

**29 October 2010**

**SUBMISSION TO THE SUPPORTING CHILDREN PROJECT**  
**C/- Deputy Commissioner, Policy Advice Division, Inland Revenue**  
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**Introduction**

1. This submission is from Stuart Birks, Director, Centre for Public Policy Evaluation, Massey University, Private Bag 11222, Palmerston North, [k.s.birks@massey.ac.nz](mailto:k.s.birks@massey.ac.nz)
2. The objective of the Centre for Public Policy Evaluation is *“To facilitate the achievement of excellence in research in priority areas and to develop its domestic and international links. The focus will be on economic aspects of policies in a multidisciplinary context.”* The work of the Centre has included, among other things, research and publications in the areas of family law and law and economics.

**Key points**

3. The child support formula proposed in *Supporting Children* is based on the Australian approach which uses a living standard measure to estimate the cost of children. This approach has problems conceptually, and in terms of data and estimation of costs.
4. Regardless of the methods used to estimate costs, there are significant implications arising from the use of legislation to allocate funds equal to the estimated **total** cost of children. In particular:
  - 4.1. There are child support enforcement and penalty structures in place for liable parents, but recipients of child support and family tax benefits have complete freedom in the use of these funds. There are no guidelines, controls, or penalties relating to their use, and, in particular, a paying parent has no say in the use of money transferred to the other parent.
  - 4.2. Allocation of funds is based solely on share of nights. The tax benefit structure and proposed child support formula fail to allocate resources to reflect the distribution of costs, instead favouring the carer with most nights.
  - 4.3. These aspects result in power and control heavily favouring one parent at the expense of the other. This is likely to generate resentment and conflict, harming relationships between adults and between adults and children.
5. An alternative approach is suggested which (i) reduces the need for accurate cost measures and (ii) produces a more balanced power allocation.

**General Comments**

6. It is encouraging to see the current attempt to address concerns about New Zealand's child support legislation. Serious weaknesses in the current legislation were described in a submission from this Centre dated 12 July 2001 on the [Child Support Amendment Bill 2001](#), and points were again presented in a submission dated 24 February 2006 on the

[Child Support Amendment Bill \(No.4\)](#). Paragraph 6 of the latter submission listed the following issues that had yet to be addressed:

- 6.1. The failure of the formula to consider the income of the other parent (so how can contributions be equitable?).
- 6.2. Failure of the formula to consider direct costs incurred by a liable parent in relation to the children (in particular, in terms of the 40% of nights threshold and the distinction between costs of “enabling” and “enjoyment of” access).
- 6.3. Weaknesses in the use of gross income as a basis for child support, e.g in cases of student loans.
- 6.4. Lack of a clear, meaningful basis for the formula in terms of the true costs of children.
- 6.5. Lack of any specification of the purposes to which child support, received by a parent with care of a child, is to be put.
- 6.6. Lack of any accountability to the liable parent for the ways in which child support is used.
- 6.7. Lack of any clear indication that the legislation is to be guided by the “best interests of the child”.
- 6.8. The need for child support reviews to be conducted by people with the relevant knowledge of possible income levels, costs and benefit entitlements.

The discussion document, *Supporting Children*, presents a proposal which considers the first, second and fourth of these points. It also gives much useful analysis, in conjunction with Claus, Leggett and Wang (2009), that provides some insights into the fifth point, and assists in clarifying the intent and possible implications of the legislation.<sup>1</sup>

7. As recognised by the researchers, circumstances vary greatly over households. It would be impractical to devise a formula that would reflect all the possibilities. The aim is therefore to select a manageable formula which would also be generally acceptable. It is suggested in the discussion document that serious anomalies in individual cases may then be addressed through a review process, although point 6.8 above indicates potential problems with this approach.
8. While it might be considered that the formula would only apply to those who are unable to devise a private agreement, literature on the shadow of the law suggests that such formulae still tend to have a marked impact on voluntary agreements (Jacob, 1992).
9. The process of analysis that was followed involved: (1) estimating the costs of children, following closely the methodology used in Australia; (2) devising a formula that reflects these costs. While there are good reasons for adopting an existing methodology, there are some aspects of this particular approach that give cause for concern.
10. An Appendix below describes some estimation issues. It concludes that the estimated costs of children are imprecise and are highly sensitive to the assumptions and parameter values. Small changes in these can produce large changes in results, and some results appear highly implausible.

