

Susan St John

Reflections on the Budget 2015

Child Hardship Package

Introduction

The 2015 Budget contained benefit rate increases for beneficiaries with children and some minor adjustments to work-based child-related tax credits. The significance of these increases when other policies are taken into account suggests a reshuffling of money in which much of the distributional effect will be minimal and offset. For children it resembles the ambulance at the bottom of the cliff rather than a structural review of child-related income policies that might be reformist, preventative and inclusive. The cost to society is more complexity in the benefit system and a cementing in of reliance on work-related child tax credits

that have unproven worth either in incentivising work or in reducing child poverty. A rational policy-making approach with the clear aim of child poverty reduction, measurable outcomes, agreed criteria and a process for evaluation might have suggested that a different policy direction was more appropriate and more likely to be effective.

Poverty or hardship?

The very real problems of struggling low-income families were highly visible in the debate leading up to the 2014 election. Reflecting the pressure from numerous

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child advocacy groups, the prime minister, John Key, promised to prioritise child poverty. In the lead-up to the 2015 Budget, however, children's groups were worried that the government would take an excessively targeted approach to reducing child poverty by concentrating its effort on only the narrowly defined 'vulnerable children' living in the most dysfunction situations. For example, the minister of finance, Bill English, appeared to think the group to be assisted was only about 12,000 children when he said that 'the roughly 1.05% of New Zealand children who are in complex families ... need the sort of intense intervention by social services' (Hosking, 2015).

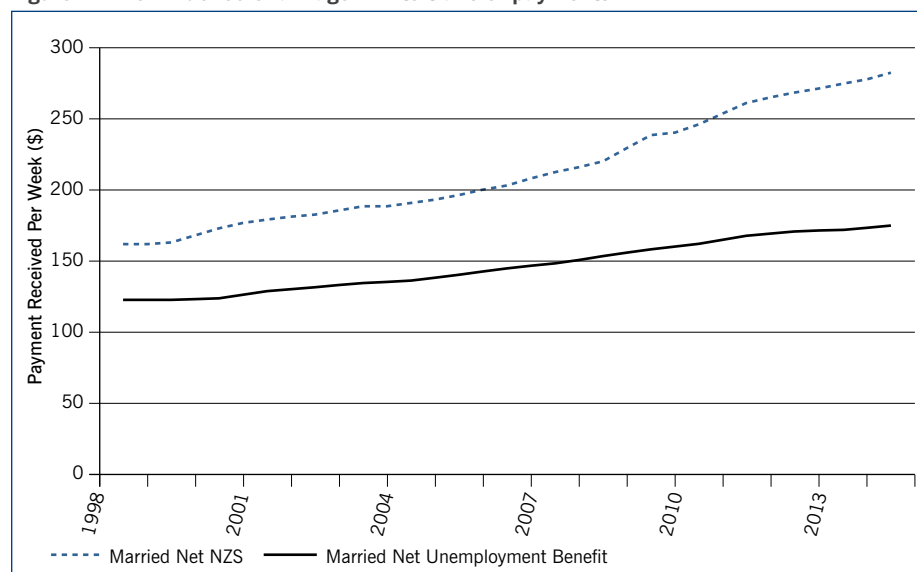
Other indicators of political sentiment came from various pre-Budget comments that income measures of poverty were flawed and overstated the problem and that hardship indicators were preferable. The prime minister dismissed the much-used statistic of 260,000 children in poverty based on the 60% income poverty line (from Perry, 2014) and claimed that 60–100,000 was more realistic. Pre-Budget the Ministry of Social Development released an update of the 2008 hardship report that had informed the Budget decision-making, also reinforcing this perception:

Household income is often used as an indicator of household material wellbeing. There is no doubt that income is a very important factor in determining a household's level of material wellbeing – especially for those with a minimal stock of basic household goods and appliances and low or zero cash reserves – but it is not the only factor. (Perry, 2015)

The regulatory statement released at the time of Budget 2015 reiterated that

the Government's overall objective was to take more immediate action to reduce material hardship amongst children ... The focus for this package was on children experiencing material deprivation at the more severe end of the spectrum. (Department of the Prime Minister and Cabinet, Ministry of Social

Figure 1: The influence of a wage link to transfer payments



Source: Author's calculations

Development and Treasury, 2015, p.2)

While the preference of the government may have been the alleviation of only the worst hardship rather than poverty prevention, the child hardship package will have a more generalised impact. Implicitly the government acknowledged that lack of income was a long-term driver of deprivation. A policy focus specifically on hardship would have been very problematic in design.

