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Policy Discussion Paper

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Improving the affordability of New Zealand Superannuation:

New Zealand Superannuation as a Universal Basic income

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The Retirement Policy and Research Centre is pleased to publish **Improving the affordability of New Zealand Superannuation: *New Zealand Superannuation as a Universal basic income*** as a contribution to the debate on the future of New Zealand Superannuation (NZS). This paper updates the original RPRC working paper that shows how the tax system could claw-back some of the net cost of NZS from high-income recipients. See St John, S (2015) Improving the affordability of New Zealand Superannuation RPRC Working paper 2015-1.

Other publications on this topic include:

St John, S (2016) **Can older citizens lead the way to a universal basic income?** In Basic Income in the Antipodes: Perspectives from the 'Other Side of the World'. (Editors: Jenni Mays, Greg Marston and John Tomlinson)

St John, S (2016) Rethinking retirement income doesn't require superpowers, **University of Auckland Business Review, (19) vol 1 2016**

St John, S (2015) The unique New Zealand system for retirement income: Too simple or simply genius? Spotlight on Retirement Incomes Policy. Lunchtime seminar presented by the Australian Social Policy Association (ASPA) and the Brotherhood of St Laurence (BSL).Melbourne15th October 2015

St John, S (2015), **Improving the Affordability of New Zealand Superannuation**, Psych sociological Issues in Human Resource Management 3(1): 81–100.

St John,S (2015) How NZ can maintain equitable superannuation NZ herald Brand Insight, July 5th

St John, S (2015) Future proofing New Zealand Superannuation, 23rd Annual Colloquium of Superannuation Researchers7, 5-6th July 2015 CPS Research Group and the School of Risk and Actuarial Studies, UNSW, Sydney

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1. Introduction

Under existing policy settings, the costs of retirement income, health, and welfare for the rapidly growing older population lift markedly over the next decades both in absolute terms and relative to other state spending. In this context there is much debate about 'affordability' of New Zealand Super in the longer term.

'Affordability' is a loaded term. While there may be debates about whether the increasing costs are manageable, spending on New Zealand Super may incur the opportunity cost of other more desirable spending, at least at the margin. If there is a reluctance to tax or borrow for the growing cost, then the 'affordability' of New Zealand Superannuation (NZS) may be improved by tweaking one or more of three main levers:

- the qualifying age,
- the level of the payment, and
- the degree of targeting.

Lifting the age of eligibility for NZS has been the most discussed lever and is widely seen as necessary for fiscal sustainability. The Retirement Commissioner has reinforced this view in the last three three-yearly reviews of retirement incomes policy (Retirement Commission, 2010, 2013; Retirement Commissioner, 2016).

Yet this is not the only policy lever available to improve affordability, nor is it necessarily the most equitable. The third lever implies some kind of means-test, an unspeakable concept in many circles. Yet there are ways of operating a targeted policy that is efficient, effective and sensible. This Policy Discussion Paper examines the way in which the tax system could be used to provide an increased claw-back of some, or all, of the net cost of NZS from high-income recipients without destroying the universal character of the pension or making it unduly complicated. By doing so, the pressure on the working age population can be reduced, and perceptions of intergenerational equity may be enhanced.

A basic income for those over 65 that aligns the single sharing and married rates, with a tax claw-back has the advantage of being capable of delivering meaningful savings immediately to help address the needs of the working age population without increasing poverty rates among the old. It could be a prototype to show how a basic income works with extension to other groups over time.

2. New Zealand Superannuation

Among developed countries, New Zealand has taken a unique approach to the provision of retirement income that has put universal New Zealand Superannuation (NZS) at the centre. As a basic income, provided on residency grounds, not contributions or work periods, it has been outstandingly successful, along with high rates of home ownership, in preventing 'after housing costs' poverty among most of those over 65.

The over-65year olds in New Zealand have low rates of significant hardship when compared internationally:

> ***…older New Zealanders have a much lower deprivation rate (3%) than their counterparts in most European countries. (Perry, 2017, p. 186)***

NZS does not discourage saving or working since it is not income or asset-tested, and there is no requirement to retire from work. Table 1 shows the three different 2018 NZS rates and the amounts retained after-tax by individuals who are taxed at the lowest tax rate, and those taxed at the top rate.

Wealthy recipients of NZS may still be in well-paid work and/or have other large private incomes and assets. Some of this group may have accumulated their wealth with tax-free capital gains and may have gained substantially from the 2010 income tax cuts and lower Portfolio Investment Entity (PIE) rates of tax. If their NZS is taxed at the top tax rate, perhaps because they still work full-time, their net NZS is still more than the net Jobseeker Support benefit rate paid to an unemployed adult (see Table 1).

NZS is price and wage-linked. When the married couple rate taxed as primary income and CPI adjusted falls below 66 per cent of the average wage after tax, it is adjusted to this floor. The sharing and living alone rates are then set at:

- 60 per cent of the married couple rate for single people sharing accommodation
- 65 per cent of the married couple rate for single people who are living alone

Table 1: New Zealand Superannuation (NZS) and Jobseeker Support rates at 1 April 2018[2]

Category	**% Net average wage**	**Annual rate**	**Annual Net**	**Annual Net**
		NZ$ (gross)	Primary Tax	33% Tax
NZS Single, living alone	43%	$24,078	$20,845	$16,132
NZS Single, sharing	40%	$22,129	$19,242	$14,826
NZS Married person or partner in civil union or de facto relationship (each)	33%	$18,240	$16,035	$12,221
Jobseeker Single, 25+ years		$12,511	$11,198	
Jobseeker Married, civil union or de facto couple (without children) (each)		$10,425	$9,331	

[2] Source: Work and Income website: http://www.workandincome.govt.nz/

3. Fiscal pressures

Based on the 2016 Long Term Fiscal Forecast, Table 2 shows the associated fiscal pressures from an ageing population, including healthcare costs.

