up to the fiscal responsibility rules which states that “the Government will reduce the level of Net Core Crown Debt to 20 per cent of GDP within five years of taking office”. There is no economic argument advanced in support of this rule. New Zealand has one of the lowest government net debt levels in the OECD as seen below. It is funding infrastructure investment through cash when standard practice is to fund long lived infrastructure through debt. The last budget document forecast Reduction of debt from 21.7% to 19.1%. If instead the very low debt ratio of 21.7% was maintained over the next 4 years the government could increase spending by $1.7b/y more over the next 4 years

There is no good reason why the Government couldn’t increase the debt level to the still very low level of 25% which would allow $3.8b per year of extra spending over the next 4 years.

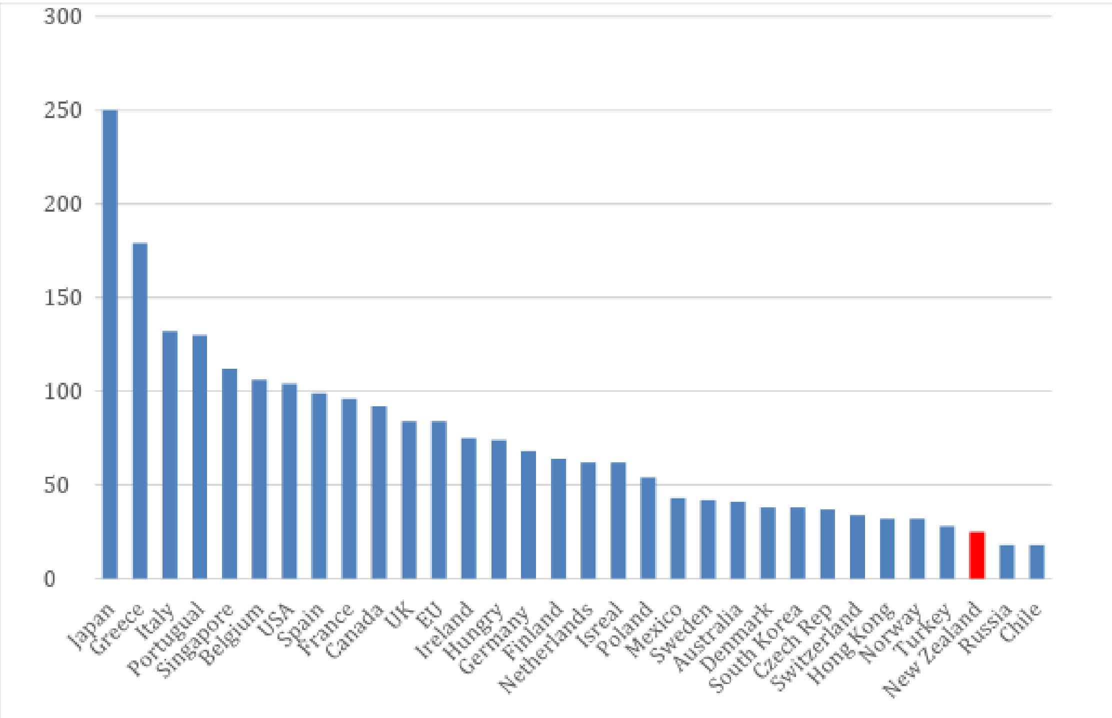

Figure 1: Government debt as a percentage of GDP for OECD countries. Source: OECD

If we consider government debt net of the superfund assets the government net debt is almost zero and very low by OECD standards (see below).

