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Understanding debt and debtors to government

Focus on MSD and IR debt

SOCIAL WELLBEING AGENCY | TOI HAU TĀNGATA

New Zealand Government

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The results are based in part on tax data supplied by Inland Revenue to Stats NZ under the Tax Administration Act 1994 for statistical purposes. Any discussion of data limitations or weaknesses is in the context of using the IDI for statistical purposes, and is not related to the data's ability to support Inland Revenue's core operational requirements.

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Summary: Debt to government is a complex issue that varies across people and debt types

While debt is an established and accepted part of New Zealand's economic system, the way debt to government is generated and treated can pose a number of concerns for individuals, families, and the government. Though a large number of people owe money to government agencies for a range of reasons, we do not have an overall picture of the occurrence or level of debt to government for individuals, or the characteristics of those individuals.

Policy decisions about debt and debt management are in many ways decisions about individuals and their debt experience. Making these decisions without sufficient understanding of debt or people with debt increases the risk that such decisions will be ineffective, counter-productive, or harmful. Therefore, it is important that work focusing on debt to government is informed by the rich information the government already holds.

This report sets out the findings from an initial analysis of debt owed to two government agencies: Ministry of Social Development (MSD) and Inland Revenue (IR). It has not been designed to aid debt recovery, but to fill a gap in our understanding about the nature and characteristics of debt and debtors as a starting point from which further research can be undertaken. It therefore both provides insights and identifies areas that merit further investigation. The key insights from our research can be summarised as follows:

- Of the people with debt to at least one of MSD or IR, 12 percent or 87,800 people owe debt to both.
- The overlap between people with debt to MSD and people with debt to IR is very dependent on the type of IR debt. People with Child Support or Working for Families tax credit debt to IR are much more likely to also have debt to MSD than people with Income Tax, GST, or PAYE debt.
- There are large differences in the financial circumstances and demographic characteristics of people who owe different types of debt to MSD or IR. For example, people who owe Income Tax are much more likely to have higher material wellbeing and to be older than people who owe Child Support debt.
- People's debt to the government shows significant persistence. We observed 68 percent of people with debt to MSD and 39 percent of people with debt to IR had at least one debt that had lasted more than three years. In addition, we observe people with debt continuing to gain more debt, and people moving both out of, and back into, debt within a single year.

The research is subject to two key limitations: First, it is unable to consider non-government debt or debt held by other government agencies and hence only provides a partial picture of all debt. Second, it only considers debt at the individual level and hence does not address the dynamics of debt at a family or household level.

This research project was initiated prior to the COVID-19 pandemic and examines 2018 debt data. As a result, it does not consider effects from the pandemic. Instead, it provides a baseline understanding of debt to MSD and IR and identifies a range of options for further policy-focused research. The original research design also included debt managed by the Ministry of Justice. However, due to New Zealand's lockdown in response to the pandemic, this data was not ready at the time of our analysis.

Contents

Debt and debtors are not all the same

Debt is an established and accepted part of New Zealand's economic system. Though borrowing and making repayments are common activities, being in debt can be a negative experience. While the vast majority of debt is owed to private lenders, the government has a significant role as a manager and collector of debt (Expert Advisory Group on Solutions to Child Poverty, 2012).

New Zealanders owe a variety of types of debt to both private lenders and to the government. The Ministry of Business, Innovation & Employment (2018) considers five different types of debt (including debt to government), with people in their sample averaging debt to two or more sources. Gordon et al. (2019) report eleven different sources of debt (including two sources of debt to government), with people in their sample averaging debt to six or more sources.

Examples of debt include:

- Debt to government (e.g.: overdue tax, overpaid entitlements, fines and charges)
- Mortgage debt
- Debt relating to financing a car
- Arrears to utility providers
- Unsecured overdraft, bank loan or credit card debt
- Debt to store or consumer cards, including hire purchase
- Finance company, cash advance loan, or payday lender
- Debt to family, friends, or employer.

Measures of the amount of debt are not available for all categories. Statistics published by the Reserve Bank (2020) report New Zealand households in 2019 owed $196 billion worth of housing loans, $16 billion in student loans, $7 billion in credit card loans, and $9 billion in other short-term consumer loans. Debt owed to the government (excluding student loans) at the same time was around $9 billion.

The way debt to government is generated and treated can pose a number of concerns for individuals and families. While a large number of people owe money to government departments for a range of reasons, we do not have an overall picture of the occurrence or level of debt to government for individuals, or the characteristics of those individuals. Improvements in the government's understanding and management of debt to government were recommended by both the Tax Working Group (2019) and the Welfare Expert Advisory Group (2019).

Policy decisions about debt and debt management are in many ways decisions about debtors and debtor experience. Making these decisions without sufficient understanding of debt or of people with debt increases the risk that such decisions will be ineffective, counter-productive, or harmful. Therefore, it is important that work focusing on debt to government is informed by the rich information the government already holds.

This paper provides an initial overview of debt to government using administrative data in the Integrated Data Infrastructure (IDI). [1] It focuses on debt to government held by the Ministry of Social Development (MSD) and Inland Revenue (IR). The original research design included debt managed by the Ministry of Justice, but due to the COVID-19 pandemic and associated lockdowns this was not available at the time of our analysis. Our research has not been designed to aid debt recovery, but to fill a gap in our understanding about the nature and characteristics of debt and debtors as a starting point from which further research can be undertaken. It does this by providing an overview of debt, of people with debt, and by identifying a range of questions that merit further investigation. The key insights from our research can be summarised as follows:

- Of the people with debt to at least one of MSD or IR, 12 percent or 87,800 people owe debt to both.
- The overlap between people with debt to MSD and people with debt to IR is very dependent on the type of IR debt. People with Child Support or Working for Families tax credit debt to IR are much more likely to also have debt to MSD than people with Income Tax, GST, or PAYE debt.
- There are large differences in the financial circumstances and demographic characteristics of people who owe different types of debt to MSD or IR. For example, people who owe Income Tax are much more likely to have higher material wellbeing and to be older than people who owe Child Support debt.
- People's debt to the government shows significant persistence. We observed 68 percent of people with debt to MSD and 39 percent of people with debt to IR had at least one debt that had lasted more than three years. In addition, we observe people with debt continuing to gain more debt, and people moving both out of, and back into, debt within a single year.

In addition to analysing data held by the government, we also consulted with a small number of financial mentors and advisers from the FinCap network and from the Citizens' Advice Bureau (CAB) during this research. [2] These conversations provided important context for understanding the experiences of people with debt – influencing what we analysed and how we interpreted it. As we drew conclusions from across conversations, we do not cite individual staff but acknowledge their contributions generally as from financial mentors and advisors.

FinCap and CAB clients who receive advice about finances or debt are more likely to have lower incomes or to experience financial hardship. Debt to government is part of the debt that their clients hold, however we know little about the private debt they hold and the interplay between these two types. FinCap staff estimate that more than 10 percent of debt owed by their clients is

[1] The Integrated Data Infrastructure (IDI) is a large research database. It holds microdata about people and households, much of which comes from administrative government records. Stats NZ maintains and protects the IDI. More details are available on their website: https://www.stats.govt.nz/integrated-data/integrated-data-infrastructure/.

[2] FinCap supports a network of 1,200 financial mentors who provide budgeting advice to 70,000 clients every year. CAB is a nation-wide community organisation that helps people understand their rights and obligations, including rights to government support and obligations to repay debt. The names of the staff who contributed and accepted the invitation to be recognised can be found in the attribution section in the preamble to the report.

to the government, and if mortgages were excluded this would rise to more than 20 percent. CAB staff advised us that almost all clients discussing debt also have debt to government.

Government debt has a range of different causes

Most debt owed by individuals to the New Zealand Government is managed by three agencies: Inland Revenue (IR), the Ministry of Social Development (MSD), and the Ministry of Justice. This report considers debt owed to MSD and IR.

We define debt to government as money that an individual (the debtor) is under obligation to pay to the government. Debt owed by a legal entity that is not an individual person – such as a trust or company – was excluded. Although much of this excluded debt is likely to be business related, business debt owed by an individual is included (for example, unpaid tax by someone who is self-employed).

Eight distinct types of debt owed to MSD or IR are considered in this analysis – two to MSD and six to IR. As these debts arise in different ways, we describe each in Table 1.[3]

Table 1: Types of debt and their origins

Debt type[4]	Agency	Description
Benefit overpayment debt	MSD	Occurs when people receiving financial assistance from MSD receive payments they are not entitled to, or more of a payment than they are entitled to, as a result of changes in circumstances (such as starting work, changes to hours worked, or changes in living arrangements).
Recoverable assistance debt	MSD	Occurs when people receive one-off recoverable grants to cover immediate, essential, or emergency expenses (such as car repairs or emergency medical treatment).[5]
Child Support debt	IR	Occurs when a parent or carer applies to IR to collect Child Support payments from a child's parent(s) and these payments are not made in full or on time. Also includes where the receiving carer has been overpaid and must repay the excess.
Working for Families (WfF) tax credit debt	IR	Occurs when people receive more tax credits during the year than an end-of-year calculation shows they were entitled to.

[3] Debts of all these types are included in our analysis even if the debt was resolved by some method other than repayment by the debtor. This means that our analysis covers debts that were written off in full (such as by IR's automatic tax calculations) or where a reassessment and recalculation of the debtor's obligations resulted in them having no debt to pay.

[4] Each of these debt types could be further classified as non-fraud or fraud debt depending on whether the person intentionally mislead MSD or IR. Debt due to fraud against MSD and IR is included in the dataset but is not separated from the type of debt it belongs to as described in Table 1. Only a small proportion of MSD debt cases are fraud: In 2011/12 only 714 cases of fraud were established covering less than 7 percent of all debt established in 2011/12. Similar, or smaller, percentages were recorded for 2014/15 through to 2016/17 (MSD 2012 & 2018).

[5] This assistance is available to beneficiaries and some low-income people and is intended to meet immediate, essential, or emergency needs. Beneficiaries can also receive an advance of up to six weeks of their benefit to cover such costs.

