WHEN WORK AND MARRIAGE DO NOT PAY: POVERTY TRAPS AND MARRIAGE PENALTIES IN NEW ZEALAND'S TAX-BENEFIT SYSTEM

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ABSTRACT

All major political parties will go into New Zealand's 2008 General Election advocating personal income tax reform. Many of these personal income tax proposals will be accompanied by proposals for reform to other income transfer programmes (the Working for Families Tax Credits, the Unemployment and Domestic Purposes Benefits, and the Accommodation Supplement). Yet in spite of this ongoing interest in tax-benefit reform there has been little independent economic research on the tax-benefit interface in New Zealand.

To help address this gap in the evidence base this paper estimates the incidence and scale of poverty traps and marriage penalties contained in the 2007-08 system. The tax-benefit interface is made up of a wide array of programmes, and as these programmes are administered on targeted bases their effects on the wedge between gross and net incomes vary among family types and according to wage rates. Thus this paper calculates poverty traps and marriage penalties for a range of different family types at different wage levels. These financial incentives have implications for a wide range of policy issues, including the labour supply of primary and secondary earners, the demand for childcare assistance, and the formation and stability of family structures.

The incidence and scale of poverty traps and marriage penalties incentives can be seen as reflecting the shift towards targeting spending being the primary vehicle for redistribution in New Zealand. A corollary to this shift towards greater targeting of spending was a flatter personal income tax scale (based on broad-base and low-rate tax policy principles). Recent years have, however, seen a shift away from a broad-base and low-rate income tax framework, which, unless offset by simplification of targeted spending programmes, will add to complexity and targeting costs and intensify incentive problems in the tax-benefit interface.

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INTRODUCTION

All major political parties will go into New Zealand's 2008 General Election advocating personal income tax reform. Many of these personal income tax proposals will be accompanied by proposals for reform to other income transfer programmes (the Working for Families Tax Credits, the Unemployment and Domestic Purposes Benefits, the Accommodation Supplement, and Student Loans). Yet in spite of this ongoing interest in tax-benefit reform there has been little independent economic research on the tax-benefit interface in New Zealand. To help address this gap in the evidence base this paper provides benchmark evidence on poverty traps and marriage penalties against which tax-benefit proposals could be evaluated.

POLICY CONTEXT

The tax-benefit interface plays a central role in New Zealand's welfare state. In fiscal terms, for example, the 2008 Budget estimated personal income tax revenue at $23 billion (out of total tax revenue of $40 billion) and expenditure on social security and welfare (including departmental expenditures) for 2008 at $18 billion (in comparison to $11 billion for health and $10 billion for education).

These tax-benefit programmes *primarily* aim to:

- generate revenue to fund government expenditure
- provide a social safety net, e.g., achieve distributional goals (such as alleviating poverty, which may be short-term or long-term) and protect families against economic shocks (such as a sudden loss of income)
- smooth families' incomes over periods of life to better match their income needs (Atkinson, 1995).

Yet ongoing economic and social changes will mean that, even if they have appeared well designed in the past, existing programmes and approaches require ongoing evaluation to assess whether they continue to remain effective at generating government revenue, or providing New Zealand families with protection against economic shocks or assistance in smoothing their incomes. Key changes that tax-benefit programmes must recognise include families becoming more diverse, labour market outcomes less equal, and programmes themselves becoming more complex. These changes are discussed in greater detail below.

Diversity and Complexity

Since the 1970s New Zealand has seen the breakdown of the sole breadwinner model of social arrangements, increasing numbers of sole-parent families, and increasing numbers of dual-income families (Nolan, 2005). Census data illustrate that in 2006 around 49 percent of households were comprised of one-person households. Of the 51 percent of households classified as families, between 1976 and 2006 the percentage of two-parent families decreased from 62 to 42 percent of all families (excluding one-person households). In 2006, of the 1,067,502 families in New Zealand two-parent families numbered 447,894. Over these three decades there were corresponding increases in the proportions of couples without children from 29 to 40 percent and sole-parent families from 9 to 18 percent.