Table 2. Projections of government expenses percent of GDP current settings (The Treasury, 2016)

	2015	2030	2045	2060
Healthcare	6.2	6.8	8.3	9.7
New Zealand Superannuation (NZS)	4.8	6.3	7.2	7.9
Education	5.3	5.4	5.5	5.7
Law and order	1.5	1.4	1.4	1.4
Welfare (excluding NZS)	4.2	4.5	4.7	4.7
Other (excluding finance costs)	6.3	6.7	6.7	6.7

Working age 'welfare' benefits are indexed to inflation alone so that over time the gap between these and NZS continues to grow. The combination of NZS and healthcare expenditure rises from 11% in 2015, to a projected 17.6% under current policy settings. This implies, ceteris paribus, over time as relatively more gets spent on ageing cohorts there will be relatively less for the working age cohorts. Many of working age and their families have much higher rates of deprivation and income poverty so that it is likely there will be pressure for changes. Either these changes can be planned for and the fiscal pressures managed or there will be ad hoc knee-jerk ill-thought-out changes in response to the perceived crisis.

In the next two decades increasing numbers of retirees will reach retirement with ever larger, subsidised KiwiSaver lump sums and qualify for NZS, which under the pay-as-you-go system must be funded by current taxpayers.

At the same time, current taxpayers are contributing to the New Zealand Superannuation Fund (NZSF). This fund has been accumulating funds since 2003. Regular contributions were suspended in 2009 and restarted in 2018. The size of the fund in June 2018 was $39.37 billion.

Capital withdrawals from the NZSF to help cover the cost of NZS begin from around the early 2030s. The most recent Budget 2018 NZSF projection suggests that, in the year 2040, for example, the NZSF will contribute close to $1 billion to cover around 8% of the projected cost of NZS as a percentage of GDP. While future taxpayers will not have to contribute as much in tax payments, from a real resource point of view, if more is allocated to the ageing population then, there will be a smaller slice of the pie for the working age population. In other words there are opportunity costs.

In the meantime, the recent resumption of allocations from the budget to the NZSF ask the working age population to not only fund the existing pensioners but also pay for some of their own, perhaps less generous, future pensions. The contributions may preclude other useful government spending or redistribution. Evidence that SAYGO schemes improve the size of the pie itself is scarce (Barr, 2001; Barr & Diamond, 2009). Accounting for government spending is not affected by where the spending is financed from so that the fund does not help the government keep within its fiscal caps or avert pressure from competing demands.

The 65+ dependency ratio (the number of people aged 65+ per 100 people aged 15–64 years) was about 20 per 100 in 2010 or 5 people of working age for each person over 65. This is projected to fall to 2.8 people of working age per person over 65 by 2032, 2.5 in 2050 and 2.1 in 2068.[3] Figure 1 shows a simplified visual picture of the scale of demographic change. Figure 2 shows the projected growth in expenditure on NZS is driven not only by demographic change but by real increases in per person expenditure (NZS expense rises faster than numbers).

Figure 1. Structural Ageing in New Zealand 2010 to 2060

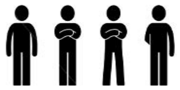
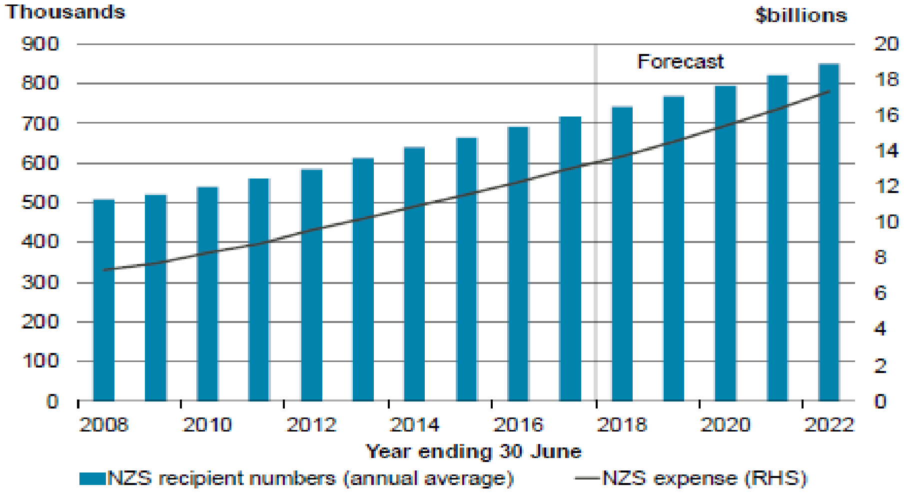
	Projected ratios of different age groups	
	15-64 years	65+ years
2010		
2020		
2030		
2060		

Figure 2. Growth of NZS recipients and expenses (The Treasury, 2018)



[3] National Population Projections: 2014(base)–2068.
http://archive.stats.govt.nz/browse_for_stats/population/estimates_and_projections/NationalPopulationProjections_HOTP2014.aspx

Future pension payments may be reduced through the use of one or more of the three main levers: the age of eligibility, the level of payments, and means-testing. While raising the eligibility age is often discussed as if it were the only option, a carefully considered mix of the three levers might most effectively maintain the best features of NZS. The first two levers are briefly discussed next, followed by a more detailed proposal for use of the third lever: income-testing. This third lever has been seldom discussed seriously in New Zealand since the late 1990s when the surcharge was abolished.

4. Lever 1: Increase the qualifying age for NZS

The New Zealand Treasury (2013), amongst other options, investigated the possibility of raising the eligibility age for NZS. This may appear inevitable in the face of an ageing population and ever improving longevity: average life expectancy for those aged 65 years in 2012-14 is 18.9 years for men and 21.3 for women

Much of the gain in life expectancy at birth is attributed to the gains made at older ages as Figure 3 shows. A woman aged 90 today can expect to live on average another 4.6 years, a 60% increase since 1950-52[4]. Medical technology is likely to see further increases in life expectancy at older ages. By the time today's 25 year olds reach 65, it is expected they will live another 25 years for men and 27 years for women on average (Commission for Financial Literacy and Retirement Income, 2013 p.36).