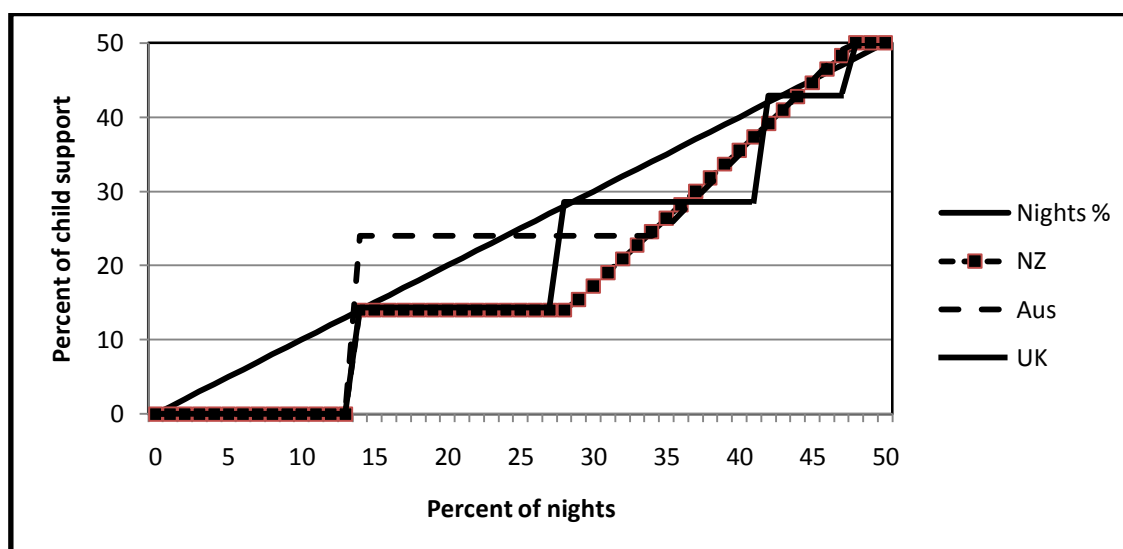
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<sup>1</sup> Thanks are due to Iris Claus, Geoff Leggett and Graeme Morrison of IRD for providing additional information on their analysis.

11. There are also issues arising from the underlying assumptions leading to the proposed formula. Central to these are: (i) the use of estimates of the cost of maintaining a child at the living standard that could have arisen had the parents at separation been living together on their combined current incomes; and (ii) the requirement that the legislation prescribe the provision and allocation of the whole estimated cost of the child(ren).
12. The first assumption is questionable for several reasons. Here are some:
  - 12.1. The parents may not have lived together;
  - 12.2. If they had, it may not have been at the current combined income;
  - 12.3. It does not reflect the economic reality of having parents who live apart;
  - 12.4. It may not be possible to maintain one individual at one living standard when others in the same household are at another standard;
  - 12.5. Even if it is possible, there is no requirement that this is done;
  - 12.6. If the child's living standard is the desired objective, why is not care awarded to the higher earning parent (as suggested in Braver & O'Connell, 1998, p. 86)?
13. More fundamentally, the living standard assumption becomes irrelevant as an objective when a recipient parent is on the DPB. In this situation, there is no possibility that the child support is intended to maintain a child's pre-separation living standard. It is merely recouping all or some of the costs incurred by the government, possibly as a result of a decision made unilaterally by that parent. The liable parent is then required to support the caregiver parent as well as the child(ren), while having no say in that decision (except in the unlikely event that a court happens to rule that Section 105.5.a of the Child Support Act 1991 is applicable to the caregiver). Funds otherwise intended for the child are diverted to the caregiver and the child's living standard is lowered. The liable parent then has depleted funds from which to actually support the child.
14. The second assumption indicates a possibly crucial flaw in both the existing and the proposed child support formula. It is clear from *Supporting Children* that the existing formula requires a liable parent to pay a sum equal to or in excess of the total estimated cost of the children, even if that parent incurs direct care costs for up to 145 nights. The recipient parent has complete freedom in the use of the money. The funds are likely to be based on estimated costs required to give a child a living standard much higher than that experienced in the recipient household, but there is no reason to expect the child to be living at a standard other than that of the rest of the household. While there are penalties and enforcement mechanisms for liable parents, the recipient parent is not accountable for the use of the funds. Moreover, if the liable parent wants money to be spent in some way for the benefit of a child and the recipient parent disagrees, then, despite having earned and paid the child support, the liable parent has to find additional money for this. Little changes under the proposed formula. While *Supporting Children* states that there will be little change in financial transfers, it is clear that not only the child support, but also the tax benefits and the caregiving parent's financial contribution are intended for the benefit of the child. Once again, a paying parent has no say over the use of any of this money, only having control of retained child support. Full power and control of money allocated to the recipient parent lies with that parent. This power and control imbalance can have a significant effect on relations between the parents, on children's relationships with their parents, and on the children's wellbeing.