Families' structures are also becoming increasingly heterogeneous and dynamic. Increases in divorce and non-marital childbearing and shifts in the living arrangements of young adults and families have led to rises in sole-parenthood, single adults living alone, and a decline in extended families (Singley and Callister, 2003). Poland, Cameron, *et al* (2007) described the characteristics of individuals in different family types and explored the characteristics of those whose family types changed. They concluded that in 2003 and 2004 around 10 percent of New Zealanders changed family living arrangements, with life-cycle changes being the key driver of change.

Labour market liberalisation has been associated with increasing polarisation of work and greater inequality in the income distribution. There has been an increase in women's employment rates and representation in managerial and professional occupations, and consequently an increasing incidence of dual-income families (Callister, 2004). There is, however, a strong relationship between age of the youngest child in the family and the labour market status of the mother in New Zealand. As Johnston (2005) has illustrated, New Zealand women tend to leave the labour force when they have children and to return strongly to the labour force when their children get older.

Further, although the income tax and family income assistance systems were largely designed as separate, people are increasingly dealing with both systems simultaneously (Stephens, 1997). This has partly reflected the changing patterns in labour market participation, and partly the increasing use of the personal income tax system to provide second-tier (or non-discretionary supplementary) family income assistance payments.[1] The latter has increased further with Working for Families (Nolan, 2005). This expansion of targeted family income assistance has played a key role in shaping the extent and depth of poverty traps and marriage penalties as is discussed in greater detail below.

Evolution of Family Income Assistance

The development of family income assistance (e.g., main welfare benefits and supplementary family assistance) in New Zealand following the 1930s Depression was in an economic and social environment of low and generally short-term unemployment and where couples with children and a single male breadwinner were the most common family type (Beaglehole, 1993; McClure, 1998).

[1] The family income assistance system has three tiers: first tier assistance (main benefits) providing basic income support; second-tier assistance (non-discretionary supplementary assistance, e.g., Working for Families Tax Credits) providing additional assistance to cover circumstances in which needs are considered to be higher than those covered by main benefits alone; and third-tier assistance (discretionary supplementary assistance) providing further and discretionary assistance for a limited set of circumstances (Stephens 1999).

Family income assistance developed alongside policies that aimed to attain full employment and to ensure adequate market incomes for male breadwinners in families. Consequently the role of the income assistance system was generally restricted to dealing with residual pockets of hardship due to temporary spells of unemployment or incapacity (Stephens and Waldegrave, 2001). Key exceptions to this residual role were the provision of the universal Family Benefit, a number of small family tax rebates, and universal pensions.

The Universal Family Benefit was provided to not only address families' financial needs, but to also promote increased birth rates and reinforce women's maternal roles in society (Beaglehole, 1993; McClure, 1998). This provision was based on assumptions that men had dependents and women did not and that married women rarely worked in paid employment. The costs of childrearing were seen as an important consideration in assessing families' need for financial assistance and a relatively high value was placed upon mothers' time outside the labour market.

As well as the Family Benefit a number of small family tax rebates were also developed that aimed to assist low-income breadwinners with the costs of maintaining a family (Nolan, 2005; Koopman-Boyden and Scott, 1984). These rebates sought to compensate breadwinners both for the direct cost of children and for the withdrawal of the secondary earner from the labour market (the indirect costs of children).

Following the 1984 election of the fourth Labour government there was increased emphasis on redesigning the family income assistance system to constrain fiscal costs, reduce scope for moral hazard, and encourage labour supply and human capital acquisition (Stephens and Waldegrave, 2001). There was a shift in expenditure towards targeted and residual assistance for working-aged people on low-incomes, particularly the unemployed and sole-parents. In 1986 a wide range of tax rebates for families with dependents were replaced with the Family Assistance Tax Credits (later renamed Working for Families Tax Credits). In 1991 the Universal Family Benefit was rolled into this targeted family income assistance by the Bolger National government.

