"It's time...New Zealand adopted a social insurance approach to welfare"

<u>Commentator</u>

Norman Gemmell

VICTORIA
UNIVERSITY OF WELLINGTON
TE WHARE WĀNANGA
O TE ŪPOKO O TE IKA A MĀUI

Chair in Public Finance
Victoria Business School

government
economics
network

So ... who to believe?

Proponent: is she a dodgy second-hand car saleswoman? ...These "contributions" are not taxes... honestly'!

Opponent: should we trust a man who promotes advice from an academic...

... with a striking resemblance to Lenin?

What do they agree on?

Both agree ... Social welfare provision:

- advantages from risk pooling
- advantages from government financing (but not necessarily provision) e.g. due to covariate risks
- is ambiguous on equity grounds
  - Lifetime versus spatial/inter-generational transfers
- there are clearly identifiable insurance *benefits* from a social welfare system – unemployment income, accident comp., healthcare, retirement income.

So *state-funded social welfare 'insurance' is a 'good thing', but what funding mechanism is best?*

- general tax revenues or 'hypothecated tax' ?

So, why do they disagree?

Disagreements boil down to:

- Funding via tax versus ‘tax-*price*’:
  - SW “contributions” are the price for perceived welfare benefits
  - SW “contributions” are a general tax (based on ability-to-pay)

You should ask three questions:

1. When are contributions most likely to be perceived as a ‘benefit principle’ tax (i.e. tax-price), as opposed to ‘ability-to-pay principle’?
2. If (compulsory) contributions are a ‘tax-price’, can the usual adverse responses to taxes be ignored?
3. Even if contributions are a ‘tax’, how damaging are the responss for efficiency?

Will contributions be perceived as a ‘benefit tax’?

Proponent: ... it is a myth but:

<u>Tax policy principle:</u>
... Make sure you fool most of the people most of the time!

Will contributions be perceived as a 'benefit tax'?

Likely depends on how far hypothecated SW contributions ('taxes') are used for redistribution.

⇒ the greater the redistribution the greater it is likely to be perceived as a tax. ... Undermines the link between 'payment' and 'benefit'; i.e. more chance of tax-type distortions

- ⇒ UK's NICs system clearly much like a tax. But could NZ 'starting from scratch' make it more benefit-related? More like Netherlands, Germany, Sweden?
- ⇒ But if no, or little, redistribution, then it becomes *either* very expensive insurance for many low-income workers, or little help to them! (Kiwisaver?)

If contributions are a ‘tax-price’, can adverse responses be ignored?

- It still involves compulsion therefore efficiency costs (ACC?)
- If government subsidises it, there are still moral hazard problems etc (EQC?)

But:

- Could there be efficiency ***gains***?
  - Stops politicians diverting ‘tax revenues’ to other things. Constrains spending? (Buchanan)
  - An insurance fund for social welfare spending provides ‘rainy day’ funds during times of macro shocks or natural disasters that could involve lower economic and social costs than emergency post-event responses. Debt crises etc. ...

Can the usual adverse responses to taxes be ignored?

Diamond and Barr (2009):

"A … system that includes poverty relief will be distortionary; minimising distortions implies minimising poverty relief … *Distortions create second-order efficiency costs but first-order distributional gains*."

Really?

- We need evidence on
  - How big are the behavioural responses to a hypothecated social welfare 'tax'
  - Does the 'salience' (prominence) of the 'effective' tax rate matter?
- Why a *payroll* tax? (related to 'work' and justifies 'employer contributions')
  - But who pays the 'employer contribution'?
  - Why exempt capital income?

So … Who to believe?

- Be suspicious of ‘tax myths’
- Be suspicious of hypothecated tax revenues (Ministers of spending departments love a guaranteed source of funding!)
- *But* is ‘willingness-to-pay’ helped by hypothecation?
- Are distortionary responses to taxes over-emphasised? Especially when taxpayers can see a ‘welfare benefit’?
- In NZ, if we want to provide better social insurance *for the poor*, why would we (a) exempt capital income; (b) pretend that their employers will pay part of the cost for them!; (c) not use a more redistributive tax?; (d) exclude unpaid ‘home workers’?