Figure 3. Age contribution to increase in life expectancy at birth[i]

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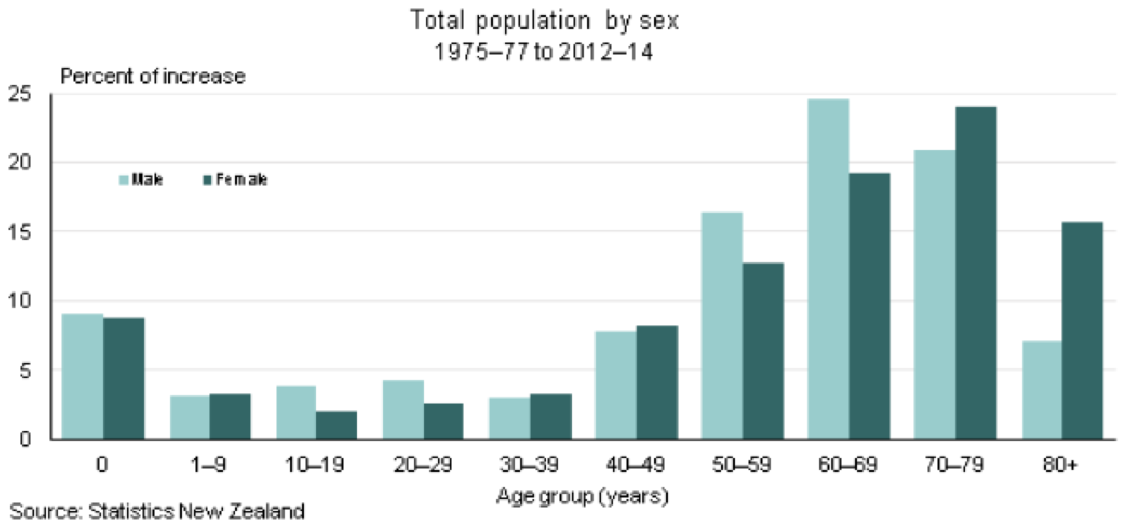

While the state pension age was increased rapidly, with little warning, by 5 years over the period 1992-2002, the current consensus is that raising the age needs to be well-signalled. The qualifying age could be raised gradually to reflect improved longevity but the long lead-in times likely to be needed preclude immediate savings. The recommendation from the 2016 Retirement Review[5] was to increase the age of NZ Super eligibility to 67 over eight years between 2027 and 2034. The National government found even that an

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[4] See http://archive.stats.govt.nz/browse_for_stats/health/life_expectancy/NZLifeTables_HOTP12-14.aspx

[5] See https://www.cffc.org.nz/reviews-and-reports/retirement-income-policy-review/

insufficient lead in-time and sought a mandate at the 2017 election for a 20 year notice period with a rise to 67 phased in over four years between 2037/38 and 2040/41.

> ***Giving an extended period of notice would ensure families and individuals will have time to adapt to these changes. (English, 2017)***

The Labour-led coalition elected in 2017 opposed to the raising of the age and Prime Minster Jacinda Ardern is on record promising to resign rather than raise the age.[6]

> ***It wasn't irresponsible to leave the age of eligibility at 65, despite New Zealand's growing population, she said. It's irresponsible not to save for it. … Ardern said she was moved by people in hard labouring jobs who said they could not continue working beyond 65.*** [7]

It is indeed an important disadvantage of relying on raising the age of eligibility to improve NZS sustainability that many people with physically demanding jobs are disabled or sick by age 65 and unable to work further. Others lack the required skills or education to meet market requirements. The cost saving from raising the age would have to take account of the costs of supporting people who could not work past 65 and would require another form of state assistance. The use of conventional welfare benefits with stringent income tests may mean those who cannot continue to work exhaust their private retirement resources before reaching the new higher age of eligibility.

Another consideration is that the voluntary work of the retired population has an economic and social value. Grandparents make a large contribution to the care of their grandchildren and other significant community activities. An entitlement to a basic income at age 65 offers the option for some to retire from paid work to do voluntary work.

Nevertheless, New Zealand is at risk of being out of step internationally. In Australia for example, the increase to age 67 for the Age Pension began in 2017 and will be achieved over only six years, by 2023, with talk of a further extension to age 70 by 2035.[8] Rather than aligning the age with Australia, New Zealand's agreement with Australia has been revised so that:

> ***… in order to claim the Australian pension or New Zealand superannuation under the agreement, an individual must have reached the higher of the pension eligibility age in both countries, regardless of the country in which the claim is made***[9]

The reality is that both major political parties have shown a lack of political will to signal a timetable for a rise in the age.

In summary, some raising of the age may prove inevitable to reflect improved average longevity, greater participation in the workforce and to align with other countries such as

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[6] https://www.stuff.co.nz/national/politics/96496437/jacinda-ardern-pledges-to-quit-rather-than-raise-nz-super-age
[7] ibid
[8] In the United Kingdom, Under the Pensions Act 2011, the State Pension age for women increased to 65 by December 2018, when the State Pension age for both men and women will start to increase to reach 66 by October 2020. Unlike the UK, where access to the State Pension is based on a person's National Insurance contribution record, New Zealand only requires 10 years residency, with 5 of those years after age 55.
[9] https://www.msd.govt.nz/about-msd-and-our-work/publications-resources/regulatory-impact-statements/revised-social-security-agreement-with-australia.html

Australia. However, if the only way to do this politically is to give a long lead-in time, there will be little or no potential for immediate savings from using this lever.

5. Lever 2: Decrease the amount of NZS

If raising the age cannot deliver needed savings for the foreseeable future that leaves the other two levers. The second lever to reduce the cost of NZS is to reduce the payment level. One approach to achieving this is to change the indexation basis for NZS. Projections show that fiscal savings from indexing the annual payment of NZS to inflation rather than wages would lead to significant long-term savings (The New Zealand Treasury 2009, pp. 57-58). The real spending power of NZS would be protected but the rate of NZS would fall relative to average wages.

However, the baby boomers now aged 49-69 are very diverse in both health status and resources. Many are not well-off, and some have lost money in New Zealand's finance company meltdown and/or the leaky home fiasco. Others have suffered through divorce and ill health. As Perry (2017, p 167) reports, the majority of older New Zealanders are very dependent on NZS and other government transfers for their income:

> ***The great majority of older New Zealanders (aged 66+) are very dependent on NZS and other government transfers for their income. 40% have less than $100 pw from other sources, 40% of singles have no other income, the next 20% have on average around 70% of their income from NZS and other government transfers… [Couples] generally have higher per capita non-government income than do those in single person EFUs.***

The level of NZS needs to be high enough to prevent hardship and it does that for most, particularly for those who are home-owners, though some pensioners clearly still struggle. For a healthy retirement that allows participation in society, O'Sullivan & Ashton (2012) calculated that about another $8,000 net a year per person (around $11,000 in 2018 dollars) is needed. This suggests that the current level of NZS as a long-term support for people over 65 with no other income is far from generous.