15. The proposed formula considers both parents' incomes after deducting a living allowance. In contrast to simply splitting child support according to income, this adjustment favours the lower income earner as it reduces that child support income by a greater percentage. In the extreme, a parent on the DPB has virtually no child support income and therefore has a near zero assessed contribution. While there is some consideration of shared time, this does not recognise the high share of care required to obtain the tax benefits. These generally go entirely to one parent. In addition, the share of child support payments also disproportionately favours the main carer, as shown by the graph below. This compares the existing Australian and UK systems and the proposed New Zealand scheme, as described in *Supporting Children* pp.32-33.

**Figure 1: Percentage share of child support by percentage of nights**



The solid diagonal line indicates where share of child support equals share of nights for the parent with fewer nights. Except for near equal sharing, the parent with less care has a less than proportionate share of child support for almost the entire range, but for a short range under the Australian formula. This is despite the more than proportionate costs incurred and the lack of eligibility for tax benefits. For most of the range, the New Zealand proposal is the least equal. As child support income is calculated after deduction of the living allowance, any percentage split in contribution is disproportionately drawn from the higher earner, increasingly so as the living allowance rises.

16. In summary, it is clear that costs may vary markedly over households according to circumstances and lifestyles. Any estimates of costs will be subject to large error. In addition, tax benefits are unrepresentatively allocated and incurred costs incorrectly acknowledged. A system that attempts to rule on the funding of these costs in their entirety results in a major power imbalance and potential source of conflict. This is especially true when there is no accountability in the use of funds discretion over which rests solely with a parent classified to be in a caregiving role.

### **An alternative proposal**

17. An alternative proposal could take as its starting point the presumptions that: (i) both (biological) parents have an interest in the wellbeing of their children; (ii) a recipient

parent may not spend as assumed in the legislation; and (iii) a paying parent would willingly make some contributions when allowed some control of the use of the funds. On that basis, a “safety net” child support system might rule over a portion of the costs of children, leaving the rest to a mix of discretion, voluntary contributions, and co-operation and agreement between the parents. A simple modification to the formula proposed in *Supporting Children* would be to halve the assessed figures. This is likely to: (i) greatly reduce the existing need for an unattainably accurate estimate of costs of children; (ii) increase accountability in use of money for children by both parents; (iii) encourage greater communication and co-operation by parents on a more level playing field; and (iv) reduce resentment by liable parents, increasing voluntary compliance and hence reducing collection costs (estimated for New Zealand at nearly 19c per dollar collected, according to <http://www.csa.gov.au/publications/schemes/06/2.aspx>).

### **Appendix: Costs of children – estimation issues**

18. Details of the analysis used to derive the following results can be provided on request.
19. As a first step in the Australian method, household expenditure is estimated in relation to household income and family composition. According to the assumed relationship, the only impact of household size is a fixed increase in expenditure per person, with the actual sum depending on the age category of the individual. In particular, the impact is independent of household income, /and there are no differences between the impact of the first and the tenth person in any age group. The first or any additional child under 13 is estimated each to increase household expenditure by \$19 per week. This can be viewed in relation to an estimated total weekly expenditure of \$958 for a couple and child household on \$1365 income per week. A large amount of the expenditure depends solely on household composition (\$360 per week for a household with a young child, and \$405 with a child aged 13-18), such that spending out of extra income starts at 45 percent, falling to 39 percent at high income. A household where the two adults are both under 25 is estimated to spend \$120 per week less at all income levels. If this is the wrong relationship, then resulting estimates will be misleading.
20. A second equation relates a living standard measure to household expenditure per capita and household composition. Living standard is represented by the share of total expenditure comprised by expenditure on food at home, non-durable household supplies and services, communication equipment and services and personal care products and services. While, for any individual household, a fall in the share might reflect a rise in living standard as assumed, it may be wrong to then assume that comparisons across households are equally meaningful. There may be many other determinants of lifestyle that have not been considered in this analysis. Some specific potential distortions can be imagined. In particular, there may be systematic differences in lifestyle according to size and age composition of households which affect both the level and composition of household expenditure.
21. This measure is then related to per capita expenditure and household composition. The use of per capita expenditure is puzzling, given that economies of scale are assumed in income equivalence scales that are used to compare households of differing composition. The estimated relationship is not a very close fit, suggesting that estimates are not precise and the specification or chosen variables are of limited explanatory value.