Child hardship package

The \$790 million child hardship package announced in the 2015 Budget sounded impressive but is to be spent over four years, and does not start until 1 April 2016. Of the approximately \$240 million per annum, the most significant change is an increase for families on benefits of a net \$25 a week, accounting for around \$132 million per annum.

While this policy was widely praised as the first time any government had increased benefits in real terms since 1972, welfare benefits had actually been cut significantly in real terms in 1991, and again for many beneficiaries with children with the introduction of Working for Families in 2005. Indexation to the consumers price index (CPI) alone affects the relativity of benefits to wages and to wage-linked New Zealand Superannuation. Figure 1 shows the difference a wage link has made since

the late 1990s to the married rate of New Zealand Superannuation compared to the jobseeker (unemployed) married rate. As discussed below, only some parts of Working for Families (WFF) have ever been indexed to the CPI, and since 2012 even the partial CPI adjustments are not made automatically on an annual basis. This means that income support specifically for children has fallen even further behind benefits.

As benefits became less adequate over time, many beneficiaries have required additional means-tested payments. Some of the \$25 increase to benefits will result in less supplementary support, especially via the accommodation supplement, income-related rents for those in social housing, and the temporary additional support payments. Such a shift of money from complex means-tested supplements to the core benefit rate is desirable, but limits the potential of the announced benefit rate changes to reduce hardship.

Reinforcing the 'work first' approach, parents on a benefit who are able to work must seek and be available for work, and be subject to work test obligations, once their youngest child turns three years of age, rather than five as now. Work obligations for all such parents increase from the current 15 hours to 20 hours a week. Sole parents must reapply each year in a new form-filling interview process that jobseekers already go through, increasing the barriers to benefit access for families with children. Beneficiaries

who must work more hours and thus face higher child care costs will be assisted by an increase in child care subsidies. The subsidy rate increases from \$4 an hour to \$5 an hour for up to 50 hours of child care and out-of-school care per week at an annual cost of around \$32 million.

The other part of the package, accounting for around just \$71 million annually, was an increase in WFF tax credits but only for non-beneficiaries. The weekly base rate of the in-work tax credit increases by \$12.50, and the minimum family tax credit by \$12. These child-related tax credits are paid only when

beneficiaries into work. Harsh sanctions have applied to those who fail to meet reporting and monitoring criteria, with as many as 80,202 sanctions applied to working-age main-benefit recipients between July 2013 and September 2014. Front-line agencies report ever-growing levels of societal distress:

What we do know is the reality of a sudden reduction of an already inadequate income to cover basic life necessities (rent, electricity and food) is further debt to family, friends or third-tier money lenders. Financial

certain clear principles or criteria and evolve from a consideration of all possible options. For a limited fiscal cost, cost effectiveness as a criteria would clearly be important (St John and Dale, 2012). The Budget provided no policy analysis along these lines and gave the impression that these minimal changes would be the last that should be expected in this term of government.

Core benefit rates

Prior to WFF, higher benefit rates for parents partially met the needs of their children. In 2005, when WFF was introduced, the child-related part of the benefit rates was removed for couples and sole parents with two or more children.¹ This was one of the reasons many low-income families found themselves no better off despite the intention of WFF to address child poverty. The other explanation was that they were left out of \$60 or more per week by exclusion from the in-work tax credit (St John and Craig, 2004). The key reform of WFF was to clearly set core benefit rates for adults and use the family tax credit, given to all children on the same basis of low parental income, as the principal way in which families of different sizes and ages of children were assisted.

The 2015 Budget, however, re-introduces a family element into the structure of benefit rates. This confuses the role of adult benefits and benefits for children and muddles the goals of policy. For example, a reduction in overall poverty is a separate policy goal. The OECD has recently given the New Zealand government some strong messages on the need for such poverty reduction:

Increasing main (basic) benefits and indexing them to median wages would reduce poverty across all beneficiary classes, including single-person households (below age 65), who have the second-highest relative risk of poverty (OECD, 2015, p.39).