This shift towards targeted family income assistance reflected attempts to respond to new and emerging economic conditions, such as the decline of full employment (for male breadwinners in families) and the greater role of market-based setting of wage rates. This shift also marked the end of provision of family income assistance on the basis of family structure regardless of income and need (Beaglehole, 1993; McClure, 1998).

From 1984 to 1999 there was also a shift towards a broad based and low rate tax system and a tax-mix shift away from income taxes towards consumption taxes (Stephens, 1993; McLeod, Chatterjee, et al, 2001). The shift towards flatter personal income tax scales, in conjunction with greater targeting of social assistance expenditure, changed the roles of taxation and social assistance programmes with targeted spending becoming the primary vehicle for redistribution (Stephens, 1997).

Although policies emphasised a broad based and low rate approach to income taxation (until recent years), the combination of income taxes and abatement of targeted social assistance led to poverty traps at lower income levels (St John and Rankin, 2002; Nolan, 2005). Poverty traps occur when people receive little or no increase in income in the hand when they increase their hours of work and have implications for a wide range of policy issues, including the labour supply of primary and secondary earners, the demand for childcare assistance, and the formation and stability of family structures (Nolan, 2005).

In recent years there has been a shift away from a comprehensive income tax framework in New Zealand (see, for example, St John (2007)), adding to the complexity and costs associated with targeting of the tax-benefit system.

Working for Families, Active Labour Market Policies and Fiscal Drag

The main areas of family income assistance are shown in Table 1. This table shows key areas of expenditure and numbers of recipients by programme for 2008 and the figures are gross of personal income taxes.

Table 1 Key Areas of Family Income Assistance (2008-09)

	Recipients	$ Billion
Total tax revenue		49.6
Total social assistance		17.0
Key areas of social assistance:		
New Zealand Superannuation	509,000	7.7
Working for Families Tax Credits (FTC and IWP)	371,000[(1)]	2.7
Domestic Purposes Benefit	97,000	1.5
Unemployment Benefit	37,000	0.4
Invalid's Benefit	131,000	1.8
Accommodation Supplement	244,000	0.9

Notes: (1) Figure for all WFF tax credits

Sources: Budget Economic and Fiscal Update (2008), Tables 6.2 and 6.3

Expenditure on superannuation is the largest single expenditure area and a key determinant of total expenditure. Current projections are for significant increases in the costs of superannuation due to the impact of demographic changes. With the recent introduction and extension of generous subsidies for retirement savings (through the KiwiSaver scheme), along with the costs of pre-funding New Zealand superannuation, the public cost of retirement provision will continue to increase significantly and dominate all other areas of social security expenditure.

Overall the total numbers of people in receipt of a main benefit (particularly Unemployment Benefits) have fallen since 1999. In contrast, following Working for Families the expenditure on and coverage of the Working for Families Tax Credits have increased. These credits are currently the most widely received income-tested transfer payment in the family income assistance system (New Zealand superannuation is not income-tested) and account for expenditure greater than the Domestic Purposes and Unemployment Benefits combined.

Since the beginning of the century, the two major changes to the income tax and family income assistance systems in New Zealand have been the Working for Families reforms and fiscal drag in the personal income tax scale. Working for Families increased the expenditure on tax credits to households from $1 billion in 2000 to $2.2 billion in 2007, with 371,300 families getting credits during the year ending March 2007. In contrast, failure to adjust personal income tax thresholds for inflation has meant that taxpayers are now paying an estimated $1.2 billion more in personal income taxes than in 2000.

The Working for Families reforms have been the flagship of the Labour-led Government's social policy agenda since 1999. These reforms have aimed to make work pay, particularly for low-wage parents (including second earners in families) as well as recipients of main welfare benefits. They have also aimed to reduce child poverty. Yet certain features of these reforms have raised concerns. These concerns include:

- financial discouragement to work facing second earners in many families
- extension of assistance to middle-to-high income families
- complexity and administrative cost
- exclusion of recipients of main benefits from some assistance.

The increased financial discouragement to work facing second earners is significant given the increasing proportion of expenditure going to partnered families (increasing from approximately one third to one half of the recipients of the Working for Families Tax Credits) (Johnson, 2005).

