Budget 2017 Commentary

BERL Briefing re 'Budget-Lite'

26 May 2017

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Introduction

The slug line for Budget 2017 was 'Delivering for New Zealanders'.

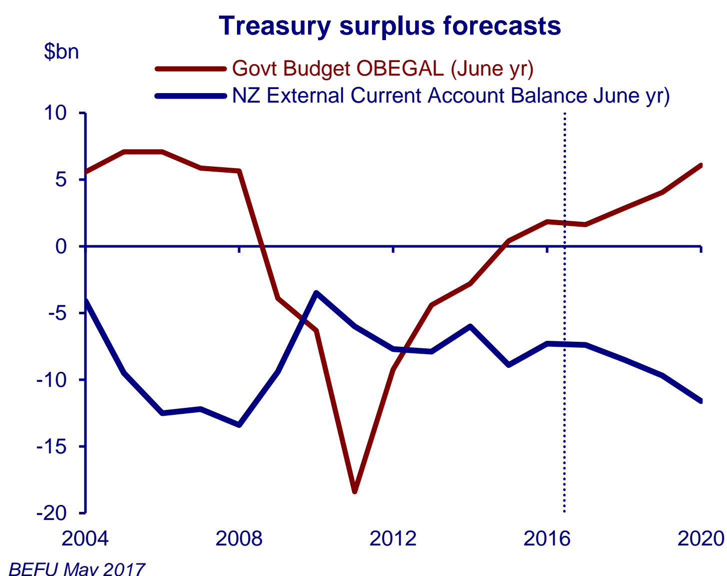
Budget 2017 responsibly, methodically, and conservatively delivers a dividend to taxpayers. But, it won't by any means make any of us fat. Thus, our assessment suggests a slug line of 'Budget Lite' as being more apt description.

The dividend is in the form of lower taxes for households via adjustments in thresholds along, along with more for families via a more generous Family Tax Credit component of Working For Families. This means that a family household on the average wage will take home of the order of $30 to $40 more per week come 01 April next year. Additional relief will also come through via changes in the Accommodation Supplement payments.

The kicker, however, is in the increase in the Family Tax Credit abatement process. This means that the average wage family household will, together with their standard tax rate, continue to take home only 45 cents for every additional $ they earn.

More broadly, the growing operational budget surpluses (resulting from forecast economic growth) are set to be used to fund a larger infrastructure package – with the government's contribution to the CRL taking a sizable slice.

As a result, despite the growing surpluses, Government net debt climbs to nearly $66bn in 2018/19. However, the rate of increase has eased so that as a proportion of GDP Government net debt slips to under 20% by June 2021.



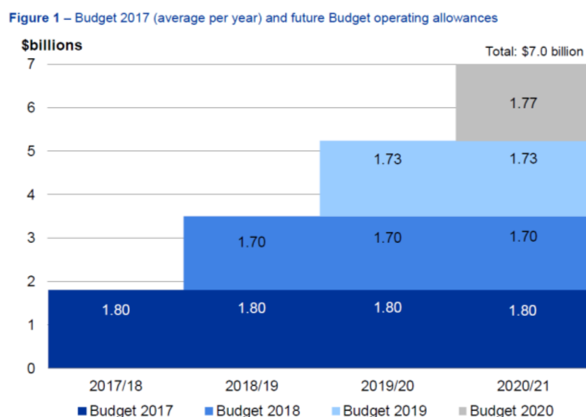
All in all, a conventional Budget, which will please the auditors and credit-rating agencies – leaving the Government in strong shape, but the nation's books experiencing growing deficit and debt. It seems little has changed in the past 2 decades. As illustrated, the Government's Budget balance (OBEGAL) is growing impressively, but the nation's external account is in a larger deficit (and getting worse).

Although, as the Minister commented during his briefing to the lock-up when 'delivering' the dividend, "this is the beginning". Fair enough, as this is only his first Budget. However, after 8 previous Budgets from this Government, some could be forgiven for expecting more progress than "this is the beginning".

The economic and fiscal foundation

Treasury economic forecasts provide the foundation for the Budget largesse. Annual GDP growth is set to climb to a remarkable 3.8% by 2019, based on surging household spending and business investment. This sees employment growth of the order of 40-50,000 a year, pushing the unemployment rate under 5.0% - reaching 4.3% in the out years.

Disappointingly, the economic outlook remains driven by the domestic economy – with export growth lagging overall GDP growth in all but the last of the four forecast years. Consequently, the earlier targets of exports accounting for 40% of GDP have now well and truly been relegated to the history books. Thus the external accounts remains in deficit, with the nation's external debt (our net international investment position) forecast to worsen over the forecast horizon.

