Changing the Dole versus Changing the Tax System

Keith Rankin, 1 July 2009

Your editorial of June 30 ("Change Tax System, not the Dole") acknowledges that there are major inadequacies in the ways that people adversely affected by the recession are supported.

However it is a mistake to suggest that the welfare system and the tax system are two completely different entities. Indeed economics, as a discipline, regards welfare payments (called transfers) as the equivalent of negative taxes.

In our paper "Escaping the Welfare Mess?", Dr Susan St John and I highlight anomalies and injustices in the provision of welfare payments (many of which are called "tax credits"), and suggest solutions that principally involve the tax system.

Hence, we largely agree with your editorial, that changes to the tax system are central to improving the efficiency and equity of our system of income support. We advocate changing the "dole" through "changing the tax system".

Meaningful change can be implemented quickly, without a major and radical overhaul of the system.

The underlying philosophy in New Zealand from the 1970s to the 1990s is that taxation is an individual matter, while social welfare is a family matter. We have an agency to manage taxation: Inland Revenue. We have another agency to manage social welfare: Work and Income. The waters got muddied in the 1990s, with the payment by Inland Revenue of Family Support, a family benefit that was called a "tax credit". Family Support has since been expanded into Working for Families, which pays an array of "family tax credits".

The first change required is to transfer responsibility for Working for Families from Inland Revenue to Work and Income. Inland Revenue would then deal with its customers as individual taxpayers, whereas Work and Income would deal with its clients as households.

The next step is to embrace the concept of negative taxation at an individual level.

At present we try to address the needs of lower earners through the use of two concessionary income tax rates. Income on the first $48,000 of an individual's income is payable at12.5% or 21% instead of at 33%. For a person earning $48,000 or more, that tax concession amounts to $6,950 per year, or $134 per week.

To introduce a basic reform, all we have to do is to replace those concessionary tax rates (and the new Independent Earners Tax Credit) with an individual tax credit (known in the jargon as a "refundable tax credit") of $134 per week.

This simple tax reform achieves three things. First, it pays a basic dole, through the tax system, to individuals who become unemployed, regardless of the circumstances of their partner. Second, it delivers the benefits of income-splitting that you advocated in your editorial. Third, it achieves both of these gains while making the tax system more simple (and transparent) rather than more complex.

If this simple tax reform was implemented, where would it leave the existing dole? An unemployed person would receive the $134 a week as of right, as a taxpayer. To receive the remainder of the present dole such a person would apply to Work and Income, exactly as they do now, for a top-up benefit.

The Work and Income component of the dole would be means-tested against the unemployed person's partner's income. The Inland Revenue component would not be subject to such a test.

I'll finish with two examples. An unemployed couple today receives a dole of $316 per week, while a single unemployed person gets $190 per week. Under the simple reform I have suggested, the couple will receive $268 automatically as two taxpayers with $0 of current income. They could then apply to Work and Income for the remaining $48, plus extras such as Accommodation Supplements and Family Support. The single unemployed person would similarly apply for a top-up benefit of $56 per week.

Much more can be done, but these two simple reforms would serve as an excellent start.
