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A Briefing from the Retirement Policy and Research Centre

New Zealand Superannuation as a basic income 2021

RPRC PensionBriefing 2021-2

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This PensionBriefing is based on the RPRC's 2019 Working Paper commissioned by the Commission for Financial Capability for the 2019 Review of Retirement Incomes Policies *Intergenerational impacts: the sustainability of New Zealand Superannuation,* an assessment of the impact of current retirement income policies on current and future generations, with due consideration given to the fiscal sustainability of current New Zealand Superannuation settings.

This PensionBriefing specifically focusses on the option of changing New Zealand Superannuation into a genuine basic income that would allow for a simple but effective clawback mechanism to operate through the tax system.[1]

Introduction

The publication of the consultation document, He Tirohanga Mokopuna, (The Treasury, 2021a) on Long Term Fiscal Projections has rekindled debate as to how the parameters of New Zealand Superannuation (NZS) could be changed to help avoid the fiscally unsustainable build-up in public debt that current policies imply.

Small and gradual changes in the near-term could help minimise the cost of fiscal pressures across generations, preventing higher debt and a larger, relatively more costly adjustment in the future (The Treasury, 2021a, p. 6)

For the 2019 Retirement Income Review, the RPRC critiqued mechanisms for saving expenditure on NZS (St John & Dale, 2019b). The arguments for the need to make retirement incomes policies fiscally sustainable are not explored in depth again here. The wide variety of ways in which cost saving may be achieved, their pluses and minuses, were widely canvassed in that paper.

[1] The RPRC gratefully acknowledges the modelling work of Matthew Bell, senior analyst at the Treasury without whose help this update would not be possible. The views expressed in the PensionBriefing however are those of the RPRC alone.

The Treasury (2021a, pp. 55-59) modelled two of the main options: raising the age of eligibility for NZS; and indexing NZS only to prices. These policies are projected to save 0.7% of Gross Domestic Product (GDP), and 2.4% of GDP respectively. The wide disadvantages of both would mean off-setting costs elsewhere, such as in the social welfare system.

The third option of some kind of means test was not modelled. However, a possible tax clawback scheme proposed by St John & Dale (2019) was described as replicated below in Box 1.

Both options would generate substantial long-term savings and could have economic benefits; but they would most affect those least able to work in older age and on lower incomes. (The Treasury, 2021a, p. 52*)*

Box 1. The third option: Tax clawback (The Treasury, 2021a, p. 59)

Box 6: Targeted options

New Zealand's current system provides a universal basic income to all people aged 65 and over, regardless of their circumstances. An alternative option is targeting payments based on those who might need it the most. A range of targeted options are possible. St John and Dale (2019) suggest a tax-based claw back system.[92] While they provide a detailed assessment of the proposal and its impacts, the key features are to:

- Apply a 'basic income' approach to NZS so that it is paid as a non-taxable grant regardless of other gross income from work or investments. NZS becomes the New Zealand Superannuation Grant (NZSG); and
- Subject other gross income earned by pensioners to an alternative tax regime that is higher than usual tax rates (the proposal and modelling were relative to the tax system in 2019).

A number of scenarios using alternative NZSG rates and tax regimes were modelled by the Treasury on the assumption of no behavioural responses.

A scenario aligning single NZS rates to the married rate and applying a flat tax rate of 39% achieved fiscal savings of 23% (with 8.5 percentage points from rate alignment and the balance from the higher tax rate on other non-NZSG income). Even if the net NZS rates are not changed, the modelling indicated fiscal savings between 9% and 14% under the three tax regimes.

In this briefing we update the original 2017/18 figures in St John and Dale (2019) to 2020/21. We show that paying NZS as a basic non-taxable grant coupled with a carefully designed clawback via the tax system could be an effective and simple way to save a useful amount of government expenditure with limited negative distributional impacts.[2]

Compared to the two options modelled by Treasury (2021a) such a policy may be politically more acceptable and could generate more worthwhile, more timely savings without undue harm while enhancing perceptions of intergenerational equity.

Parameters of NZS

Table 1 sets out the current and expected numbers on NZS and the projected costs sourced from the 2021 New Zealand Superannuation Fund Contribution Rate Model (The Treasury, 2021b). Between 2021 and 2060, the numbers of NZS recipients are expected to roughly double. The nominal costs are projected to increase around 6.5-fold over this period, but the net NZS expenditure (after tax) rises from 4.2% to just 6.3% of GDP, reflecting the large anticipated growth in nominal GDP. The relative share of NZS as a percentage of GDP increases, but even so New Zealand's expenditure on the pension will not reach the share in 40 years' time that many other countries are actually experiencing today (OECD, 2019). Nevertheless, total expenditure on those over 65 including healthcare and long-

[2] The RPRC again thanks Matthew Bell for his assistance in producing these projections.

term care costs is expected to be a source of increasing fiscal pressures, alleviated only partially by the New Zealand Superannuation Fund (NZSF) (Bell, 2021).[3]

Table 1. Fiscal projections* NZS 2001-2060 (The Treasury 2021b)

Fiscal Year (Year ended 30 June) →	2021	2022	2031	2041	2051	2060
Nominal Gross Domestic Product (GDP) ($billion)	334.399	349.742	530.013	762.477	1074.543	1435.536
Gross New Zealand Superannuation expenditure ($billion)	16.554	17.691	30.285	49.087	72.825	108.352
Gross NZS expenditure as percentage of nominal GDP	5.0%	5.1%	5.7%	6.4%	6.8%	7.5%
Net (of tax) NZS expenditure	13.964	14.892	25.401	41.171	61.081	90.879
Net NZS expenditure as percentage of nominal GDP	4.2%	4.3%	4.8%	5.4%	5.7%	6.3%
Average number of NZS recipients in Fiscal Year (thousands)	825	851	1,125	1,354	1,492	1,699
Annual percentage growth of NZS recipients	3.8%	3.2%	2.5%	1.0%	1.1%	1.3%

* 2021-2022 Budget estimates, 2031-2060 projections

Table 2 shows that more than one half (56.4%) of today's superannuitants is aged 65-74. These early baby-boomers are relatively healthy and their paid work participation is high and expected to rise see St John and Dale (2019, pp. 11-17). However, from 2030, the baby-boom bulge (born 1945-1965, currently aged 56-76 years old) will begin to move into the 85+ age group adding extra pressure on health, long-term care, and accommodation services for the next 20 or more years.