Income Tax debt, GST debt, & PAYE debt	IR	These three types of debt occur when people do not meet their obligations to pay Income Tax, GST, or PAYE by the due date in the corresponding tax year.
Overdue Student Loan	IR	Occurs when people do not meet their contracted obligation payments towards their student loan. This is determined by their income, when New Zealand based, or their student loan balance, when overseas based.

It is clear from this list that little of the debt to MSD and IR considered in our analysis is 'borrowed' in the same way that people borrow from a bank or other private lender. Much of this debt occurs as arrears, from recoverable assistance payments, and from overpayment of entitlements. Existing debt to IR can increase further from penalties and interest.

Changes in people's circumstances are thought to be the most common cause of debt. As circumstances change, such as employment, household composition, and living arrangements, entitlements and obligations also change. Where entitlements decrease or obligations increase, a debt can be created when payments have continued at the old rate and need to be corrected in retrospect. In addition to changes in circumstances, other known causes of debt include incorrect assessment of entitlements, lack of savings giving no protection against unexpected events (Kempson et al., 2004), and refusal to pay[6].

People have obligations to notify the government of changes in their circumstances so that payment amounts can be adjusted. This helps ensure they receive their full and correct entitlements. Financial mentors and advisors noted that meeting this obligation can be difficult for people whose circumstances change rapidly. There are also concerns that people are confused about who to notify, and that even when government agencies are notified on time, processing to update records may be slow due to high volumes of clients and system constraints.

For most of the debt types described above there are only two parties involved: the debtor and the government. However, Child Support debt involves a third party: the receiving carer. While IR manages the debt, some Child Support payments[7] are not owed to IR but are passed on to the receiving carer. It follows that Child Support debt can have consequences for the financial circumstances of the receiving carer.

Student Loan debt has only been included in this analysis where it is overdue. This is deliberate as Student Loan debt is expected to be long-term debt that creates an asset (higher qualifications increasing future earnings) in a way that the debt described in Table 1 is not.

[6] Refusal to pay is thought to affect Child Support debt more than other types as people may be unwilling to support an ex-partner.

[7] Child Support is paid directly to the receiving carer if they are not receiving a benefit at the sole parent rate or receiving the unsupported child's benefit from MSD. When the carer is receiving such a benefit, IR collects child support from the liable parent to help cover the cost of benefits paid. Some or all of the payments by the liable parent are retained by the government up to the amount of the receiving carer's benefit. This is to offset the cost of the receiving carer's benefit to the Government.

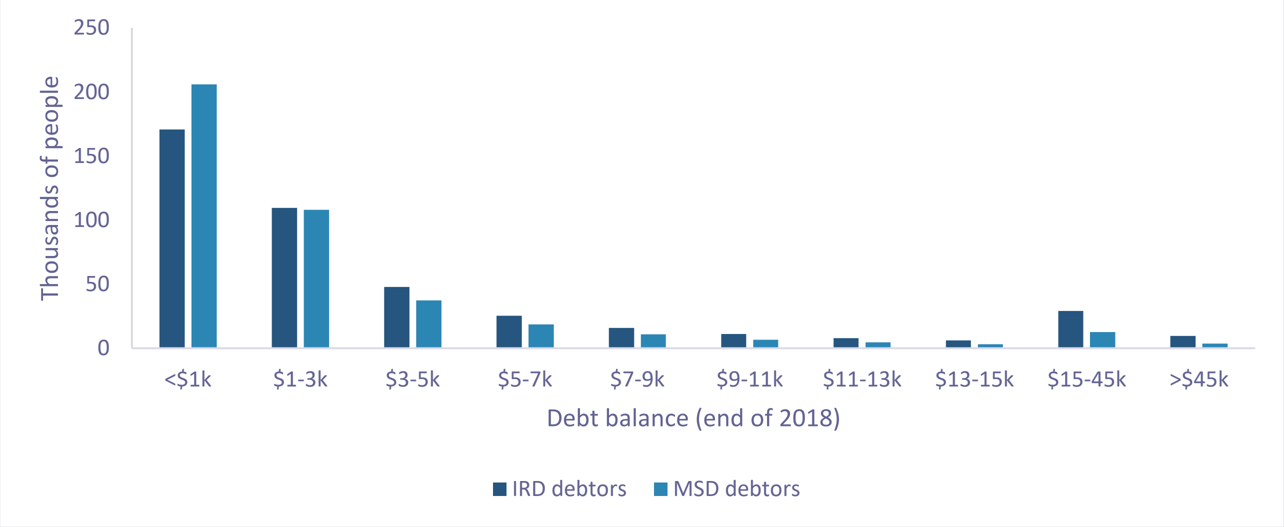
Table 2 gives an overview of debt and debtors to both agencies at the end of 2017 and 2018. It shows a combined debt of $4.6 billion at the end of 2018, with mean debt to MSD of $3,350 per person and mean debt to IR of $7,500 per person.

Table 2: Total debt and number of debtors, at the end of 2017 and 2018

	Debt ($ billions)		Debtors (thousand people)	
	2017	**2018**	**2017**	**2018**
Total MSD	1.27	1.39	397	412
Total IR	3.77	3.26	513	435

Figure 1 gives the distribution of individual's debt balances to both MSD and IR. The median debt to MSD is around $1,000 per person, the median debt to IR is around $1,300. While the vast majority of people with debt owe less than $5,000 (85 percent of people with debt to MSD and 75 percent of people with debt to IR), there is still a significant number of people with much larger debts.

Figure 1: Distribution of debt balances end of 2018



Note that the population used throughout our analysis is people who are resident in New Zealand during 2018. This is the population for which we have the most robust information. Because of this, our numbers will differ from those published by both MSD and IR as they report on all debt and people with debt regardless of place of residence. This difference is most significant when considering the amount of money owed to IR as hundreds of millions of dollars in overdue Student Loan payments and Child Support are owed by overseas customers (Inland Revenue, 2017).

There are several key limitations to this analysis

The data used for our analysis is subject to several limitations. The key limitations to note are:

1. The information that government holds is limited to debt owed to, and managed by, government. Conducting an analysis on private or non-government debt was not possible with the available data.

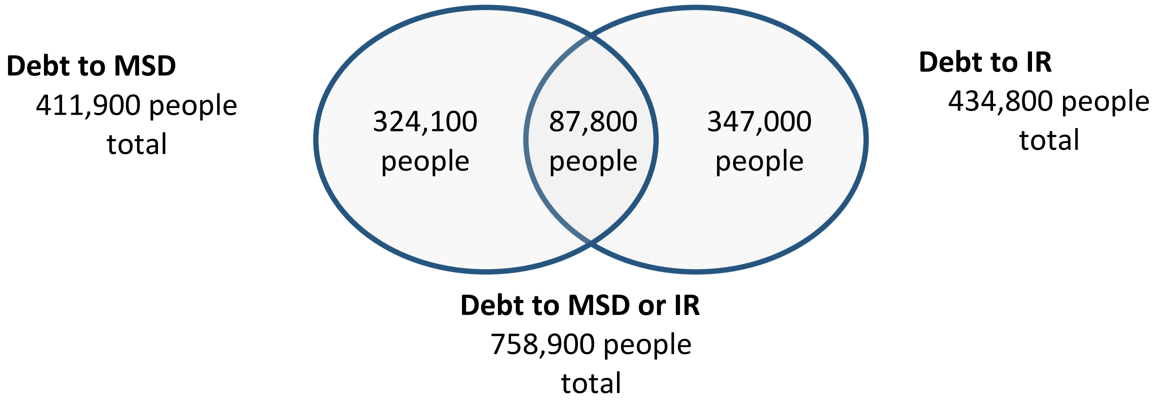
2. While this study focused on individuals, one of the driving complexities in social policy is how relationships are defined, and how changes in relationships affect entitlements (and hence debt). Considering household dynamics (such as joint income) was beyond the scope of this paper.
3. Debt owed to MSD was only available as a single combined total, rather than itemised by type or debt case.[8] This is consistent with the way MSD presents to its clients any amounts they owe: a single combined total (Welfare Expert Advisory Group, 2018).
4. While IR records contain separate debt cases for each tax year, all debt of the same type has been merged across tax years in our data.
5. Child Support debt can be further classified into three sub-types – payments that are owed to IR, payments that are collected by IR but will be passed on, and overpayment to the receiving carer. The debt data available does not distinguish between these sub-types.[9]

There is some overlap between MSD and IR debt

Given the many types of debt New Zealanders owe (MBIE, 2018; Gordon et al., 2019), we might expect that most people who owe debt to the government would owe debt to more than one government agency. This would be consistent with observations by financial mentors and advisors.

However, this is not the case for debt to MSD and debt to IR. Figure 2 gives the number of people with different combinations of debt to both MSD and IR. It shows that 12 percent of people with debt to at least one of MSD and IR owe debt to both government agencies. This is consistent with previous analysis by the Tax Working Group (2018).

Figure 2: Number of debtors and joint debtors



We ran the same checks for people with children: About half of people with debt to MSD or IR have biological children under the age of 15.[10] A very similar proportion (within 3 percentage

[8] Separating debt to MSD into its three types might be possible using additional data in the IDI but has been left for future research.

[9] Separating Child Support debt into its three sub-types might be possible using additional data in the IDI but has been left for future research. All three of these types may contain penalties and interest in addition to principal.

