Welfare: Savings not Taxation

“Please imagine a ladder, with steps numbered from 0 at the bottom to 10 at the top.

The top represents the best possible life and the bottom represents the worst possible life for you.

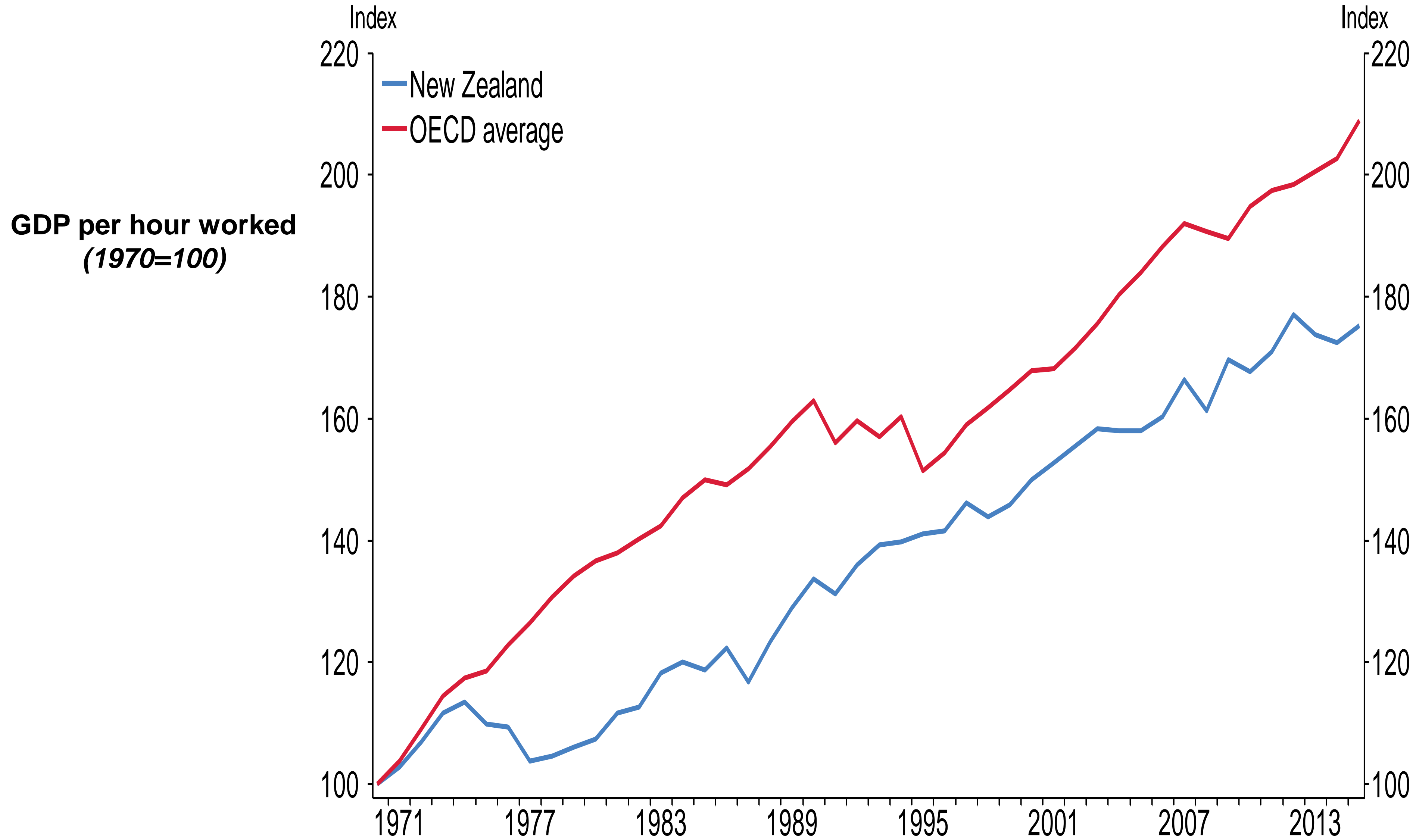
On which step of the ladder would you say you personally feel you stand ***at this time****?”*