22. Other aspects of the living standard measure are problematic. For example, the treatment of housing costs in expenditure can give misleading results. Interest is included in the expenditure measure, but capital repayments are not. Consider a household with a fixed expenditure pattern, including mortgage payments (interest plus capital). Over time, the interest component declines and capital repayments increase, so measured living standard would be declining although there is no change to the actual living standard and the household is becoming wealthier. The failure to recognise implicit rent to owner occupiers is equally distorting. Consider one household that is a mortgage-free owner occupier, and another that is renting, with non-rent expenditures equal. The household that is renting would be considered to have a higher standard of living due to the higher total expenditure.
23. The cost of a child is then derived by equating this measure of living standards for households with and without children and calculating the difference in expenditure. Large changes in expenditure and income are required to give small changes in estimated living standards. This can result in high estimates of costs of children. According to the model, the following results apply where low income is \$704 per week, and middle and high incomes are \$1365 and \$2838 respectively. A middle income childless household could almost halve its income to \$704 per week and still be on a higher living standard than a middle income household with two children. A high income no child household could cut its income by 75% and still be on a higher living standard than a four child household on the same income. In fact, the model suggests that a four child household on an annual income of nearly \$150,000 is on the same living standard as a couple on just over \$25,000.
24. The use of per capita expenditure in the second (living standard) equation can greatly increase the estimated cost of children. In a simplified equation with living standard a function of per capita expenditure only, a couple with a child would have to spend 50 percent more than a childless couple to achieve the same standard of living. According to a commonly used New Zealand measure, the Jensen Equivalised Annual Household Income, an income 19 percent higher would be sufficient to match a couple on \$29,400.
25. Results from the model are also sensitive to the age of parents as shown in the following table, suggesting problems with the approach

**Table 1: Costs of 1 child under 13, by age of parents**

	Low income household	Middle income household	High income household	Average income household
Adults 25+	\$147	\$243	\$426	\$268
Adults <25	\$308	\$356	\$551	\$381

26. It is also possible to consider the effects of slight changes in the values of the estimated coefficients. Table 2 presents cost of child figures with adults over 24. The coefficients for age of child in the living standards equation are changed by plus and minus 0.2 standard errors, relatively small adjustments. It can be seen that these have a major effect on estimated costs of children. The +0.2SE figures are all more than a third of total household expenditure.

**Table 2 Cost of child, adjusting the age coefficient in the LS equation**

	Low income household	Middle income household	High income household	Average income household
Child <13				
Age(1) + 0.2SE	\$246	\$339	\$533	\$365
Age(1)	\$147	\$243	\$426	\$268
Age(1) - 0.2SE	\$73	\$169	\$342	\$193
Child 13+				
Age(2) + 0.2SE	\$296	\$388	\$585	\$414
Age(2)	\$196	\$291	\$477	\$316
Age(2) - 0.2SE	\$90	\$183	\$355	\$207

27. In summary, the estimated costs of children are, in some instances at least, questionable. They are also imprecise and are highly sensitive to the assumptions and parameter values. Small changes in these can produce large changes in results.

Braver, S. L., & O'Connell, D. (1998). *Divorced dads: shattering the myths*. New York: Jeremy P. Tarcher/Putnam.

Claus, I., Leggett, G., & Wang, X. (2009). *Costs of raising children*. Paper presented at the New Zealand Association of Economists Conference. Retrieved from [http://www.nzae.org.nz/conferences/2009/pdfs/Costs\\_of\\_raising\\_children\\_NZAE\\_paper\\_v2.pdf](http://www.nzae.org.nz/conferences/2009/pdfs/Costs_of_raising_children_NZAE_paper_v2.pdf)

Jacob, H. (1992). The Elusive Shadow of the Law. *Law & Society Review*, 26(3), 565-590.