Data from MSD show that expenditure of those over 65 on supplementary assistance payments for accommodation disability temporary additional support and special benefit rose from $256 million in year ended March 2010 to $304.3 million the year ended March 2016, (Ministry of Social Development, 2016). Therefore, reducing either the level of NZS or the relativity to wages over time may undermine the desirable achievement of low hardship rates for the 65+ group and/or further increase the expenditure on supplementary assistance.

Another approach to decreasing the level of NZS is to rationalise the three different rates for NZS. As shown in Table 1, there is a net married rate, a single sharing rate at 60% of the married rate, and a single living alone rate at 65% of the married rate. As previous Retirement Commission or Periodic Report Groups Reviews (eg, 1997, 2007, 2010) have noted, these differences are hard to justify.

Rationales from the MSD (2016) are:

> ***Couples living together in a married, civil union or de facto relationship are paid less than double the single rate because it is considered that they can take advantage of certain economies of scale that individuals in shared***

accommodation cannot. Thus, the rate paid to a married person is less than that paid to a single person. For example, a married couple:

- ***could be able to enjoy lower accommodation costs than two single people***
- ***could be able to have their personal household effects on one insurance policy whereas two single people who are sharing accommodation would be more likely to have separate insurance costs totalling a higher amount***
- ***could share vehicle expenses, while two single people may be more likely to have their own individual transport and vehicle costs***
- ***could generally share meals, while two single people sharing accommodation may not have merged their lives to that extent.***

None of these rationales are particularly convincing or substantive. It is fair to say the different rates are historical and they are unsuited to a modern world of flexible living arrangements and relationships (St John, MacLennan, Anderson, & Fountain, 2014). There is a case therefore to pay the same flat rate to everyone, set somewhere between the married person and single sharing rate, and have an additional means-tested payment where high housing costs are demonstrated.

The elimination of the living alone rate would reduce the cost of NZS somewhat although it may create additional complexity for some. The means-tested Accommodation Supplement is currently already accessed by 5.8% of those over 65. (Ministry of Social Development, 2016). This payment could be further adapted for the over 65 group to assist with high housing costs independently of whether superannuitants are sharing or living alone.

As shown in Table 3 around 26% of superannuitants live alone and possibly the majority would still need accommodation assistance. Nevertheless, savings here can be made without affecting the living standards of those dependent solely on the pension. Whether or not there is a separate rate for living alone, the alignment of the married and single rates appears justified.[10] To save costs without direct cuts the single sharing rate could be frozen until the married rate catches up with normal annual adjustments.

Using the data in Table 3 and the rates of NZS in 2016, paying everyone the married rate reduces the gross cost by around 10% and the net cost by at least 9%. If everyone was paid the single sharing rate, the gross cost increases by around 9% and the net cost by 9%.

[10] The Retirement Commissioner's Review (2010, p. 13) endorsed the alignment of the single sharing and married person rates In the interests of simplicity it suggested that the living alone rate remained unchanged.

Table 3: NZS and Veterans' Pension recipients as at 31 March 2016

	NZ Super		Veterans		
	female	male	female	male	total
Married, civil union, de facto couples, both qualify	184,596	233,355	1,331	2,717	421,999
Single sharing	59,746	29,696	1,010	501	90,953
Single living alone	120,267	59,277	2,238	1,219	183,001
Non-qualified partner	11,221	1,615	166	0	13,002
TOTAL	375,845	320,958	4,745	4,437	705,985

Source: MSD (2016)

In summary, apart from modernising and improving simplicity by aligning the rates of NZS, there appears little justification for reducing NZS costs by lowering the level of NZS payments as this approach entails the risk of increasing old age hardship.

6. The third lever: a means test

This leaves the 'third rail'[11] of superannuation policy: some form of means test. This has been a politically unattractive option because of New Zealand's history, summarised below. Yet this Working Paper suggests there is a way to apply an income test that could be seen as fair and acceptable with enough useful savings to take the pressure off relying solely on raising the qualifying age or reducing the rate of NZS as the principal levers.

In Australia the means test on the Age Pension takes account of both income and assets (see Appendix, St John, 2013). It is likely that New Zealanders would find that a step too far. This paper concentrates on an income-based means test, but that does not preclude an attempt to include as much imputed income from assets as feasible over time.

History of income tests on NZS for high income earners[12]

When the National government introduced 'National Superannuation' in 1977, it was much more generous than the previous age pension arrangements. Between 1977 and 1985, National Superannuation was fully universal, as now, and while the relativity to the average wage was reduced from its initial 80% for a married couple, it was always higher than the rate for 'welfare' benefits.

While there was no income test for National Superannuation, the top personal tax rate was 60%, and then 66% between 1982-86 when a 10% surcharge was imposed. This meant that top income retirees could retain net, only 34-40% of the gross pension with the tax system effectively clawing 60-66% of it back from those who were still in well-paid

[11] *Touch it and you die*. The phrase 'third rail' is a metaphor in politics to denote an idea or topic that is so 'charged' and 'untouchable' that any politician or public official who dares to broach the subject would invariably suffer politically. The third rail in a railway is the exposed electrical conductor that carries high voltage power. Stepping on the high-voltage third rail usually results in electrocution. The use of the term in politics serves to emphasise the 'shock' that results from raising the controversial idea, and the 'political death' (or political suicide) that the unaware or provocative politician would encounter as a result. (Wikipedia).

[12] For more detail see St John (2013).

jobs, or in receipt of substantial other income. Universal pensions and progressive taxation went hand in hand.

In 1985, in a very controversial move and despite its pre-election promise not to reduce the state pension, the Labour government imposed a surcharge of 25% on all other income over an exempt amount. This surcharge had the effect of recovering the full amount of the state pension from high earners. When the top tax rate was reduced to 48% in 1986 and later to 33% in 1988, the surcharge effectively acted as a substitute for more progressive taxation for those in receipt of the universal pension.