The last five years of changes as shown in Table 2 suggest that longevity improvements are increasing the numbers living to older ages, and that Māori, Pacific people and other ethnicities over 65 are growing at a faster rate than the NZ European group.

Of those turning 65 today, fewer have their own homes mortgage-free and many are struggling in the private rental market.[4] Nearly 20% of the 24,000 applicants on the housing register, which indicates extreme housing need, are over 55.[5] Evidence of pressures in the housing market are reflected in high rates of increase in additional accommodation and hardship support shown in Table 2.

This suggests that the current rates of NZS may be inadequate for an increasing number. The second option considered by Treasury of CPI indexing would see NZS as a fraction of the average wage fall well below its current 66% for a married couple to around 50% by 2060 (The Treasury, 2021a, p. 58). While the 2.4% of GDP saved means that the gross cost of NZS relative to GDP returns to its early 2020s level of around 5%, there would be a profound risk of creating elder poverty levels not seen since the early 1970s.

Table 3 shows the 2021 rates of NZS and contrasts their values as a percentage of the net average wage and adult Jobseeker and Supported Living Payment net rates. Of the numbers receiving different rates of NZS, approximately 62% are married, 13% are single sharing and 25% live alone (McKenzie, 2019). Gross NZS for 2021/22 is forecast (Table

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[3] The NZSF was set up as a sovereign wealth fund in 2002 to tax smooth the contributions from current taxpayers for NZS. Under the current formula, withdrawals of significance will not occur until 2055 and be no higher than 11% of the net cost of NZS by the end of the century (Bell,2021)

[4] See Kay Savile Smith, Grace Walker (eds), special 2021 edition [NZPR_Vol.-47_final_cr.pdf (population.org.nz)]

[5] https://www.hud.govt.nz/assets/News-and-Resources/Statistics-and-Research/Public-housing-reports/Quarterly-reports/Public-Housing-Quarterly-Report-March-2021.pdf

1) to be $17.691 billion, of which approximately $9.9 billion is paid to married persons, $2.5 billion to single sharing and $5.3 billion to superannuitants living alone.[6]

Table 2. NZS recipient characteristics, March Quarter 2021 (MSD benefit facts)

Recipient characteristic	Mar-16	Mar-21	% change
Gender			
Male	320,958	386,952	21%
Female	375,846	444,987	18%
Age Group			
Under 60 years	3,816	3,744	-2%
60-64 years	9,900	11,379	15%
65-69 years	229,527	243,768	6%
70-74 years	171,162	225,861	32%
75-79 years	125,448	156,258	25%
80-84 years	80,598	103,884	29%
85-89 years	51,165	55,254	8%
90 years and over	25,191	31,806	26%
Ethnic Group			
NZ European	428,028	518,175	21%
Māori	36,084	49,149	36%
Pacific peoples	17,097	21,936	28%
All other ethnicities	104,328	137,331	32%
Unspecified	111,261	105,357	-5%
Receipt of additional support			
Accommodation Supplement	36,585	47,148	29%
Disability Allowance	126,189	130,323	3%
Temporary Additional Support	4,539	9,549	110%
Total	**696,804**	**831,951**	19%

Table 3. Rates of NZS and selected core benefits before and after tax as at 1 April 2021, derived from MSD website

Category	**% Net average wage**	**Annual rate Gross**	**Annual Net** Primary Tax	**Annual Net** 33% Tax
NZS Single, living alone	42.9%	$26,345.28	$22,720.88	$17651.15
NZS Single, sharing	39.6%	$24,233.56	$20,973.16	$16,236.11
NZS Married person or partner in civil union or de facto relationship (each)	33%	$19,991.92	$17,477.72	$13,393.97
Jobseeker Single, 25+ years	25.4%	$15,105.48	$13,442.00	
Jobseeker Married, civil union or de facto couple (without children, each)	20.3%	$12,015.64	$10754.12	
Supported living payment single 18+	31.1%	$18,770.44	$16,465.80	
Supported living payment (married couple each)	25.1%	$14,901.64	$13,274.04	

As discussed, the level of NZS needs protection, nevertheless some alignments of the three rates of NZS may be justified. It is time to ask whether in the 21st century there is still value basing amounts paid on living arrangements and marital status. There is a

[6] RPRC estimates.

presumption that a person living alone has higher expenses than a person sharing accommodation and a person sharing accommodation has higher costs than a married person. The latter is unlikely, and all superannuants who live alone do not necessarily face high housing costs on low incomes. Nor can be assumed that all married persons fare well- some have high housing costs and low incomes.

Means testing and alternatives

As was argued in St John & Dale (2019), the tools of raising the age for eligibility, or cutting the base pension rate for reducing the costs of NZS are limited. In brief, raising the age would affect the worst off the most, leaving many on the inadequate welfare system dependent on supplementary assistance and foodbanks. It would have to be phased in over a long period of time reducing any immediate savings.

> **Means tests** take other income and assets into account in determining the amount of benefit a person is entitled to. A simpler version is an **income test** alone.
>
> Welfare benefits in NZ are subject to a stringent income test that aims to target payments to only those who 'need' them.
>
> A gentle test that affects only the top end may be described as an **affluence test**.
>
> A progressive income tax and a taxable benefit automatically ensures some income testing or **clawback**.
>
> A basic non-taxable income and other income taxed at progressive rates is another way to operate an affluence test.

Cutting the base rate of benefit would be an effective way to save money but at the cost of generating severe hardship for the increasing numbers who have very little other than the pension to live on. As discussed above, a highly effective way as modelled by Treasury (2021) is to reduce the cost of NZS by indexing NZS to the CPI (not wages as currently). As social welfare benefits are now wage-linked this would be a retrograde step.

This leaves the 'third rail'[7] of superannuation policy: some form of 'claw-back' from those who do not 'need' it. This has been a politically unattractive option because of New Zealand's history, (see St John, 2015; St John, 2018).

