Progressive Thinking:

Ten Possible Futures for Public & Community Services

User charges and cost recovery: why don't we call it a tax?

Andrea Black

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Earlier this year Mike Moore – the US filmmaker and not the shortest serving former Prime Minister of New Zealand and proponent of lamburgers – compared the US system of high co-payments for Health, fees for university education and lower taxes with the French system of much higher taxes but almost free universal healthcare and education.

His point was that, unlike France with its high taxation, the US had extra charges for Health and Education – 'but we don't call it a tax'.[2]

This got me thinking about the New Zealand system.

This article focusses on Student Loans and Child Support, but the analysis could equally apply to prescription or Early Childhood Education co-payments, GP fees, school donations, (previously) NCEA exam fees, and most recently the payment for Managed Isolation and Quarantine. Or any other payment for a service that provides a benefit for the common good as well as having an individual benefit.[3]

And what many of them share is that by having the nature of a user charge or a cost recovery – they are inherently regressive unlike the personal income tax system.

I had already been surprised during my time with the Tax Working Group to find out just how unprogressive our tax system was.[4] Low income households had an average tax rate of 23% including income tax, ACC and GST while high income households, even before any allowance for tax free capital gains, only had an average tax rate of 31%.

And then this is all before factoring in any clawback of Working for Families, Student Loans or the accommodation supplement which would further raise the effective average tax rate of low-income households.

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[1] Andrea is also currently the Policy Director/Economist of the New Zealand Council of Trade Trade Unions. She wishes to thank Richard Wagstaff, Bill Rosenberg, Simon Chapple, Michael Fletcher, Max Rashbrooke and Susan St John for their review and comments. However, this article reflects the views of the author and not those of the reviewers or that of the Council of Trade Unions.

[2] https://www.democracynow.org/2019/12/26/michael_moore_sicko_medicare_for_all

[3] Whether the common good element of a public service exceeds the individual benefit is inherently one of judgment. As I have a more collective than individualistic view of society my analysis is from this frame.

[4] https://taxworkinggroup.govt.nz/resources/future-tax-final-report-vol-i-html.html#section-6 Figure 3.2

It wasn't always like this.[5]

When I started work in late 1985 as a junior accountant, I earnt $15,000 and paid $5,000 in tax. There were some sales taxes, but no comprehensive GST and I was paid to go to university. Student loans were still but a twinkle in the eye of Phil Goff. My average tax rate was 33% and my marginal tax rate was 45%.[6]

Graduates now start on about $50,000. They pay about $8,000 in income tax, $3,800 in GST[7] and $3,600 in student loan repayments. This gives a comparable graduate average tax rate of 31% and a marginal 'tax' rate of 49.6%.[8] That is a slightly lower average tax rate but a slightly higher marginal tax rate.[9]

Student Loans

Including student loans in this calculation is controversial as it is technically a loan repayment and with no interest and repayment in real terms will be less than the amount originally lent. But in my view a student loan represents is a user charge for a service that provides a public benefit through an educated population which previously was paid for – as when I was a young worker – through taxation.

It is true it will involve a private benefit to the individual but then so does primary and secondary education, the road that enables a person to get to work, the legal system that underpins private property or the universal system of income for those over 65.

The other thing about student loans is that, unlike tax, not everyone pays it. There is a cohort of middle class children – my own included – whose parents either pay their costs or - and this is my particular favourite – give their children the value of the loan on graduation which then is put in an interest earning account.[10]

But young people from low income households without the means to pay their costs do bear the cost of repaying their loan meaning this can be a barrier to undertaking university education in the first place as student loan debt arises even if courses are failed.

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[5] It is true that the base was previously narrower and rates were higher but there was also fewer user charges, more universal benefits and the Labour share of GDP was higher thereby removing the need for top up payments such as Working for Families.

[6] https://taxjustice.nz/wp-content/uploads/2020/06/Reforming-Income-Tax-TJA-Policy-Brief-Four.pdf deflating the tax brackets given on page 4. That is the author has inflated the tax brackets at the time to rebase them in today's dollars. I have taken his thresholds and deflated them to get to the original thresholds in the dollar values of the time.

[7] I have assumed GST on all income less tax, student loan and $250 per week for rent. This gives $25,400 to be spent now or in the future giving GST of $3,810.

[8] $15,400/$50000 = 31% average tax rate and 30% personal income tax, 12% student loan repayment 42% plus GST 3/23 on remaining 58% (7.6) = 49.6% marginal tax rate.

[9] There could also be clawback of accommodation supplement of 25%. I haven't included working for families as my comparison is a me in 2020 – childless and single.

[10] While the value of this option is declining with falling interest rates, it provides the option of paying student loan repayments but using this as a capital base for a future house deposit.

Child Support

State administered child support was introduced in 1992 as a mechanism for ensuring the parent that no longer lived with the children – usually the father – continued to financially contribute to the upkeep of their children. It involves a complex formula which incorporates both parents' income, allowance for other children[11], and the amount of time the children are in a parent's care.

This money goes to the receiving or custodial parent unless they are receiving the sole parent rate of a benefit.[12] For those on the student allowance it is completely ignored, and for non-beneficiaries in receipt of Working for Families it is included in income and abated at 25% over a joint family income of $42,700.

However for the group who are most likely to be in hardship – those receiving the sole parent rate of a benefit – and for whom there is the largest public benefit in ensuring children supported by this income have adequate nutrition, warm housing and school supplies; they receive none of the child support paid for their children and so effectively face a 100% tax on this income.[13]

In 2017 $468 million of Child Support was collected by the State. $279 million was passed on to the receiving or custodial parent and $189 million was retained to offset the cost of benefits.[14] $189 million that could otherwise be spent on children in some of the lowest income households in New Zealand.

New Zealand prides itself on a tax to GDP ratio below the OECD average (32.7% v 34.3% in 2018) but that is not without consequences. While we are nowhere near the scale of user charges or cost recovery for public services as the United States; we are still a solid performer. And all too often the effect of them is regressive, whether it is student loans, child support, or GP fees.

And just like the United States – we 'don't call [them] a tax'.

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[11] Although not other children of the non-custodial parent.
[12] Also the Unsupported Child Benefit.
[13] The idea that this is acceptable as the State has stepped into the shoes of the non-custodial parent by providing financial support doesn't withstand scrutiny as it also claws back amounts of the benefit that relate to the upkeep of the parent itself. It also doesn't apply that approach to other State payments for children such as Working for Families or even the Winter Energy Payment. In those cases, there is no clawback.
[14] http://www.weag.govt.nz/assets/documents/WEAG-report/background-documents/c0e11c562b/Child-Support-010419.pdf page 19