The National government, elected in 1990, despite promising to repeal the surcharge, instead effectively intensified means-testing of the pension. The 1991 Budget announced that NZS was to be made into a welfare benefit, with the same strict income test as applied to other welfare benefits (St John, 1992). The policy was deeply unpopular and was abandoned before it began. In a policy U-turn, the surcharge was again reinstated, but at a more stringent level. However, by its last year, 1998, the threshold of exempt income for the surcharge had become more generous and the rate of clawback was only 20%. By that point, only 16% of people were affected and only the top 5% of earners had all of their net NZS clawed back (Periodic Report Group, 1997).[13]

While the surcharge was complicated and contentious, it performed a useful cost-saving function without imposing hardship. Some better-off retirees did not bother claiming the state pension, and most of those still in high-paid work received little benefit after-tax and surcharge.

The fiscal cost of abolishing the surcharge in 1998 was estimated to be $400m or 10% of the net cost of NZS. This indicates that the surcharge created a 10% fiscal saving on the net cost of NZS (Periodic Report Group, 1997 p48). By the end of the 1990s, the state pension was again fully universal and for a brief time, the better-off paid only a maximum of 33% tax on it. When Labour was elected in 1999, the top tax rate was raised to 39%, but even so, the top earners retained 61% of the gross NZS.[14]

On 1 October 2010, the National government reduced the top personal tax rate back to 33%. Figure 4 shows how the current disposable income of a married superannuitant compared to an ordinary taxpayer. In 2018, if there is no other income, the gross amount of NZS is taxed at the lowest tax rate and net disposable income is $16,132 for a married person (see intercept on vertical axis in Figure 4). High-income superannuitants retain at least 67% of their gross NZS: at all high income levels, a married NZS recipient receives $12,220 more disposable income than other high income taxpayers.

In the context of the overall population, the net $12,221 NZS paid to the wealthiest married superannuitant significantly exceeds the net Jobseeker Support of $9,334 (annualised) paid to an unemployed married adult with no other income or assets. The current net gain to single sharing and single living alone wealthy superannuitants is even greater: $14,826 and $16,132 respectively compared to the single Jobseeker Support of just $11,198.

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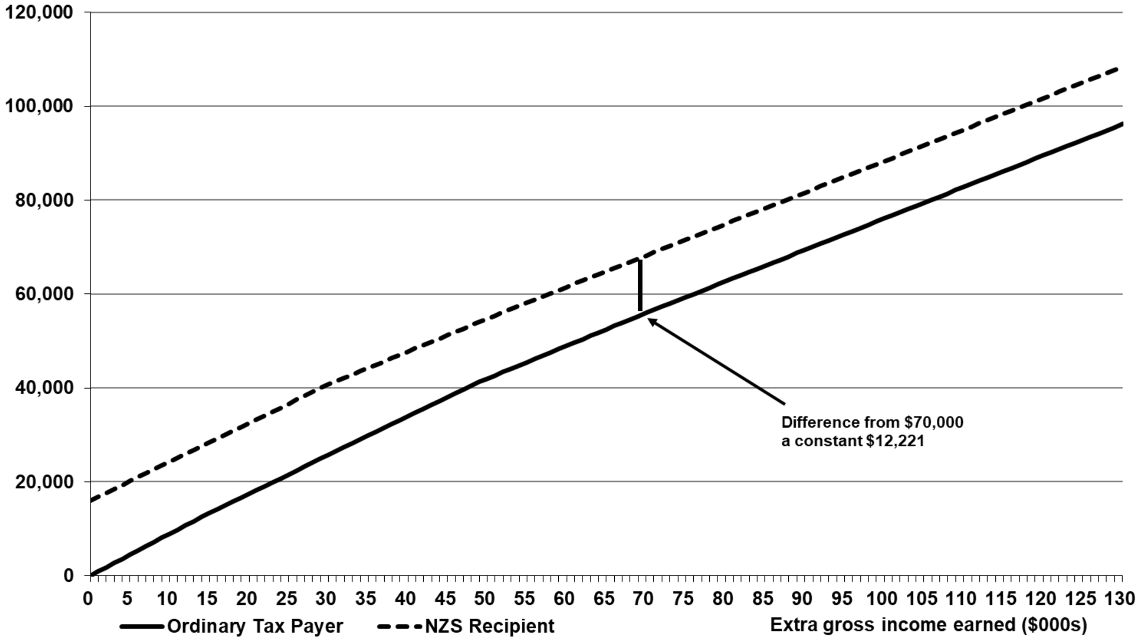
[13] In some cases, the surcharge was avoidable for those not on a salary; some commentators called it a 'voluntary tax'.

[14] The increasing prevalence of tax avoidance in the decade following the increase in the top marginal personal tax rate suggests that many top income earners would have retained more than 61%. See Inland Revenue Department (2008) for a discussion of this trend.

Figure 4: **A married superannuitant: disposable income with NZS (2018).**

Disposable income



Using the tax system

Finding a way for the top line to meet the bottom line in Figure 4, by reducing the generosity of net NZS at the top end is one approach to cost saving. It may reduce the degree to which the other two main levers of raising the qualifying state pension age or reducing the rate of payment must be employed. As suggested above, both of these mechanisms may impact unfairly on those least able to manage. In contrast, only those with significant 'other' income will be affected by using this tax lever for reform.

To 'make the lines meet' in Figure 4, a 'negative income tax approach' could be used. In the past, when the surcharge operated, such an approach was suggested as a sensible rationalisation (St John, 1991) and discussed further in St John (2013). This reform option means that the flow of tax to the IRD on gross NZS and other income, and the surcharge paid by a superannuitant, is offset against the gross NZS payment from the IRD. Money would flow one way only. The value of this approach is a simplification compared to the very confusing way the surcharge operated.