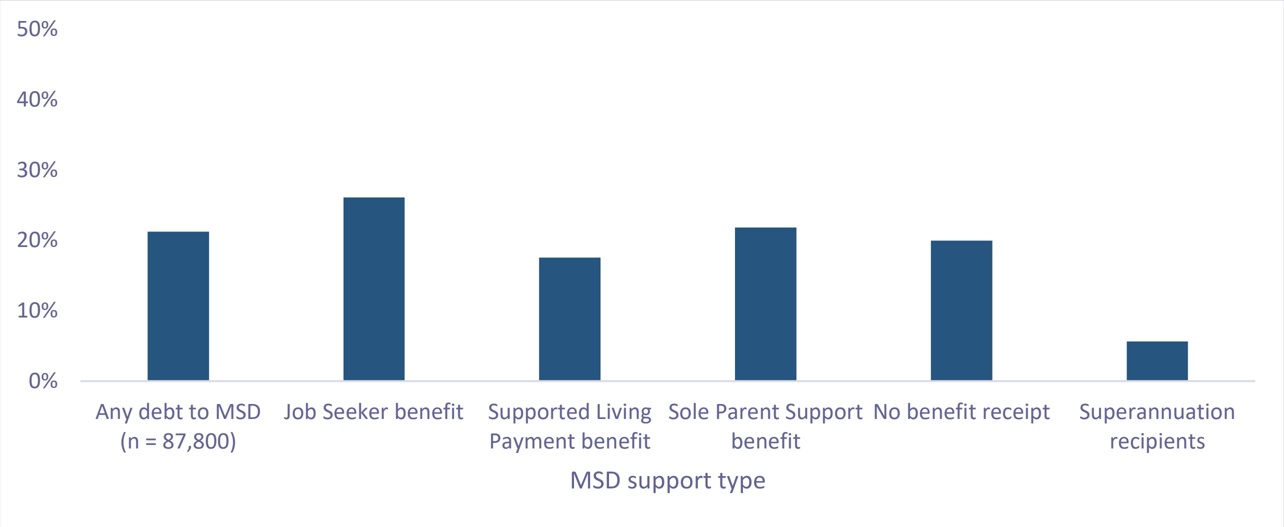
[10] One of the current limitations of the IDI is that households cannot be constructed with accuracy. This makes it difficult to identify parents or guardians with dependent children. For this paper, we consider having biological children under the age of 15 as a proxy for having dependent children.

points) have debt to both government agencies. However, financial mentors and advisors expected that people with dependent children are more likely to have debt to private lenders.

The comparison in Figure 2 makes no allowance for the different types of debt people can owe to MSD and IR. Even if there is minimal overlap in general, there could be overlap between specific types of debt. This is explored in Figure 3 and Figure 4.

As only a single combined MSD debt figure was available for our analysis, Figure 3 gives the percent of people with debt to both MSD and IR at the end of 2018 by the type(s) of benefit they received in 2018. The joint debtors from Figure 2 form the left-most group. New Zealand Superannuation and no benefit receipt are included for comparison. We calculate that 75 percent of people with debt to MSD received some form of benefit in 2018.

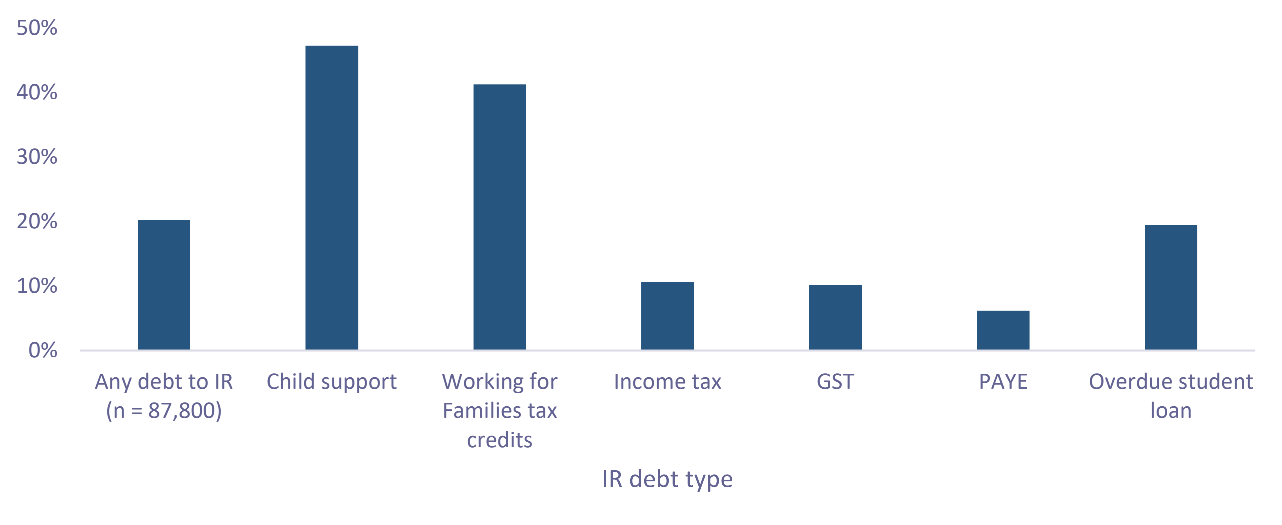
Figure 3: Percent of people with debt to MSD who also have debt to IR, by type of benefit



From Figure 3 we observe limited variation between the different benefit types, with all benefit types being within six percentage points of the any debt category and of the no benefit category. Some variation between benefit types is to be expected given that people on different benefit types differ in their entitlements to Working for Families (WfF) tax credits and in their likelihood of having some employment.

Figure 4 gives the percent of people with debt to both MSD and IR at the end of 2018 based on the type of IR debt owed. The joint debtors from Figure 2 form the left-most group. Note that a single person can owe debt of more than one type to IR and so there are overlaps between these categories.

Figure 4: Percent of people with debt to IR who also have debt to MSD, by IR debt type



From Figure 4 we observe that a significant proportion of people owing Child Support or WfF tax credit debt to IR also have debt to MSD, while a much smaller proportion of people owing Income Tax, GST, or PAYE to IR also have debt to MSD. These differences are at least three times the magnitude of those observed in Figure 3.

The results from Figure 3 and Figure 4 together show that debt to both MSD and IR is most common for people with Child Support debt or WfF tax credit debt. Further investigation is needed to explore the causes of this, but some of this pattern will be due to administrative reasons: People with dependent children who receive a main benefit are also eligible for WfF tax credits. This means that a single change in circumstances can reduce both their benefit entitlements and their tax credit entitlements, leading to overpayment debt of both types. Benefit overpayment debt is collected by MSD but WfF tax credit overpayment debt is collected by IR, even for entitlements paid out by MSD. This means that part of what we observe in Figure 3 and Figure 4 is due to how a single change in circumstance can create two different types of debts.

There are also statutory interactions between Child Support payments and benefit receipt. People receiving sole parent support from MSD are required to apply for Child Support via IR (Child Support Act 1991, s 9), [11] and people receiving a main benefit from MSD who are liable to pay Child Support are required to pay by automatic deduction (Child Support Act 1991, s 131). These requirements create links between debt managed by MSD and debt managed by IR that are beyond the control of their customers. This means that part of what we observe in Figure 3 and Figure 4 is how the same population is affected by the policy settings at MSD and IR.

Hardship affects people's experience of debt

While this paper describes debt to MSD and IR, many people will also have private debt, including credit cards, hire purchase, overdraft, and loans from banks and finance companies. Traditional economic models consider private debt as a temporary buffer for adapting to circumstances in the

[11] Unless they are eligible to be exempt from this requirement. This requirement also includes customers receiving the Unsupported Child Benefit.

short term, or as part of a longer-term investment that will bring greater returns. However, such models tend to perform poorly when the borrower's survival is at stake. Zinman (2015) observes that no existing model can generate the levels of credit card debt observed in practice. Thinkplace & Auckland City Mission (2014) demonstrate how private borrowing is one of the few immediate solutions available to people who are struggling to feed their family. Drentea & Reynolds (2015) find no support for "the idea that debt may buffer economically disadvantaged groups by providing a stop-gap means to cover costs".

Coupled with inadequate income, private borrowing can lead to more debt in a worsening spiral: As debt increases, interest and repayments also increase. This reduces the income available to meet daily expenses and increases future dependence on debt (Families Commission, 2009). This is less of a concern with debt to government, as repayment rates are often adjusted to prevent hardship and some debt can be written off (most often penalties and interest by IR) where collecting this debt would impose hardship on the debtor.[12]

Financial mentors and advisors expressed concern that many of their clients are borrowing because it is difficult to live on a benefit, even more so while making repayments on existing debt balances and/or meeting minimum Child Support payment obligations.[13] In addition, when requests for additional support or advance payment of benefits from MSD are declined, some clients would instead borrow from high interest private lenders. This is one of the experiences illustrated by Thinkplace & Auckland City Mission (2014). While such borrowing addresses their immediate need, it contributes to ongoing hardship. Addressing the harms caused by high interest lenders was the focus of the Credit Contracts Legislation Amendment Act 2019, which introduced a cap on interest rates starting from mid-2020.

The vulnerability of people experiencing hardship due to debt is caused by more than just their financial circumstances. Wilson et al. (2009), Cartwright (2011), and Coppack et al. (2015) identify a range of factors that create vulnerability including: lack of choice, limited access to information they can understand, and predatory lending and debt collection practices. Porter (2010) records that people who were recently declared bankrupt were repeatedly solicited for new credit. Financial mentors and advisors have observed private lenders to push debt in arrears to debt collection companies very quickly, with debt collectors frequently being aggressive or intimidating. However, in contrast, borrowers have much less ability to hold lenders (or debt collectors) to account.

Financial education and mentoring programmes are often a recommended approach for helping people out of debt (Families Commission & Retirement Commission, 2009; MSD, 2010; Wang 2010). However, the effectiveness of budgeting decreases when income fluctuates – especially if it drops. Furthermore, while the preferred way out of debt and poverty is to increase income via

[12] IR has legislative powers to write off interest and penalties relating to tax debt where collecting these would cause serious hardship, or as an incentive for people with debt to enter into repayment agreements (IR, 2018). Similar legislative powers apply to Child Support debt (IR, 2019) and Student Loan debt (IR, 2020). Note that IR cannot write off principal amounts owed to the receiving parent even where they can write off principal amounts owed to the Crown. In all cases IR can agree to instalment arrangements, and all arrangements are at the discretion of the Commissioner.

[13] For liable parents, there is a minimum annual rate of child support payable, even if they have zero income. The 2021 rate is $954. If this is not paid, penalties are added which increase the liable parent's debt.

employment (Williams & O'Brien, 2003; Families Commission & Retirement Commission, 2008), a more common strategy by people in debt is to cut back on expenditure, not because it is effective but because it is actionable (Williams & O'Brien, 2003). While financial mentors and advisors observe budgeting to empower debtors by bringing things back under their control, debtors in hardship may ask "how can I budget when I have no money?" (Thinkplace & Auckland City Mission, 2014).

People with debt to government differ from each other

Different types of debt occur in different ways, and hence are associated with different characteristics of debtors. This section provides a description of the characteristics of people owing four different types of debt to MSD and IR.