All adult benefits are too low and if all rates had been increased by at least the 8.4% represented by the \$25 given to sole parents, and indexed in future to wages, there would be some inroads into adult poverty.

families fulfil the criteria of minimum hours of work (20 hours for a sole parent and 30 hours for a couple) and being off-benefit.

The in-work tax credit increases were confined to low-income 'working' families by a higher abatement (an increase from 21.25% to 22.5%) of WFF tax credits above the threshold. The threshold was unchanged but had been reduced by \$450 to \$36,350 in 2012, with further reductions signalled out to 2018. The KiwiSaver kick-start subsidy of \$1,000, which is of the most assistance in relative terms to the lowest paid, was also abolished, largely affecting only younger people who have not yet joined.

The 2015 Budget changes for families sit within the context of a new approach to welfare. This sees an intensification of the relentless focus on paid work as the solution to poverty, including child poverty. Investment in this approach since 2012 has been about not more money for families but more money for the infrastructure of management of

sanctions mean more family stress, particularly for those without family/social supports or who have more complex needs. For these people financial sanctions simply undermine any ability to be self-sufficient and to lead better lives. (New Zealand Council of Christian Social Services, 2015)

Nevertheless, the Budget changes to benefit rates moderate the strict work-first approach. As the minister of finance, Bill English, explained: 'This package strikes a balance that offers more support to low-income families with children, while ensuring there remains a strong incentive for parents to move from welfare to work' (English and Tolley, 2015).

Child hardship package and child poverty

If child poverty was the main problem for the Budget to address, then the package should be judged against its measured reduction in child poverty indicators. A well-designed package would have

poverty. If reducing child poverty is the focus, a different policy tool to the flat-rate \$25 per family on benefits is required. A fixed payment gives less per person the bigger the family size. Data show 79% of children in hardship live in households containing two or more children and almost half (46%) in households with three or more (Perry, 2015, p.24). For a four-child, two-adult family less than \$4 per week for each person will have a minuscule effect on living standards, yet we know from Perry (2015) that one quarter of children in the severest poverty are in larger families.

The work of Boston and Chapple shows that significant amounts are needed to lift beneficiary families over the familiar 50% and 60% after-housing-costs poverty lines (Boston and Chapple, 2014, p.97). Table 1 shows that a flat \$25 per family is clearly not enough for even the one-child family.

The OECD notes that the use of supplementary means-tested payments for the very worst-off families and their lack of access to the full WFF benefits explains why living standards of those on benefits have fallen so far behind:

Poverty rates could be cut by increasing social benefits, which have been falling relative to wages as they are indexed to the Consumers Price Index. In addition to these main benefits, most beneficiaries receive supplementary benefits (a variety of means-tested benefits available to both beneficiary and working households) targeted at vulnerable families. However, increases in supplementary benefit payments have been smaller for beneficiary households than for low-income working households owing to the introduction of Working for Families, which provides greater benefits to low-income working households than beneficiaries. (OECD, 2015, p.38)

The increase of a flat \$25 per family in 2016 complicates the rates by now needing to distinguish between parents who are married and will get a \$12.50 increase each, and others who may have

Table 1: Additional weekly income needed for families on benefits to get over four poverty lines.

Benefit category	Before Housing Costs		After Housing Costs	
	50% 2012 median	60% 2012 median	50% 2012 median	60% 2012 median
Sole parent one child	\$0	\$30	\$82	\$148
Sole parent two children	\$0	\$78	\$111	\$194
Couple one child	\$0	\$69	\$156	\$244
Couple two children	\$0	\$110	\$184	\$286

Source: Chapple & Boston, (2014).

shared care arrangements. Students with children are included, necessitating a new category of ‘student with dependent spouse with children’ (Inland Revenue, 2015, p.29). The minister stated that the purpose is ‘to ensure that the children of low-income students share these gains and to reward students’ efforts through study, rather than creating an incentive to move back on to a benefit’ (Tolley, 2015). This is very interesting as it illustrates the complexities and unintended consequences that arise when goals are muddled and policy is not based on clear principles. Thus, for example, given the intent to make it clear that student allowances are not benefits, there can now be no justification for denying students the in-work tax credit for their children.

