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The income tax and transfer system: issues and options

This note is intended to be an internal resource for officials to support the analysis of tax and transfer settings. It is not government policy or advice.

The scope of this report is the personal income tax system and the transfer payments (benefits, supplementary assistance and tax credits) received by working-age individuals and families. This report discusses the broad structure of the tax and transfer interface and does not evaluate each individual transfer payment. Retirement income policy is not within scope.

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3. The nature of work is changing, which poses challenges for the tax and transfer system. There is greater diversity of working arrangements than in the past and there may be greater use of the social safety net in the future to support workers as they transition between occupations. Some argue that a universal basic income (UBI) should be introduced to reduce job insecurity in this environment. However, there is not a strong case for a UBI in New Zealand as it would reduce the effectiveness of the welfare system in reducing poverty, although overseas pilot studies should be monitored for their outcomes.

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Cash transfers are one component of overall social spending. New Zealand’s social spending is approximately equally split between cash transfers and social services (around 10% of GDP is spent on each). For the working-age population, two-thirds of social spending is through in-kind support and one-third is in cash transfers.

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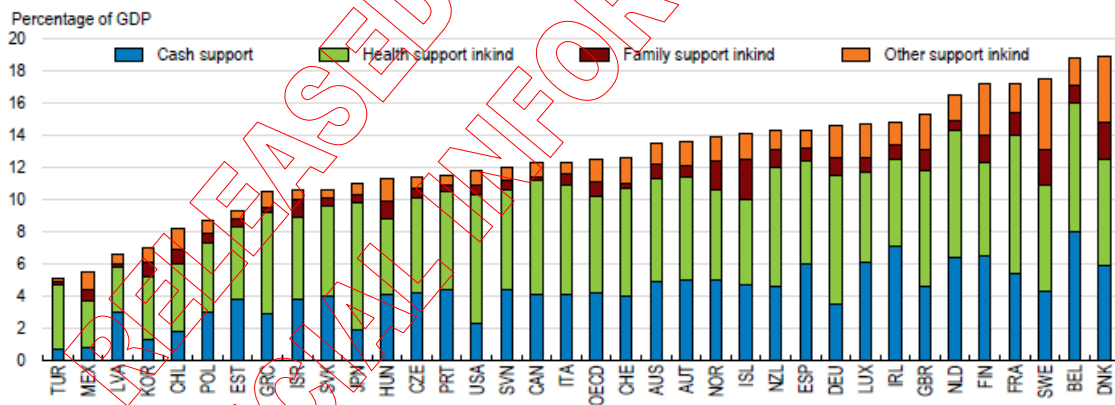
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FIGURE 1 - SPENDING ON CASH BENEFITS AND SOCIAL SERVICES



Source: OECD

FIGURE 2 - PUBLIC SOCIAL SPENDING ON THE WORKING-AGE POPULATION



Source: OECD

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There are two fundamental types of structures for income transfers: 1) a universal basic income or 2) means-tested benefits. Both can achieve a poverty alleviation goal and create a progressive effective tax rate structure. However, there will be different properties in terms of average and marginal tax rates. Related to this is the concept of target efficiency. A universal basic income is simple but is also received by the whole population, which means that some receive a transfer that is not necessary to alleviate poverty. It is typically associated with a high average tax rate to fund the universal transfer payment. Means-tested benefits generally have greater target efficiency but are associated with potentially higher effective marginal tax rates for recipients as benefits are abated.

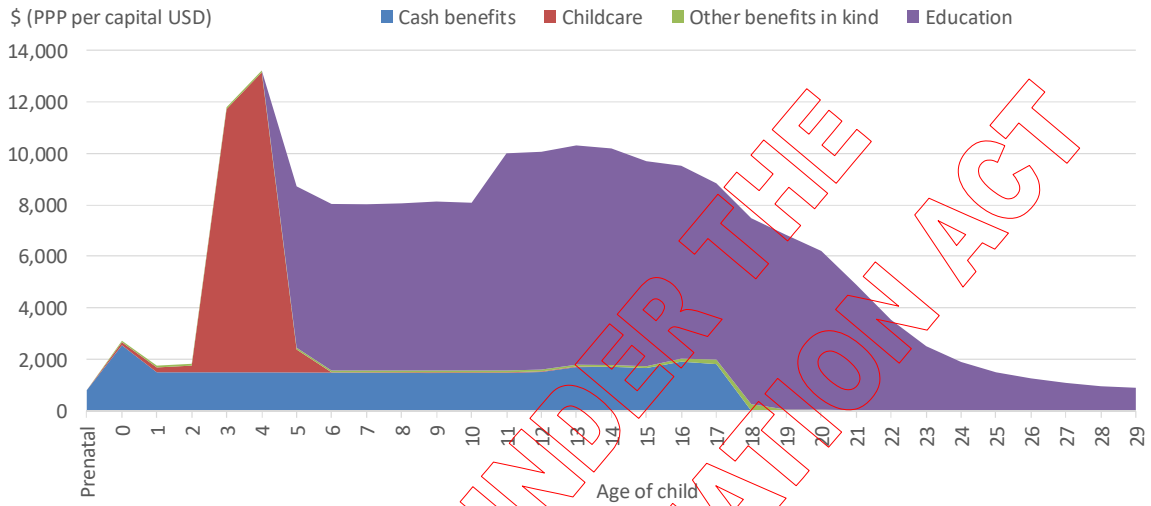
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FIGURE 21 – SOCIAL EXPENDITURE BY AGE OF CHILD IN NEW ZEALAND



Source: OECD. Note: Data is for 2011, but pattern would be expected to be similar in 2017.

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Part 2: Options

The options that are considered will depend on objectives. We discuss the general issues relating to addressing barriers to employment and income adequacy.

Options to addressing barriers to employment

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A universal basic income avoids the question of varying incomes from wages or salaries, since - by definition – this kind of payment is not conditional on earned income. In a highly targeted transfer system, however, state income support is withdrawn as income from wages and salaries increases. This can have the perverse impact of discouraging people from taking up more employment. Income taxes combine with abatement of transfers create high effective marginal tax rates.

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Universal basic income

A universal basic income (UBI) is a type of tax and transfer policy that provides a guaranteed minimum income to all households, irrespective of income, work-status or other criteria.

It is an old idea, but has received renewed attention. Its key advantage is its simplicity. Economic changes mean that workers may have greater job insecurity, technological disruption and different types of working arrangements (eg, the 'gig economy') than in the past. A UBI may support greater income security in this type of economic conditions.

The disadvantages of a UBI is that it will likely increase poverty rates, in the absence of large increases in tax revenues. Spreading existing working age benefits to the entire working age population will materially reduce the level of payment to those who already receive benefits. At current spending levels, a UBI would be substantially below the poverty line in most OECD economies (OECD, 2017). This is particularly the case for New Zealand, given New Zealand's existing transfer payments are highly targeted. To illustrate, New Zealand spends around 10% of GDP on working age benefits, which is around \$8,500 a year per working age person. A sole parent jobseeker currently receives around \$17,000 a year.