“HAPPIEST” COUNTRIES in 2016

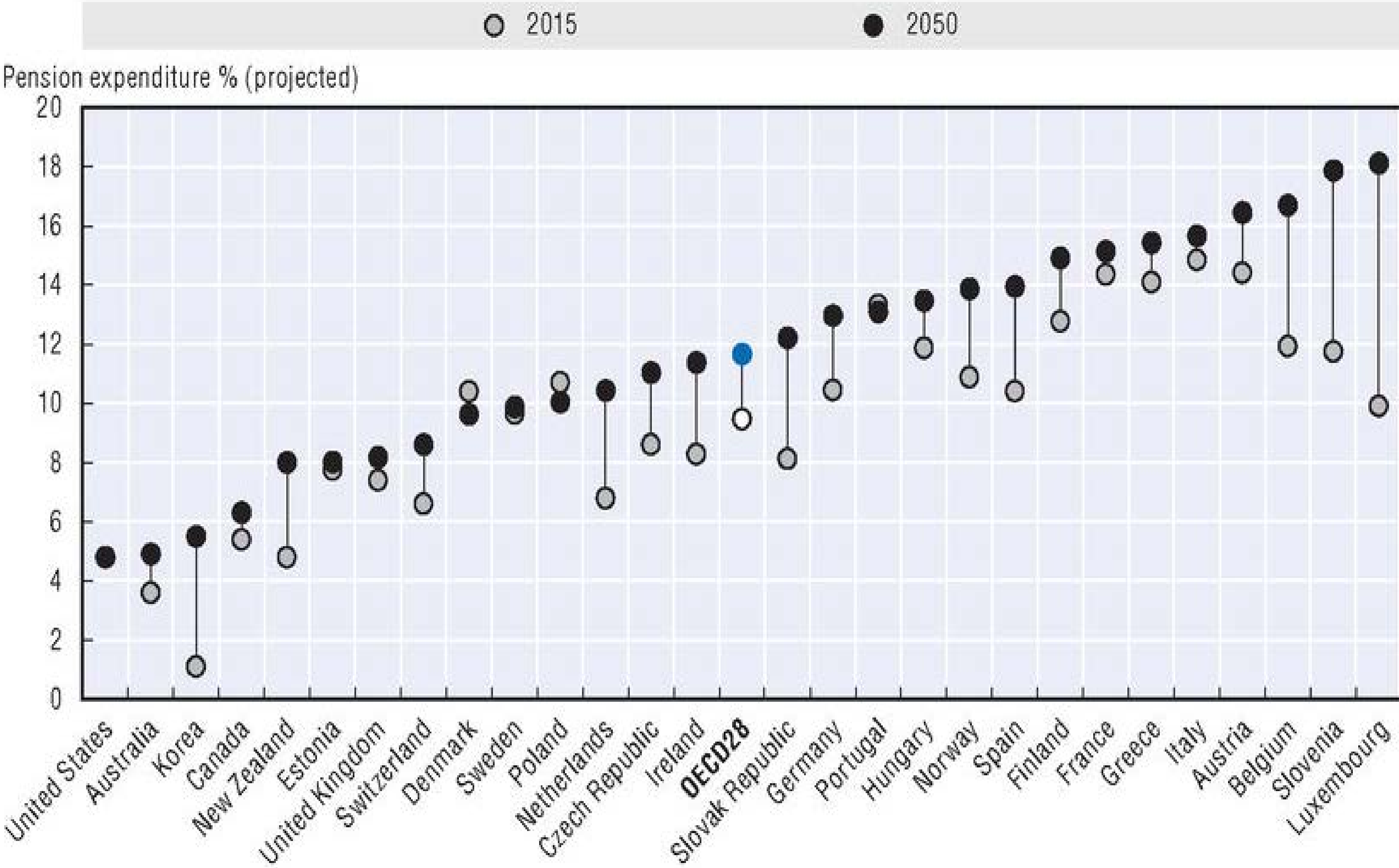
	Country	Score
1.	Norway	7.54
2.	Denmark	7.42
3.	Iceland	7.5
4.	Switzerland	7.49
5.	Finland	7.47
6.	Netherlands	7.38
7.	Canada	7.32
8.	New Zealand	7.32
9.	Australia	7.28
10.	Sweden	7.28

Source: The World Happiness Report (2016)