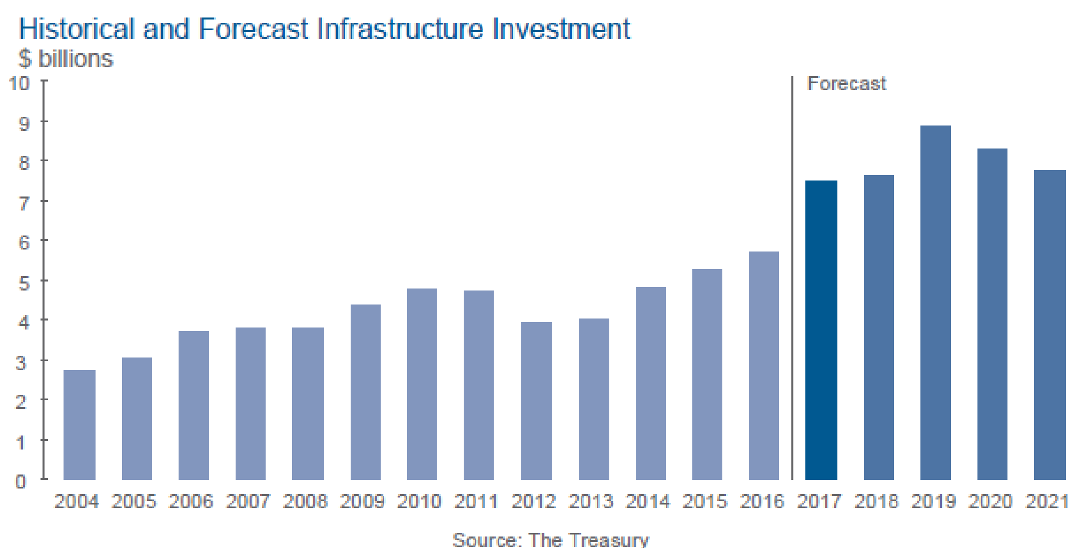


In contrast, the government's books look decidedly rosy. The OBEGAL surplus hits $1.6bn in the current 2016/17 June year and is forecast to grow further, topping $7bn in the 2020/21 June year. Within this forecast are allowances for new additional spending of $1.8bn for the 2017/18 June year, and a further $1.7bn each year thereafter.

Rather than paying down debt, though, these surpluses are being used to fund an infrastructure programme comprising a range of projects. Just under an additional $4bn is set aside for the 2017/18 June year, with a further $2bn to $2.5bn allowance for capital spending in each of the following 3 years thereafter. The Auckland CRL takes a sizable chunk of the immediate year, as does the already announced for the post-Kaikoura earthquake reinstatement of the Southern Corridors (between Picton and Christchurch). There are large additional investments for NZTA as well as KiwiRail (including funds for an upgrade for Wellington Metro Rail Network).

Infrastructure package

As illustrated, the proposed infrastructure investment package is a significant jump on that of earlier years.



True to the Budget Lite perspective, there are no iconic or headline seeking infrastructure proposals in the spending package. However, a recurring theme in the budget speech was the idea of the economy pushing up against capacity. Hence, the capital expenditure on infrastructure sends a consistent message. But there is an argument (backed up by the chart above) that the capacity shortage resulted from previous years of neglect.

To be expected, there has been infrastructure spending in Kaikoura (about $3.8m in total). This has been directed to Three Waters restoration and harbour rehabilitation after the earthquake. Three Waters is investment in sewerage, drinking water and storm water systems.

The composition of the rest of infrastructure capital spending is: rail, roads, prisons, schools, and housing. Tacked on are investments in tourism infrastructure.

Rail investments into the Auckland City Rail link of $436m are ear-marked over the next ten years. To complement this there is also $450m over ten years going to KiwiRail. This investment is going to be welcomed by Auckland Council and commuters.

Additional rail funding is being directed into the restoration of the South Island Main Trunk Line. This was hampered by slips and obstructions. Further rail investment is going into Wellington's metro rail network.

Overall the road transport operating budget is $8.7m, with just under $2 billion in capital spending. This has been directed to various road projects such as Transmission Gully and SH1 from Peka Peka to Otaki. This includes new Public Private Partnerships which are a step in the direction of privately provided road networks, albeit a politically palatable one.

A boost in prison capital spending of $763m has been forecast, representing the building of more prison capacity. A raft of related expenditure is in the social investment package to help reduce reoffending and rehabilitating prisoners.