While concerns around impact on poverty rates could be addressed with a higher payment rate, this could not be budget neutral. It would require a significant increase in tax revenues, and therefore average tax rates would rise. This could materially weaken work incentives and reduce employment levels.

There are a number of pilot studies planned for UBIs in certain municipalities, including in Canada, the Netherlands and Finland. It is too early to evaluate the effects of these pilot studies, but they should be monitored for their results.

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Summary of modelling capabilities in terms of potential options

	Universal Basic Income (UBI)	Deleted - Not Relevant to Request
Potential data sources	HES	
Taxwell	Such a significant change to the system means that any results based on a static analysis may be too removed from the actual impacts.	
Taxwell B	No	

27

http://www.stats.govt.nz/browse_for_stats/people_and_communities/Children/ChildcareSurvey_HOTP2009revised/Commentary.aspx

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MSD – MSIM	Only for MSD clients	Deleted - Not Relevant to Request
IR	No – insufficient data as does not include people with no income	

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Draft 1

NEGATIVE INCOME TAX SYSTEMS

Ewen McCann¹
6 September 2000

Prepared for a Working Group on Financial Incentives to Work

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¹ I have had useful conversations with Martin Neylan while preparing this paper.

Summary

1. The negative income tax system of delivering welfare benefits consists of,
 - A lump sum transfer payment clear of tax.
 - A tax on market income.
2. All welfare delivery systems are compromises between the conflicting objectives of,
 - Decent living standards.
 - Low levels of break-even income.
 - Low rates of the abatement-tax
3. A negative income tax with wide coverage would,
 - Be administratively cheap and transparent to beneficiaries.
 - Preserve horizontal equity.
 - Offer similar work incentives for all.
4. Effective marginal tax rates are high under the existing welfare system. A negative income tax system requiring high tax rates is therefore not necessarily disadvantaged in comparison with the present welfare payment system. One issue is what tax schedule would be required to finance a negative income tax system.
5. Negative income tax methods of welfare delivery could be particularised to specific groups.
6. The issue with all welfare delivery systems in promoting incentives to work is the low rates of response of the labour supply to after tax incentives. This has been demonstrated for welfare payments generally and also in experiments with negative income tax systems.
7. New Zealand unknowingly has an extensive system of negative income tax welfare payments.
8. One part of this is the family tax credit. It is a cash grant of \$15080 p.a. after which each dollar of income is taxed at 100% until the lump sum is paid back. Education and health services are lump sums paid in kind. Families receiving them pay income tax on market income. The services thereby meet the two requirements for a negative income tax. Present welfare payments can be shown to be equivalent to a complicated system of selective or earmarked negative income taxes.
9. The negative income tax framework is a useful way of conceptualising the current New Zealand welfare payment system and thinking about reforms to it. There is a diagrammatic representation of the scheme in the Appendix.

1. Introduction

10. A comprehensive negative income tax fully integrates the tax and welfare payment systems and is the only way of doing so. It consolidates the two systems.

11. A negative income tax system requires just two things: a lump sum transfer from the Government to a person and a tax on market income.

12. The term is a mite confusing. Positive income tax is paid by people to the Government. Negative income tax is paid by the Government to the people. The receipt of money from the Government is the negative tax as far as the household is concerned because tax money usually flows in the other direction. Think of it as a poll tax in reverse. Instead of paying it a person receives it from the Government.

13. The negative income tax provides a single type of benefit that is a lump sum payment made at, say, the beginning of the period though in practice probably at intervals through it. That is the end of the benefit side of the tax/welfare system. Thereafter, all is tax. Tax is applied only on what is subsequently earned. There may or may not be a single tax schedule for all.

14. The system can be seamless between transfers to and from the Government. Threshold problems need not emerge. There is no point in falsifying welfare claims if there is universal entitlement. Tax fraud remains profitable.

15. A negative income tax need not be as comprehensive as this and it can be piecemeal, earmarked or in kind as we will see.

16. A negative income tax system would not impose marginal tax rates above 100% the way the existing tax/abatement regime occasionally does.

17. Beneficiaries apparently see at present just the total of the welfare payments that they receive without distinguishing the component benefits. There need be no separate benefits in the lump sum of the negative income tax.

18. The conflicting requirements of a decent living standard, low breakeven income (the level of earned income where benefits are clawed back in tax or benefit abatement), low tax or abatement rates, and low budgetary cost apply to all welfare payment systems.

19. There is a diagrammatic representation of the scheme in the Appendix where design and important issues around incentives to work are discussed.

2. Features of the System

20. The advantages of the negative income tax method of poor relief are that,

- It is administratively cheap and transparent to beneficiaries.
- Horizontal equity is preserved.
- Work incentives are the same for all.

21. The negative income tax system is distinguished from earmarked welfare payments which have effects that are the opposite of these. Earmarked welfare payments provide sub-groups with individualised welfare benefits. High effective tax rates of the abatement regimes can be a consequence of beneficiaries receiving more than one earmarked benefit, a core benefit and a supplementary benefit. Labour market inefficiencies result.

22. If the negative income tax reached a significant portion of or even all the population, it would be expensive and marginal tax rates have therefore to be high for at least some taxpayers in order to finance it or recoup it. There would then be significant work disincentives with it, as there are with the extant earmarked benefits.

3. Marginal Tax Rates

23. The relatively high marginal rates of income tax that would accompany a negative income tax system with broad coverage is **not** a particularly important objection to it. This is because the system of earmarked benefits that we have at present is widespread and is accompanied by high effective tax rates.

24. An extensive negative income tax system would probably involve high marginal tax rates because of the Government's budget imperative. In its pure form a negative income tax system would have the same tax schedule applying to everyone's market income. The difference between this and the high effective marginal tax rate system is that the present skyscraper skyline diagram of effective marginal tax rates need not accompany the negative income tax system. Labour market distortions should be less under the negative income tax system than under the present system of supporting the poor.

25. The proper question is, given the broad coverage and high EMTRs of the present benefit system, what income tax schedule would be required to finance a parallel negative income tax system?

4. Earmarked Negative Income Taxes

26. Half way houses seem possible, like applying the negative income tax system to earmarked groups. The trick to cost containment would be to sort groups by non-economic criteria that are not readily under the control of individuals, or that are costly for them to meet.

27. The privileged status of one group causes others to try to join it. Their success in joining would raise the budgetary cost of a programme and the new members may not be work responsive. Any social assistance scheme contains an incentive to move from work to welfare in some degree. This may make their effects on the distribution of income ambiguous. Take the case where sizeable numbers went from work to welfare, accepting an income reduction. This increases the income inequality that the programmes are designed to reduce.

28. Demographic characteristics are the obvious selection criteria for a restricted system of negative income tax. Age, gender, congenital abnormalities and dependents are either impossible or costly to modify. Excluded groups cannot readily join in. Earmarked groups could be taken off their present benefits and become a part of the restricted negative income tax system.