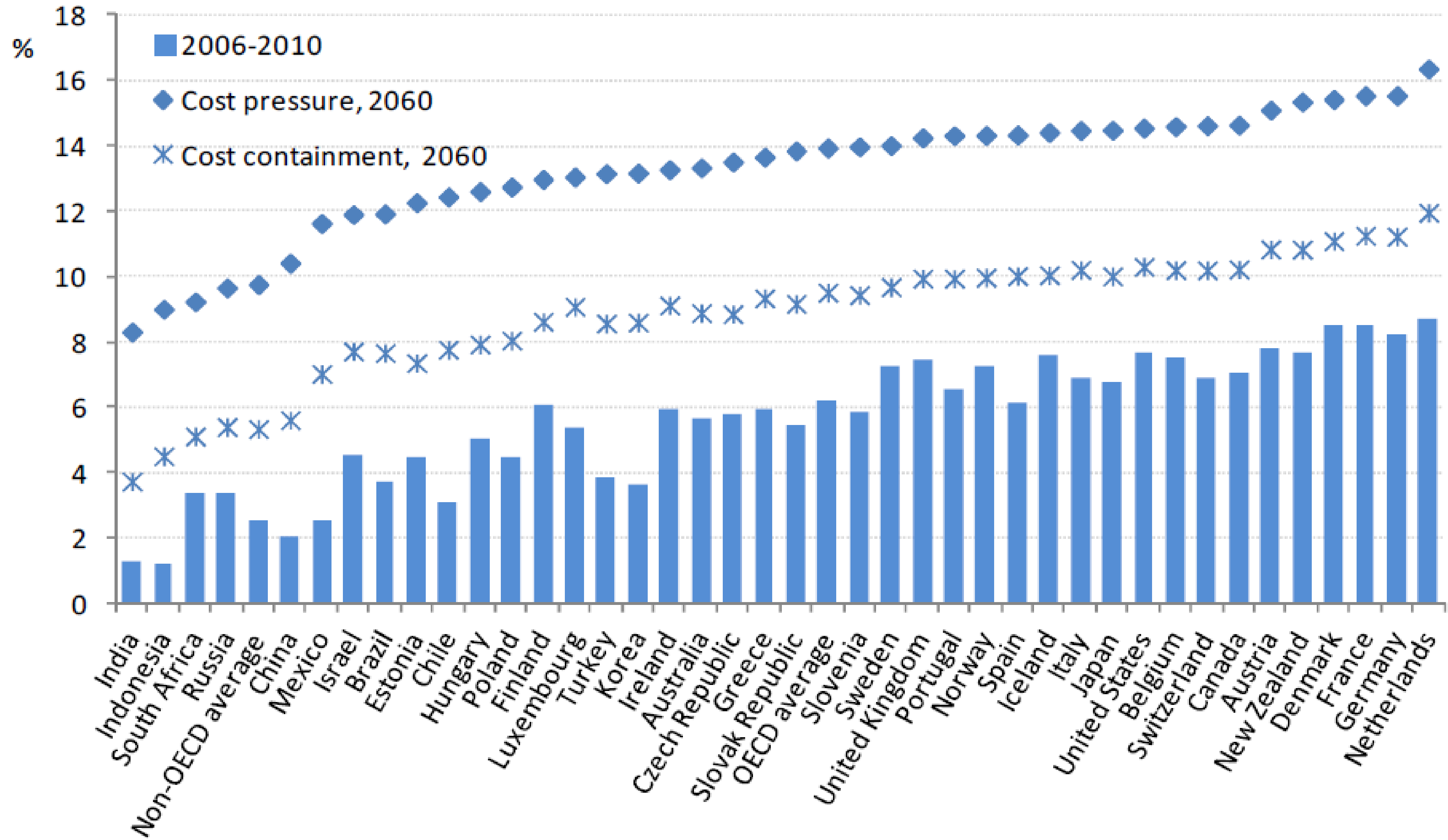
GDP per hour worked



Projections of public pension expenditure as a share of GDP from 2015 to 2050.



Public Health and Long Term Care Spending as a Proportion of GDP: Projections to 2060 under two scenarios (*source*: OECD, 2012).