Additional school capacity is being funded to the tune of $392m. This reflects the growing demand for schools around New Zealand and adds six new schools to cope with demand.

Housing has already proven to be a contentious political issue. To which the Government has responded with more allocated to help the smooth operations of the Housing Infrastructure Fund. An additional $100m in has also been ear-marked to acquire land for housing. This represents land for about 1,200 new houses.

The Tourism infrastructure fund has been allocated $14m more for operating purposes, while nearly $16m has been allocated for infrastructure for new walks.

Table 1 – Summary of Budget 2017 Initiatives

$m	2016/17	2017/18	2018/19	2019/20	2020/21	4-Year Total
Business Growth Agenda	39	200	264	268	268	1,001
Investing in Public Services	52	1,233	1,390	1,369	1,453	5,444
Infrastructure for a Growing Economy	6	26	37	32	59	154
Māori Development	-	25	25	24	19	93
Other	-	100	160	154	150	566
Contingencies	49	123	110	99	80	412
Revenue and Savings	(27)	(62)	(134)	(191)	(189)	(576)
Budget 2017 Net Package	**119**	**1,645**	**1,852**	**1,756**	**1,840**	**7,093**
Care and Support Workers Pay Equity Settlement[3]	-	348	389	413	392	1,541
Total	**119**	**1,993**	**2,241**	**2,168**	**2,232**	**8,634**

Māori Development package

Budget Lite includes a small serving for Māori development ($93m over four years, in total). Initiatives include expenditure categories around Māori tourism operators, Te Reo programming, Whānau Ora extensions, Sustaining the Marae, Rangatahi Suicide Prevention Fund and Pathways to Home Ownership.

We identify these as notable because they mirror other initiatives (with a focus on mental health in the social investment package and housing in the infrastructure package).

Māori tourism is to receive $2.5m annually for the next four years. This is to assist in building capacity and the operation of Māori historical trails.

Te Reo programming is also to receive $2.5m annually for the next four years. This programming funding has been announced to be over multiple platforms. It has not been announced, but it would be interesting if Te Reo programming funding extended to services like YouTube.

Whānau Ora has been extended geographically. This programme has been allocated $2.5m in each year for the next four years.

Earthquake strengthening has been undertaken in many government buildings recently and in this year's budget there is provision for such strengthening to be undertaken on marae. Along with earthquake strengthening health and safety and restoration activities on marae are to be funded. This "sustaining the marae" initiative has been allocated $2m for the next two years and then $3m annually up to 2020/21.

Mental health is the biggest benefactor in the social investment package and the Māori development package includes measures that are related. One such measure is the Rangatahi Suicide Prevention Fund. This fund has been allocated a further $8m over the next four years to support entities that work to prevent suicide and self-harm in Māori youth.

Finally, the issue of housing looms over this election cycle so we see that theme carried through into the Māori development package. The package include $9m directed into pathways into home ownership over the next three years. This is to help whānau achieve housing independence. BERL has shown that such investment is beneficial in terms of the impact on the fiscal accounts.

Social Investment package

Budget 2017 Social Investment Package

	Operating ($m)				
	2016/17	2017/18	2018/19	2019/20	2020/21
Burglary Prevention and Reduction Services	-	3.463	6.102	9.826	13.552
Contraceptive Services for Low-income Women	-	1.500	4.000	6.000	6.000
Expanding Behaviour Services	-	5.790	10.130	9.380	9.380
Family Start – Expansion to National Coverage	-	5.760	6.755	7.568	8.032
Housing First Expansion	-	1.724	3.248	4.882	6.596
Incredible Years for Children with High Needs	-	0.680	1.110	1.310	1.090
Individual Placement Support for Clients with Mental Health Conditions	-	0.103	1.339	1.332	1.332
Industry, Treatment, and Learning Interventions – Increasing Access	-	2.780	4.520	5.650	5.650
Intensive Client Support – Extension	-	7.200	6.100	6.200	-
Mental Health Contingency	-	25.000	25.000	25.000	25.000
Oral Language – Removing Barriers to Access	-	1.132	1.685	1.685	1.518
Positive Pathways for People with a Corrections History	-	1.111	2.453	3.951	5.583
Prisoners at Risk of Self-harm and Suicide	-	1.883	3.223	3.230	3.265
Youth Offending – Services to Reduce Offending	-	1.691	2.836	4.082	5.327
Total	**-**	**59.817**	**78.501**	**90.096**	**92.325**

In the social investment field the surprise from Budget Lite was its lack of substantive weight. Given early signals around the importance this government was placing on its social investment approach to spending, we were expecting some significant announcements. For those not familiar with this line of thought, Social Investment refers data-driven targeting of spending using initiatives aiming to improve individual's outcomes. This includes early intervention for drug and alcohol abuse and preventing burglaries, among others.