29. For example, all or some DPB beneficiaries could be given a suitable weekly lump sum, usually expressed as a fraction of the average wage. Then, whatever they earned above this **could** be taxed at the income tax rates applying to non-beneficiaries. The high EMTRs inherent in the current benefit abatement and income tax regimes are removed for them as a result. Work incentives improve for this earmarked group. This is an earmarked negative income tax system.

30. In a pure form of negative income tax the same lump sum is paid to all though this need not be the case. Lump sums could rise with family size or other circumstances. Administration costs would rise with them.

31. It is not necessary for its operation that the beneficiaries of the negative income tax face the same income tax schedule as other taxpayers. There are, however, clear administrative and labour market efficiency advantages a single tax schedule.

5. Responsiveness

32. Groups with the higher labour supply elasticities are the ones that are the better candidates for an earmarked negative income tax rate, as long as their memberships can be circumscribed for budgetary reasons, perhaps by demographic criteria.

33. The rates of response of work effort to changes in after tax wages are typically low. Deadweight losses are probably low because of it. From this point of view beneficiaries' present high effective marginal tax rates involve little social cost in the economic sense of the term because their labour supplies are probably inelastic.

34. It is hard to see why the high EMTRs receive the attention in policy discussion that they do when their economic welfare costs are likely to be small.

35. Just as the present welfare system appears to do little to get people working, not too much should be expected of a negative income tax either, and for the same reasons *viz*, the supposedly low labour supply elasticities.

36. This expectation has been confirmed by experiments with the negative income tax. There were tests of this welfare delivery method in the 1970's in New Jersey, Gary Indiana, Seattle, Denver and in Manitoba. The Denver experiment lasted eight years.

37. The designers of the negative income tax have problems with all of the experiments because,

- The lump sums were set at too high a level.
- It did not replace other benefits but was in addition to them.

It is for these reasons that one of them (Milton Friedman) publicly opposed President Nixon's variation of the scheme².

38. There have been a number of studies of the work incentives in the Aid to Families with Dependent Children programme in the USA. This is not a negative income tax but nevertheless,

Changing benefits formulas to increase work incentives are likely to generate minimal increases in the labour supply³

6. New Zealand Case

39. A negative income tax requires just two things: an untaxed lump sum and a tax on market income.

40. Without realising it, New Zealand presently operates an extensive though complicated negative income tax. There are three parts to the New Zealand negative income tax (*i.e.* welfare) system. One is through Family Tax Credit scheme and some similar practices, another is through benefits in kind and the other is the current general welfare payment system. We treat them in turn.

41. The Family Tax Credit is a negative income tax. It applies to a restricted group of people who receive a cash grant of \$15080 p.a. Each dollar of market income reduces the \$15080 by one dollar⁴. The two requirements of a negative income tax are therefore met by this welfare benefit. These are the lump sum grant and the taxation of market income. In this case the lump sum grant from the Government is not of a gross amount, though it can be converted to one, and the tax-abatement rate is 100%. This along with other tax credits is the first of New Zealand's negative income taxes.

² Parker, Hermione (1989). *Instead of the Dole*. Routledge, London. p 144.

³ Hoynes, H.W.(1996) *Work Welfare and Family Structure: What have We Learned?* National Bureau of Economic Research, Cambridge MA. Working Paper 5644 p 34.

⁴ This dollar reduction is composed first of income tax and then of the abatement tax.

42. The second negative income tax system is of payments in kind. Health and education goods are transfer payments in kind that the Government provides to families. These do not abate, they are lump sum transfers in kind and are unrelated to income, just like a full scale negative income tax would be. Education and health recipients pay tax on their market income at the standard income tax schedule. They are on a negative income tax system for health and education goods.

43. Negative income tax types of transfers in kind could be extended. Food stamps and rent subsidies are obvious extensions. Payments in kind are not optimal for the recipients because they will be better off, by their own lights, upon the receipt of a benefit to the same value in cash.

44. We do not hear these optimality arguments mounted to replace negative income taxes in kind by cash transfers. This is because taxpayers want to know what the transfers are being spent on.

45. A voucher system of welfare payments preserves the specified good characteristic of the transfer and would also be a negative income tax in kind that is supposedly more economically efficient than state produced goods. The accommodation supplement is similar to a voucher inasmuch as the recipient can spend it on any supplier of a specified good.

46. The current cash welfare payments are the third component of New Zealand's negative income tax system. The current system of the payment of cash benefits is a complicated negative income tax system though it is not seen as such because of the way that the abatement regimes are interpreted.

47. We see abatement as reducing the amount of the benefit in the hand as income increases. And we see income tax as reducing income in the hand as income increases. These viewpoints probably arise because of the separate functions of the Department of Work and Income and the Inland Revenue Department. We will look at them a little differently.

48. It will be helpful to imagine that the "first" division of the Department of Work and Income decides on an applicant's gross benefit entitlement and that the "second" division applies the abatement regime.

49. Let us focus on the second division's activity. A beneficiary would see no economic distinction between a reduction in a welfare cheque determined by the second division and the same reduction in take-home market income determined by the Inland Revenue Department. The person's disposable income is reduced by the same amount and has the same smaller total in each case. Income tax and abatement have the same effect on the beneficiary, as long as the penalties are equal. The reason for this is that is that abatement and income tax are both determined by the amount of market income.

50. An abatement at 70 cents in the dollar is entirely equivalent to an income tax at the same rate as far as the income-taxpaying-beneficiary is concerned.

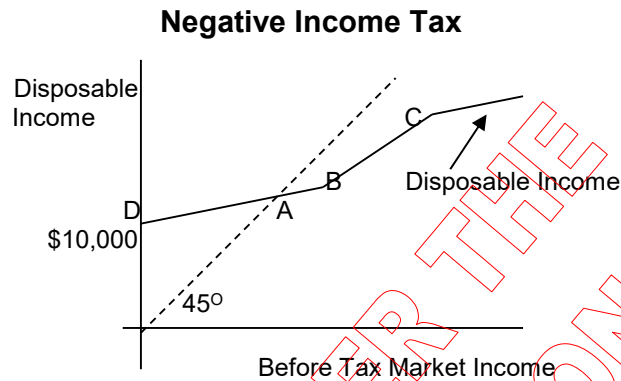
51. To a beneficiary, a particular abated benefit plus an after tax market income is therefore equivalent to a lump sum benefit plus a gross market income that is taxed at a rate suitably greater than is specified by the statutory income tax schedule. A welfare payment under the current system has been shown to meet the two requirements of a negative income tax, the lump sum transfer and a tax on market income.

52. This proves our point. The incentive effects of the benefit-abatement-income-tax regimes are the same as a specific and highly structured negative income tax system as far as beneficiaries are concerned.

53. We can, and we perhaps should, view the present tax and benefit systems as complicated negative income tax regimes. This would provide a framework for welfare payment reform, if reform is necessary.