There are a number of ways to save costs by reducing access to NZS by the well-off. Probably few people would wish to contemplate a means test based on joint income and assets as operates for the age pension in Australia described in Box 2, or a welfare-type income test as in the benefit system or means test for supplementary assistance. The last time that was attempted (1991 budget) there was outrage and anger among the powerful superannuitants' lobby and the legislation that would have changed NZS into a welfare benefit was reversed before it was implemented (St John, 1999; St John & Ashton, 1993).

Under the Australian means test 80% of those eligible by age get at least some age pension[8], as noted, this model's income and asset test most unlikely to be acceptable for New Zealand and would encourage avoidance activity.[9] However, the income-based

[7] *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).

[8] See https://www.austaxpolicy.com/better-targeting-australias-age-pension/.

[9] It can be argued that the means test in Australia clawbacks some of the cost of tax incentives for private saving https://www.abc.net.au/news/2021-07-19/wealthy-australians-exploiting-superannuation-tax-loophole/100303336.

clawback modelled in this paper, would not preclude counting as much imputed income from assets as feasible over time (St John & Baucher, 2021).

Box 2. Age Pension means test in Australia[10]

Rates of Age Pension March 2021 (including energy and pension supplements)
Single: $952.70 per fortnight (approximately $24,770 per year)
Couple (each): $718.10 per fortnight (approximately $18,670 per year)
Couple (combined): $1,436.20 per fortnight (approximately $37,341 per year)
Couples separated: due to illness each receive the Single rate (see above), which combined is $1,905.40 (approximately $49,540 per year)
Income test
Single: for a full Age Pension income must be below $178 per fortnight ($4,628 per year). There is a 50 cents abatement for each dollar over $178. A part Age Pension is payable when income is less than $2,083.40 per fortnight (approximately $54,168 per year).
C**ouple**: for the full Age Pension combined income must be below $316 per fortnight (approximately $8,216 per year). There is a 50% abatement for each dollar over $316. A part Age Pension is payable when income is less than $3,188.40 per fortnight (approximately $82,898 per year).
A **work bonus** of up to $300 per person per fortnight from working is not included in the Age Pension income test.
Assets test
Single: for a full Age Pension, assets must also be below $268,000 if home-owner, or $482,500 if not. A part Age Pension is possible if assets are up to $585,750 if home-owner), $800,250 if not.
Couple: for the full Age Pension combined assets must be below $401,500 (home-owner) or $616,000 if not. A part Age Pension is possible if assets are worth less than $880,500 (home-owner), or $1,095,000 if not.
Both tests apply: The Age Pension is based on the test that delivers the lower amount of age pension.
Relationship tests are stringent, and the definition of income and assets used is broad.

From 1985 to 1998 New Zealand operated a surcharge on superannuitants' other income (Preston, 2001). This was highly unpopular and complex for people to understand. Nevertheless, it did deliver useful savings.

> *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 after-tax benefit from it.*
>
> *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.* (St John, 2015, p. 8)

In New Zealand, the challenge is to find a way to apply an income (or "affluence") test that could be seen as fair simple 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. Increasingly, the younger working age population who are struggling in the property market and may also have large student debts are questioning the largess of a universal pension for well-off, well-housed superannuitants.

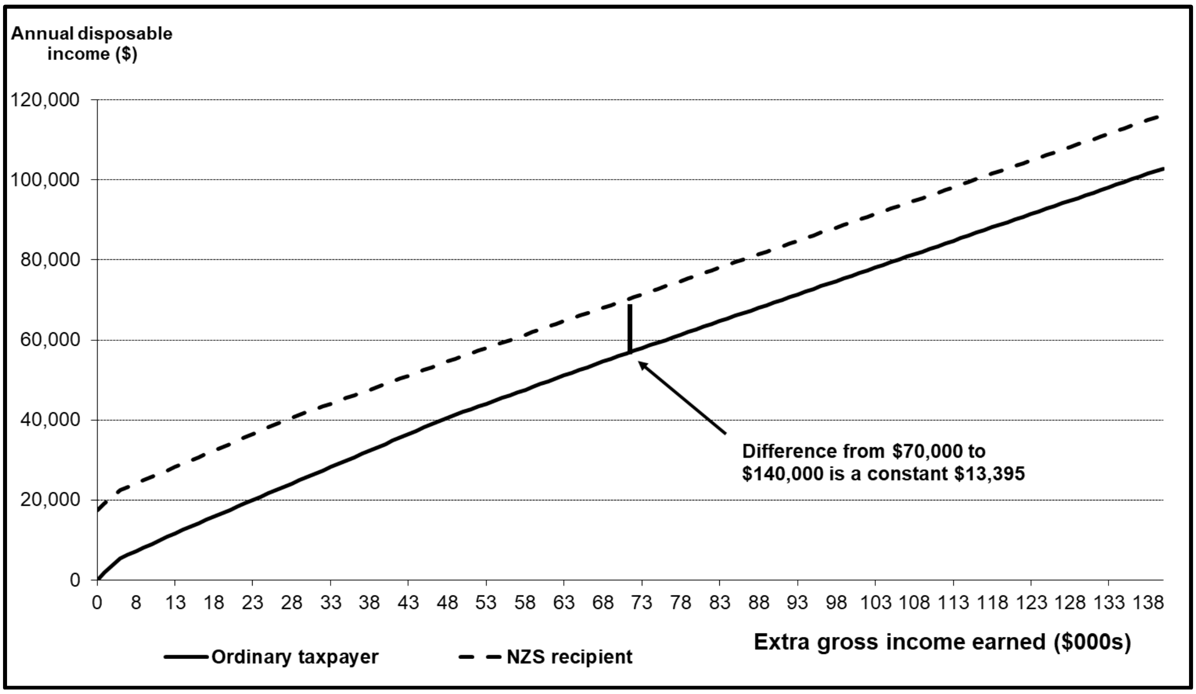
Wealthy recipients of NZS may still be in well-paid work and/or have other large private incomes and assets, and sometimes annuities or private pensions (see St John and Dale 2019). Wealthy recipients of NZS are likely to have accumulated their wealth with tax-free capital gains, especially in housing, and may have gained substantially from the 2010 income tax cuts, lower Portfolio Investment Entity (PIE) rates of tax. Under the PIE regime,

[10] See https://www.superguide.com.au/accessing-superannuation/age-pension-rates. and https://www.servicesaustralia.gov.au/individuals/services/centrelink/age-pension/how-much-you-can-get/your-relationship-status.

the top rate of tax is 28%. Compared to the top rate of 39% this is an 11-percentage point advantage.