As well as Working for Families, the Labour-led Government has also pursued an active labour market policy of providing intensive employment support. Reforming the main benefit system into a single core benefit, where recipients receive a core benefit with supplementary assistance provided on the basis of need rather than benefit category, has also been signalled but with limited progress being made, given the challenges associated with such a reform (including a number of families possibly losing some income support). For those recipients of main benefits who work there has been no relief from benefit abatement this century (with abatement thresholds and rates remaining unchanged (in nominal terms)).

To show the effect of the Working for Families reforms and fiscal drag on households' incomes in the hand, Table 2 contains NZIER estimates of the effect of the income tax and family income assistance systems on the four household types with gross earnings of $12,500, $25,000, $50,000, and $75,000 in 2008. These households' gross wages were then assumed to have grown in line with the adjusted Labour Cost Index (Wages and Salaries) and deflated to produce gross incomes for 2000.

Table 2 Effect of Working for Families and Fiscal Drag
Percentage Increase since 2000

Family Type	Gross Income 2008			
	$12,500	$25,000	$50,000	$75,000
Sole Parent With Two Children Under 13	26.2%	27.4%	35.3%	23.3%
Single Person, No Dependents	12.9%	21.7%	18.8%	18.1%
Partnered Parent With Two Children Under 13	20.9%	28.7%	35.3%	23.3%
Partnered, No Dependents	14.2%	14.3%	18.8%	18.1%

Notes: (1) Notes: Assumes that partnered families have one income earner and that wages grow at the rate of the increase in the Labour Cost Index.

Source: NZIER

The appropriate tax and family assistance systems were then applied to these gross incomes. This process included estimating income taxes, ACC levy, abated main welfare benefits, and abated Working for Families Tax Credits. For partnered households it was assumed that the household's market earnings were earned by one spouse only.

The main results of this modelling were that:

- Low to middle-income households with children were the clear winners of changes to the income tax and family income assistance system since 2000. For example, although they faced additional abatement of the main benefit and increased personal taxes due to fiscal drag, the large increase in the Working for Families tax credits meant that the nominal net income of a sole parent earning $12,500 and with two young children increased by around 26 percent since 2000. This increased to 35.3 percent for such a household on $50,000. For a partnered parent earning $50,000 and with children of the same age, their nominal net income also increased by around 35 percent.
- Partnered and single people without children fared less well due to fiscal drag through the personal income tax scale and failure to increase the thresholds at which main benefits begin to abate. The nominal net income of a single person on $12,500 and without dependents increased by around 13 percent over this period, and a partnered person in similar circumstances by around 14 percent.

POVERTY TRAPS AND MARRIAGE PENALTIES

Poverty traps and marriage penalties indicate how families are influenced by the family income assistance system when they change their work effort or family structure.

- Poverty traps occur when there is a range of hours of work where, due to taxation and the clawback of assistance, there are few or no financial incentives for people to enter into or remain in work, or to increase their hours of work or wage rates.
- Marriage penalties occur when two parents (or spouses) have a higher total income (net of income transfers and living costs) when separated than when a partnered unit. The presence of marriage penalties means that some people are discouraged from entering into or remaining in a relationship in the nature of marriage by the family income assistance system.

Poverty traps and marriage penalties arise from the complex interaction of a wide range of family income assistance programmes. These programmes include the personal income tax scale, the ACC earners' levy, the Working for Families Tax Credits (the Family Tax Credit, the In-Work Tax Credit, and the Minimum Family Tax Credit), main welfare benefits (the Unemployment Benefit and Domestic Purposes Benefit), the Accommodation Supplement, and Child Support.

Poverty traps and marriage penalties are difficult to measure. One source of difficulty is the (often complex) interaction tax-benefit programmes. Different programmes often use different definitions of what counts as income, income units (individual, family, and household), income periods (annual, fortnightly, or weekly), and implementation agencies (the Inland Revenue Department and the Ministry of Social Development) and be earned and abated in different ways. Population heterogeneity is a further source of difficulty, with financial incentives differing among people with different characteristics, depending on factors such as hours of work, wage rates received, marital status, number and ages of children, availability of childcare, accommodation needs, and receipt of other assistance.

