Retirement Incomes in New Zealand

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Abstract

New Zealand has a unique approach to retirement income provision. The state pension arrangements have the advantage of being very simple and easy to understand and administer. While there are numerous issues associated with the ageing of the population that may require modification to the parameters of state provision in the future, there is little political disagreement about the basic design of the state pension. In ensuring universal coverage with a flat rate taxable pension for everyone without the need for a contributions record, New Zealand has prevented elderly poverty to date. Supplementary private provision has been unsubsidised and recent debate has focused on the need to encourage more private saving particularly through work-based schemes. Nevertheless there are numerous advantages to New Zealand's tax neutral approach, which may offer lessons to reformers in other countries. With some caveats, New Zealand appears well placed to weather the increased expenditures associated with the retirement of the baby boomers.

1. Introduction

The New Zealand pension system is perhaps the simplest in the developed world. It comprises a universal state pension called New Zealand Superannuation, and voluntary unsubsidised private saving.

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Comments on early drafts from Michael Littlewood, David Feslier, Executive Director of the Retirement Commission, and an anonymous referee are acknowledged.

https://doi.org/10.1177/103530460501500205 Published online by Cambridge University Press

Public Provision

The parameters of New Zealand Superannuation (NZS) are set out in Part 1 of the New Zealand Superannuation Act 2001. After years of political debate, this part of the Act at least, enjoys wide political support. NZS is payable at age 65 years to all New Zealanders who meet the minimal residency requirements of 10 years residency since the age of 20 years and not less than 5 years residency since attaining the age of 50.

The net rate of payment for a couple without other income is legislated to be within the band of 65% and 72.5% of net Average Ordinary Time Weekly Earnings (AWE).[1] For each married person this means a floor of 32.5% of AWE is guaranteed. Each year there is an annual adjustment to reflect movements in the Consumer Price Index, unless the floor of 65% is breached at which point wage indexation restores the floor. The rate for a single pensioner who shares accommodation is 60% of the married rate, or a minimum of 39% of AWE. The rate for pensioners living alone is 65% of the married rate or a minimum of 43.25% of AWE. Each person is taxed in their own right as an individual on the gross amount, so that with mildly progressive income tax rates, the top income pensioner receives a pension worth approximately 72% of the pension of the lowest income pensioner.

Private Provision

As in other countries, tax subsidised private pensions were originally the preserve of employees in large companies and the government sector. The chief beneficiaries in the private sector were characteristically white, male, high-income long-term employees of large companies. In the state sector, a defined benefit scheme called the Government Superannuation Fund enjoyed wide coverage in the 1960s and 1970s.

In a dramatic move in the late 1980s the government flattened the tax scale and abolished all tax subsidies for saving. Previously, pension schemes had received preferential tax treatment on both employee and employer contributions and on fund earnings. While pensions were taxed as income, up to 25 % of pension savings in these schemes could be taken as a tax-free lump sum. Pure lump-sum schemes were also tax subsidised, but less generously after reforms in the early 1980s.[2]

Under the new tax regime, contributions to savings plans are made out of after-tax income so that contributions may be described as 'taxed' (T). Income accruing as fund earnings is taxed (T) at the company rate of 33%, while withdrawals from the fund are exempt from tax (E). In the terminology used in the subsequent debate, the traditional expenditure

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tax treatment involves an Exempt/Exempt/Taxed (EET) regime while the New Zealand income tax treatment of savings involves a Taxed/Taxed/ Exempt (TTE) regime (see Table 1).

Table 1. Different Tax Treatments of Superannuation

	Expenditure tax treatment	Income tax treatment
Contributions	Exempt	Taxed
Investment income	Exempt	Taxed
Withdrawals	Taxed	Exempt
	EET	TTE

By 1 April 1990 the new tax regime was fully operational with the Income Tax Amendment Act 1989 and the Superannuation Schemes Act 1989 providing the necessary taxation and supervisory legislation.[3] Schemes became 'registered' by the Government Actuary rather than 'approved' as previously for tax concession purposes.

From this point New Zealand's tax regime for retirement income saving no longer distinguished between pension and lump sum schemes. With no tax concessions, no restrictions could apply as to how scheme benefits were to be received although the trust deed could specify such details. Also there was no restriction on the amount of the employer's contribution. Rather than tight regulation, New Zealand adopted a full disclosure approach as consistent with free market reforms.[4]

These far-reaching reforms made New Zealand the only OECD country not to treat private savings for retirement differently from other forms of saving.[5] While the intent of removing privileges from certain classes of saving was to encourage investment in more productive areas, the idea of tax neutrality in the treatment of saving has been difficult to realise in practice as discussed further in the section on tax issues below.

2. Demographic Trends

As is common in OECD countries, the New Zealand population continues to age with the median age rising from 32.0 years in 1993 to 35.0 years in

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2003.[6] The working age population (15-64 years) grew 13% in this time, largely as the baby-boom cohort moved into the older age bracket (40-59 years). The number of older workers rose by 33.4 % to just over 1 million, while numbers of workers aged 20-34 fell 5.0 % to just over 800,000.