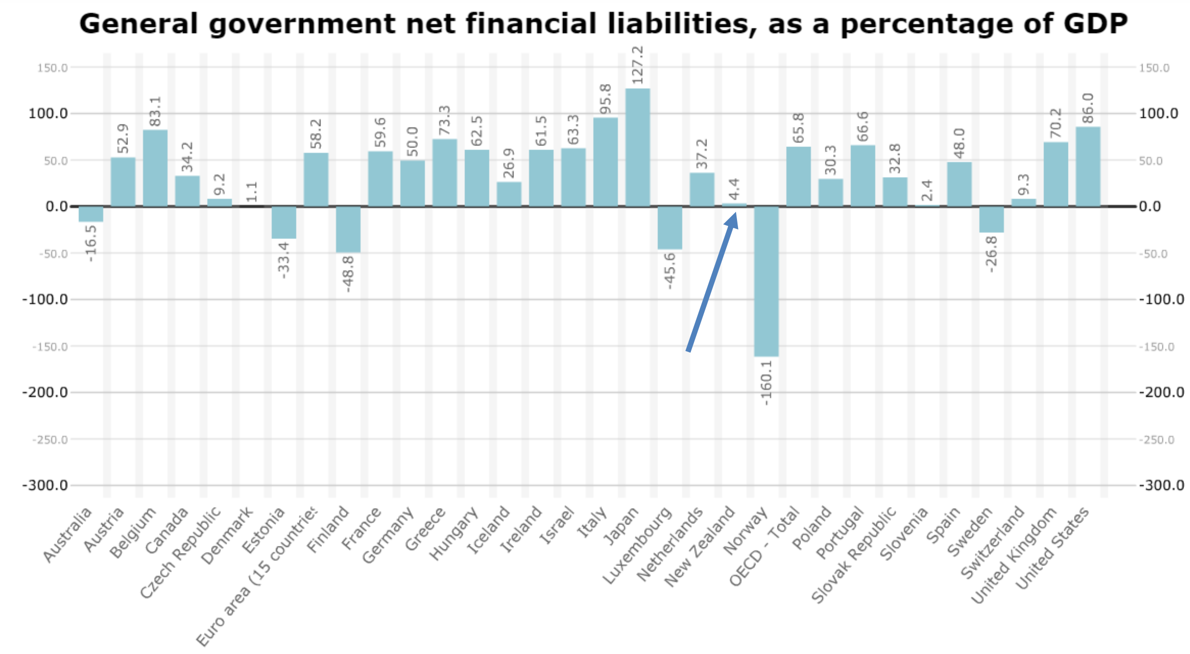

Figure 2: Government net debt as a percentage of GDP for OECD countries. Source: OECD

Working age people are paying taxes not only to fund the existing retirees' pensions but also to allow contributions to the NZ super fund from surpluses to help fund their own state pension. This is at the expense of the spending that is needed to invest in that working age population and their children. We call for contributions to the super fund to cease and the money used to address the urgent problems of child poverty and underfunding of essential services.

The fiscal responsibility rules also require "the government will maintain its expenditure to within the recent historical range of spending to GDP ratio." Again there doesn't seem to be any clear economic argument for this. The graph below shows that New Zealand government spending to GDP is extremely low by OECD standards. New Zealand has the second lowest government spending to GDP ratio in the OECD.

CPAG calls on the Government to fund much of the upcoming capital spending over the next five years through increased government borrowing which would allow much needed increase in social spending to address the urgent shortfalls. CPAG calls on the Government to ditch the fiscal responsibility framework and instead address the pressing social needs of the country.