APPENDIX

54. The diagram for a person under a negative income tax is,



55. The solid line shows the person's disposable income. The lump sum transfer from the Government is \$10,000 at point D. As the person earns income in the market place tax is paid just on that income. The slope of DB reflects that first rate of income tax. At point A the tax paid equals the lump sum transfer payment. At point B the tax rate reduces and at C it increases. The negative income tax is \$10,000 because that is what the Government gives the person.

56. The characteristics of the disposable income line reflects the incentives to work that are designed into the negative income tax system. The flatter is a segment the higher is the tax rate. Different designs shift the disposable income line and alter the slopes of the segments, *i.e.* the tax rates.

57. The slope of DB reflects a relatively high first tax rate to clawback the transfer. Point A is the clawback point, where tax paid equals the transfer received, and is always at a market income of the lump sum divided by the first tax rate, $\$10,000/(\text{tax rate})$ in this case. A lower first income tax rate moves point A north-east and increases the fiscal cost of the scheme. Points A and B could coincide.

58. The type of tax schedule reflected in the diagram carries the problem that the taxpayer-beneficiary can be trapped on segment DB. Schedules that bend the other way can also leave them stuck - at a kink such as C.

59. These sorts of problems apply to most tax schedules and they are not peculiar to the negative income tax system. Their importance is that they show that transfers, wages and taxes are only half of the incentive story.

60. The full picture involves the individual's personal evaluations. **The incentive to work is not the after tax and transfer wage.** The incentive is the difference between this amount and the individual's personal valuation of an hour's work times a constant. When this difference is positive a person will increase the amount of work that they do.

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Modelling a Cost-Neutral Guaranteed Minimum Income (GMI) Scheme – Welfare Working Group 2010

STATUS QUO – Summary of fiscal costs and measures under settings for the 2011/12 tax year

- The status quo model incorporates the personal tax structure as from 1 October 2010:

Income	Rate
\$0 – \$14,000	10.5%
\$14,001 - \$48,000	17.5%
\$48,001 - \$70,000	30.0%
Over \$70,000	33.0%

- GST set at 15%
- Rates for core benefits, Working for Families and NZ Superannuation and income projections are based on assumptions and settings from the *Budget Economic and Fiscal Update* (BEFU), 2010

	Total (\$ millions)
Financial Assistance	
Invalid Benefit	\$ 1,457.3
Sickness Benefit	\$ 884.3
Domestic Purposes Benefit	\$ 1,614.3
Widows Benefit	\$ 264.9
Unemployment Benefit	\$ 1,082.1
NZ Super and Veterans Pension	\$ 8,246.3
Under Age Non-Qualified Partner	\$ 184.1
Supplementary Assistance	\$ 748.0
Other Benefits	\$ 518.4
Student Allowance	\$ 319.9
Working for Families Tax Credit Total	\$ 2,848.2
Social Transfers Total	\$ 17,983.7
Taxation	
Tax on Benefits	\$ 584.5
Tax on Super	\$ 967.2
Other income tax	\$ 22,939.0
Individual Rebates	\$ 18.9
Tax Payable	\$ 24,471.8

Equality Measures	
Gini Coefficient	0.355
80 / 20 Ratio	3.010

Poverty Reference Line	Median HH disposable income (equivalised)
Relative Reference	\$31,671

Poverty line: % of relative reference line	% households below poverty line
50% relative	13.4%
60% relative	23.7%
70% relative	32.1%

Notes:

- This analysis is based on Statistics New Zealand's *Household and Economic Survey* (HES) 2008/09 – results are subject to sampling error
- Fiscal cost estimates detailed here are generated using Treasury's static micro-simulation model 'Taxwell' – these may differ from official Inland Revenue Department (IRD) and Ministry of Social Development (MSD) forecasts

Model 1 – GMI with NZ Superannuation

Model specifications

- Benefit system abolished
- Status quo settings for NZ Superannuation retained
- Working for Families retained – payments for dependants aged 16 – 18 set to zero
- GMI scheme - payment of \$300 per week for each person between the ages of 16 and 64 inclusive – people aged over 64 who do not receive NZ Superannuation are eligible for GMI
- All other settings and assumptions as per BEFU 2010

Fiscal Cost of GMI

Weekly payment for GMI	\$300
Total population	4,344,921
# People eligible for GMI	2,839,284
Fiscal cost of GMI (\$ millions)	\$44,463

Estimating a flat tax for GMI

	Total (\$ millions)
Financial Assistance	
General Minimum Income (GMI)	\$ 44,463
Working for Families	\$ 2,813
NZ Super and Veterans Pension	\$ 8,262
Social Transfers Total	\$ 55,537
Taxation	
Taxable income	\$ 122,380
Tax NZ Super	\$ 969
Total Tax payable	\$ 23,801
Net Benefit Cost (Tax Payable – Total Social Welfare)	-\$ 31,736

- For cost-neutrality (whereby social assistance payments are fully funded by personal tax revenue), tax payable needs to be \$55,537 million
- Revenue from personal taxes under 1 October 2010 settings is estimated at \$23,801 million
- Additional amount to raise from personal tax to fund GMI \$31,736 million
- The tax rate that raises this additional amount is $(\$55,537 / \$122,380) \approx 45.4\%$ (this is the flat tax rate for cost-neutrality)

Taxwell simulation with a flat tax of 45.4%

	Total (\$ millions)
Financial Assistance	
General Minimum Income (GMI)	\$ 44,463
Working for Families	\$ 2,946
NZ Super and Veterans Pension	\$ 8,596
Social Transfers Total	\$ 52,005
Taxation	
Taxable income	\$ 118,716
Tax NZ Super	\$ 2,081
Total Tax payable	\$ 53,843

Increase mainly due to MFTC

Broadly cost-neutral

Model 1 Contd.

Winners and Losers – Model 1 compared to status quo settings

Families (total across population)	# Families	% Families
Winners	1,485,353	65.86%
Losers	769,433	34.12%
No Change	-	-
Total (approx.)	2,255,260	

Households (total across population)	# HH	% HH
Winners	1,004,174	60.51%
Losers	655,357	39.49%
No Change	-	-
Total	1,659,531	

Mainly superannuitants and high income earners

Equality and Poverty Measures

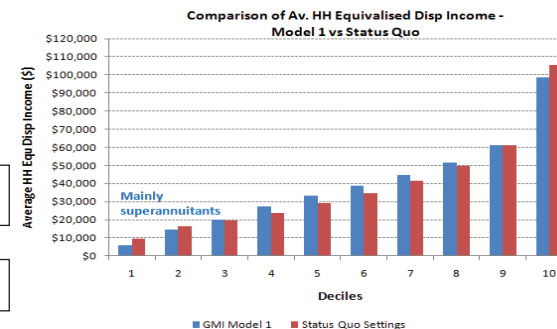
Equality Measures	
Gini Coefficient	0.349
80 / 20 Ratio	3.491

Poverty Reference Line	Median HH disposable income (equivalised)
Relative Reference	\$36,009

Poverty line: % of relative reference line	% HH below poverty line
50% relative	22.2%
60% relative	27.4%
70% relative	32.3%