Those aged 65 years and over have steadily increased since 1993, rising 17.2% to approximately 480,000 in 2003, with the greatest growth rates at the older ages. For example, the number aged 85 and over increased 52.6%. In this age group there are nearly twice as many women as men. Life expectancy continues to improve. Today, a newborn baby boy can expect to live 76.0 years and a newborn girl 80.9 years, representing gains of 3.1 years and 2.2 years respectively since 1990–92. These gains are due largely to the reduction in mortality rates at late-working and retirement ages.

The overall population is expected to grow slowly from 4 million in 2004 to around 4.8 million mid century.[7] By then the median age will rise to 45 years as the ageing of the large baby boom cohorts combine with low fertility and longevity gains. At this time those aged 65 and over will account for around 25% of the population, compared with only 12 % in 2001. It is however expected that total dependency will rise more slowly in New Zealand than in other OECD countries.

> New Zealand will move from near the top of the international distribution for total dependency ratios to near the bottom. Concern at dependency burdens created by population ageing thus needs to be tempered by the realization that any adverse effects of ageing per se are likely to be felt more strongly in other OECD countries. (J. Bryant, 2003).

The net cost of paying New Zealanders NZS is currently 3.6% of GDP. Without policy change, this is expected to increase to 7.3% of GDP by 2051 (The New Zealand Treasury, 2004). But, the fiscal pressures of the ageing population are caused by more than just rising public pension costs. Health expenditures are expected to increase rapidly as the baby boom generation moves into retirement, especially as they move into the older age brackets in 20-25 years time. Figure 1 shows gross government expenditure projections for health increasing from 5.6% to 8.4%, while education expenditure drops slightly.[8]

To date, the increase in health expenditure has been affected more by factors other than demographic change, such as an expansion in the range of treatments provided, and increases in input prices such as wages (B. Bryant, Teasdale, Tobias, Cheung, & McHugh, 2004). If growth in expenditures due to these factors continues it will exacerbate the expected demographic influence on the growth in health expenditure as the population ages.

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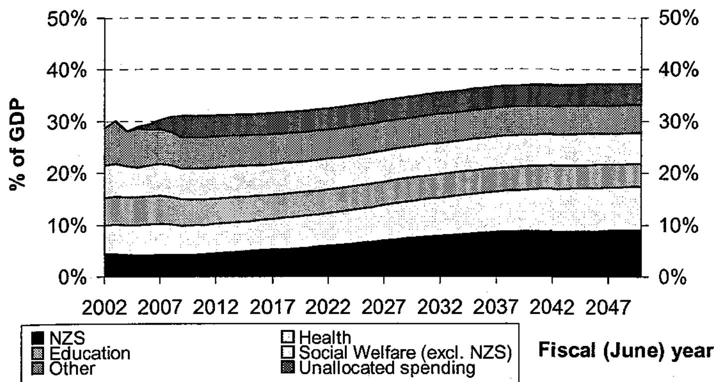
Figure 1: Gross Core Crown Operating Expenditure (excluding debt servicing) as a percentage of GDP



Source: Office of the Retirement Commission, based on 2004 Treasury forecasts from the Long Term Fiscal Model at http://www.treasury.govt.nz/ltfm/default.asp

Long-term care costs may be underestimated. Projections show an expected doubling in demand for residential care by 2021 (NZIER, 2004), and reductions to residential care asset testing from 2005 will further increase the expenditure incurred by the state. While official projections to 2051 are not available, some earlier costings projected a four-fold increase in state expenditure even without the proposed asset test changes as the 'older old' themselves age rapidly (St John, 2004a).

3. Threats to Future Retirement Incomes

For New Zealanders of modest means and with limited lifetime earnings, New Zealand Superannuation provides a replacement income sufficient in most cases to keep pensioners out of the poverty statistics (Ministry of Social Development, 2004). As discussed below, the government has sought to protect this basic floor with legislative assurance that it will be secured for everyone in the future.

While Treasury researchers have claimed there is no evidence of widespread under saving (Scobie, Gibson, & Le, 2004), some real concerns are emerging for the middle-income group. Their ability to secure a reasonable replacement rate may be significantly compromised by the demise of private pensions as a fundamental component of the retirement

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income mix. In part this is the outcome of the general decline in membership of occupational superannuation schemes, which in turn reflects the changed tax environment since 1990.

Active membership of private sector employer and government employee schemes dropped from 22.6% of the employed labour force in 1993, to 14.1 % in 2003 (see Table 2).[9] Coverage in private employer schemes shrank from 18.5% to just 11.4% while coverage in the public sector dropped from 4.1% to 2.7% largely reflecting the closure to new entrants of the Government Superannuation Fund (GSF) in 1992. A new scheme introduced in July 2004 for state sector employees and discussed below lifted this figure to around 4.6% in 2004.