1. People with debt to MSD
2. People with Child Support debt to IR
3. People with WfF tax credit debt to IR
4. People with Income Tax debt to IR.

The other types of IR debt (GST, PAYE, and overdue Student Loan debt) were considered in our analysis but we do not show them here as they provide minimal additional insight: People with GST and PAYE debt are broadly similar to people with Income Tax debt. People with overdue Student Loan debt are also broadly similar to people with Income Tax debt but are more likely to be younger with higher qualifications and earnings (as expected given the educational origin of their debt).

While our results here highlight the differences between groups of people with debt, they do not determine the cause or effect of debt. This would require controlling for the specific characteristics of people with debt – for example comparing people with Child Support debt against people who pay Child Support but do not owe Child Support debt. As we have not prepared such comparisons, our results here are primarily descriptive.

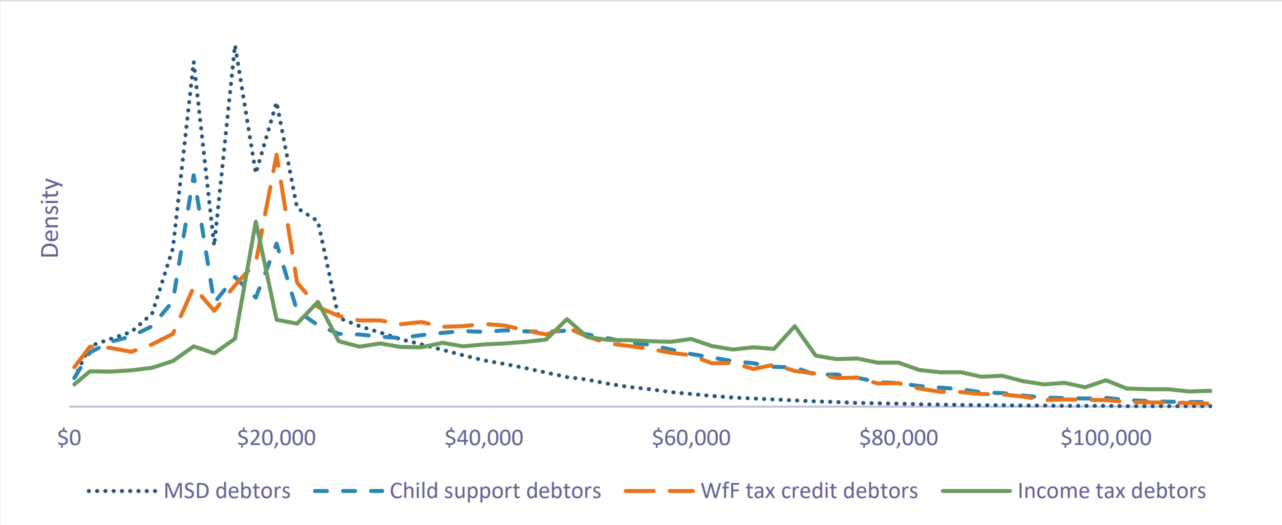
There are differences in the financial circumstances of people with debt

More than any other factor, people's financial circumstances determine whether they get into debt, to what extent they can make debt repayments, and whether they can get out of debt. Furthermore, low or insufficient income reduces a person's resilience to unexpected life events and increases the extent to which they are dependent on debt (Townley-Jones et al., 2008; Families Commission & Retirement Commission, 2008; Bodsworth, 2013; Green et al., 2019).

The differences between people with debt will be broader than the income, deprivation, and material wellbeing distributions considered below. Townley-Jones et al. (2008) highlights differences in net wealth, with more vulnerable people being not just income poor, but also asset poor. Wilson et al. (2009) and the Families Commission (2009) discuss the differences in personal networks – differences in financial circumstances are likely to be matched by differences in the support people can receive via their close community.

Figure 5 gives the distribution of annual taxable income for people with income in each group. The spikes in the income distribution around $20,000 correspond to the payment rates for the main benefits. As the figure does not include other (non-taxable) income supports, such as WfF tax credits and the Accommodation Supplement, total income from all sources will be higher than shown. For reference, the living wage in 2018 was $20.55 an hour, which corresponds to a full-time annual salary of $42,700.

Figure 5: Distribution of annual taxable income by debt type (2018 tax year)

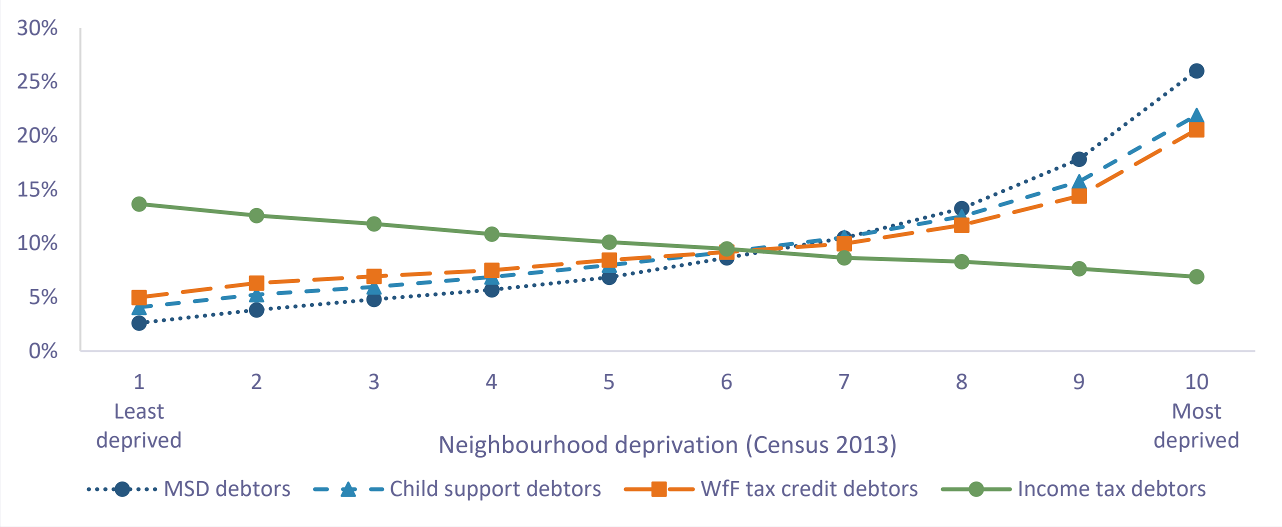


From Figure 5, we observe that people with debt to MSD have the lowest income of all people with debt to MSD or IR, and people owing Income Tax debt have higher incomes on average. It is to be expected that some people with debt to MSD have incomes greater than $40,000 (and therefore must have non-benefit income): People may transition between employment and main benefit receipt during a year (and benefit overpayment at these transitions can create a debt to MSD), and recoverable assistance payments (that create a debt to MSD) are income tested, not benefit receipt tested, and so can be accessed by non-beneficiaries.

The results in Figure 5 have several limitations: They exclude people without any income (about 5-10 percent of each group) and do not control for whether a person was earning for only part of the year. In addition, we use individual income which is a less robust measure than household income or income with a partner, both of which are difficult to construct in the IDI.

Figure 6 provides an alternative approach to consider people's financial circumstances. It gives the distribution of neighbourhood deprivation for each group. Unlike income in Figure 5, Neighbourhood deprivation is a geographic measure not an individual measure. Nine Census 2013 questions are used to divide areas into deciles ranked from 1 – the least deprived, to 10 – the most deprived (Atkinson et al., 2014). Because it combines a range of measures, deprivation can capture hardship in a more holistic way than just income. However, because it is a geographic measure, it does not capture differences between people in the same neighbourhood.

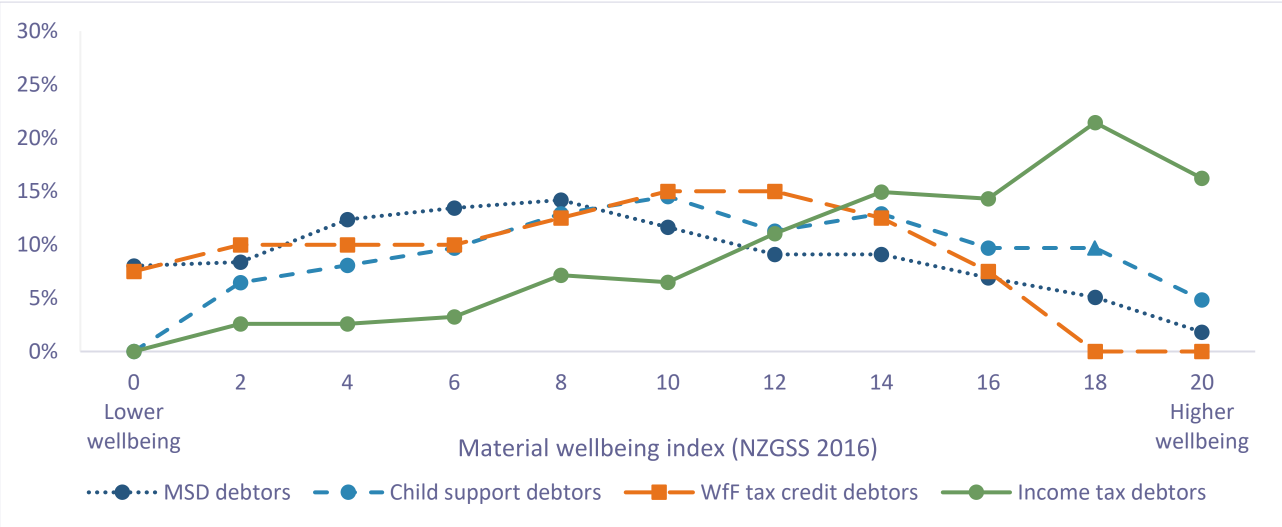
Figure 6: Distribution of neighbourhood deprivation by debt type



From Figure 6 we observe a very similar pattern to that observed in Figure 5: People with debt to MSD are more likely to live in higher deprivation neighbourhoods, and people owing Income Tax debt are more likely to live in low deprivation neighbourhoods. For reference, deprivation is designed so that 10 percent of the population sit in each category, so a horizontal line would match the New Zealand residential population.