This Working Paper however, suggests a 'basic income' approach may be simpler to implement and understand. The basic income, named here the 'New Zealand Superannuation Grant' (NZSG), would be paid to all superannuitants as a weekly non-taxable grant. Then, for any other gross income, a separate tax scale would apply for each additional dollar. [15] For illustrative purposes it is proposed that the NZSG is the same for everyone (married; single sharing; single living alone) and any extra supplement for high

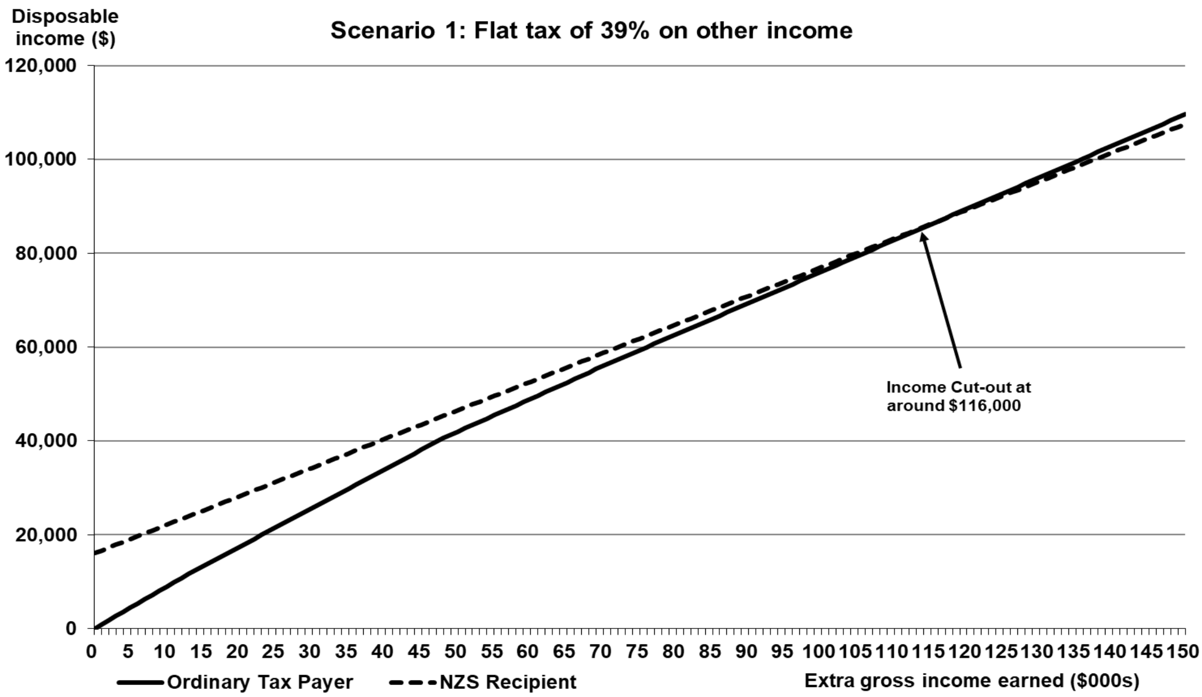
[15] Paying the pension as a non-taxable grant and a progressive tax on other income makes the pension analogous to how universal payments such as the old Family Benefit were traditionally viewed. It fits the labour government's ideas of progressive universalism, introduced with Best Start, Winter Energy Payment, tertiary study fees.

housing costs would be part of the welfare system.[16] While the NZSG could be set at any level, Figure 4 shows it as equal to the current (after-primary tax) rate of NZS: i.e. $16,032 for a married person.

A break-even point exists (Figure 5) where the NZSG, plus extra income from work or investment, net of the new tax rate, is equal to the disposable income of an ordinary taxpayer paying the usual rates of income tax. This point is effectively where the gain from the NZSG has been effectively clawed back or offset by the new tax. Any over-payments of tax above break-even or cut out point could be claimed back at the end of the income tax year.

This proposal is technically different to the surcharge of 1985-1998 because the NZSG payment is not part of taxable income. The surcharge was exceedingly complex, applying until the net advantage from NZS was equal to the surcharge paid and could mean different end points (when NZS had been fully clawed back) for different taxpayers. Few could follow the calculations. The surcharge was also perceived as an additional, discriminating tax that could result in marginal rates of tax exceeding 50% (see St John, 1991 for further discussion of how the surcharge worked).

Figure 5: Scenario 1. Flat tax of 39% on other income



NZSG has the further advantage that as a non-taxable grant it is consistent with receiving a private annuity that is also not considered to be taxable income under the TTE[17] regime for saving for retirement that New Zealand has adopted. If future-focussed decumulation policies require encouraging the translation of KiwiSaver lump-sums into an annuity or

[16]As shown in Table 3 around 180,000 superannuitants get the single, living alone rate. Of these, many would continue to require a supplementary payment to reflect higher costs. A suitably modified accommodation supplement may be required.
[17] TTE refers to the tax regime New Zealand has adopted for all saving contributions made out of after tax income (T), earnings taxed in the fund (T), and withdrawals tax-free (E).

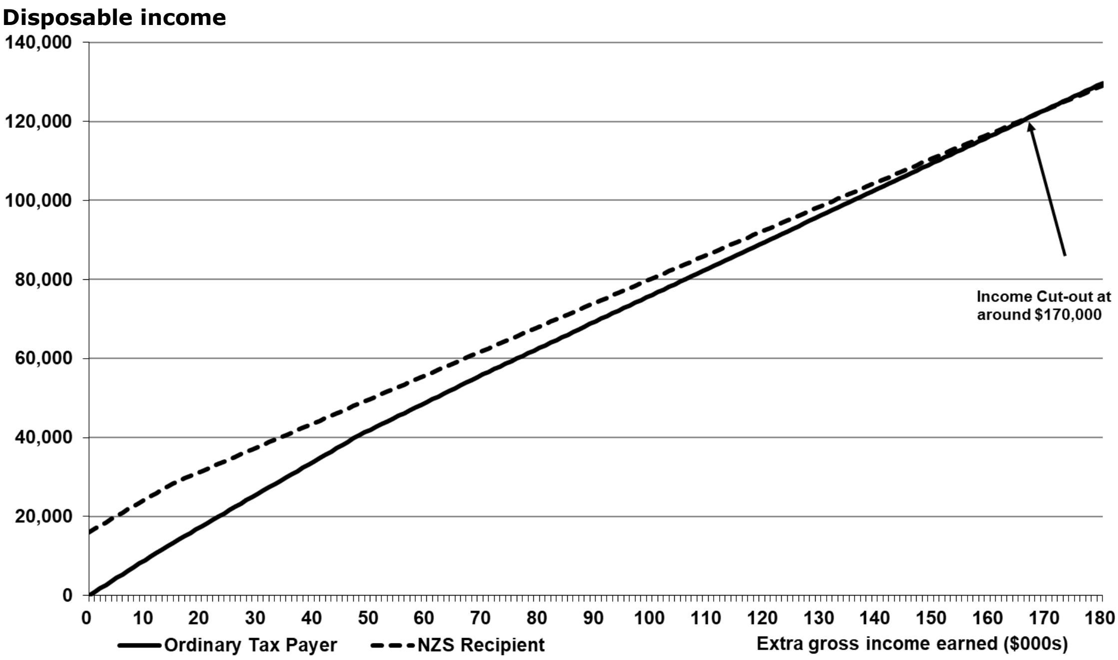
add-on to NZS, the NZSG approach provides a consistent treatment. It is also consistent with the 2018 policy of adding a universal non-taxable opt out Winter Energy Payment.