The current generosity of NZS is illustrated in Figure 1 for the case of a married superannuitant. It shows the addition to net income provided by NZS at all income levels. Where there is no other income, the NZS payment is a net $17,448 (Table 1). When earned income exceeds $70,000, their total NZS is taxed at 33% so that the effective net NZS payment is reduced to $13,395. The additional income remains constant at $13,395 as shown in Figure 1. Since 2020, very high incomes over $180,000 are taxed at 39% (not shown in Figure 1) From this income the net value of NZS falls, but never below $12,195.

Figure 1. Disposable income with NZS, married rate NZS 1 April, 2021



The 1993 Accord[11] endorsed the principle that the net amount of NZS should reduce as total income increases, ether by a surcharge or a progressive tax regime that had equivalent effect. After the collapse of the Accord and the promised abolition of the surcharge in 1998, the 1997 Periodic Report Group on Retirement Incomes noted:

> *We strongly support the sentiment that there are higher priorities for government resources. Therefore, we regret the impending abolition of the surcharge…*
>
> *The abolition of the surcharge will provide a breathing space in which we can inform and educate the community about the future shape of public provision and explain why some kind of targeting mechanism will be needed in future*. (Periodic Report Group, 1997, p. 47)

In contrast to other levers, such as raising the age of eligibility or reducing the rate of NZS only those with significant 'other' income were affected by the surcharge. Finding a way for the top line to meet the bottom line in Figure 1, by reducing the generosity of net NZS at the top end is worth exploring.

[11] Between the three major political parties: Labour, National and the Alliance in 1993.

New Zealand Superannuation as a Basic Income[12]

This section draws on St John (2018) and St John and Dale (2019) to propose various basic income options for a tax-based, simple claw-back scheme to improve sustainability, with modelling to show approximately how much could be saved.

A basic income approach aligns with the Government's future of work programme, led by the Productivity Commission (2019), where it is acknowledged that the 21st century workplace no longer provides certainty of employment or sufficient hours of work for many workers.[13] The idea of a basic income paid as of right to every individual has gained currency.

In a basic income approach, each person has a universal grant that is not part of taxable income. When additional income is earned, it is taxed under a progressive tax regime so that the tax system does the work of providing a claw back of the universal grant for high income people. The higher the basic income, the higher tax rates on earned income must be and the more earning extra income is discouraged. Unfortunately for advocates, a universal basic income at a level high enough to prevent poverty for all adults over 18 years old would require prohibitive tax rates and result in probably unacceptable disincentives to work.

However, NZS already provides a high-level universal income for a well-defined group, and it is therefore an ideal candidate for a basic income reform. Paying NZS as a proper basic income offers a compromise between aggressive means testing as applied for second tier benefits, or abatement on additional income in the welfare system (or the affluence test as applied in Australia), and a fully universal taxable pension approach such as for the current NZS. It offers people flexibility in their employment choices in early retirement.

Currently the tax system does provide some clawback, but the 33% MTR superannuitant still receives around 77% of the net pension paid to the lowest MTR superannuitant (Table 1).[14] To make NZS a proper basic income, a more effective tax claw back mechanism is required (the meeting of the lines in Figure 1).

The idea is to retain NZS's simplicity and universality while reigning in the expenditure at the top end to provide some useful additional revenue to balance intergenerational concerns and to reduce income inequality within the retired population.

The New Zealand Superannuation Grant

Taking a 'basic income' approach may be simple to implement and operate but it requires a new way of thinking. 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 in Figures 1- 4 the NZSG is the same for everyone (whether married; single sharing; single living alone): any extra supplement for high housing costs

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[12] The RPRC gratefully acknowledge the modelling of these results provided with the help of Matthew Bell, NZ Treasury but this in no way implies any endorsement of these policies.

[13] The Labour government has also been investigating the role that an earning-related social insurance scheme might play for the unemployed. This is controversial, for example, see [CPAG social insurance concerns regarding inequity and poverty web.pdf]

[14] A superannuitant on the top 39% MTR still receives 71% of the lowest MTR payment.

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

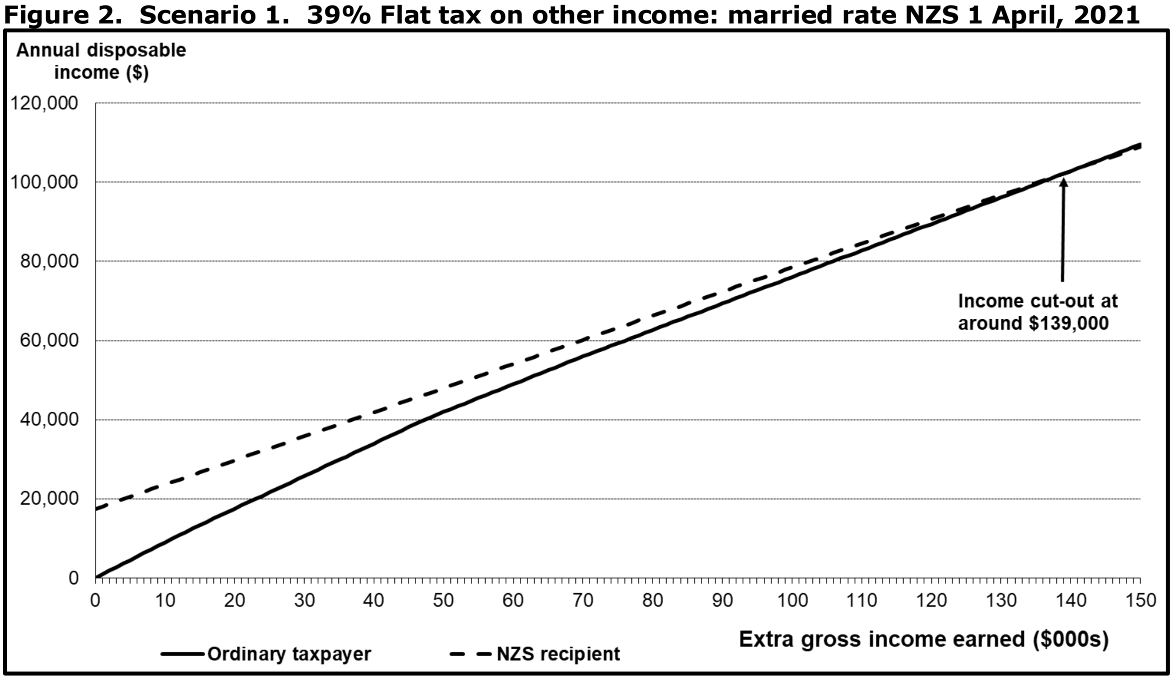
> *The great majority of older New Zealanders (aged 66+) are very dependent on NZS and other government transfers for their income 40% have less than $100 pw from other sources (40% of singles have no other income) the next 20% have on average around 70% of their income from NZS and other government transfers. Around 40% of older New Zealanders receive more than half their income from sources other than NZS. This group has grown in size in recent years (15% in 1998, 30% in 2009), mainly due to increasing non-government income for those in 'younger' couple (aged 66-75), and especially higher income from employment.* (Perry, 2019)