Material wellbeing can be inferred from Figure 5 and Figure 6 on the basis of income or neighbourhood deprivation. Figure 7 measures this directly for those people who responded to the New Zealand General Social Survey (NZGSS). It gives the distribution of individual material wellbeing as measured using the 2016 wave of the NZGSS, with higher values representing greater wellbeing.

Figure 7: Distribution of material wellbeing index by debt type



From Figure 7 we observe a very similar pattern to that observed earlier in this section: People with debt to MSD have lower material wellbeing on average than other people with debt, and people owing Income Tax debt have higher material wellbeing than other people with debt. These results have several limitations: First, as the NZGSS is a household survey it does not capture people in transient living situations. Second, unlike income and deprivation that are population measures, material wellbeing is a survey measure – about 1600 people with debt at the end of

2018 also answered the NZGSS 2016. Third, people's circumstances may have changed between answering the 2016 wave of the NZGSS, and the end of 2018 when we measure debt. However, as it is common for people to have debts that last for more than two years, we expect the effect of such changes to be minimal.

Demographic characteristics differ between groups of people with debt

This section illustrates how age, highest qualification, overall life satisfaction, ethnicity, number of children, and the experience of several types of life events differ between different groups of people with debt. While our analysis considered a wider range of variables than those reported here, the results below represent the patterns we identify as most meaningful.[14] Note that our results only show associations between debt types and people's characteristics. They are not enough to establish a causal relationship.

Figure 8 gives the age distribution of each group. It shows distinct patterns for each debt type. We have checked these patterns and found them to be consistent with the age distribution for each of the underlying populations (not shown): The age distribution for people with debt to MSD is consistent with the age distribution for people receiving a benefit from MSD (higher number of people aged 20 to 30, and fewer aged 40 to 60). The age distribution for people with Child Support and WfF tax credit debt is consistent with the age distribution for people with dependent children (rising through the 20s and declining through the 50s). The age distribution for people with Income Tax debt is consistent with the distribution of earnings against age (average earnings rise through 30s and 40s and decline during 50s and 60s).[15] That these age distributions are consistent with the distributions for the underlying populations suggests that age has little impact on whether people owe debt to MSD or IR.

[14] We observed minimal difference in location between the different groups. Each group of people with debt showed a very similar distribution across regional councils, and across urban/rural area types. In addition, the distribution of physical and mental health measured using the NZGSS is very consistent with the distribution of overall life satisfaction shown in Figure 10.

[15] As compared against Incomes by region, sex, age groups and ethnic groups on http://nzdotstat.stats.govt.nz/wbos/Index.aspx?DataSetCode=TABLECODE7471 (accessed November 2020).

Figure 8: Distribution of age by debt type

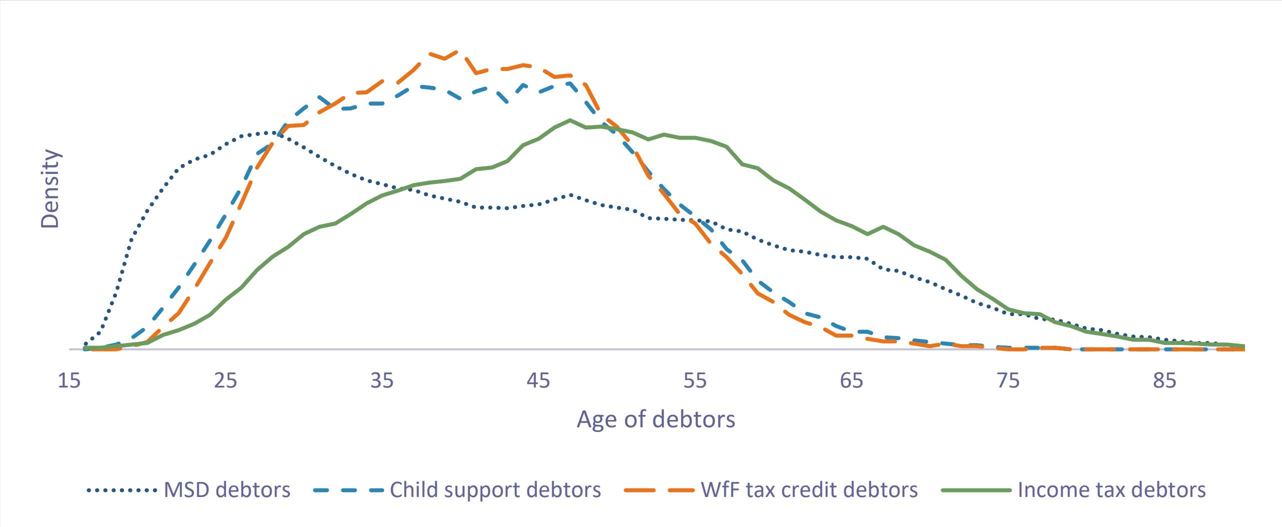


Figure 9 gives the distribution of highest qualification obtained by debt type. This makes it clear that people with debt to MSD and people with Child Support debt are less likely to have higher qualifications compared with people with Income Tax debt. Given the differences in age distribution in Figure 8, some of this difference in qualification will be due to different age groups, as people tend to become more qualified over time. Whether this explains the entirety of the difference in qualifications would require further investigation.

Figure 9: Distribution of highest qualification by debt type[16]

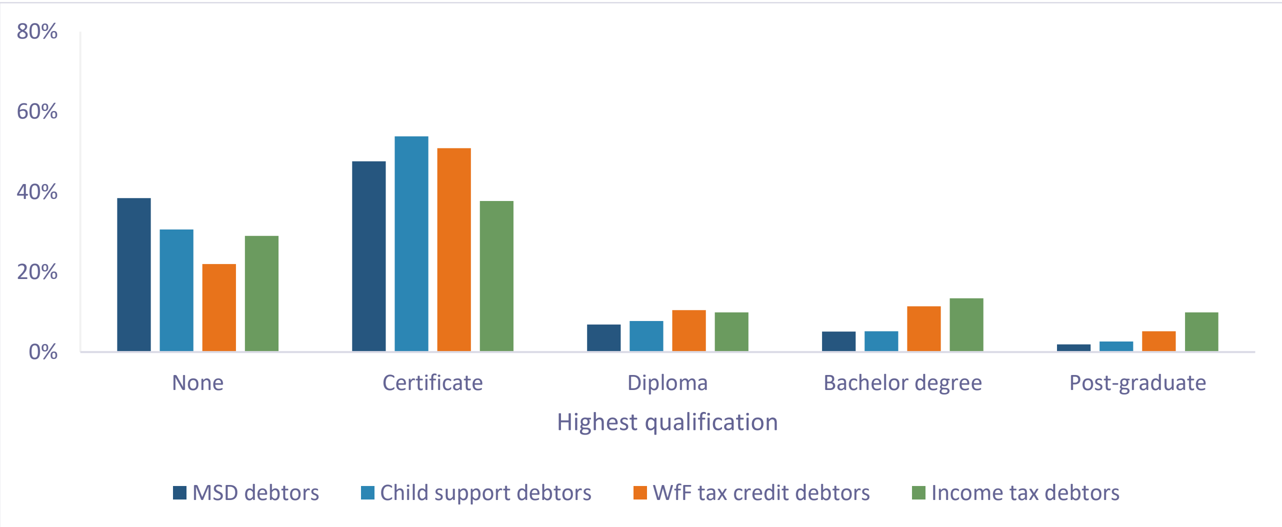


Figure 10 gives the distribution of overall life satisfaction in the 2016 wave of the NZGSS, for those people who responded to it. It shows that people with debt to MSD are more likely to have lower overall life satisfaction, while people with Income Tax debt are more likely to have higher satisfaction.

[16] The New Zealand Qualifications Framework (New Zealand Qualifications Authority, 2016) sets out ten levels of qualifications. We apply their standard classification of levels 1-4 as certificates, levels 5-6 as diplomas, level 7 as bachelor degrees, graduate diplomas and certificates, and levels 8-10 as different types of post-graduate degree (bachelor honours degrees, postgraduate diplomas and certificates, master's degrees, and doctoral degrees).