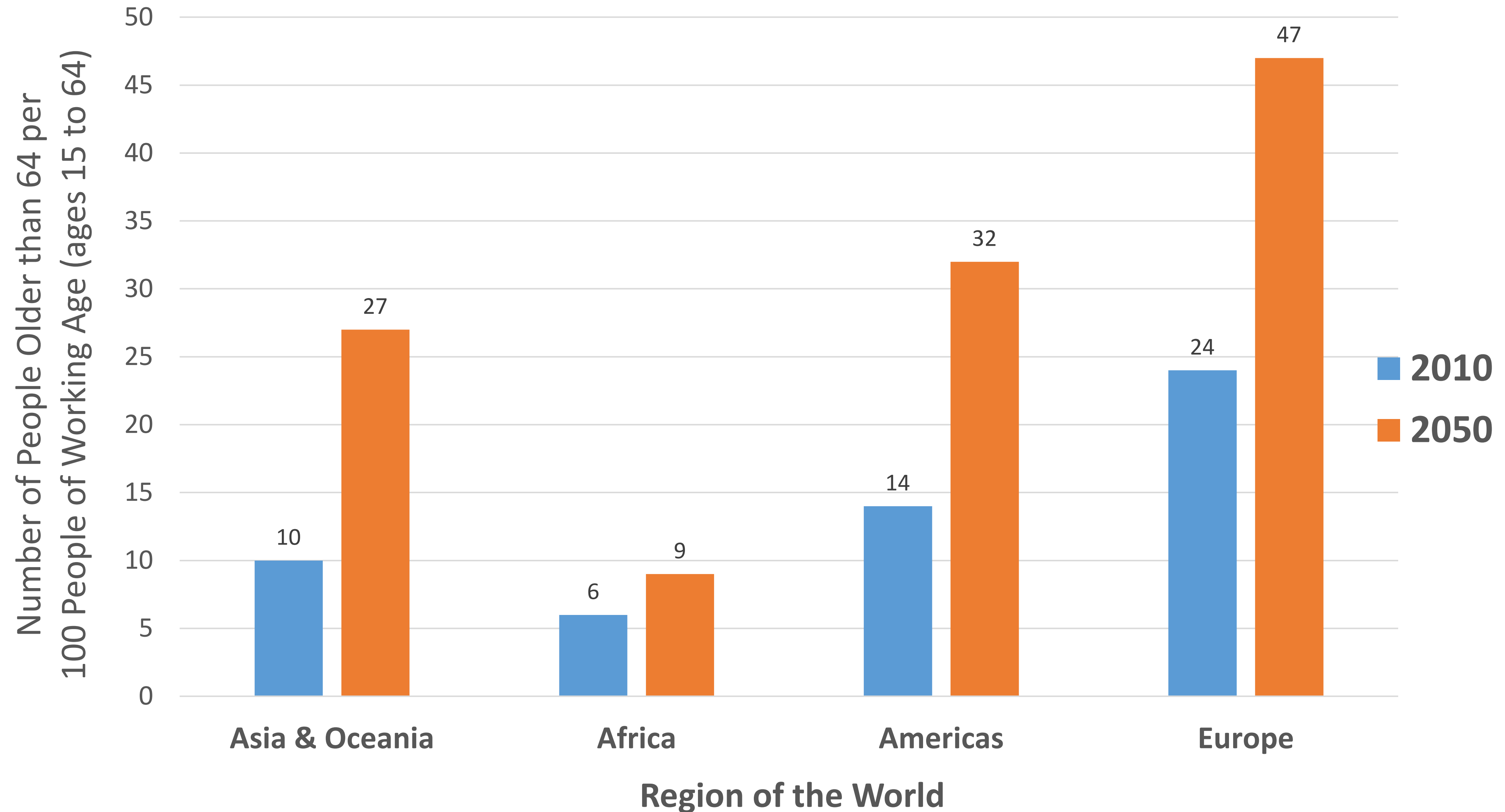


- Public health & pensions spending in NZ is forecast to rise from 12.9% to 23.4% of GDP by 2060.