Under the NZSG, an individual could either opt for the NZSG and the new tax scale for all other income or wait until end of the tax year and take any NZSG due as a rebate. About 40% of retirees who have no additional income would notice no difference. For high-income earners, whether that income is earned from paid work or from investments, the new tax scale would not remove their right to the basic income floor of the NZSG if other income reduces or disappears. Thus, the NZSG is the prototype of a basic income that provides automatic income security as of right.

The break-even point is very sensitive to the tax rate chosen, or in the case of a tiered tax schedule, to the highest rate of the schedule. An example scenario is depicted in Figure 5 with a flat tax at 39% on other income. The breakeven point occurs when the NZSG recipient's 'other' income is $116,000. If a recipient of NZSG receives more than $116,000 then it would be rational for them to either, forego the NZSG and be treated as an ordinary taxpayer, or to apply for a refund of any tax overpaid on income above the cut out at the end of the year.

Given that for 80% of NZS recipients, NZS provides the majority of their income a tiered structure may be useful to give some relief to those with limited extra income. Figure 6 illustrates a tiered scenario; with rates of 17.5% for the first $15,000 of other income, and 39% on each dollar above that. The break-even point in this case would be much higher than in Figure 6, at $ 170,000

Figure 6: Scenario 2. Two-tiered rate of 17.5% (for first $15,000 earned) and 39% above $15,000.



As with the flat rate example, at an end-of-year adjustment, a rebate would arise if an individual earned less income than the break-even or cut-out point, and did not choose to take weekly payments of NZSG. It is likely that some wealthy people would not bother to receive the NZSG, as happened with the surcharge, however they would have automatic entitlement if they needed it at any point.

The breakdown of annual losses in disposable income relative to current settings is shown in Table 4 for the two scenarios depicted in Figures 5 and 6, at bands of extra income earned. Under a single tax rate of 39% there are losses for people with small amounts of additional income, but these may be compensated in other ways, or minimised as in the two-tiered tax approach of scenario 2.

Table 4: Losses in annual disposable income (rounded) relative to current settings

Other taxable income	Scenario 1	Scenario 2
$5,000	$1,068	$0
$10,000	$2,143	$0
$15,000	$3,218	$0
$20,000	$4,293	$1,068
$25,000	$5,368	$2,143
$50,000	$8,213	$4,998
$75,000	$9766	$6,541
Around $116,000 cut out for scenario 1	$12,226	$9,001
Around $170,000 cut out for scenario 2		12,241

Another possibility is to adapt scenario 2 to minimise losses on lower incomes by taxing more income at only 17.5%, followed by a tax of 39%. The price is a higher cut-out point than $170,000. Other scenarios can be explored. For example, if the NZSG tax scale was: tax of 20% on other income up to $20,000, then 33% to $40,000, and then 45% above that, the cut-out point is $120,000.

Features of the New Zealand Superannuation Grant

The NZSG would be far less complicated than other forms of clawback such as the surcharge, a welfare-type means-test directly on NZS, or even a negative income tax approach. As with any targeting regime, an increase in the degree of targeting will result in some avoidance activity. New Zealand's past experience shows that opportunities and incentives for tax avoidance were features of the history of the surcharge. It must be noted here however that the NZSG proposal is not nearly as harsh as the welfare means-test that applies to rest home care subsidies or welfare benefits. It provides a gentle clawback using the principle of progressive taxation which, it can be argued, is the natural counterpart of universal provision. The NZSG is consistent with the current arrangements that do not require any retirement test.

Another concern may be that the NZSG would need to be carefully packaged so as not to adversely influence the decision to save. This of course would be much more of a problem with a full means-test including an asset-test rather than the proposed income-test operated through the tax system.

The integrity of the NZSG approach would require that the top PIE rate be aligned so that for the two scenarios given, the top NZSG PIE rate would be 39%. Alternatively, gross PIE income could be included as 'income' to be taxed at 39% less the tax already paid by the PIE on the member's behalf (similar to the imputation regime).[18] The same argument applies to income earned through trusts, companies and overseas vehicles.[19] Treatment of current annuities and defined benefit pensions raise other complex but not insoluble problems. In the past, such annuities were apportioned 50% as income for surcharge purposes. There may also be opportunities. If for example there was desire to encourage annuitisation, an annuity to a limited value could be added to the NZSG grant instead of apportioned 50% as income as a means of making it attractive to middle income people in the absence of compulsory annuitisation (St John, 2016).

Costing

The fiscal saving possible by using the NZSG depends on the decision about the alignment of rates and critically on the tax rates chosen. If the degree of targeting was similar to the surcharge as it operated at the end of the 1990s, savings of the order of 10% or more could be expected.

Table 5 Projected costs of NZS (The Treasury, 2018)

($millions)	2018	2019	2020	2021	2022
	Forecast	Forecast	Forecast	Forecast	Forecast
New Zealand Superannuation	13,703	14,539	15,439	16,333	17,353

Table 5 suggests that for the 2018/19 year, a surcharge equivalent would produce saving of $1.45 billion in gross terms or around $1.2 billion net. It has not been possible for Treasury to cost the options in this paper for the 2018 figures.

The latest costings available are those in the original affordability paper (see St John, 2015). These costings by the New Zealand Treasury for 2010/2011, 2011/2012 and 2012/2013 for scenarios one and two, were presented as a percentage of aggregate net NZS expenditure under current NZS regime in that year. Scenario One assumes the alternative tax regime is a flat tax rate of 39% on non-NZS taxable income. Scenario Two assumes a tax of 17.5% on the first $15,000 of taxable income and 39% above that.

Costings were run over three consecutive March-end years 2010/2011, 2011/2012 and 2012/2013 to ensure consistency.