Figure 10: Distribution of overall life satisfaction by debt type

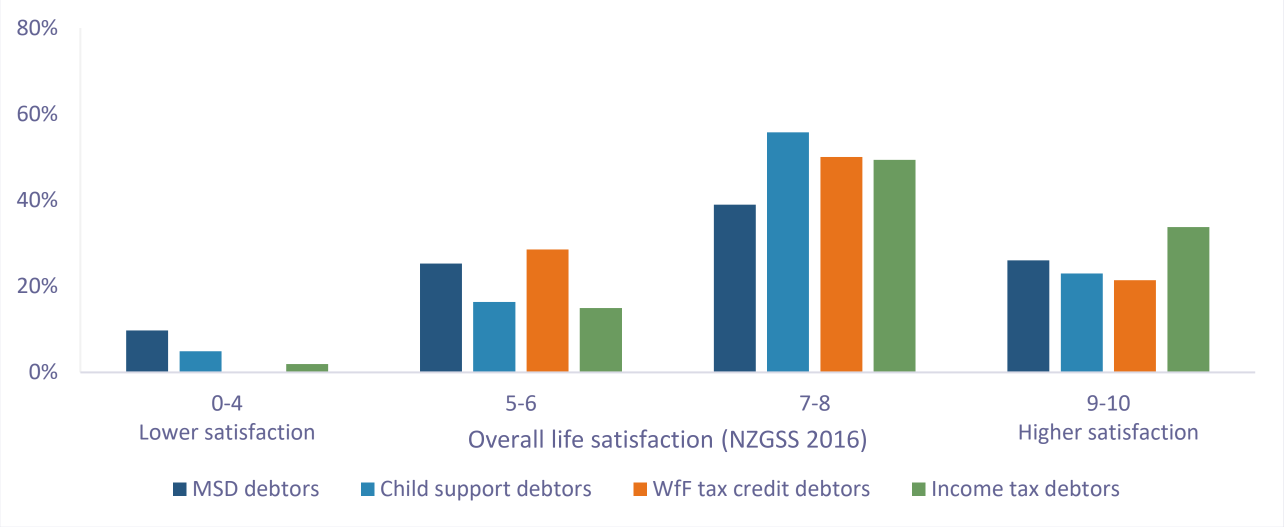
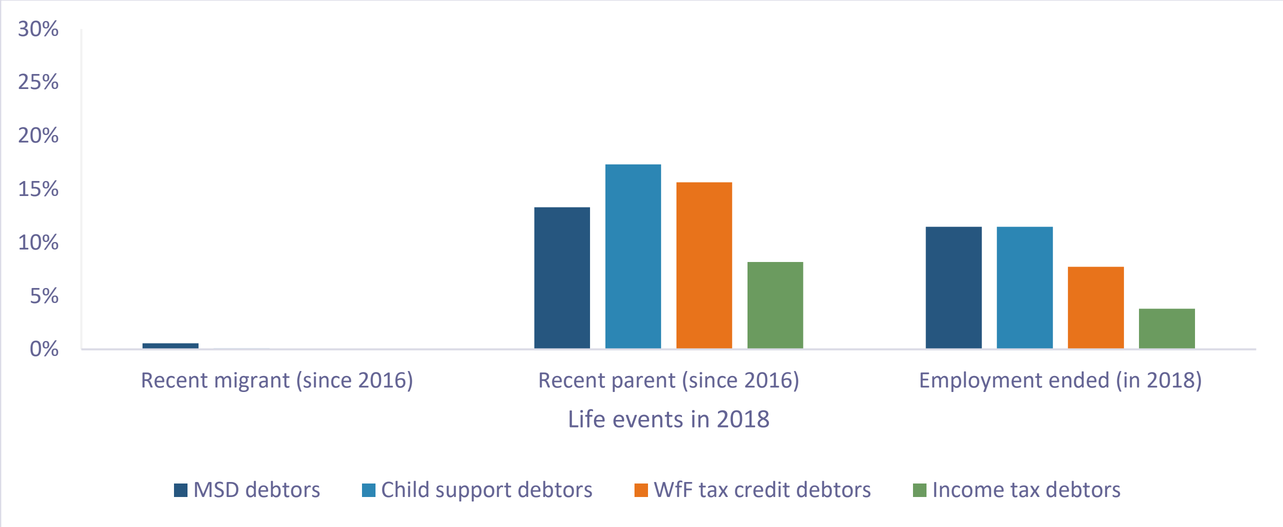


Figure 11 gives the percent of people with different debt types who experienced three life events. First, we observe that very few people with debt to MSD or IR are recent migrants. Second, we observe that people owing debt that relates to Child Support or WfF tax credit entitlements are more likely to have had a child born to them in the last three years. Note that we have not been able to exclude absent parents, so these results include biological parents who do not participate in the raising of their children. Third, we observe that people with Child Support debt or debt to MSD are more than twice as likely than people owing Income Tax to end work without a new role, resulting in at least a month where they do not have reported wages and salaries.[17] Coupled with the lower income distribution we observe in Figure 5 and the lower qualification pattern we observed in Figure 9, this could indicate insecure working arrangements and is consistent with concerns that debt is associated with barriers to successful employment (Williams & O'Brien, 2003; MSD 2004 and 2010).

[17] Using IR Employer Monthly Schedule (EMS) records, we look for cases when a person stops receiving wages and salaries from their current employer and does not start receiving wages and salaries from another employer in the next month (but has not stopped working, as they have future wages and salaries recorded with IR).

Figure 11: Occurrence of specific life events by debt type



This descriptive analysis cannot determine the causal impact of any of these events. A more detailed analysis of life events is one of the areas this study suggests merits further investigation. Other life events to consider include significant injury or illness, the death of a family member, and the start or end of a marriage or civil union. These are some of the experiences that can contribute to people being in debt (Townley-Jones et al., 2008; Wang, 2010; Bodsworth, 2013).

Figure 12 gives the distribution of the number biological children under the age of 15 by debt type. We use this definition as a proxy for having dependent children because current administrative data is not well suited for determining whether a parent lives with, or cares for, their children. The distributions shown in Figure 12 highlight that people with different types of debt differing in the present or absence of children more than the number of children. This is unsurprising given the different age distributions shown in Figure 8, and how Child Support payments and WfF tax credits are associated with dependent children.

Figure 12: Distribution of number of biological children under 15 by debt type

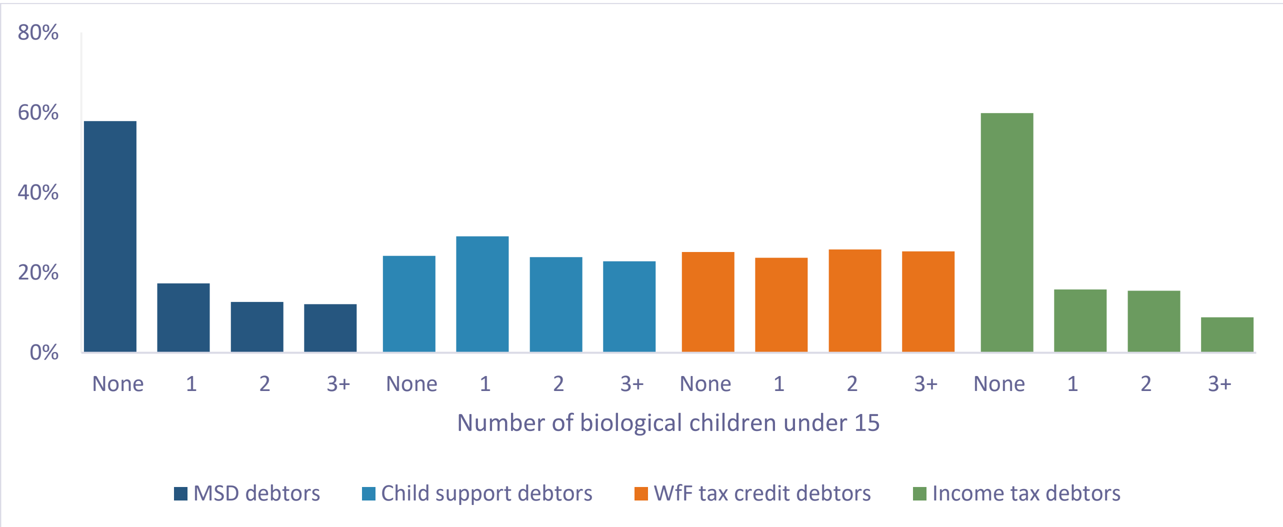
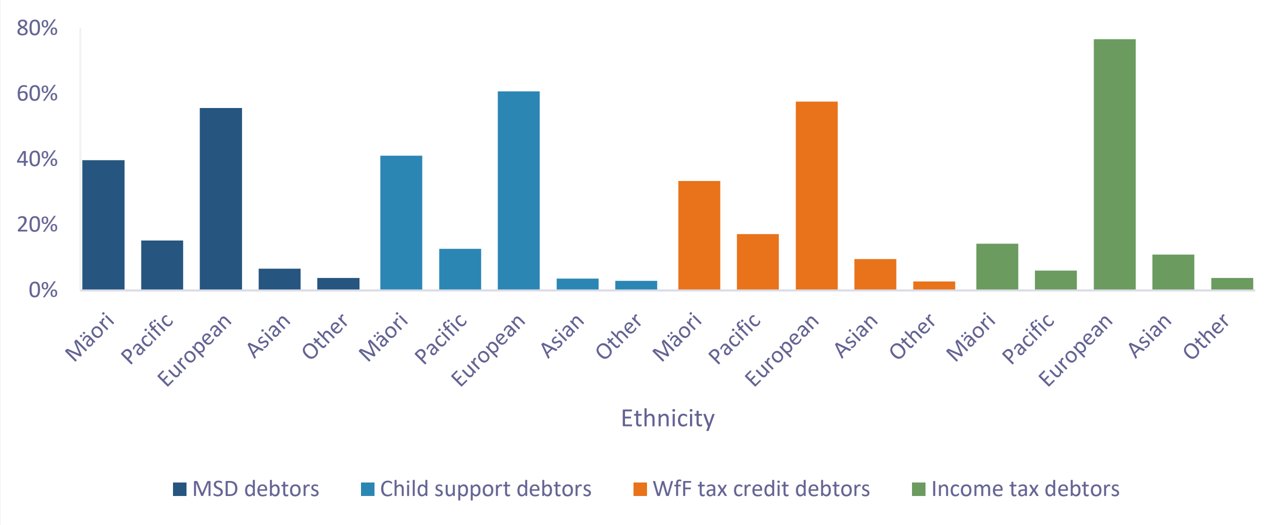


Figure 13 gives the distribution of ethnicity by debt type. This shows clear differences in the ethnic distribution between the different types of debt. As people may identify with more than one ethnicity the percentages for each debt type sums to more than 100 percent.

Figure 13: Distribution of ethnicity by debt type



Only some of the unequal distribution of debt across ethnic groups will be due to differences in cultural or ethnic practices (such as discussed by Families Commission, 2012). Figure 5, Figure 6, and Figure 9 show that debt varies with income, neighbourhood deprivation, and highest qualification respectively. Because there are known inequalities in income, deprivation, and qualifications between different ethnic groups (Marriott & Sim, 2015; The Treasury, 2018), inequalities in debt are to be expected. Initial attempts to control for differences in deprivation between ethnicities suggests that deprivation alone might explain up to a quarter of the differences in debt between ethnicities.

Debt to government is persistent

The persistence of debt for a longer period than intended can be a concern for both debtors and creditors. For debtors, such concern may arise alongside financial hardship and the stress of unresolved obligations. For creditors, delays in repayments reduce the likelihood that the entire debt will be repaid and can indicate that the debtor is not able to complete their repayments.

While some borrowing arrangements (such as mortgages and student loans) are intended to be long-term, most debt to government considered in our analysis are not intended to be long-term. However, given that many people with debt have limited ability to repay (Tax Working Group, 2018) and 40 percent of families in financial difficulty had been so for more than a year (Kempson et al., 2004), it is unsurprising that debt to MSD and IR is persistent. We observe 68 percent of people with debt to MSD[18] and 39 percent of people with debt to IR[19] in 2018 had at least one debt that had lasted more than three years. For people receiving a main benefit in 2018 this is even more common: We calculated that 75 percent have debt to MSD or IR, and 77 percent of

[18] As the MSD debt data did not include individual debt cases, but combines all debt, we estimate the length of each debt by comparing principal and repayment amounts, and assuming that repayments are applied to the earliest un-repaid debt.