But Budget Lite lifts total social investment by only $60mm, growing to an additional $92m by 2020/21.

The biggest item on the Social

Investment package is the Mental Health Contingency. This fund has allocated and additional $25m annually for the next four years. Budget notes indicate this will be used to trial mental health interventions.

Government has expanded the initiatives targeted at the early lives of children, new investment into this fund totals $73m. The largest measure in this package is to expand the provision of Behaviour Services. This will allow specialists to reach a further 1,000 children with severe behavioural issues.

The next item cited is titled addressing barriers to employment and independence. The measures in this package seem eclectic; one is to provide more services to intergenerational welfare recipients, another is to reduce homelessness by providing housing for homeless people. And the last is to provide free contraceptive consultation to women in high deprivation.

The last group in the Social Investment package are initiatives focused on improving outcomes for people who have been convicted of a crime and been to prison. One of these measures is the Positive Housing Pathways which received an additional $13.1m. This measure provides housing and reintegration for prisoners. BERL research has found that people in more secure housing tenure appear to have lower rates of prison sentencing (though we note that the direction of causality can go both ways i.e. people with low rates of prison sentencing are also going to be more secure in their tenure).

Family Incomes package

Despite Budget 2017 being light on substance, the notable headline was the Family Incomes Package. This package was undoubtedly the centrepiece of the 'Delivering for New Zealanders', distributing a dividend with a full-year cost of the order of $2bn. From the table, the lion's share of the package is from tax threshold changes, although the 'consequential impacts' (e.g. extra GST collected as a result of households spending their additional income) do mitigate some of the fiscal cost.

Table 2 – Family Incomes Package

$m	2016/17	2017/18	2018/19	2019/20	2020/21
Tax Reductions	-	486	1,896	1,895	1,976
Working for Families	-	97	373	318	310
Accommodation Supplement	-	87.6	361.6	380.3	399.7
Accommodation Benefit	-	6.3	19.5	19.5	19.8
Transitional Fund	-	1.1	0.5	0.4	0.3
Consequential Impacts[4]	-	(74.3)	(575.2)	(760.9)	(693.7)
Total	**-**	**603.6**	**2,075.3**	**1,852.3**	**2,012.0**

The Family Incomes Package, which is set to take effect on 01 April 2018, is according to the Minister "a coordinated set of measures to lift family incomes and improve the rewards for hard work. Each element works together." The key changes that the Family Incomes Package brings about, particularly for lower income families, are changes in the income tax brackets, family tax credits and the accommodation supplement.

"Significant change" to the Family Tax Credit

Of the four components of the Working For Families system, changes to the Family Tax Credit (FTC) were significant. In contrast, there were no changes to the Minimum Family Income Tax Credit or the Parental Tax Credit, while changes to the In Work Tax Credit (IWTC) were as a result of the changes to the FTC.

Most significantly, the FTC payments rates for young children were increased so that now there is the same payment rate for all children through to the age of 18. Thus, the FTC payment becomes

- $101.98 per week for the first child

  - an increase of $9.25 if the first child is under 16
  - unchanged if the first child is aged 16 to 18.
- $91.25 per week per child for all subsequent children
  - an increase of $17.75 for all subsequent children aged 13-15
  - an increase of $26.81 for all subsequent children aged under 13
  - unchanged for all subsequent children aged 16 to 18.

Just as significantly though, are changes to the abatement rate and abatement threshold. Currently, the FTC starts reducing when the household's annual income reaches $36,350. Each additional $ if income earned above this figure sees that household's FTC reduce by 22.5 cents. But, come 01 April, 2018, as soon the household's annual income hits $35,000 the FTC will start reducing, and also at a faster rate of 25 cents for each additional $ earned above that $35,000 mark.

The abatement rate for the In Work Tax Credit will also rise from 22.5 cents currently to 25 cents after 01 April 2018.

"Greater rewards for low and middle income earners" in tax threshold changes

The largest component of the Family Incomes package is the change in tax thresholds. Currently, the first $14,000 of an individual's annual income is taxed at 10.5%. Income between $14,000 and $48,000 is taxed at 17.5%, while that part of your income between $48,000 and $70,000 attracts a 30% tax rate and tax of 33% is levied on all income above $70,000.