Tax credits

As the OECD insists, all beneficiaries need more income, not just some. This requires an across-the-board increase and indexation to median wages. The link to wages is crucial. Once the adult benefits are increased and indexed, WFF child-related tax credits are the best way to recognise the needs of children in low-income households. These need to be given to all low-income children on the same basis if reducing child poverty is the goal. Budget 2015 helps only those families in low-paid work who meet rigid work criteria and makes only very minor adjustments to these work-related tax credits.

The increase in the base rate of the in-work tax credit by \$12.50 to \$72.50 per week for low-income working families from 1 April 2016 is a mere inflation adjustment. It leaves hanging what changes to the in-work tax credit are appropriate for larger families where the fourth and subsequent children currently get another \$15 each. The in-work tax

credit was never automatically inflation-adjusted along with other parts of WFF. One interpretation of this may be that the government was happy to see it lose value and importance. That it was also the subject of a lengthy court case, *CPAG v the Attorney General* (2002–2011), in which the courts accepted that it is discriminatory (but not illegal) with a harsh impact on the left-out poorest children, may have had something to do with its neglect until now (Child Poverty Action Group, 2014).

Unfortunately, the Budget increase to the in-work tax credit reinforces the use of complex work-based measures to meet the needs of children. Had the family tax credit been the tool used and increased by \$12.50, all low-income children would have benefited. The leakage to better-off families could have been reduced by offsetting reductions in the in-work tax credit. As argued strenuously over the years by the Child Poverty Action Group, the most cost-effective way to reduce the worst child poverty is still to join the in-work tax credit to the first-child family tax credit (St John, 2015).

Much was made in the Budget of an increase for some low-income working families of another \$12 a week. This comes from an increase to the minimum family tax credit, another work-based tax credit that gives guaranteed minimum income to those with children (see Figure 2). However, only 3,500-4,000 families will be entitled to this extra \$12 a week, at the minimal cost to the government of only \$1.8 million annually. To put this in context, the government will spend \$27 million over four years to administer the child hardship package, including around \$5 million per annum for annual benefit reapplications and new work obligations (Inland Revenue, 2015, p.23).

Figure 2: Family income and tax credits

Parental tax credit	
In-Work tax credit	
Family tax credit	
Minimum Family tax credit	income floor \$22,776 net guaranteed
Earned income	

The minimum family tax credit is a very unsatisfactory and complex part of family assistance. As it entails a 100% effective marginal tax rate, it is one of the worst designed work incentives imaginable (O’Brien and St John, 2014).

Figure 2 shows the fixed guaranteed income floor: any additional earned income simply reduces the minimum family tax credit. The figure illustrates how WFF tax credits are added on top of this minimum income to compensate for the costs of children. The family tax credit, the in-work tax credit and the parental tax credit for newborns are paid weekly to the caregiver and are abated sequentially in that order from the threshold of \$36,350 family income.

Data obtained from Inland Revenue under the Official Information Act shows that few families are receiving this payment at any point in time, but the numbers have increased steadily since 2010. Of the 10,386 families entitled to the minimum family tax credit between 2010 and 2014, 67% were on it for a year or less, and only 13% for three–five years. Table 2 shows that the number of couples on the minimum family tax credit has fallen by a quarter since 2010, while sole parent numbers have increased by 58%. At July 2015 there were nearly 4,000 families receiving the minimum family tax credit, and of these 89% were sole parents. The new work obligation for sole parents to work 20 hours is likely to further increase these numbers on this

precarious tax credit as they are cajoled into coming off the benefit system.

Indexation issues

History tells us that indexation of benefits and pensions to the CPI alone is a recipe for alienation and poverty. The indexation policies for WFF are therefore unusual and perverse. While the WFF tax credits (but not the in-work tax credit) were originally indexed to the CPI, in 2011 a rule was introduced to make adjustments only when cumulative inflation reached 5%. Cumulative inflation since September 2011 has not yet exceeded 5%, so there has been no adjustment to date to any part of WFF and under current projections none will be made until 2017. Families will thus have endured five years of no adjustment to their tax credits while costs such as rents, power, transport and child care have steadily risen.³

The changes announced in Budget 2011 were designed to reign in the costs of WFF by making it more targeted, with savings accruing over time. The changes would accrue in the future and the changes to overall WFF may have appeared minor and remote. The minister of finance claimed that ‘[t]hese changes are expected to generate \$448 million of savings over the four years to 2014/15. As a result, the total cost of WFF will reduce from \$2.8 billion in 2011/12 to \$2.6 billion in 2014/15’ (English, 2011).