would be part of the welfare system.[16] While the NZSG could be set at any level, it is set equal to the current (after-primary tax) rate of NZS, i.e. $17,448 for a married person.

A break-even point exists (Figure 2) 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 (i.e. offset by the additional tax).

The scenario depicted in Figure 2 with a flat tax at 39% on all other income shows the breakeven point occurs when the NZSG recipient's 'other' income is $139,000.

Figure 2. Scenario 1. 39% Flat tax on other income: married rate NZS 1 April, 2021



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, and few could do their own tax returns. 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).

Given that most NZS recipients have modest amounts of non-NZS income only,[17] a tiered structure may be required to give some relief to those with limited extra income.

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[16] Around 25% of superannuitants get the single, living alone rate. Of these, many but not all would continue to require a supplementary payment to reflect higher costs. A suitably modified accommodation supplement may be required.

[17] It is noted that PIE income is excluded.

The St John & Dale (2019) paper illustrated a tiered scenario; with rates of 17.5% for the first $15,000 of other income, and 39% on each dollar above that. However, under the current levels of NZS, using this tax scenario there is no cut-out point: from $180,000 where the new 39% tax rate for ordinary taxpayers now applies, the lines continue in parallel, showing that all the very highest income groups would still be better off (albeit by a modest $823 per annum only). Had there been no change to the tax rate for those on incomes over $180,000, the cut-out point would have been $190,000.

Clearly, an infinite combination of tax rates and thresholds can be modelled. For example, Figure 3 models a second tax scenario with rates of 17.5% for the first $15,000 of other income, and 43% on each dollar above that. The break-even point in this case is $122,000.

Figure 3. Scenario 2. Two-tiered rate of 17.5% (for first $15,000 earned) and 43% above $15,000: married rate NZS 1 April, 2021

Figure 4 offers a third tax scenario that bites a little harder on first $20,000, while implementing a slightly higher top rate of 45% with a cut-out point of $112,000.

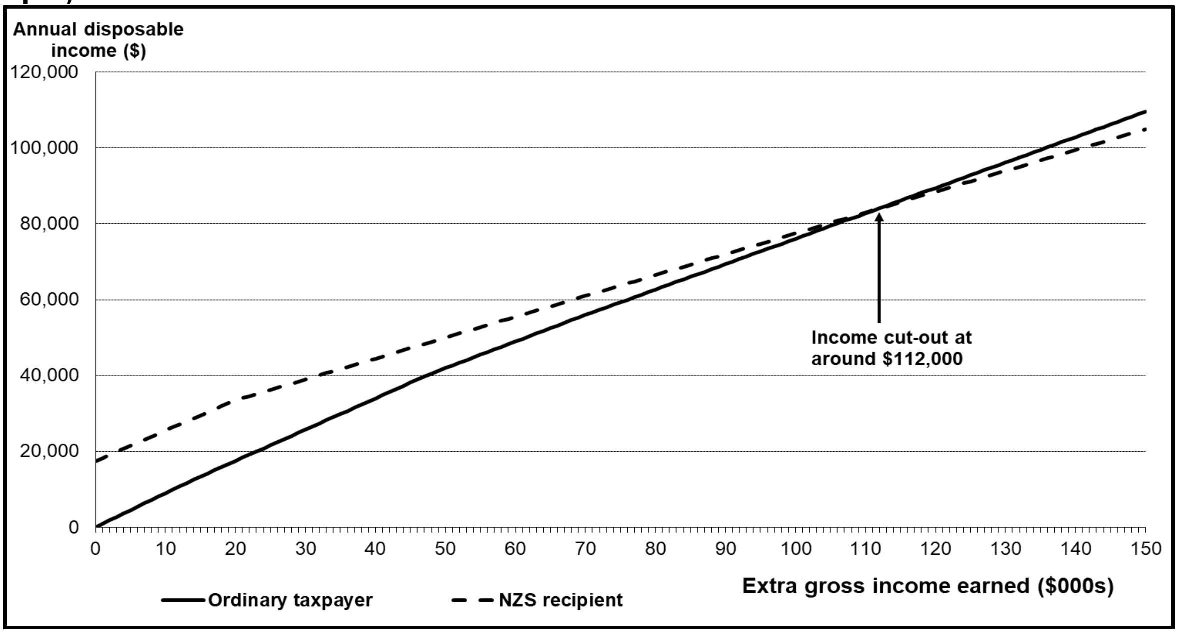
In all scenarios if the recipient of NZSG receives more than the break-even amount of other income then it would be rational for them to either: forego the NZSG and be treated as an ordinary taxpayer, or to apply for a refund of any tax overpaid on income above the cut-out at the end of the year.

Whether other income is from paid work or from investments, and whether it reduces or disappears, the right to the basic income floor of the NZSG remains. Thus, the NZSG is the prototype of a basic income that provides automatic income security as of right.