The redistributive effect of GMI with NZ Superannuation

Better off compared to SQ - households in deciles 3 to 8
Worse off - mainly superannuitants who are in deciles 1 and 2 and high income earners (mainly decile 10) whose higher tax contribution exceeds the GMI payment



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Modelling a Cost-Neutral Guaranteed Minimum Income (GMI) Scheme – Welfare Working Group 2010

Model 2 – GMI without NZ Superannuation

Model specifications

- Benefit system abolished
- NZ Superannuation abolished
- Working for Families retained – payments for dependants aged 16 – 18 set to zero
- GMI scheme - payment of \$300 per week for each person aged 16 years and older.
- All other settings and assumptions as per BEFU 2010

Fiscal Cost of GMI

Weekly payment for GMI	\$300
Total population	4,344,921
# People eligible for GMI	3,361,325
Fiscal cost of GMI (\$ millions)	\$52,638

	Total (\$ millions)
Financial Assistance	
General Minimum Income (GMI)	\$ 52,638
Working for Families	\$ 2,819
Social Transfers Total	\$ 55,458
Taxation	
Taxable income	\$ 114,127
Total Tax payable	\$ 22,581
Net Benefit Cost (Tax Payable – Total Social Welfare)	-\$ 32,876

- For cost-neutrality (whereby social assistance payments are fully funded by personal tax revenue), tax payable needs to be \$55,458 million
- Revenue from personal taxes under 1 October 2010 tax settings is estimated at \$22,581 million
- Additional amount to raise from personal taxes to fund GMI \$32,876 million
- The tax rate that raises this additional amount is (\$55,458 / \$114,127) = 48.6% (this is the flat tax rate for cost-neutrality)

Taxwell simulation with a flat tax of 48.6%

	Total (\$ million)
Financial Assistance	
General Minimum Income (GMI)	\$ 52,638
Working for Families	\$ 2,993
Social Transfers Total	\$ 55,631
Taxation	
Taxable income	\$ 114,127
Total Tax payable	\$ 55,444

Broadly cost-neutral

- A flat tax of ≈ 49% (that broadly allows cost-neutrality) converts the tax less transfers deficit to a surplus

Model 2 Contd.

Winners and Losers - Model 2 compared to status quo settings

Families (total across population)	# Families	% Families
Winners	1,466,691	68.03%
Losers	788,094	34.94%
No Change		
Total (approx.)	2,255,260	

Households (total across population)	# HH	% HH
Winners	1,039,695	62.65%
Losers	619,836	37.35%
No Change		
Total	1,659,531	

Equality and Poverty Measures

	Equality Measures
Gini Coefficient	0.294
80 / 20 Ratio	2.622

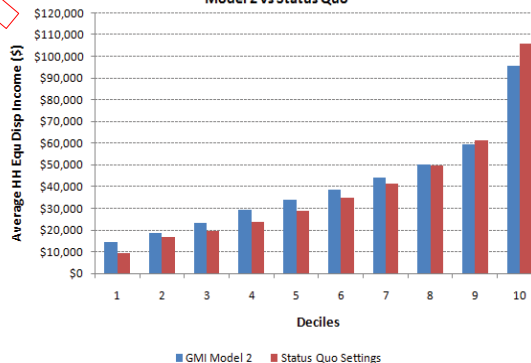
Poverty Reference Line	Median HH disposable income (equivalised)
Relative Reference	\$36,381

Poverty line: % of relative reference line	% HH below poverty line
50% relative	14.1%
60% relative	22.7%
70% relative	29.0%

The redistributive effect of GMI without NZ Superannuation

Better off compared to SQ - mainly households in deciles 1 to 7
Worse off - households in deciles 9 and 10

Comparison of Av. HH Equivalised Disp Income Model 2 vs Status Quo



Model 2A – Model 2 without Working for Families

Model specifications

- As for model 2 but with Working for Families abolished and replaced with a payment of \$86 per child per week (assuming child is aged 0 to 15)

Fiscal Cost

Weekly payment for GMI	\$300
Total population	4,344,921
# People eligible for GMI	3,361,325
# Children eligible for weekly payment	983,596

	Total (\$ millions)
Financial Assistance	
General Minimum Income (GMI)	\$ 52,638
Weekly child payment	\$ 4,416
Social Transfers Total	\$ 57,054
Taxation	
Taxable income	\$ 114,127
Total Tax payable	\$ 22,581
Net Benefit Cost (Tax Payable – Total Social Welfare)	-\$ 34,473
Tax rate that funds this scheme	50%

Taxwell simulation with a flat tax of 50%

	Total (\$ million)
Social Transfers Total	\$ 57,054
Taxation	
Taxable income	\$ 114,127
Total Tax payable	\$ 57,042

Equality and Poverty Measures

	Equality Measures
Gini Coefficient	0.292
80 / 20 Ratio	2.646

Poverty Reference Line	Median HH disposable income (equivalised)
Relative Reference	\$36,644

Other poverty measures similar to those for model 2

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Analyst - Economic Research and Analysis Unit

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The Treasury's position on income adequacy and poverty: previous advice and potential directions

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Barbara Annesley

7 April 2017

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Executive Summary

This report reviews previous Treasury advice on policy settings that directly influence income adequacy: taxes and transfers, wages and other work incentives. It considers this advice in relation to data about the adequacy of current benefits and wages, evidence on the effectiveness of different levers for addressing poverty, and wider social and labour market changes.

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Current and emerging labour market trends in New Zealand and overseas point to risks associated with low work intensity and precarious employment. These risks may contribute to reduced income adequacy, security, mobility and smoothing over the life-course. In response to such trends there have been calls for a shift from highly targeted to universal forms of income support, and from redistributive mechanisms (such as tax credits) to approaches that ensure earned income is sufficient to meet basic needs (such as 'living wage' proposals).

While previous Treasury advice is high quality, analytically sound and reflective of the agencies wider economic and fiscal interests, there is scope to strengthen it further. Suggested areas of focus for future work include: clarifying the application of the Living Standards Framework and investment approach to some income adequacy policy settings; better articulation of the respective roles and application of targeted and universal approaches; additional analysis and modelling of the universal basic income or similar concepts; the provision of advice on opportunities to improve the integrity and coherence of the tax and transfer system; and a deep-dive analysis of trends and determinants of wage levels at the lower end of the income distribution.

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Introduction

1. This report reviews previous Treasury advice related to income adequacy, considers relevant New Zealand and overseas trends and developments, and identifies potential areas of focus and opportunities to strengthen future Treasury advice.

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4. This report is accompanied by a slide pack that provides visual and summary information on the key points.

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Treasury advice on directions for change in existing policy
se *(slide 17)*

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46. A consistent message in Treasury advice is that universal benefits, and changes to tax settings and wage levels (e.g. minimum wage increases, a 'living wage') are ineffective mechanisms for addressing poverty and material hardship. Advice notes that they are costly and poorly targeted, with the potential to create significant labour market and economic distortions.