O’Brien and St John (2014) argue that these savings were grossly understated, because the projected savings were measured against the actual 2011 cost of WFF. The true cumulative savings from 2011/12 to 2014/15 from less-than-full CPI indexation, a higher abatement rate and a reduction in the abatement threshold is actually around \$1.1 billion (O’Brien and St John, 2014). Compared to the costs if there had been full CPI indexation of the threshold from the inception of WFF, the savings grow rapidly. If indexation

had been to wages to reflect the growth in living standards, the savings would be even more pronounced. The pain of this policy change for working families is very significant.

Because the next cumulative 5% inflation adjustment is not expected until 2017, the 2015 Budget advances by one year (to 2016) the timing of the increase to the abatement rate by 1.25% to 22.5% to recoup some of the cost of the increase to the in-work tax credit. One of the background papers provided in July 2015⁴ suggests that there may be a further increment to the abatement rate in 2017 to 23.75%, and that the rate will eventually be increased to a maximum of 26.25% in 2023 (Inland Revenue, 2015, p.6). As well, there will be reductions in the threshold for abatement at each 5% adjustment phase until it falls to \$35,000. This represents a significant and sustained reduction in the assistance for low-income working families and has ongoing ramifications. For example, the calculation of the living wage has to take these cuts into account (O’Brien and St John, 2014).

To gauge the impact on low-income families affected by the abatement, had the threshold of \$35,000 been CPI-linked from 2005, in 2015 it would be \$43,500. The current threshold is \$36,350, so that a family in 2016 on \$43,500 is \$1,608 worse off than they would have been with proper CPI indexation of the threshold alone. In Australia, not only are the tax credits for children much more inclusive of all children, indexation of all tax credits and thresholds is an annual event. In 2015 the corresponding threshold for abatement of the Australian family tax benefit A is \$51,027.⁵

With the clear possibility that inflation will rise (as the exchange rate falls in 2015), the policy changes set in train since 2011 and reinforced by the 2015 Budget will be harsh indeed on the working poor.

Working for Families

The structure of WFF is very complex, with different rules of eligibility for different parts. The two tax credits of the in-work tax credit and parental tax credit (for newborns) are confined to those who

Table 2: Marital status of people entitled to minimum family tax credit as at July 2015²

Tax year	2010	2011	2012	2013	2014
Couple	568	510	492	478	419
Sole	2,244	2,293	2,598	2,895	3,555
Number entitled to MFTC	2,812	2,803	3,090	3,373	3,974

are off-benefit and meet work-based rules. The evidence suggests that the first few years of a child's life are the most crucial, and the poorest families are those with the youngest children. While the 2014 Budget increased the parental tax credit for babies born on or after 1 April 2015, from \$150 a week to \$220 a week, and extended the payment period from eight weeks to ten weeks, it remains unavailable to families on benefits. There was no attempt in the child hardship package to secure more income for the very poorest babies who continue to miss out.

When fully implemented in 2007, WFF made a significant difference for families that gained the full amount. Without this improvement in weekly child payments, child poverty would have been very much higher. Perry noted, however, that children in workless households were little helped by WFF:

From 1992 to 2004, children in workless households generally had poverty rates around four times higher than for those in households where at least one adult was in full-time work. From 2007 to 2012, the difference was even greater – around six to seven times higher for children in workless households. This to a large degree reflects the greater WFF assistance for working families than for beneficiary families ... The fall in child poverty rates from 2004 to 2007 for children in one-full-time-one-workless 2 parent households was very large (28% to 9%), reflecting the WFF impact, especially through the In-work Tax Credit. (Perry, 2014, p.156)

The biggest problem is that WFF does not put the needs of the child at the centre of policy design (St John, 2014). It excludes the poorest children for a good part of it, and its critical purpose has become lost in a morass of arguments over entitlements, overpayments, abatements and work tests.

The in-work tax credit and work incentives

The justification of the use of the in-work tax credit to incentivise work has rarely been scrutinised, but it is clearly ineffective in protecting vulnerable children whose parents, for whatever reason, cannot work.