Realistically, the basic income approach suggested in this paper is likely to mean that high income people simply do not bother to apply for NZSG even if they could be a few dollars better off. The more income that is included in the base, the fewer wealthy superannuitants will bother to apply for the NZSG.[18]

[18] In the 2021 budget, the Minister of Revenue, the Hon David Parker allocated $5m to Inland Revenue to gather better information on the distribution of wealth and income in New Zealand.

Figure 4. Scenario 3. 20% tax first $20,000 earned and 45% beyond: married rate NZS 1 April, 2021



There are losses in annual disposable income relative to current settings as shown in Table 4 for the three tax scenarios depicted in Figures 2, 3, and 4 at bands of extra income earned. Any losses for people with small amounts of additional income are minimised in the two-tiered tax approach of tax scenario two and three.

Once in place, the NZSG would be 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 history shows that opportunities and incentives for tax avoidance were features 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 (see St John and Dale, 2019). It provides a gentle clawback using the principle of progressive taxation which is the natural counterpart of universal provision. The NZSG is consistent with current arrangements that do not require any retirement test and therefore there should be little significant disincentive to earn extra from paid work.

Table 4. Losses of non-NZS disposable (rounded) income for superannuitants relative to current system. 2021/22 NZS married rate. [19]

Non NZS Income		Tax Scenarios One	Two	Three
$5,000		$1,070	$0	$120
$10,000		$2,145	$0	$245
$15,000		$3,220	$0	$370
$20,000		$4,295	$1,270	$495
$25,000		$5,370	$2,545	$1,870
$50,000		$7,996	$6,171	$5,996
$75,000		$9,497	$8,672	$8,997
$111,700	**Around Cut-out point for Three**	$11,699	$12,342	$13,401
$122,200	**Around Cut-out point for Two**	$12,329	$13,392	
$140,000	**Around Cut-out point for One**	$13,397		

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 if a full means-test was proposed including an asset-test rather than the proposed income-test operated through the tax system.

PIE tax regime

The holding of net financial wealth is highly skewed, favouring older age groups.[20] It is therefore likely that there is significant PIE income among the top 20% of superannuitants. PIE income is treated as tax paid with the underlying estimated PIE rate supposedly a proxy for the actual marginal tax rate of the investor. The costing done in the next section does not capture the undertaxed PIE income or indeed any PIE income as it is not included in the Household Expenditure Survey data base.

The integrity of the NZSG approach would require that the correct rate of tax is paid on all income. The current top PIE rate of 28% is highly advantageous to top marginal tax rate payers: investing in PIE funds is one way the better-off might seek further advantage in the NZSG tax regime. However, gross PIE income is now recorded for each taxpayer by the IRD and could be imputed as 'income' to be taxed at the NZSG rate with a credit for tax already paid by the PIE on the member's behalf (as in the imputation regime for dividends). The same argument applies to income earned through trusts, companies and overseas vehicles.[21] PIE income is already included in the other income used to abate tax credits in Working for Families, the other major redistributive programme in New Zealand.[22]

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. If for example, there was desire to encourage annuitisation, an annuity of a limited value could be ignored instead of apportioned 50% as income as a means of making annuitisation attractive to middle income people (St John, 2016; St John & Dale, 2019a).

The current tax treatment of income from housing is widely perceived as unfair. Better-off superannuitants are likely to have considerable amounts of untaxed imputed housing income from home ownership and rental property investments. The inclusion of such income (after a per person exemption) as suggested in the Fair Economic Return proposals (St John & Baucher 2021) would also draw more income into the NZSG net. The more the tax base is widened the greater the savings including those from many who may not bother to apply for the NZSG.

Putting NZSG onto a separate tax scale also helps perceptions of fairness when older people receive other help such as the winter energy payment and free public transport. There is a case for not offering a final tax reconciliation at all to high income people who chose to take the NZSG and its associated benefits.

[20] 60% are over age 60 and 83% of HWI are aged over 51. See High Wealth Individuals – Wealth Accumulation Review 2016.
[21] 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, 2019).
[22] See https://www.ird.govt.nz/situations/i-am-a-pie-investor-with-a-student-loan-or-working-for-families.

Costing[23]

The fiscal saving possible by using the NZSG approach depends on the decision about the alignment of rates and critically on the tax rates chosen. Savings of around 10% of the net cost of NZS would be similar to that achieved by the surcharge as it operated at the end of the 1990s (Periodic Report Group, 1997).

Table 1 showed the current projected costs and average numbers of superannuitants. A surcharge equivalent (10%) for the 2021/22year, would produce saving of $1.77 billion in gross terms or $1.49 billion in net terms. In contrast to raising the age, such savings could be reaped much sooner.

For this update, Treasury has modelled cost savings to assist in the production of this paper. It does not represent government policy or Treasury advice. It is based on several assumptions. Non-NZS incomes is adjusted from 2017/18 levels to 2021/22 levels by applying a 3% income growth per year.[24]

The Treasury model assumes:

- 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.

A total of 12 combinations: 4 NZS net rate options costed by three different scenario tax regimes are modelled. The previous 2019 paper showed that the option of paying everyone the single sharing rate does not save any money and so is not modelled here. The 12 combinations and the savings are summarised in the Appendix.

The 4 NZS net rate options are:

1. Anyone who receives NZS gets the net married person rate
2. Any married person who receives NZS gets the net married person rate and any single person who receives NZS gets the net single sharing rate.
3. Anyone who receives NZS gets the net rate they are currently entitled to
4. Those living alone get the living alone rate—single sharing and married get the married rate.

The 3 alternative tax regimes are:

Tax Scenario 1 39% flat tax rate on all non-NZS taxable income
Tax Scenario 2 17.5% on the first $15,000 of non-NZS taxable income and then 43 % on non-NZS taxable income above $15,000 per year
Tax Scenario 3 20% on the first $20,000 of non-NZS taxable income and then 45% on non-NZS taxable income above $20,000 per year

The true cost to the government of providing the public pension is the aggregate net (after-tax) NZS expense. Relative to its value in the 2021/22 year, costed under the NZS and personal tax regime existing in that year, modelling showed that savings in net NZS was possible for all net rate options. The results are summarised for the net rate NZSG options 1, 2, 3, 4 above respectively:

[23] The authors gratefully acknowledge the modeling of these results provided with the help of Matthew Bell, The Treasury but this in no way implies any endorsement of these policies.
[24] This is a conservative assumption but aligns with the combination of the historical average and recent Budget 2021 Treasury forecasts for nominal wage growth over this period (3.46% per year).