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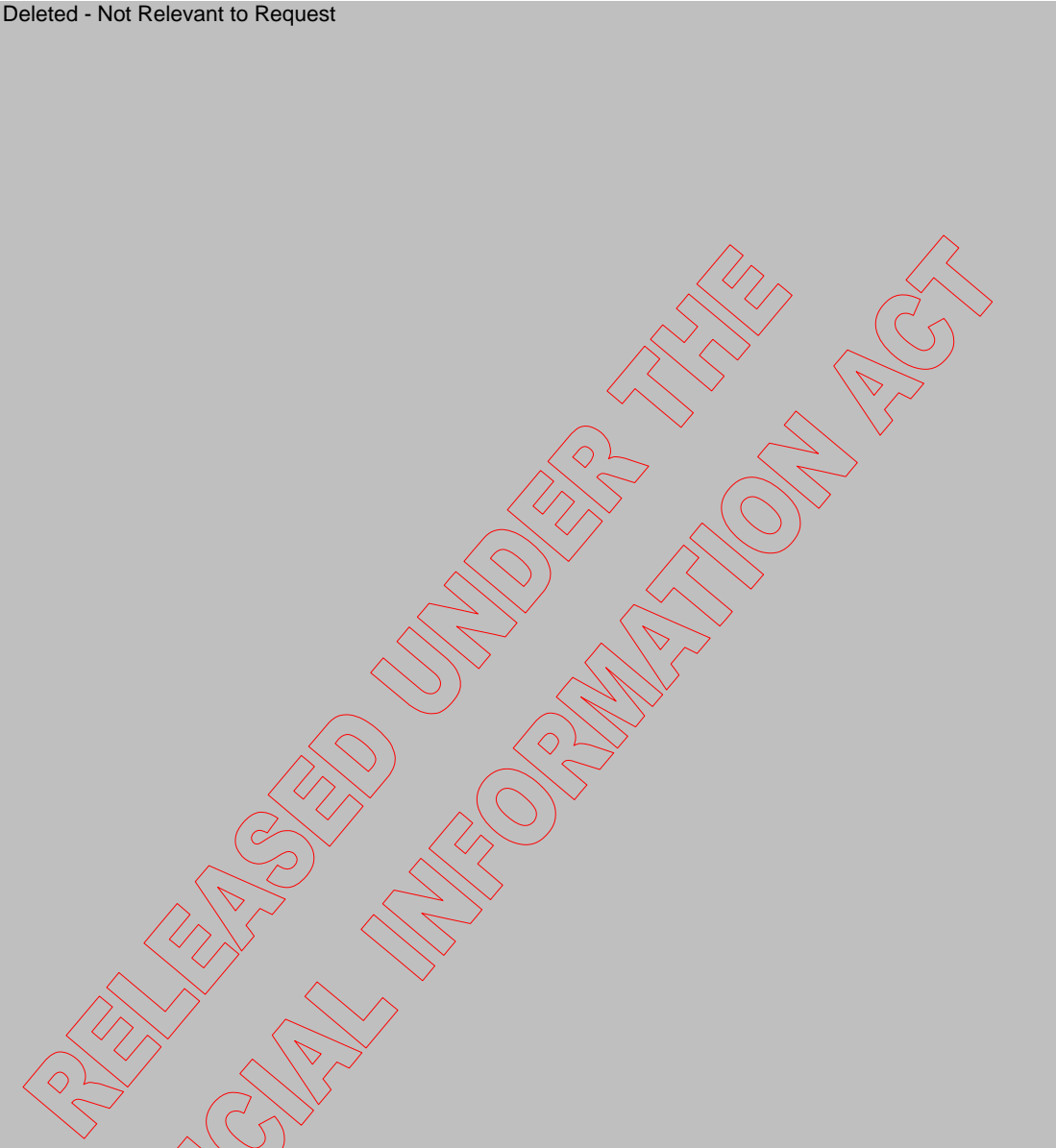
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Emerging challenges to targeted approaches to income support and social investment (slide 24)

80. Central to Treasury’s advice on income adequacy and the social investment approach is an emphasis on closely targeting assistance to those who stand to benefit the most, including using administrative data to identify risk propensity.

¹² The OECD defines activation strategies as aiming to “bring more people into the effective labour force, to counteract the potential effects of unemployment and related benefits on work incentives by enforcing their conditionality on active job search and participation in measures to improve employability, and to manage employment services and other measures so that they effectively promote and assist the return to work” (Martin, 2014, Pg 3)

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81. Standing in stark contrast to this is the growing political momentum and popular support for more universal and broad-based approaches to poverty reduction, such as through the provision of universal child benefits or a universal basic income (UBI) to replace existing means-tested and work-tested income support.

Universal basic income (slide 25)

82. The idea of a Universal Basic Income has a long history, and has recently re-emerged in response to a range of social and economic changes. These include increased inequality of income and wealth, the changing nature of work (particularly the rise of precarious and part-time employment), lack of recognition and value attached to unpaid family responsibilities and voluntary work, and concerns about some of the downsides of narrowly targeted income support (e.g. their stigmatising nature, poverty traps and work disincentives, and administrative complexity).
83. The general idea of a UBI is to provide everyone in the population (or a subsection thereof) with a minimum level of income, generally with no work obligations or means-testing. It's important to note, however that there is not one version of UBI – specific versions can include abatements and targeted additional support.
84. Proponents of a UBI suggest that it is likely to have multiple and varied benefits, including reduced bureaucracy as a result of its administrative simplicity, reduced family stress, improved incentives to develop skills and be entrepreneurial, better skills matching and labour market efficiency (as people will be able to be more selective about the employment they undertake) and increased household savings and spending, contributing to economic growth.
85. Many of these suggested benefits are purely speculative, and the lack of a robust evidence base makes it difficult to ascertain the extent to which they would be realised. Many commentators and policymakers have drawn attention to the significant costs associated with implementing a UBI, along with other issues such as negative effects on work incentives, reduced returns to skills, potential for employers to reduce wages and exploit vulnerable workers; regressive redistribution of government transfers to middle income earners.
86. For these reasons, even many of those who support the UBI concept in principle advocate a cautious approach to its adoption, such as small-scale trials to its effectiveness in delivering expected outcomes. Current and proposed overseas examples of such trials include:
- **Finland:** 2000 randomly selected unemployed people will receive a basic income instead of a benefit for 2 years
 - **Netherlands:** 250 beneficiaries in Utrecht will receive a flat sum guaranteed income for 2 years
 - **Italy:** 200 families in Livorno have received a basic monthly income, with plans to expand this further
 - **Ontario, Canada:** the provincial government is currently consulting on details of a potential pilot project to test UBI in three sites
 - **Glasgow, Scotland:** the city's council is partnering with the Royal Society of Arts to research the design of a pilot UBI project

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- **USA:** Professor Greg Duncan (an economist at the University of California) and colleagues from a number of other major American universities have completed a pilot study looking at the impact of UBI receipt on children’s brain development, and are planning a larger study involving 1000 low-income mothers and their children.