To illustrate the incidence and depth of poverty traps and marriage penalties, the NZIER developed a model that calculates the interaction of these family income assistance programmes for a range of family types and which contains the programmes listed above. Some results from this modelling follow.

Table 3 Marriage penalties and poverty traps

2008-09 Tax-Benefit System (Family With Children)

Marriage Penalties

Marriage Penalties

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	$9,930.36	$10,442.19	$11,995.36	$20,649.96
Mum $12,480 Earned Income	$13,965.34	$14,685.53	$12,530.60	$23,700.20
Mum $24,960 Earned Income	$12,269.40	$9,281.49	$9,641.56	$18,073.36
Mum $52,000 Earned Income	$11,937.64	$11,464.73	$9,087.00	$10,044.60

Marriage Penalties

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	29.63%	28.10%	29.96%	41.56%
Mum $12,480 Earned Income	37.57%	36.16%	26.55%	43.62%
Mum $24,960 Earned Income	30.64%	19.67%	18.81%	29.56%
Mum $52,000 Earned Income	24.02%	21.10%	14.86%	12.80%

Marriage Penalties (net of Child Support and Accommodation)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	$ 2,813.36	$ 3,325.19	$ 3,012.32	$ 5,177.32
Mum $12,480 Earned Income	$ 6,848.34	$ 7,568.53	$ 3,547.56	$ 7,128.92
Mum $24,960 Earned Income	$ 4,379.40	$ 1,391.49	-$ 1,980.52	-$ 6,527.92
Mum $52,000 Earned Income	$ 4,202.24	$ 3,729.33	-$ 2,007.27	-$ 12,730.95

Marriage Penalties (net of Child Support and Accommodation)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	8.39%	8.95%	7.52%	10.42%
Mum $12,480 Earned Income	18.43%	18.64%	7.52%	13.12%
Mum $24,960 Earned Income	10.94%	2.95%	-3.86%	-10.68%
Mum $52,000 Earned Income	8.46%	6.86%	-3.28%	-16.22%

Poverty Traps

Poverty Traps (change in income in hand)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	$0.00	$0.00	$0.00	$0.00
Mum $12,480 Earned Income	$3,653.74	$3,445.38	$7,153.48	$4,638.48
Mum $24,960 Earned Income	$6,529.12	$10,028.86	$11,221.96	$11,444.76
Mum $52,000 Earned Income	$16,179.16	$17,163.90	$21,094.80	$28,791.80

Poverty Traps (percentage lost)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	N/A	N/A	N/A	N/A
Mum $12,480 Earned Income	70.72%	72.39%	42.68%	62.83%
Mum $24,960 Earned Income	73.84%	59.82%	55.04%	54.15%
Mum $52,000 Earned Income	68.89%	66.99%	59.43%	44.63%

Note: Assuming mother changes work effort only, based on joint incomes

Notes: Assumes two children under 13 who always live with their mother, the mother's accommodation costs are $365 in region one, the father's accommodation costs are $122 when alone

Source: NZIER

Table 4 Marriage penalties and poverty traps

2008-09 Tax-Benefit System (Family Without Children)

Marriage Penalties

Marriage Penalties

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	-$ 163.36	$ 348.47	$ 3,671.21	$ 10,276.24
Mum $12,480 Earned Income	$ 348.47	$ 2,887.63	$ 1,545.73	$ 6,254.33
Mum $24,960 Earned Income	$ 3,671.21	$ 1,545.73	-$ 590.20	$ 998.40
Mum $52,000 Earned Income	$ 10,276.24	$ 6,254.33	$ 998.40	$ -

Marriage Penalties

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	-0.66%	1.22%	12.40%	24.88%
Mum $12,480 Earned Income	1.22%	9.58%	4.31%	12.64%
Mum $24,960 Earned Income	12.40%	4.31%	-1.39%	1.69%
Mum $52,000 Earned Income	24.88%	12.64%	1.69%	0.00%