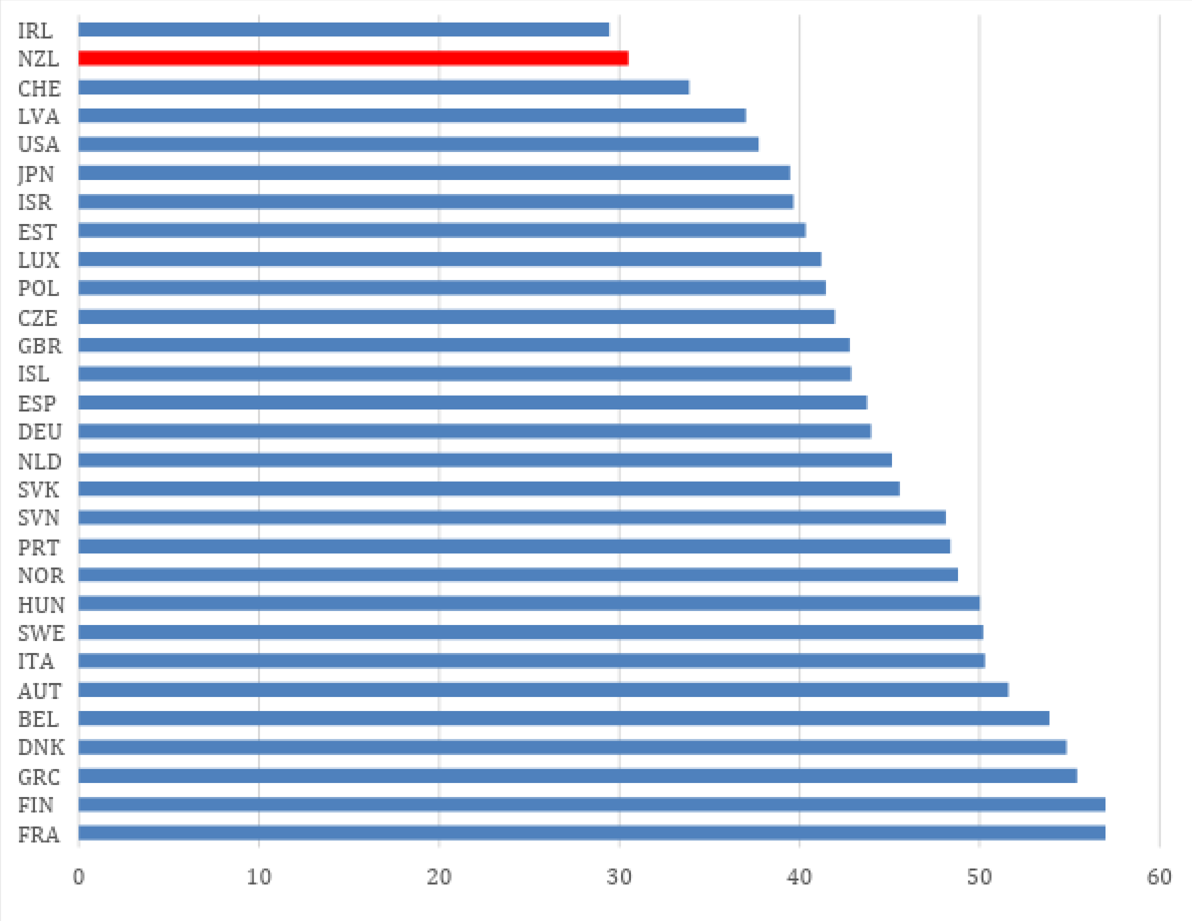

Figure 3: Government spending as a percentage of GDP for OECD countries. Source: OECD

The last Budget stated that, “for the last 20 years, Core Crown spending has been around 30% of GDP and we will manage our expenditure carefully to continue this trend.”

Actual spending is projected to be well under this at 28.5% of GDP. While it can be argued that government spending should be lower when there is an economic boom and higher when there is a recession New Zealand is not in normal times but in times where there are vast social deficits to address. Bringing it up to 30% of GDP would give an extra $4b a year and still be well under OECD average of 40%. The current operating surplus of $3.1b would come down to a small deficit.

The Government is spending $41.8 billion over the five years to 2022) on capital for school and hospital buildings, housing, rail, prisons, defence, computer systems and other investment. These all being long-term projects with an expected future benefit to the country could and should, at least in part, be funded from borrowing.

CPAG calls for the arbitrary fiscal responsibility rules to be abandoned with a substantial increase in government spending on health, education, social housing and child poverty funded initially by an increase in borrowing. Further down the track the government mail need to find additional sources of revenue such as increased taxation or widening the tax base.

In our view it is impossible to have a modern social democratic state that caters for the needs of all its citizens including the most vulnerable with anything like the extreme low levels of government spending as a fraction of GDP seen in New Zealand.