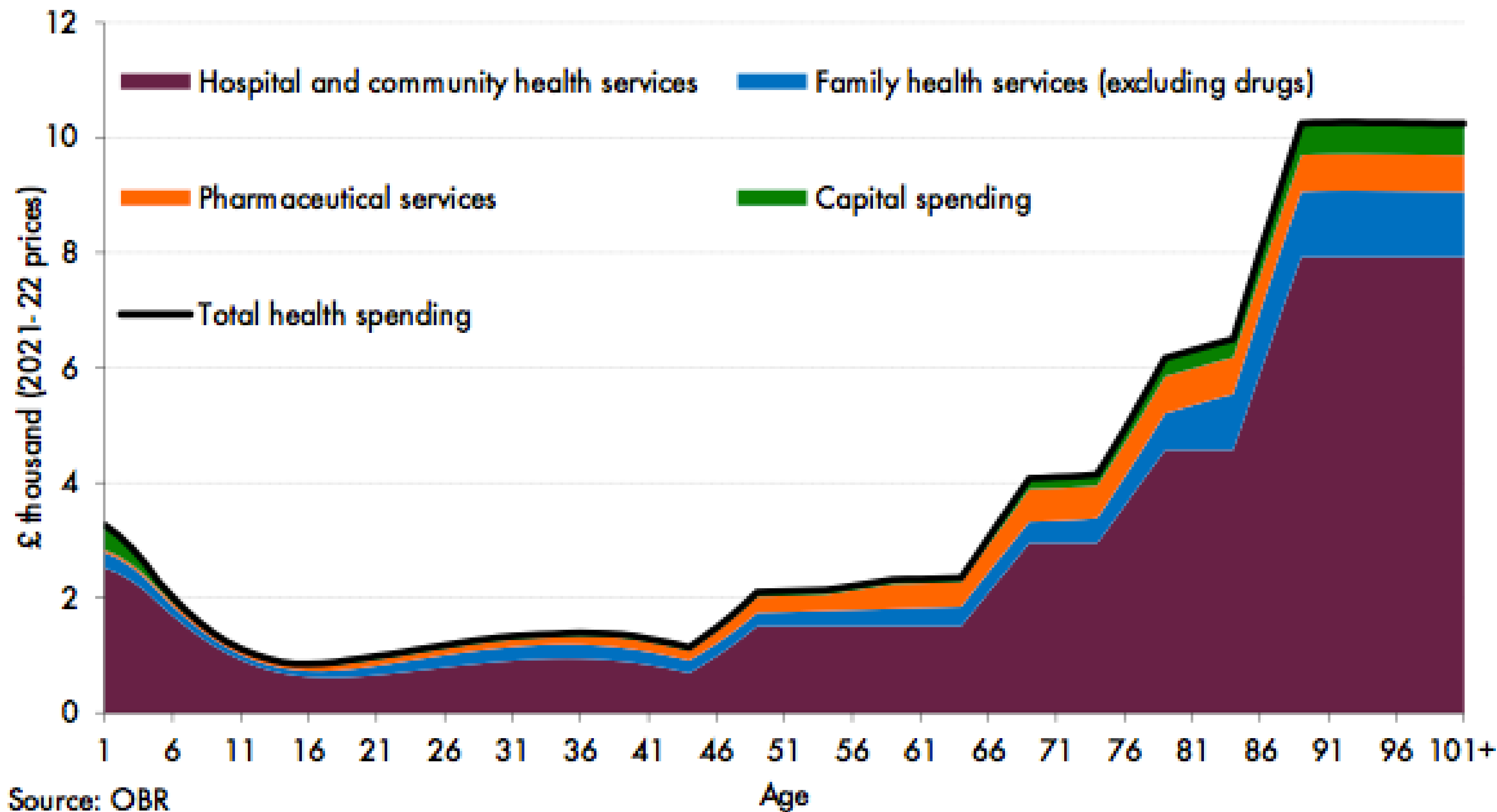
- Population ageing and expensive new technologies are blamed for rising health-care costs.

- No political party is offering solutions to address these long-term strains on our economy.

Old-age Dependency Ratios by Region: 2010 and Forecasts to 2050.



How Health Spending Depends on Age: United Kingdom



At present, there are several problems concerning welfare state reforms

- Disagreements often focus on two opposing ideological viewpoints:
  One demands *higher* welfare spending & taxes; the other *lower* welfare & taxes.