The assumptions used by the Treasury were that:

- All eligible people elect the option that delivers the higher disposable income, even if only by $1 per annum. In other words, the only people who turn down the NZSG are those whose non-NZS income exceeds the 'break even' point, where they would end up with the same disposable income under either option.
- There are no behavioural responses, in particular, no change to labour supply or average hours worked by eligible superannuitants.

[18] There is a case for using a consistent definition of taxable income for everyone, not just superannuitants. Thus extensions to the definition of taxable income, such as apply in Working for Families, might capture other possible avoidance activity.
[19] The issues around the need for an overall reform of these vehicles so that they are taxed at the individual's appropriate marginal tax rate are explored in Chamberlain & Littlewood (2010).

The true cost to the government of providing the public pension is the aggregate net (after-tax) NZS expense. Relative to its value in each year, costed under the NZS and personal tax regime existing in that year:

- Scenario One (39% tax on all other income) produced overall savings of 22%, 23% and 26%, in the 3 consecutive years respectively; and
- Scenario Two (17.5% of first $15,000, 39% on balance) produced overall savings of 14%, 16% and 18%, in the three consecutive years respectively.

These figures assumed an immediate adjustment of all rates to the married rate of NZS. In practice the alignment of the rates would be phased in over time and the savings would increase more gradually. The costings also take no account of the additional supplements required by many of those living alone with high housing costs. Over time, as the baby boomers swell the numbers over age 65, savings will likely increase. This will be reinforced in Scenario Two if the threshold for the second tax rate is unadjusted for inflation.

The rate of NZSG could be set anywhere between the single sharing and married rate. If the rates were immediately aligned to the single sharing rate by raising the married rate there would be much less saving. However, there would be little justification for taking this more expensive route to align the rates. A range of costings for each tax scenario using different assumptions about the rate of the NZSG was summarised in Table 6.

Table 6: Costing the savings of using different assumptions for the rate of NZSG paid to all NZS-eligible individuals.

Option a. The NZSG is the net married person annual amount for all		
Tax year	**Scenario One**	**Scenario Two**
2010/11	22%	14%
2011/12	23%	16%
2012/13	26%	18%
Average of three tax years	**24%**	**16%**
Option b. The NZSG is the net married person annual amount for all married individuals and the net single sharing NZS annual amount for all single individuals		
Tax year	**Scenario One**	**Scenario Two**
2010/11	16%	8%
2011/12	17%	9%
2012/13	20%	12%
Average of three tax years	**18%**	**10%**
Option c. The NZSG is equal to the rate that the individual is eligible for under current system i.e. married person, single sharing or single alone rate		
Tax year	**Scenario One**	**Scenario Two**
2010/11	13%	6%
2011/12	14%	7%
2012/13	17%	10%
Average of three tax years	**15%**	**8%**

The comparisons in Table 6 suggested that even if the single and married rates are not aligned so that no-one has a reduction in their net payment (Option c in Table 6), worthwhile savings are possible even with Scenario Two that provides the more gentle clawback.

If the living alone rate is reduced to single sharing rate (Option b in Table 6), more savings are possible (3 and 2 percentage points under Scenario One and Two respectively) but there are extra costs of accommodation assistance to account for. Options a and b have no separate living alone rate. When the single sharing rate is eliminated in Option a savings are 6 percentage points higher.

The large saving under either tax scenario suggested by Option a would only materialise once the married and single rates were aligned to the married rate, and this may take some time. Nevertheless, this may be the appropriate longer term strategy.

Conclusion

This preliminary analysis suggests that the combined approach of: adopting the two-tiered tax scenario, freezing the single sharing rate so that over time there is alignment with the married rate, eliminating, will give worthwhile savings of around 10% of net NZS, or more if the living alone rate is eliminated, and supplementary assistance for accommodation costs increased where needed. More up to date costings will be helpful.

It is clear that fiscal savings are possible without imposing hardship or affecting those with modest amounts of additional income and can be achieved relatively sooner compared to raising the eligibility age with an appropriate lead-in time. The inevitable increase in the eligibility age to reflect improved longevity could be more gradual which would reduce the disadvantages for individuals who, given the arduous nature of their employment, may expect to retire from work earlier than others.

The proposed NZSG option that simplifies the treatment of relationship status by paying a single rate of NZSG for all – a tax-free grant equal to the net amount now paid to a married person is most effective at saving costs although additional payments for those with high accommodation costs would be required.

The NZSG approach does not unduly penalise extra income, depending on the parameters. Given that for the bottom 60% of NZS recipients, as measured by gross incomes, NZS payments comprise at least 80% of their total income, and for the bottom 80% of recipients it comprises at least 55%, the majority of over 65s will face little if any reduction in disposable income, especially in scenario Two.

As with any targeting regime, efforts to maximise returns will lead to some tax planning activity. However, those who should be paying the top rate of tax of 33% already have an incentive to reduce their taxable income and some already pay little or no tax. It is debateable as to whether a marginal 39% tax rate would substantially change behaviour but there is the possibility that it could provide the impetus for a full investigation into, and exposure of, current and potential tax avoidance activities by wealthy individuals. Under the proposed NZSG, a wealthy person would have to reduce taxable income to under $15,000 to avoid the 39% rate completely.

Where income is in PIE funds the tax regime should ensure that individuals declare their PIE income and tax paid as they do for share dividends so as to pay tax at the appropriate marginal tax rate.

The proposed change would decrease the fiscal cost of NZS through reductions in payments to high income superannuitants and thus allow more spending or lower taxes for younger New Zealand taxpayers. It may therefore lead to improved perceptions of inter-and intra-generational equity.

If it is agreed that the cost of net NZS should be reduced by increasing the degree of targeting, using the tax system and the proposed NZSG has a number of potential advantages compared to other targeting regimes:

- **Relatively simple**: Simplicity in administration when compared to other income tests and the old surcharge.
- **Universality is maintained.** The grant is paid irrespective of other income as a basic income grant
- **Flexibility**: The choice of tax rates for other income allows flexibility and clarity in reaching a desired breakeven point and required fiscal savings. It also provides choice and clarity for very high-income superannuitants who are not denied access to the basic income floor of NZSG if their situation changes.

More work is required not only on up to date costings but also to determine the scope of income to be included and to limit opportunities for avoidance. NZSG is one of a range of possible reforms to NZS to be considered as a means of enhancing the sustainability of an already world-class retirement system.

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