Marriage Penalties (net of Child Support and Accommodation)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	-$ 6,507.36	-$ 5,995.53	-$ 2,672.79	$ 3,932.24
Mum $12,480 Earned Income	-$ 5,995.53	-$ 3,456.37	-$ 4,798.27	-$ 89.67
Mum $24,960 Earned Income	-$ 2,672.79	-$ 4,798.27	-$ 6,934.20	-$ 5,345.60
Mum $52,000 Earned Income	$ 3,932.24	-$ 89.67	-$ 5,345.60	-$ 6,344.00

Marriage Penalties (net of Child Support and Accommodation)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	-26.19%	-21.03%	-9.03%	9.52%
Mum $12,480 Earned Income	-21.03%	-11.47%	-13.37%	-0.18%
Mum $24,960 Earned Income	-9.03%	-13.37%	-16.33%	-9.03%
Mum $52,000 Earned Income	9.52%	-0.18%	-9.03%	-8.08%

Poverty Traps

Poverty Traps (change in income in hand)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	N/A	N/A	N/A	N/A
Mum $12,480 Earned Income	$ 3,653.74	$ 1,626.41	$ 6,291.05	$ 8,187.48
Mum $24,960 Earned Income	$4,759.55	$7,396.86	$12,855.53	$17,871.96
Mum $52,000 Earned Income	$ 16,459.16	$ 20,992.90	$ 29,571.57	$ 37,175.00

Poverty Traps (percentage lost)

	Dad $0 Earned Income	Dad $12,480 Earned Income	Dad $24,960 Earned Income	Dad $52,000 Earned Income
Mum $0 Earned Income	N/A	N/A	N/A	N/A
Mum $12,480 Earned Income	70.72%	86.97%	49.59%	34.40%
Mum $24,960 Earned Income	80.93%	70.37%	48.50%	28.40%
Mum $52,000 Earned Income	68.35%	59.63%	43.13%	28.51%

Note: Assuming mother changes work effort only, based on joint incomes

Notes: Assumes two children under 13 who always live with their mother, the mother's accommodation costs are $365 in region one, the father's accommodation costs are $122 when alone

Source: NZIER

In relation to marriage penalties facing a family with two children under 13 (shown in Table 3), key results include that:

- When the mother and father both have no market earnings, the marriage penalty before cost differences and child support is equivalent to 29.6 percent of net income (e.g., net income when two single people is 29.6 higher than when a couple)

  When separated, the non-custodial parent in this case is liable for $773 Child Support, however as the custodial parent receives a main welfare benefit the Child Support payments made are retained by the state to offset the cost of the benefit, giving a marriage penalty net of child support of 27.3 percent

  When the assumed reduction in rental expenses is taken into account the marriage penalty falls to 8.4 percent, or $2,813.36

- When the mother (custodial parent) has an income of $12,480 and the father has no earnings, the marriage penalty before cost differences and child support is 37.6 percent

  As the custodial parent does not receive a main welfare benefit, the full $773 child support liability is received by the custodial parent. The payment is, however, included in assessable income for WFTC purposes and so is fully offset by withdrawal of the MFTC, giving a marriage penalty net of child support of 35.5 percent

  When the assumed reduction in rental expenses is taken into account there is a net marriage penalty of 18.4 percent, or $6,848.34

- When the mother has no earnings and the father earns $52,000, the marriage penalty prior to cost differences and child support is 41.6 percent

  When separated, the non-custodial parent is liable for Child Support of $9,128.64, however as the custodial parent receives a main benefit in excess of this amount the Child Support payment is retained by the state to offset the cost of the benefit. This gives a marriage penalty following child support of 23.2 percent

  When the assumed reduction in rental expenses is taken into account there is a net marriage penalty of 10.4 percent, or $5,177.32

- When the mother earns $12,480 and the father $52,000, the marriage penalty prior to Child Support and cost differences is 43.6 percent

  When separated, the non-custodial parent is liable for $9,128.64 in Child Support liability. This is received by the custodial parent, but $8,030.80 is lost through the abatement of the MFTC, giving a marriage penalty following child support of 28.8 percent

  When the assumed reduction in rental expenses is taken into account there is a net marriage penalty of 17.2 percent, or $9,325.40.