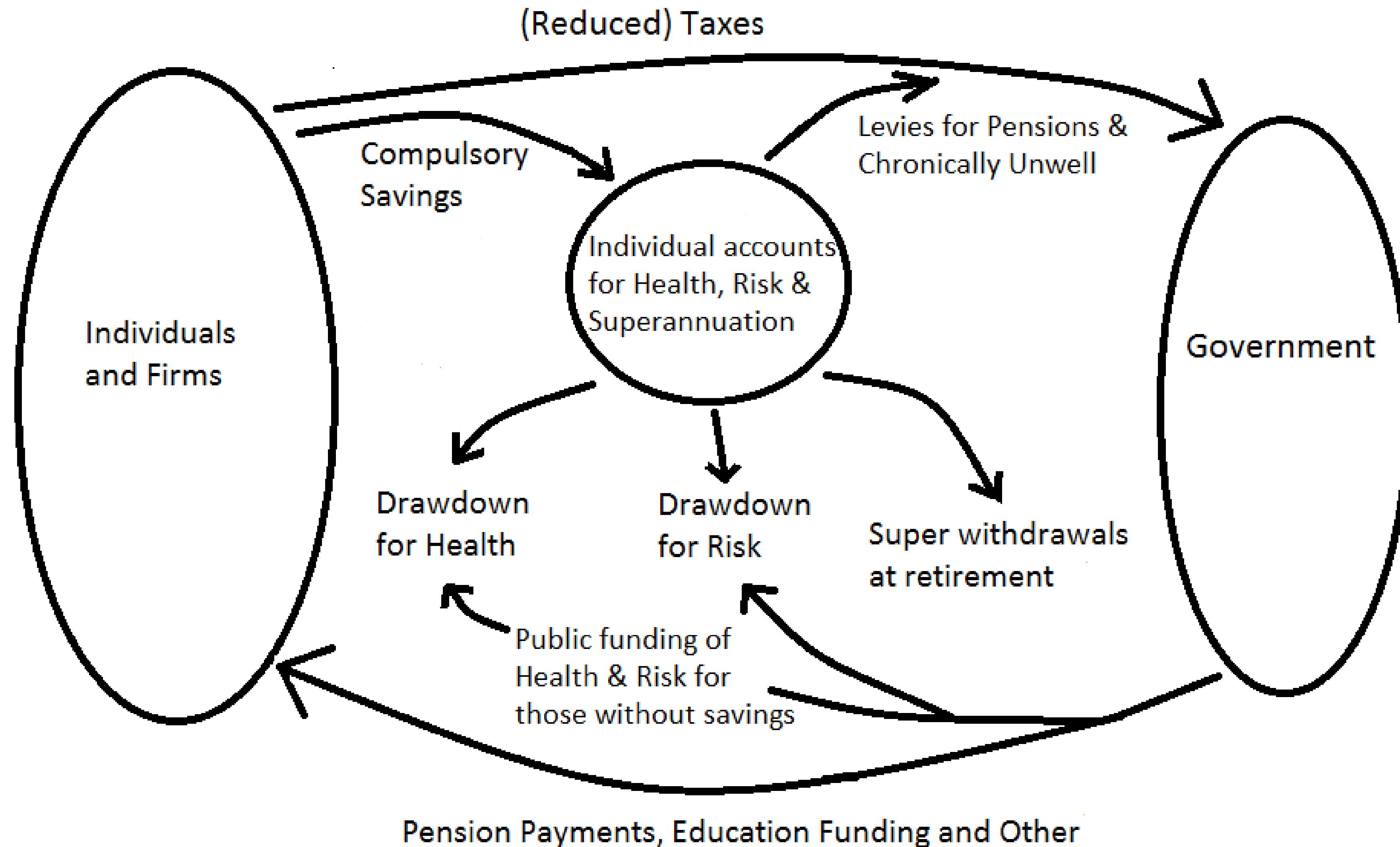
- Even when a welfare reform is proposed that looks promising in theory, designing a politically feasible transition is often overlooked.

- The debates are narrow. They seldom focus on a comprehensive reform that rewrites the rules governing the entire welfare & tax system.

A new approach to Welfare: Savings not Taxation

- Tax cuts weighted towards lower income earners enable the funding of individual compulsory savings accounts. These a/c's can be used to pay directly for medical expenses, cover events related to job-loss or accidents, purchase mandatory catastrophic insurance plans, as well as build up retirement savings.
- A drop in the corporate tax rate helps to fund employer contributions.
- These changes allow for privately funded welfare payments to substitute for many existing public ones.

Welfare: Savings not Taxation



- Our aim is to design a quality reform, where every action improves the working of the system as a whole. It is not a quick-fix that treats problems separately.