The slight impact, if indeed any, on work incentives for a handful of sole parents does not justify the harm to 230,000 children whose families have been left out and left behind (St John and Dale, 2012). The latest evaluation of the work incentive effect from Treasury suggests that, overall, hours worked may have actually fallen: there was a very small increase of 0.6 hours a week for sole parents, but a fall of 0.5 hours a week for partnered women (Mok and Mercante, 2014). There is no attempt in this Treasury paper to reflect on the costs of this policy to those families excluded

work hours in a natural disaster or in an economic downturn, or in an increasingly casualised and insecure job market. Some of the absurdities of the design can be seen from examples on the Inland Revenue website, as discussed in Child Poverty Action Group (2012).

It is sometimes argued that the in-work tax credit is justified because there are extra costs of working. When there are very young children, for example, the costs of child care may be very high. A major source of extra costs arises because the formerly unpaid work of child-rearing is crystallised as a real cost once

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from it when it achieves little or no work incentive effects.

In the aftermath of the global financial crisis, child poverty rates began to rise in the OECD generally. At the release of an OECD report on family well-being, *Doing Better for Families*, the secretary-general, Angel Gurría warned that

[f]amily benefits need to be well designed to maintain work incentives, but they need to be effective in protecting the most vulnerable, otherwise we risk creating high, long-term social costs for future generations (OECD, 2011).

The current system for WFF is far too complex and convoluted. The minimum family tax credit, the in-work tax credit and the parental tax credit are all very badly designed. They pose dangers when a parent moves off a benefit into insecure work, or loses

it is outsourced to the private sector. The in-work tax credit, however, is ill-suited to meeting the child care needs of families in different circumstances. It may be paid in full, for example, to a caregiver who is not in paid work when her partner fulfils the work criterion.

If the state must provide subsidies to make work pay, the much promulgated view that paid work alone is the way out of poverty is further undermined. It needs to be acknowledged that when children are small, their care is inevitably expensive. The cost is either explicit, if the care is outsourced, or implicit when a parent forgoes paid work to do it. This suggests that our policies need to better recognise the unpaid work of caregiving. If the in-work tax credit was given to all caregivers who are not themselves in paid work, it could be used to help pay for any outside child care if needed.

Conclusion

Current benefit policy is almost entirely focused on moving people from a benefit

into paid work, with little consideration of income adequacy, or the short- and long-term health and well-being of children. It is acknowledged that paid work is part of a poverty reduction and elimination strategy, but it is only a part. Beneficiaries with children often cannot undertake paid work because of personal needs and circumstances. Others cannot find work that allows them to meet their parenting obligations satisfactorily. It is unacceptable that these families live in poverty because of the currently inadequate levels of social assistance, originally introduced to keep families out of poverty.

In addition, as the data on the distribution of child poverty indicate, paid work in itself does not guarantee that children will move above the poverty line: 37% of the children living in poverty are in households reliant solely on market

income. Nor does it suggest that WFF payments for children are overly generous. Moreover, current policy is cutting the real value of WFF over time for low wage earners, with perverse effects.

The 2015 Budget was a missed opportunity to thoroughly review the nature of WFF and examine whether the current indexation rules, the fixed hours of work requirements and off-benefit rules operate in the best interests of children, or are appropriate in the changed labour market of the 21st century. We are at a critical tipping point. The 2015 Budget changes are better than no extra spending on families, but in many ways they take us in the wrong direction. A different policy frame might focus more clearly on immediately alleviating child poverty, especially the worst child poverty, and on providing an inclusive, preventative

income floor. Most New Zealanders now recognise that persistent child hardship has a very high cost both for society and for the children themselves.

- 1 The sole-parent rate was still higher than the childless rate of benefit but that is best seen as a recognition that a sole parent has a handicap in working akin to being an invalid.
- 2 Official Information Act request from the Child Poverty Action Group to IRD, July 2015.
- 3 The CPI has been kept low by the high exchange rate affecting many goods such as travel that low-income families do not enjoy.
- 4 See <http://www.treasury.govt.nz/publications/informationreleases/budget/2015/other-s-w/index.htm#socdev>.
- 5 See Australian Government, Department of Human Services for full details: <http://www.humanservices.gov.au/corporate/publications-and-resources/a-guide-to-australian-government-payments>.

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