[19] These percentages vary by specific types of debt to IR: For Income Tax debt 54% of people had at least one debt that lasted more than three years. The equivalent percentage for people with both GST and PAYE debt is 66%, for people with overdue student loan debt it is 24%, for people with Child Support debt it is 48%, and for people with tax credit debt it is 78%.

those with debt had at least one debt the lasted more than three years. The percent who have been in debt for more than three years (even if each individual debt lasts less than three years) will be even higher.

Debt increases for many people with existing debts

Figure 14 and Figure 15 give the distribution of new debt, to MSD and IR respectively, by whether the person changed from being debt free to owing debt in 2018. For both of these figures the dashed line gives the distribution of all new debt in 2018, while the solid line gives the distribution of new debt (excluding interest and penalties) to people who became debtors during 2018. The gap between the solid and dotted line is the distribution of new debt to people who were already debtors.

Figure 14: Distribution of new debt to MSD in 2018 by whether person has existing debt

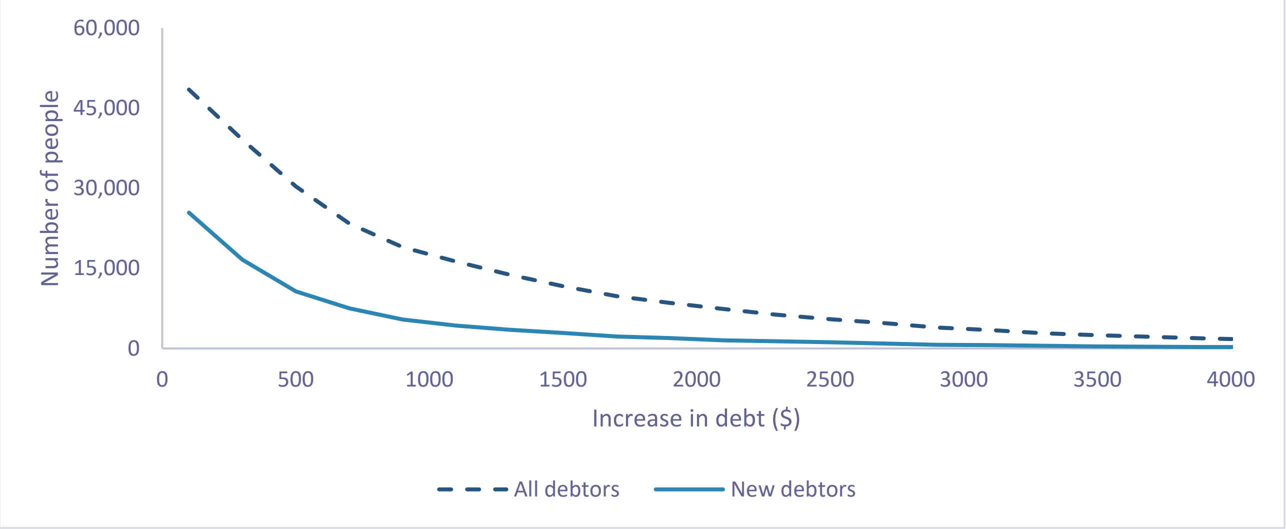
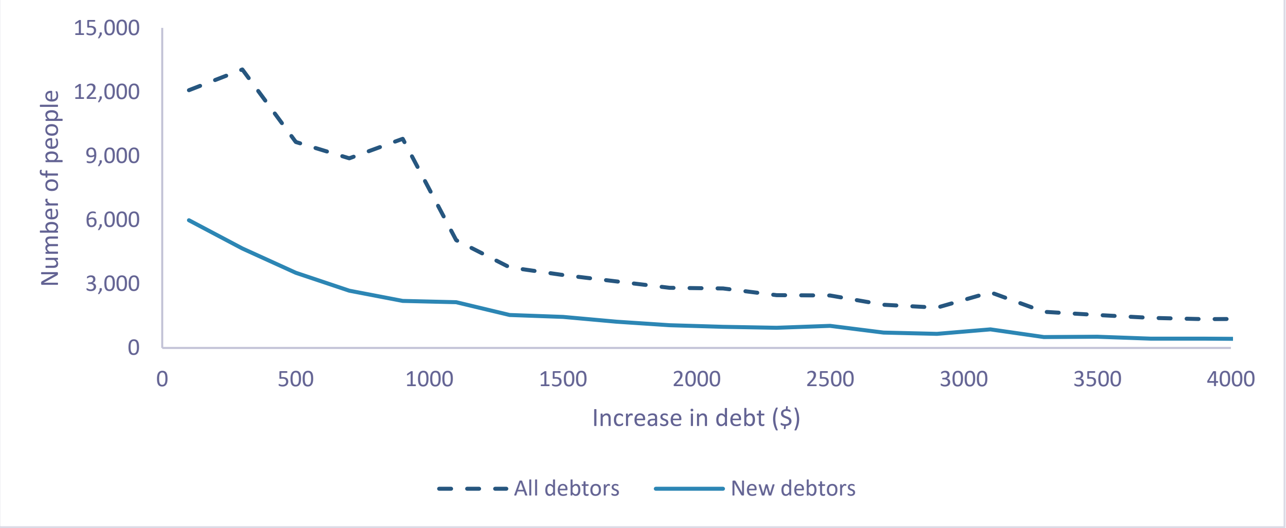


Figure 15: Distribution of new debt to IR in 2018 by whether person has existing debt



From Figure 14 and Figure 15 it is clear that a significant proportion of new debt to MSD and IR in 2018 was accrued by people who already had debt to that agency. Closer calculation suggests more than 63 percent of people who had new debt to MSD or IR in 2018 had existing debt to the same agency. That some people with debt to MSD or IR gain further debt during the year helps explain the persistence of this debt.

Only some people making repayment become debt free

Having considered new debt and new debtors, Figure 16 and Figure 17 consider the reverse: repayments and finishing debtors. Similar to above, the dashed line gives the distribution of repayments of all debt in 2018, while the solid line gives the distribution of repayments (excluding write-offs) for people who changed from owing debt to being debt free in 2018. The gap between the solid and dotted line is the distribution of repayments by people who remained in debt.

Figure 16: Distribution of repayments to MSD in 2018 by whether person remains in debt

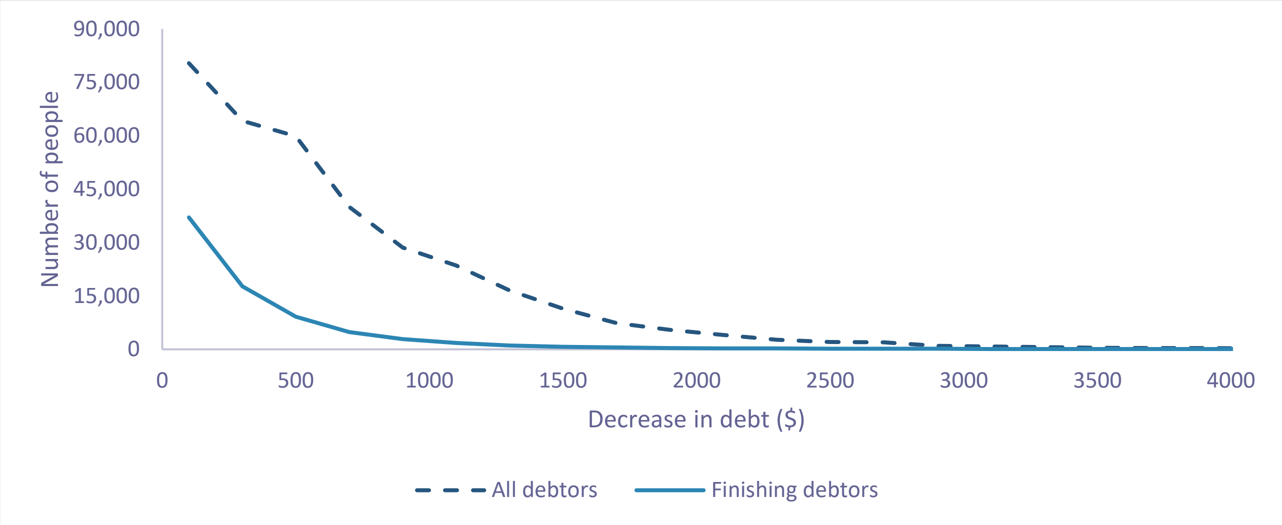
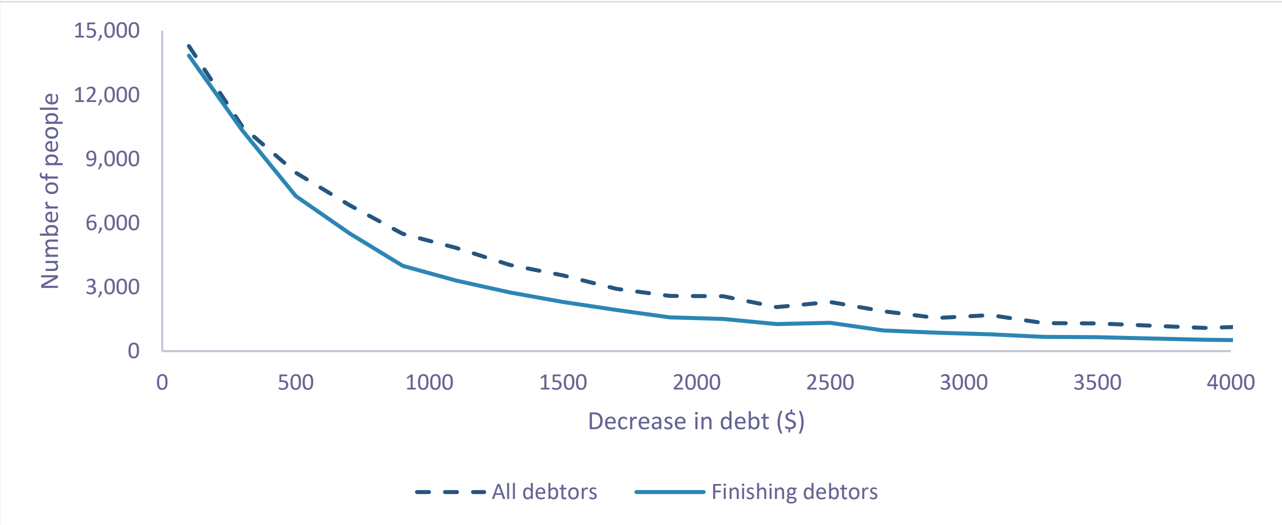


Figure 17: Distribution of repayments to IR in 2018 by whether person remains in debt



Unlike Figure 14 and Figure 15 which show a similar picture for both MSD and IR, the pattern of repayments in Figure 16 and Figure 17 are very different for MSD and IR. For MSD, Figure 16 shows a large gap between repayments by all people with debt and repayments by people who became debt free. This means than only a minority (22 percent) of people with debt to MSD who made repayments in 2018 paid off all of their debt – and furthermore only those with the smallest outstanding balances did so. For IR, Figure 17 shows a small gap between repayments by all debtors and repayments by debtors who became debt free. This means that the majority (75 percent) of people with debt to IR who made repayments in 2018 paid off all of their debt.

