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Economic Policy Centre

Pensions and Intergenerational Equity

The new government needs a simple fix to improve child poverty- here's what it should do

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PIE Commentary 2023-14[1]

PIE highlights intergenerational equity issues around the rapid ageing of the population including the ageing of the old. What are we doing to invest in the young who will be the workforce the future will depend on? As argued in PIE commentary 2023-11 we really need to improve what we do for children. The incoming National government has promised to halve child poverty and wants to grow the economy. A few tweaks of its Working for Families policy would help it achieve these objectives or at very least set it on a better path to do so.

With thanks to the Conversation,[2] we republish this commentary by Susan St John[3] as a beginning to the needed political debate around how we take care of our children.

With a National-led coalition government taking shape (how long it takes is another matter), the nation's "squeezed middle" awaits the financial relief promised during the election campaign.

As the lead party, National's policies should be central to negotiations. For those without children, its proposed payment of the full Independent Earner Tax Credit for incomes between NZ$24,000 and $66,000 would kick in from April 1 next year.

This would help some 380,000 people in low and modestly paid work with an extra $10 a week. It's not a lot, but better than nothing. For those with children, National has promised an extra $25 a week from the In Work Tax Credit – providing neither parent receives any part of a core welfare benefit.

At an annual cost of about $200 million, around 160,000 low-income "working families" would gain enough each week to buy a large block of cheese.

But for those roughly 180,000 families where parents are without work and who need welfare to survive, National's election promises will deliver nothing.

[1] PIE Commentaries are opinion pieces published as contributions to public debate, and do not necessarily reflect the view of the Pensions and Intergenerational Equity Hub.
[2] First published 9th November in the Conversation. https://theconversation.com/if-nzs-new-government-wants-a-simple-fix-to-improve-child-poverty-heres-what-it-should-do-217260?utm_source=linkedin&utm_medium
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This raises real questions about incoming prime minister Christopher Luxon's promise to stick to the targets outlined in the Child Poverty Reduction Act and halve child poverty by 2028.

With a willingness to re-examine what is on the table, however, New Zealand's worst-off children can be helped in a meaningful way. At the same time, the work effort of low-income parents can be better rewarded.

How the poverty trap works

The various tax credits available through Working for Families (WFF) are fiendishly complicated but utterly critical for the negotiating coalition parties to understand.

When a family's joint gross income exceeds the (very low) fixed $42,700 threshold, every extra dollar earned denies them 27 cents of WFF assistance. To help explain this, it's useful to imagine a typical family in those circumstances.

Let's say this family has two children at school, with one parent in full-time employment and the other half-time, both on the minimum wage. That gives them a total annual gross income of $70,824, or $63,984 after tax.

WFF currently provides a maximum of $320 per week, made up of $248 from the Family Tax Credit (FTC) and $72 from the In Work Tax Credit (IWTC). But the parents' joint income is over the fixed threshold, meaning they lose entitlement to $146 of WFF. This leaves just $174 a week for the needs of their children.

With rent or a mortgage taking maybe half of their net income, their budget just doesn't add up. The weekly deficit must be covered by food parcels from foodbanks, special assistance from Work and Income, defaults on payments, high-interest borrowing or selling assets.

The parents are already stretched, but let's say the mother decides to go back to full-time paid work. Her additional gross income would see Inland Revenue reduce her WFF entitlement by $116 a week – or demand repayment of any overpaid entitlements.

If she has a student loan, as many do, she could be liable for another repayment of $51 a week. Her extra income of $454 for 20 hours' work leaves her better off by just $207.

A very low income abatement threshold penalises low-paid workers for working or earning more.

Letting people work and earn more

To alleviate this kind of poverty trap, National proposes to increase the WFF threshold from $42,700 to $50,000. But this does not happen until 2026, just in time for the next election. In the meantime, rising costs will erode the family's extra weekly $25 from the IWTC.

To increase the threshold to $50,000 immediately would cost about $250 million according to National's own calculations. Delaying the change only decreases the incentive to work, with flow-on effects for productivity.

Rather than increasing the IWTC by $25, bringing forward the higher income threshold would be a more effective way to help squeezed middle-income "working" families by loosening the vice of that poverty trap.

It would deliver an extra $38 a week of WFF on joint incomes between $50,000 and $100,000, or more, depending on the number of children. This would also address child poverty, as about half of the country's poor children are in families in low-paid work.

But what of the other poor children in families that get nothing from National's election promises? If their parents are so poor they need a benefit, or part of a benefit, they do not receive the IWTC and would gain nothing from the threshold increase.

These families live on budgets that fall far short of a liveable income. Many slip further into debt every week, waste precious time arguing for means-tested top-ups from Work and Income, or need food parcels from stretched and underfunded foodbanks.

A simple solution

For child poverty targets to have even a remote chance of being met, these worst-off children must be helped. This would best be achieved by an immediate increase to the Family Tax Credit, over and above the required inflation adjustment.

Here is a counter-intuitive but serious suggestion: *reduce* the In Work Tax Credit by $25 a week and *increase* the Family Tax Credit by the same amount.

This would mean the poorest families are better off. The working poor would see no difference, as their IWTC goes down while their FTC goes up. But they would still be helped greatly by the increase in the income abatement threshold, because any extra earnings would not be quite so badly penalised.

Much more could be done to reduce the poverty trap, including a reduction of the 27% abatement rate, indexation of the threshold for inflation, and a review of the penal student loan arrangements.

But this basic suggestion could still be a win-win for National's key objectives at roughly the same eventual annual cost. It should be only a beginning, but it would provide a better path for future adjustments.

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