CURRENT BRACKET $	NEW BRACKET $	RATE
1 - 14,000	1 - 22,000	10.5%
14,001 - 48,000	22,001 - 52,000	17.5%
48,001 - 70,000	52,001 - 70,000	30%
70,001+	70,001+	33%

The two lower thresholds have been altered to deliver a dividend to low and middle income earners. Come 01 April 2018, the first $22,000 of your annual income will be taxed at the 10.5% rate, with the 17.5% rate being applied to income from 22,000 up to the new threshold of $52,000. This change will potentially see an extra $20 more per week in the pockets of those earning $52,000 or more.

Minister Joyce argues that the income tax system needs to keep pace with rising incomes, hence the reason for this change in the income tax system, and that it has been seven years since the Government last made changes to income. Over that time, he argues, the average wage has risen from $49,500 to $58,900. Further reason for a change in tax thresholds, or as the Budget puts it: "greater rewards for low and middle income earners".

In the fine print, however, is the abolition of the Independent Earner Tax Credit (IETC). This means that for individuals (i.e. with no children, and so not eligible for Working For Families) earning between $24,000 and $48,000 their gain from these threshold changes is much less.

Who gains, who doesn't?

Essentially, the gains from the Family Incomes package are, as per the name, mostly for families and for those who are working. Superannuitants should also benefit as their income is linked to the average net (i.e. post-tax) wage. However, the gains for individuals and those on benefits will be noticeably less.

For example, a family with 2 primary-school aged children and a main income earner close to the average wage ($59,000) and a secondary earner bringing in another $20,000 per year, will have $37.52 more per week in their pockets after 01 April 2018. This household earns too much to receive FTC, but do gain through changes to the IWTC for which they do qualify.

A similar family on more modest incomes ($40,000 and $15,000) will have $32.72 more in the hand each week.

In contrast, a single-parent full-time worker earning $40,000 with one primary-school aged child stands to gain $11.77 per week out of these changes, as the increased FTC payments are effectively negated by the increased FTC abatement rate.

And the gain for an individual worker (with no children) earning $40,000 amounts to a princely 77 cents per week, due to the loss of the Individual Earner Tax Credit.

Change in household income ($ per week) for selected household types

from Family Incomes package (before Accommodation Supplement change)

Household type	Person 1 income tax change	Person 2 income tax change	FTC change	IWTC change	IETC change	total change
2 earner ($59,000 + $20,000) household with 2 children at primary school	20.38	8.08	0.00	9.06	0.00	37.52
2 earner ($40,000 + $15,000) household with 2 children at primary school	10.77	1.35	20.60	0.00	0.00	32.72
Single parent earner ($40,000) with 1 child at primary school	10.77	0.00	1.00	0.00	0.00	11.77
Single earner ($40,000) with no children	10.77	0.00	0.00	0.00	-10.00	0.77
Single parent (1 child) on job-seeker benefit	8.08	0.00	9.25	0.00	0.00	17.33
Individual (with no children) earning more than $70,000	20.38	0.00	0.00	0.00	0.00	20.38

However, a single-parent (with 1 child) on the job-seeker benefit gains 17.33 extra per week from the combined tax threshold and FTC changes.

While the gain for any individual (with no children) earning more than $70,000 amounts to $20.38 per week.

Accommodation Supplement

In addition to the gains listed in the table are changes arising from changes to the Accommodation Supplement.

Changes to the Accommodation Supplement are included in the Family Incomes Package, with this payment not having been updated since 2005,when it was based on 2003 rents. It will now be based on 2016 rents and will now also include areas of New Zealand that were previously not eligible for the accommodation supplement. Some areas are also being reallocated into areas with a higher maximum payment.

For example, two-person households in Tauranga, Queenstown, Wanaka, Arrowtown, Southern and Western Auckland who are eligible for an Accommodation Supplement will receive $35 more per week. The increase in these areas will be $60 more per week for a three (or more) person household.

Last words

Budget Lite does indeed deliver a dividend for New Zealanders. Surprisingly though, it is a relatively small dividend targeted at a relatively selective section of the population. Notably, families with income from employment gain substantially. Those on benefit or without children gain relatively little. And little has been done to lower the steep marginal tax rate (over 50c) that the average household effectively faces on every additional $ earned.

The Government's additional spending plans focus on growing surpluses being used to fund new infrastructure – with the bulk going for roads and KiwiRail. The extent to which these infrastructure plans are essentially a catch-up from 2 decades of neglect is moot.

And as we have stated several times before, while the Government's books look sound, the nation's books show little sign of improvement.

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