- **Tax Scenario 1** (39% tax on all other income) produced overall savings of 24%, 16%, 14%, 15%.
- **Tax Scenario 2** (17.5% of first $15,000, 43% on balance) produced overall savings of 17%, 11%, 9%,11%.
- **Tax Scenario 3** (20% on the first $20,000, 45% on balance) produced overall savings 17%, 11%, 9%, 11%.

These figures assumed an immediate adjustment of all rates to the prescribed NZS net rate option. In practice any 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 those with high housing costs. Over time, as the baby boomers continue to swell the numbers over age 65, some still in work and others with high f financial assets, savings under the NZSG will likely increase. This will be reinforced if the tax thresholds for the NZSG tax schedule are unadjusted for inflation.

The scenario of aligning the single living alone and single sharing rate to the married rate achieves the most saving in all 3 tax scenarios (24%, 17%, 17%). Appendix 1 shows that over one third or 8 percentage points of this saving is due to the alignment of the rates for each tax scenarios.

If the net rates are not changed as for net rate option 3, the costings show that 9-14% savings of net NZS are possible as modelled under the three tax scenarios.

For the combination of aligning the single to the married rate and a flat tax schedule of 39%, around 14%, or 119,300 of age-eligible superannuitants are unlikely to apply as they would not gain from the NZSG. For other tax combinations 4%-5% drop out. It is likely these figures are very much understated as many would find it not worth the bother to ask for the NZSG especially if they are in well-paid work. It is also likely that others would be deterred if more income in the future, such as PIE income and deemed housing income are included.

Thus, the savings set out in Appendix 1 for the 12 combinations are all likely to be underestimates of the true potential of the NZSG approach. However, especially if the living alone rate is aligned to the married rate, there will be more needed for separate assistance with accommodation costs for many low-income retirees.

Summary

This preliminary analysis suggests that the combined approach of using a separate tax schedule for other income and freezing the single rates so that over time there is alignment with the married rate, will give large savings of at least between 17-24% of net NZS depending on the tax scenario.

Even if the net rates are not aligned (status quo) there are possible savings of 9-14%.

Paying a single rate of NZSG for all equal to the net amount now paid to a married person simplifies the treatment of relationship status in the system. But any alignment of rates would have to be done over time by freezing the single rates (or only CPI adjusting them) while indexing the married rate to wages.

In particular, there is little sound rationale for the difference between the single sharing rate and the married rate. With modern relationships of very different kinds, it can be very confusing. The distinction famously led to a case taken by Winston Peters to the High Court in 2019.[25]

There is a better rationale for a higher living alone rate, but that too is a blunt tool for compensating for higher living costs. A single rate (at the married rate) is most effective at saving costs although additional payments for those with high accommodation costs would be required.

If the single sharing and married rates are aligned (column 4 Appendix 1) while the Living alone rate left as is, the savings are 11-15%. This may be preferable and more politically saleable than paying all singles the net sharing rate (column 2 Appendix 1)

With respect to the tax scenarios and referring to Table 4, a flat rate of 39% is simplest and most effective in saving costs. However, compared to what happens currently, this imposes an extra impost on those with only modest amounts of non-NZS income. A 2-tiered tax option such as scenario 2 or 3 in table 4 helps solve this but saves less net NZS.

The design of the NZS is a matter of judgement. One way forward is to introduce the NZSG at the net status quo rates, freeze the single rates, achieving alignment of single sharing and married over time. The case for further alignment of the single living alone with this rate can then be assessed and alongside development of new ways to meet higher accommodation costs. Under tax scenario 2, a minimum of 11% cost saving can be expected ($1.54 billion modelled for 2021/22), with more as the tax base expands to include PIE income and other base broadening measures such as for housing.

Such a scheme may be easier to introduce than raising the age, and hence savings could be reaped earlier. But raising the age slowly could be a companion policy if other protections are in place with constant monitoring to ensure individuals who cannot work longer are looked after.

The proposed change would decrease the fiscal cost of NZS through reductions in payments to high income superannuitants and there would be choices for using this revenue to relieve pressure on younger New Zealand taxpayers or for other redistributive policies. 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 potential advantages compared to other targeting regimes:

- Relatively 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 if eligible people elect to take it.
- Continuity: Higher income superannuitants already elect a separate tax code to reflect the appropriate taxation of their NZS: there should be acceptability of a separate tax code for other income under the NZSG
- 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.

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[25] See St John, S (2019) The real problem in Winston's case Newsroom, 13th November 2019 and St John, S (2019) Winston's trial this week should be a wake-up call for-everyone Daily Blog 4th November 2019.

- Many better-off superannuitants under an opt-in arrangement for NZSG would not apply, including some who would be somewhat better off. For example, it could become the norm for those still in full time well-paid work not to apply.
- Once seen as working well as a basic income, the NZSG could be usefully extended as a basic income to other groups such as those in their 60s on the supported living payment.

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Comments on this Pension Briefing welcome.

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Appendix 1: Alternative NZS scenario costings for 2021/22 March year

Status quo in tax year 2021/22 (1 April 2021 to 31 March 2022)	**($ billion)**
2021/22 aggregate net of tax cost of New Zealand Superannuation (NZS)	**14.618***
2021/22 aggregate tax paid by superannuitants on all taxable income (modelled)	**6.928**
2021/22 aggregate tax paid by superannuitants on non-NZS taxable income (modelled)	**4.742**