- Politically feasibility is paramount
  - Tax cuts are used to fund savings a/c’s
  - Total (public & private) welfare funding is kept similar to pre-reform levels
  - Universal coverage is maintained

- Health, retirement, risk-cover (and the taxation) systems are jointly reformed.

NZ Case Study

- Personal income tax rate (PIT) falls to 0 for single tax-payers earning < $50,000. It becomes 17.5% for $50,000 < incomes < $70,000, and 23% on incomes beyond $70,000. For one-income families with dependent children, the PIT rate falls to 0 for incomes < $65,000.

- The corporate tax rate is cut from 28 to 17.5 cents in the $ of profit. GST rises from 15% to 17.5%.

- Compulsory savings a/c's for Health, Pensions & Risk are funded by the transfer to them of taxes paid on income up to $50,000, supplemented by employer contributions.

How are the compulsory savings accounts funded?

Individual	17.5 %	*	$50,000	in lieu of personal taxes & ACC
Individual	5 %	*	$50,000	in lieu of Kiwi-Saver contributions
Employers	12.5 %	*	$50,000	in lieu of employer's taxes, ACC & Super

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→ Most individuals save 35% * $50,000 = $17,500 per year (and couples $35,000)

The Health Reform

- Each person builds up a Health Savings a/c which receives 45% of their total compulsory savings.
  An annual health insurance policy is taken out for medical events costing > $20,000 in any year.

- Once a person's health a/c reaches a certain level, required contributions↓ and disposable income↑
  A 12.5% levy is made on annual contributions to pay for chronically ill, retired & beneficiaries.

- Public spending falls, although is fully offset by more spending from compulsory a/c's.
  The gov't retains sufficient tax revenues to act as 'insurer of last resort'.
  Total health & LTC spending in Singapore is 4.8% of GDP; 17% in US and 9.5% in NZ.

Pensions and Risk-Cover

- Each person has a Super Fund a/c, which gets 35% of their compulsory savings (in lieu of Kiwi-Saver payments for many). Retirement age ↑ from 65 to 70 over the next 20 years. The gov’t pension is retained, though increasingly funded by a 25% levy on each person’s Super Fund on the date they retire.

- A Risk-Cover a/c is created, which gets 20% of compulsory savings. Once it reaches a certain level, required contributions drop. A risk insurance policy must be purchased. If out-of-work → drawdown; for medium length stays one relies on insurance; for long-term stays, gov’t assistance is given.

Summary:

Where do the compulsory savings go?

$17,500 per year =

45%	*	$17,500	=	$7,875 to Health a/c
35%	*	$17,500	=	$6,125 to Super a/c
20%	*	$17,500	=	$3,500 to Risk a/c

Corporate Welfare & Grants to High Earners

- The reform ends privilege, in the form of ‘Callaghan Innovation’, to movies that are *“produced in NZ”*, and so on. In addition, a range of ‘accelerated depreciation’ tax allowances are ended.

- It also restricts interest-free loans & grants so only students from low income, low capital families have access. Note: University students are the group who gain most from lower personal taxes under the new regime when they get older.

New Zealand Government and Savings-Based Budgets for 2015-2016

		(1)	(2)
Row		Government Budget ($NZ millions)	Savings-Based Budget ($NZ millions)
	Revenue Budget		
1	Taxation (Personal, Corporate, Goods & Services) -		
	Government cash income for year	75,200	53,350
2	Current & Future spending for Health, Risk-cover & Super		
	from private savings a/c's		20,650
	Total Income	75,200	74,000
	Expenditure Budget		
3	Health, Super, Risk-cover, Education & Other - Government	68,750	58,000
4	- Ex savings a/c's		8,750
5	Corporate Welfare and Grants to High Income Earners	6,450	0
	Total Expenditure	75,200	66,750
	Government Cash Balance (= row 1 - row 3 - row 5)	0	(4,650)
	Savings Based Budget Balance (= row 2 - row 4)		11,900
	Overall Balance	0	7,250

Conclusion

Our reform uses tax cuts to help fund compulsory savings a/c's to enable a publicly funded welfare system to be replaced by one that is largely privately funded. An important part of our contribution is to show how this transition can be achieved in a politically feasible way.

A reform of this type has the potential to lead to long-run efficiency gains, especially with respect to health-care & other forms of risk-cover.

It also helps to secure the fiscal viability of the welfare state, whilst retaining sufficient government resources to help ensure equitable outcomes.