Several factors contribute to this pattern for debt to MSD: First, MSD can make repayment deductions directly from client benefit payments. Second, repayment rates to MSD can be adjusted based on the financial circumstances of the client. Third, MSD clients may continue to borrow – financial mentors and advisors observe clients who have requested the maximum possible advanced payment of their benefit (a form of recoverable assistance debt to MSD), and once they have made sufficient repayments to be able to borrow further then they do so immediately.

Movements out of debt may only be short term

Figure 14 through Figure 17 use a simple definition of movements into and out of debt: An entry into debt occurs when a person owes debt in any quarter of 2018 but did not owe debt in the previous quarter. An exit from debt occurs when a person is debt free in any quarter of 2018 but owed debt in the previous quarter.

One limitation of this definition is that it ignores how frequently a person moves into and out of debt, and how long they remain in either state. Depending on the application it may be necessary to use a more nuanced definition. For example, when considering persistent debt, we might wish to exclude those people who pay off all their debt as soon as they are notified of an amount owing. Alternatively, when considering debt cycles, we might want to require that a person remains debt free for twelve months.

Table 3 gives the number of people who entered into, or exited from, debt during 2018 and divides them into people who had only a single transition (entering: no debt → debt; exiting: debt → no debt) and people who had more than one transition during 2018. Of the people who entered into debt during 2018 and owed debt at the end of 2018, 13 percent of people with debt to MSD and 20 percent of people with debt to IR had more than one transition (they also exited from debt). Of the people who owed debt at the start of 2018 and exited from debt during 2018, 14 percent of people with debt to MSD and 7 percent of people with debt to IR had more than one transition (they also entered into debt).

Table 3: Movements into and out of debt within 2018

	Entered into debt and owed debt at the end of 2018		
Debt type	Total number of people	One transition (Did not exit from debt)	More than one transition (Also exited from debt)
MSD	73,329	63,648 (87%)	9,681 (13%)
IR	24,063	19,326 (80%)	4,737 (20%)

Owed debt and exited from debt during 2018			
Debt type	Total number of people	One transition (Did not enter into debt)	More than one transition (Also entered into debt)
MSD	60,987	52,572 (86%)	8,415 (14%)
IR	82,302	76,443 (93%)	5,859 (7%)

The key point to take away from Table 3 is that whether or not a person owes debt to the government can change multiple times within a single year, and that a small but non-trivial number of people move in and out of debt with high frequency.

Table 3 omits some people with two or more transitions in 2018. As people are only counted if they had debt at the start or end of 2018, those people who entered into debt during 2018 but exited from debt before the end of 2018 will not appear in the table. However, as people entering into debt and exiting soon after are of less concern than people exiting and re-entering soon after, Table 3 is focused on the patterns of multiple transitions that are of most interest.

There are many unexplored questions

Research into debt to government in New Zealand has been relatively limited to date. While this report provides an overview of patterns among people with debt to MSD and IR, a wide range of questions remain unexplored. We have identified the following areas where further investigation could be insightful.

1. **Expand the data to consider more government debt**. Debt to government is owed to, and managed by, more agencies than MSD and IR: The Ministry of Justice manages debt associated with fines and charges, legal aid, and family court contribution orders; Kāinga Ora manages debt associated with unpaid rent for social housing; and ACC manages debt associated with unpaid levies and overpayment of compensation. A more complete picture of debt and debtors to government requires consideration of the debt held by as many agencies as possible.
2. **Investigate the interaction between private debt and debt to government**. Debt to government is only a small part of all debt owed by people with debt to government (Families Commission & Retirement Commission, 2008). Financial mentors and advisors consistently see clients who are in debt to government and have several different types of private debt. It follows that a complete picture of the situation of people with debt to government requires an understanding of private debt. Two possible ways this might be approached using existing government data, are expenditure on interest and debt repayments by people who responded to the Household Economic Survey (HES) by Stats NZ, and attachments orders arising from private debt.
3. **Consider longitudinal patterns in debt**. Our analysis has been focused on people with debt at the end of 2018. Understanding what makes a difference to people getting, and staying, in or out of debt requires research to consider how people's experiences and circumstances change

over time. Such a longitudinal analysis could also consider the impact of noteworthy events, such as policy changes, recessions, or the COVID-19 pandemic.

4. **Examine different debt types to MSD**. The data used for this analysis did not distinguish between different types of debt to MSD but combines overpayment and recoverable assistance debt into a single amount. Classifying the total debt by type would allow for a more detailed examination of the different ways people have debt to MSD, especially as there are different causes behind different types of debt. Financial mentors and advisors recommended this given how different types of MSD debt are handled differently. There are several options for how this classification might be accomplished depending on data and subject matter expert availability.
5. **Investigate the persistence of debt to IR**. The persistence of Income Tax, GST, and PAYE debt to IR might be considered unusual given that these debts are associated with income generating activity. One potential cause is differences in the timing of income and debt, but further investigation is required to understand why this type of debt to IR persists.
6. **Investigate non-resident debtors**. Our analysis has been limited to people with debt who are resident in New Zealand during 2018. This is the population for which we have the most detailed information. However, a significant proportion of debt owed to the government is owed by people who are overseas. Therefore, it is worth considering a dedicated analysis of these debtors.
7. **Study Child Support debt and its effects on caregivers**. Child Support debt was a significant type of IR debt in our analysis. However, IR is not the final recipient of all this debt. In some cases, Child Support payments are collected from one parent and passed on to the receiving carer. For these cases, Child Support debt could imply instability of income for the receiving carer, increasing their vulnerability and the vulnerability of the child. Future research could explore the extent to which non-payment by a non-caring parent causes hardship for the receiving carer and child(ren).
8. **Consider dynamics of debt across families and upon children.** Financial circumstances such as income, assets, and debt are often shared between members of the same household. Considering household and family relationships would allow us to understand how debt impacts on partners and children, and how changes in entitlements because of relationship changes affect debt.
9. **Assess adequacy of income against repayments.** Debt is of particular concern where making repayments leave debtors with inadequate income to meet their needs. Comparing household income against debt repayments would provide insight into hardship caused by debt. This would require the inclusion of Student Loan repayments (in addition to overdue Student Loan repayments) and could also include compulsory KiwiSaver deductions for salary and wage earners.
10. **Explore income instability and debt**. It is well established that negative events, including changes in income, have a stronger impact on people's wellbeing than positive events (Baumeister et al., 2001; Boyce et al., 2013). Debt may have a compounding effect on this pattern as repayments create a decrease in income that persists beyond the initial event that created the debt. An exploration of income instability and debt would help determine the extent to which this is a concern.

11. **Explore deductions from debtors' income sources**. Some debt repayments are arranged via direct deductions from debtors' main source of income (whether this is wages, salaries, or benefit receipt). Where people with debt already have limited, or insufficient, income these arrangements can contribute to further hardship and additional borrowing. This is a concern as an individual can have many deductions, MBIE (2018) noted an increase in the use of these deductions, and the starting value for such deductions is observed by financial mentors and advisors to often be higher than is sustainable. Further investigation could be done to assess the extent to which this practice is affecting hardship and future borrowing.
12. **Consider how changes in life circumstances affect debt.** Changes in life circumstances are known to impact people's levels of debt. Even people whose financial position has been stable and debt free for a long time may end up in debt following unexpected changes in circumstances (Townley-Jones et al., 2008; Families Commission & Retirement Commission, 2008; Families Commission, 2009; Wang, 2010; Bodsworth, 2013; Green et al., 2019). The birth of a baby, loss of a job, declining health, or a death in the immediate family are common examples that could be explored using the IDI. Determining the prevalence and magnitude of changes in debt to government associated with these types of events is important for understanding the extent to which debt is associated with specific events or financial circumstances more generally.
13. **Consider how debt affects wellbeing and mental health.** The relationship between debt and different measures of health has been explored in a variety of ways, with different conclusions depending on the population and the type of debt studied (Drentea, 2000; MSD, 2004; Ross et al., 2006; Worthington, 2006; Nelson et al., 2008; Choi, 2009; Families Commission, 2009; Fitch et al., 2011; Bodsworth, 2013; Drentea & Reynolds, 2015; Dunn & Mirzaie, 2016). Of these studies, only two address the New Zealand context – one via interviews and the other via literature review. Since these took place, New Zealand's measurement of wellbeing has improved, so there are new options for quantitative research into how debt to government impacts the wellbeing of people with debt in New Zealand.
14. **Study different impacts by gender.** Women may have some additional vulnerability to debt. Bailey (1996) identifies a pattern of "sexually transmitted debt" when women sign for a private loan while in a relationship and remain liable for it even after the relationship has broken up. Wilcox (2000) notes that women leaving abusive relationships are overly indebted because of the cost of re-establishing their lives and homes. Dunn & Mirzaie (2016) find that while women have lower debt than men, because they also have lower incomes their ratio of debt-to-income is higher. Cook et al. (2019) explores some of the impacts of debt to government on women in an Australian context and would be a strong starting point for investigating these patterns in New Zealand.

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