*This differs from Table 1 which is based on the June year

Scenario One: Flat tax of 39% on non-NZS taxable income	All on net married rate	All singles on net sharing rate	All on their current rates	Singles LA net living alone rate others MR
Aggregate net of tax cost of New Zealand Superannuation (NZS)	11.513	13.901	14.208	13.984
Aggregate tax paid on non-NZS taxable income	5.198	6.318	6.318	6.318
Saving on aggregate net NZS payments	3.105	0.717	0.410	0.634
Saving on aggregate net NZS as % of status quo aggregate net NZS	21%	5%	3%	4%
Extra tax paid on non-NZS income	0.456	1.576	1.576	1.576
Increase in tax revenue as % of status quo tax on non-NZS income	10%	33%	33%	33%
Overall saving relative to status quo	**3.561**	**2.293**	**1.986**	**2.210**
Overall saving as % of status quo aggregate net NZS	**24%**	**16%**	**14%**	**15%**
Aggregate saving on NZS just from paying net rate option	1.217	0.307	0.000	0.224
Saving just from paying net rate option as % of status quo aggregate net NZS	8%	2%	0%	2%
Percentage of overall saving due to paying the net rate option	34%	13%	0%	10%
Percentage of superannuitants who no longer receive NZS relative to status quo numbers	14%	3%	3%	3%

Scenario Two: 17.5% tax on non-NZS taxable income up to $15,000 and then 43% beyond that				
Aggregate net of tax cost of New Zealand Superannuation (NZS)	12.903	13.840	14.157	13.928
Aggregate tax paid on non-NZS taxable income	5.553	5.588	5.601	5.596
Saving on aggregate net NZS payments	1.715	0.778	0.461	0.690
Saving on aggregate net NZS as % of status quo aggregate net NZS	12%	5%	3%	5%

Extra tax paid on non-NZS income	0.811	0.846	0.859	0.854
Increase in tax revenue as % of status quo tax on non-NZS income	17%	18%	18%	18%
Overall saving relative to status quo	**2.526**	**1.624**	**1.320**	**1.544**
Overall saving as % of status quo aggregate net NZS	**17%**	**11%**	**9%**	**11%**
Aggregate saving on NZS just from paying net rate option	1.217	0.307	0.000	0.224
Saving just from paying net rate option as % of status quo aggregate net NZS	8%	2%	0%	2%
Percentage of overall saving due to paying the net rate option	48%	19%	0%	15%
Percentage of superannuitants who no longer receive NZS relative to status quo numbers	4%	4%	3%	3%
Scenario Three: 20% tax on non-NZS taxable income up to $20,000 and then 45% beyond that				
Aggregate net of tax cost of New Zealand Superannuation (NZS)	12.790	13.760	14.070	13.840
Aggregate tax paid on non-NZS taxable income	5.437	5.510	5.515	5.509
Saving on aggregate net NZS payments	1.828	0.858	0.548	0.778
Saving on aggregate net NZS as % of status quo aggregate net NZS	13%	6%	4%	5%
Extra tax paid on non-NZS income	0.695	0.768	0.773	0.767
Increase in tax revenue as % of status quo tax on non-NZS income	15%	16%	16%	16%
Overall saving relative to status quo	**2.523**	**1.626**	**1.321**	**1.545**
Overall saving as % of status quo aggregate net NZS	**17%**	**11%**	**9%**	**11%**
Aggregate saving on NZS just from paying net rate option	1.217	0.307	0.000	0.224
Saving just from paying net rate option as % of status quo aggregate net NZS	8%	2%	0%	2%
Percentage of overall saving due to paying the net rate option	48%	19%	0%	14%
Percentage of superannuitants who no longer receive NZS relative to status quo numbers	5%	4%	4%	4%

Appendix 2 Non-NZS income

Non-NZS taxable income in tax year 2021/22 (1 April 2021 to 31 March 2022)	($billion)	% of total income
Amount of income under the $14,000 taxable income band	4.439	25.6%
Amount of income between the $14,000 and $15,000 taxable income bands	0.232	1.3%
Amount of income between the $15,000 and $20,000 taxable income bands	1.042	6.0%
Amount of income between the $20,000 and $48,000 taxable income bands	3.938	22.7%
Amount of income between the $48,000 and $70,000 taxable income bands	1.759	10.1%
Amount of income between the $70,000 and $180,000 taxable income bands	3.404	19.6%
Amount of income above the $180,000 taxable income band	2.530	14.6%
Tax paid under existing tax regime	**4.016**	
Note that the above figure does not include gross NZS in the gross income, so won't match the calculated tax on all income of superannuitants less the tax they pay on NZS, which is $4.742 billion		

Increased tax from 39% flat tax rate	($billion)
From income under the $14,000 taxable income band	1.265
From income between the $14,000 and $15,000 taxable income bands	0.050
From income between the $15,000 and $20,000 taxable income bands	0.224
From income between the $20,000 and $48,000 taxable income bands	0.847
From income between the $48,000 and $70,000 taxable income bands	0.158
From income between the $70,000 and $180,000 taxable income bands	0.204
From income above the $180,000 taxable income band	0.000
Overall increased tax from 39% flat rate on non-NZS taxable income	**2.748**
Tax paid under 39% flat tax rate scenario	**6.764**

Increased tax from 17.5% tax rate up to $15,000 and then 43% tax rate beyond that

From income under the $14,000 taxable income band	0.311
From income between the $14,000 and $15,000 taxable income bands	0.000
From income between the $15,000 and $20,000 taxable income bands	0.266
From income between the $20,000 and $48,000 taxable income bands	1.004
From income between the $48,000 and $70,000 taxable income bands	0.229
From income between the $70,000 and $180,000 taxable income bands	0.340
From income above the $180,000 taxable income band	0.101
Overall increased tax from 17.5% up to $15,000 and then 43% beyond that on non-NZS taxable income	**2.251**
Tax paid under 17.5% tax rate up to $15,000 and then 43% tax rate beyond that scenario	**6.266**

Increased tax from 20% tax rate up to $20,000 and then 45% tax rate beyond that

From income under the $14,000 taxable income band	0.422
From income between the $14,000 and $15,000 taxable income bands	0.006
From income between the $15,000 and $20,000 taxable income bands	0.026
From income between the $20,000 and $48,000 taxable income bands	1.083
From income between the $48,000 and $70,000 taxable income bands	0.264
From income between the $70,000 and $180,000 taxable income bands	0.408
From income above the $180,000 taxable income band	0.152
Overall increased tax from 17.5% up to $15,000 and then 43% beyond that on non-NZS taxable income	**2.361**
Tax paid under 20% tax rate up to $20,000 and then 45% tax rate beyond that scenario	**6.376**