When this modelling exercise is repeated for a family without children (Table 4), the following conclusions become apparent:

- Marriage penalties are higher for families with children than for families without, which reflects the greater provision of targeted assistance to families with children
- Poverty traps are higher for families without children at lower income levels, but higher for families with children at higher income levels. This reflects the fact that for families with children the clawback of assistance takes place at higher incomes and/or at lower rates of abatement (as illustrated by the higher abatement of the Unemployment Benefit at lower incomes than the Domestic Purposes Benefit), which means that abatement takes place over a longer income range. This result also reflects the greater levels of targeted assistance provided to families with children
- For families with and without children, at the range of incomes shown marriage penalties are higher the greater the disparity between the primary and secondary income earners' incomes. This reflects the situation where one person has to largely forego an unabated independent income, the other person faces additional clawback of assistance, and there is little increase in the household gross income.

As well as these financial incentives, people's decisions regarding work effort and family structure are influenced by many other factors, including social norms, uncertainty and the administration of the family income assistance system. Yet while financial incentives are more likely to influence decisions regarding work effort than decisions regarding family structure, both poverty traps and marriage penalties may have significant effects on the perceived fairness of and the administration and compliance costs associated with the family income assistance system.

DISCUSSION

For some households the average increases in wages and salaries since 2000 and the introduction of the Working for Families reforms have failed to offset average cost increases. This can help explain changing pressures on household budgets and slowing growth in private consumption (NZIER, 2008).

Those households with the greatest falls in consumption power were households without children. In the 2006 Census these households accounted for around 49 percent of all households. This decline in private consumption power is not only important for these households directly, but also has implications for the economy more broadly. In particular, should this decline in consumption power lead to demand for wage growth to exceed output growth, this would in turn lead to pressure on inflation and interest rates (a potential wage-price spiral). Targeted government spending to address this decline in consumption power would also run the risk of increasing inflationary pressure in the economy.

Further, based on cases where gross incomes and costs grew at average rates, arguments that family income assistance reform this century has left beneficiary families with children out in the cold are not completely accurate. While there are problems with the presence of poverty traps and marriage penalties in the family income assistance system (and declines in the effectiveness with which assistance is targeted to those in need), based on the analysis above, Working for Families can be seen to have protected much of the consumption power of low to middle-income households with children.

In relation to poverty traps and marriage penalties in the tax-benefit system, no system of targeting can completely avoid the incidence of poor financial incentives. Improving financial rewards for work effort at lower income levels, for example, generally comes at an economic cost of discouraging work effort further up the income distribution (unless levels of assistance are also reduced, which may sacrifice reducing child poverty). Given this need for trade-offs key issues are thus whose financial incentives to work should be given priority and whether increases in participation or in hours of work should be given emphasis.

Addressing child poverty is a key concern motivating tax-benefit reform and sustained child poverty is negatively correlated with participation in the workforce. Emphasis could thus be given to ensuring that all families have at least one adult with a connection to the labour market. Yet this target needs to be tempered with the value to families with young children from having at least one parent at home (OECD, 2007). Consequently emphasis should continue to be placed on improving labour market incentives for sole parents and low-wage primary earners in families with children.

As part of the Working for Families reforms this objective has been pursued through the introduction of the In-Work Tax Credit, coupled with the removal of the child component of main benefits. Based on overseas experiences with similar programmes and preliminary New Zealand research, the In-Work Tax Credit has particularly encouraged work effort among low-wage sole parents. However, the introduction of this programme, coupled with the increased generosity of the Family Tax Credit, has led to increased receipt of assistance by families above the poverty line and discouraged some second earners from working in the labour market. Potentially this could lead to these parents not maintaining their employment-related skills (Bryant, Jacobsen, Bell, and Garrett, 2004).

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