87. Closer to home, several political parties have indicated support, to a greater or lesser extent, for a UBI. The Green Party has said that they support debate and experimentation; the Labour Party has signalled that it would consider a limited trial of a UBI, while its ‘Future of Work’ discussion document suggests combining a lower UBI with targeted supplemental support. The newly established ‘The Opportunities Party’, has released a detailed proposal outlining a progressive approach to introducing an Unconditional Basic Income, starting with \$200 per week to all families with children aged under 3 (replacing paid parental leave) and for all people aged over 65 (replacing New Zealand Superannuation, but accompanied by a means-tested top-up). This would be augmented by an additional non-work tested payment of \$72 per week to all low income families with dependent children (replacing the current In-Work Tax Credit) and free full-time childcare for the under 3 year olds from families with low income parents engaged in any paid work.

88. While Treasury hasn’t undertaken a general analysis of UBI, in 2010 it undertook ‘preliminary’ modelling for the Welfare Working Group (WWG) on a specific UBI proposal involving a universal and unconditional payment of \$300 per week to all individuals aged 16 and over, with an extra payment to families with children. This modelling highlighted a range of issues and negative consequences, not least of which is the considerable fiscal cost. The following table summarises the Treasury’s conclusions about the GMI scheme, and this appears to stand as Treasury’s advice on UBIs to date (*slide 26*).

Table 4: UBI Benefits and Costs identified by the Treasury, 2010

Benefits	Costs
<ul style="list-style-type: none"> • More equal distribution of income • Removes disincentive for beneficiaries to undertake part-time work • Poverty is reduced but only at the 60 and 70 percent relative levels* • May improve labour market outcomes in some areas: more employee flexibility; encourages unpaid work; additional employee bargaining power; encourages entrepreneurial activity; and reduces the opportunity cost of full time training or education. • Lowers administrative, management and operating costs <p><i>* These specific effects relate to one or more of the three versions of the GMI that were modelled by Treasury. Fuller information is contained in the Treasury report</i></p>	<ul style="list-style-type: none"> • Poverty is either increased across all relative levels as Superannuitants have their payment decreased by 44% on average*, or is increased when measured at the 50 percent relative level*. • Horizontal equity problems due to differential treatment of one and two parent families • Many current beneficiaries (e.g. sole parents, the disabled and carers) will be financially worse off under the scheme • Reduces the supply of labour: decreases hours worked; increases migration of skilled workers; discourages people from taking entry level jobs; discourages further education and training; and the EMTRs for families with children are very high discouraging further work, MFTC*. • High personal income taxes have negative implications for saving, investment and productivity • Lowers economic growth (estimated at 2.8 percentage points per year) • Non-alignment causes integrity and coherence issues for the tax system

[\(GMI - A Preliminary Assessment of the Tax and Equity Implications:1909076\)](#) .

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89. A core assumption in Treasury's 2010 modelling was that the GMI scheme would be funded by increased personal income tax, although it was noted that it may be possible to fund part of the GMI by increasing other taxes, by base broadening, or by reducing government expenditure in other areas.
90. In developing advice for the incoming government, Treasury should consider providing well-considered advice on the risks and benefits of a UBI-type approach to income support, key design considerations, and options for meeting the costs associated with such a policy. This is likely to require new modelling to reflect different assumptions. Treasury could also consider presenting alternative options that could achieve similar objectives to a UBI, with fewer downsides.
91. More generally, the UBI debate highlights the perceived binary nature of targeted and universal approaches to improving income adequacy and distribution. In reality, all systems have a combination of both approaches. Even within an investment approach, there will continue to be a core set of universal provisions (e.g. in health and education), with explicit decisions needed about the balance between these and more targeted interventions.
92. There may be value in Treasury better articulating the respective roles of targeted vs universal support and services. A report by Gugushvili and Hirsch (2014) reviews the effectiveness of universal and targeted social spending in reducing poverty, against the background of longstanding debate and emerging evidence in this area. They note that the universal vs. means-tested debate is far from resolved, but that more recent studies have challenged the previously established correlation between universal systems, higher redistribution and improved poverty reduction. Sen (2009) whose work on capabilities has strongly influenced Treasury's Living Standards Framework, has also written on the political economy of targeting.

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Suggested areas of focus for future Treasury advice

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- Clarifying its policy position and strengthening advice on the roles and respective uses of targeted vs universal support and services, and the balance between them.

105. With regard to welfare settings, Treasury could *(slide 31)*:

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- Refresh modelling and analysis in relation to the universal basic income concept, to take account of current international developments and New Zealand proposals (though not costing specific political party policies);

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The Treasury's position on income adequacy and poverty:

Previous advice and
possible future directions

Barbara Annesley

7 April 2017

Purpose and scope

This work:

- Identifies policy levers and reviews policy advice
- Discusses emerging trends and issues
- Makes suggestions for areas for further work and focus

It doesn't:

- Provide an exhaustive review of advice, data and evidence
- Include a detailed discussion of definitional and measurement issues
- Consider the distribution of income (inequality)
- Propose specific policy changes

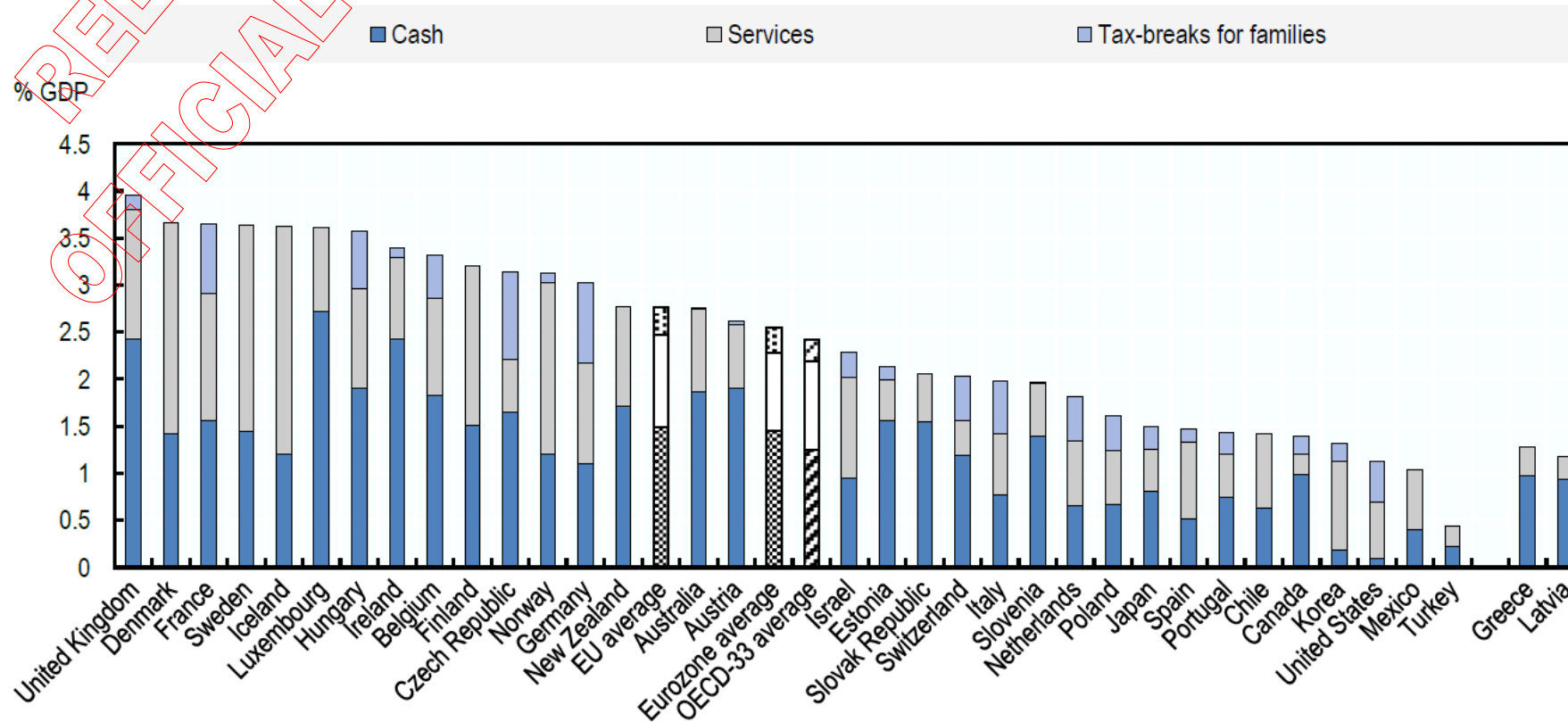
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Setting the scene:

Measures, data and policy levers

NZ has a mix of measures (noting difficulty of cross-country comparisons)

Public spending on family benefits in cash, in-kind and through tax measures (percentage of GDP, 2013)



Source: OECD Benefits and Wage Indicators Database

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Previous Treasury advice:

Frameworks used, issues identified and proposed directions for change

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Suggested areas for change identified in Treasury advice (mainly 2013-15)

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➤ **Universal benefits and changes to personal tax settings and wage levels are not supported** as ways to lift incomes (high cost, poorly targeted, potential distortionary economic and labour market effects)

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New and emerging considerations:

The nature and quality of employment; challenges to current paradigms

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Challenges to existing paradigms, settings and advice

Universal vs. targeted approaches to addressing poverty:

- UBI the most obvious example (a response to increased targeting, 'new social risks' and changing nature of work)
- In reality universal vs. targeted approaches are binary – there's a place for both
- Treasury's 2010 modelling based on specific set of features and assumptions. Worth re-visiting and doing modelling a few options

Universal Basic Income

The concept

Provide everyone in the population (or a subsection) with a minimum level of income, generally with no work obligations or means-testing

Drivers & potential benefits

Drivers

- Bureaucracy & complexity of targeted / needs-based benefits systems
- Changing nature of work (precarious, part-time & temporary employment)
- Future of work (automation, robotics & AI)
- Poverty traps & work disincentives for beneficiaries

Potential benefits

- Simplicity
- Reduced bureaucracy
- Individual flexibility & choice re training, work & entrepreneurship
- Reduce family stress & improve wellbeing (Morgan Foundation)
- Better skills matching / LM efficiency
- Recognition of unpaid work

Potential downsides

- Costly (need higher or broader tax base)
- Blunt - not tailored / targeted to different needs
- May reduce labour supply by disincentivising work
- May reduce returns to / incentives for education & training
- Implications for minimum wages.
- Could contribute to exploitative employment conditions
- Cost of low paid employment shifted to the State
- Potentially negative for union collective bargaining power
- Risks shifting emphasis away from improving the quality of work
- Risk that UBI reduces in times of economic austerity

Current/planned experiments

Finland: 2000 randomly selected unemployed people will receive a basic income instead of a benefit for 2 years.
Netherlands: 250 beneficiaries in Utrecht will receive a flat sum guaranteed income for 2 years.
Italy: 200 families in Livorno have received a basic monthly income
Ontario: currently consulting on details of a potential pilot project to test UBI in three sites.
Glasgow: Council partnering with RSA to research design of pilot.
US: Duncan et al proposal to look at impact of UBI on children's brain development (pilot study completed)
Dauphin, Canada (4 yr pilot in 1970s): Joint federal & provincial government pilot. Basic income of approx. 60% of poverty threshold.

The NZ context

- NZ data doesn't show evidence of significant job automation / rise in precarious employment
- **Greens:** support debate & experimentation. **Labour:** FoW discussion document suggests combining a lower UBI with targeted supplemental support. **TOP / Morgan Foundation:** basic income to all families with children. Labour & TOP both favour trialling
- **Treasury:** Oct 2010 modelling of 3 variations for WWG. Identified \$45-57b cost, limited / negative effect on poverty, negative impacts on LMP & HK incentives, tax coherence & economic growth. (Q whether model captured / quantified potential benefits?)

NZ Superannuation as a natural UBI experiment?

- 65+ poverty rate is one of the lowest in the OECD
- No apparent impact on LFP (high amongst 'younger'; older people)
- 65-74 yr age group has highest rate of volunteering (Stats NZ).
- But....**
- Easy to set rates as assumes no dependents & relative homogeneity
- Augmented by additional targeted support (e.g. AS) & subsidised / in-kind services.
- Indexed to wages / CPI so value is maintained
- Costly, with questions around sustainability

Previous Treasury advice on UBI

Benefits	Costs
<ul style="list-style-type: none"> • More equal distribution of income • Removes disincentive for beneficiaries to undertake part-time work • Poverty is reduced but only at the 60 and 70 percent relative levels* • May improve labour market outcomes in some areas: more employee flexibility; encourages unpaid work; additional employee bargaining power; encourages entrepreneurial activity; and reduces the opportunity cost of full time training or education. • Lowers administrative, management and operating costs <p><i>* These specific effects relate to one or more of the three versions of the GMI that were modelled by Treasury.</i></p>	<ul style="list-style-type: none"> • Poverty is either increased across all relative levels as Superannuitants have their payment decreased by 44% on average*, or is increased when measured at the 50 percent relative level*. • Horizontal equity problems due to differential treatment of one and two parent families • Many current beneficiaries (e.g. sole parents, the disabled and carers) will be financially worse off under the scheme • Reduces the supply of labour: decreases hours worked; increases migration of skilled workers; discourages people from taking entry level jobs; discourages further education and training; and the EMTRs for families with children are very high discouraging further work, MFTC*. • High personal income taxes have negative implications for saving, investment and productivity • Lowers economic growth (estimated at 2.8 percentage points per year) • Non-alignment causes integrity and coherence issues for the tax system

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Potential areas of focus for future
Treasury advice

At a strategic level, Treasury could:

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- Clarify its policy position and strengthen advice on the roles and respective uses of targeted vs universal support and services, and the balance between them

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