Table 2. Active Membership of Occupational Schemes 1993-2003

Year	Private 000's	Government 000's	Labour force, 000's	Private	Total
1993	273	61	1,475	18.5%	22.6%
1995	254	58	1,608	15.8%	19.4%
1997	244	52	1,731	14.1%	17.1%
1999	222	49	1,741	12.8%	15.6%
2001	218	45	1,806	12.1%	14.6%
2003	217	51	1,898	11.4%	14.1%

Source: Government Actuary (Government Actuary, 2004)

Within this overall decline, membership of employer-sponsored registered defined benefit schemes fell markedly more than membership in defined contribution schemes, reflecting not just the changed tax environment in New Zealand, but a world-wide trend (Disney & Johnson, 2001: 23-27). Labour market changes probably make this shift inevitable. As Barr (2001) for example argues, albeit reluctantly, the new realities of the modern world, increasing globalisation, labour market mobility, and different family structures including more divorce, all act to make defined contribution plans more practical. The growing problem of what to do with the lump sums so generated is driving increased international attention to the annuities market. This interest has not yet been manifested in New Zealand and the private annuities market continues to stagnate (St John, 2003).

Along with a sharp decline in occupational schemes generally, "total remuneration" packages became more common in the 1990s. In these, income is grossed up and the employee chooses the nature of the savings instrument and how much to save in it, while the employer's role may be limited to facilitation and/or administration only. However, the Minister

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of Finance signalled some dissatisfaction with this approach portending changes discussed below:

> I do detect a change of attitude. The 1990s were a high watermark for individualism. A part of that was the rise of the idea of the total remuneration package. Employers recruited on a set fee for service and the worker did what he or she decided they wanted to with the wage. While this is fine in theory, there is a growing body of research that suggests that the hands-off approach works against some of that total remuneration going into long term saving. (Cullen, 2003)

Tax Issues

The tax regime adopted by New Zealand in 1990 (TTE) for retirement saving works best for superannuation schemes if the tax rate system is fairly flat. That way, the contributions tax rate applied to employer contributions, the tax rate on fund earnings and the marginal tax rate of contributors will be similar.

Once the middle tax band was lowered in 1996, and the top rate rose to 39% in 2000 as shown in Table 3, there were big disparities between taxes paid on superannuation and the marginal rates actually faced by middle-income earners. Employer fund contributions (under a withholding tax SSCWT) and earnings in the fund have attracted tax at 33%, making the regime tax penal for anyone on only a 21% tax rate.[10]

Table 3. New Zealand Tax Schedule for Personal Income Tax

Bracket	Effective marginal tax rate* 1988-1996	Effective marginal tax rate* from 2000
$0-9,500	15	15
$9,501-30,895	28	21
$30,895-38,000	33	21
$38,001-60,000	33	33
$60,000+	33	39

* Includes the low income earner's rebate

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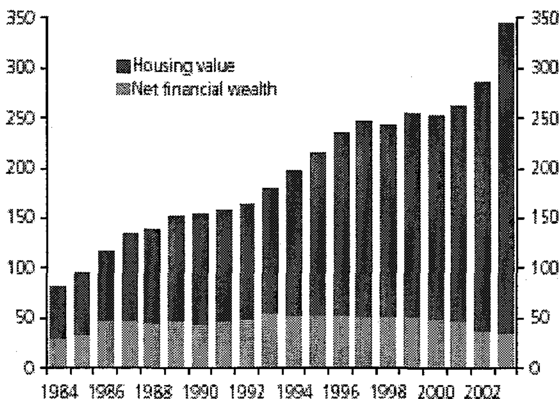
In addition, superannuation funds have had to pay tax on capital gains where such funds are deemed to be trading rather than 'passive'. Individuals who invest on their own account are usually exempt from such a tax. In 2004, a report commissioned by government to determine an acceptable tax treatment of investment in New Zealand recommended the removal of capital gains tax on non-passive managed funds (Stobo 2004).[11]

Despite the best endeavour of a working party (TOLIS, 1997) to resolve the marginal tax rate issues, there were no easy answers. In 2004 a partial solution was introduced so that employers could use the marginal tax rate of the employee for the tax on employer contributions. The option was voluntary and did not address the over taxation of fund earnings for employees on tax rates of less than 33%.

Significant tax advantages from saving in employer-sponsored schemes for high-income superannuation fund members on a tax rate of 39% can now arise. Nevertheless the 'salary sacrifice' option for high-income earners to exploit these advantages is not widespread. The Taxation (FBT, SSCWT and Remedial matters) Act 2000 imposed a fund withdrawals tax (FWT) to reduce the ability of high-income people to use superannuation vehicles as a short term means of avoiding the 39% rate.

The New Zealand experience shows that the pursuit of tax neutrality in the treatment of savings is not only difficult to achieve in the absence of flat tax, but is also illusory when other savings vehicles such as housing are taken into account. Significant biases towards investment in housing arise from the non-taxation of the imputed rent in owner-occupied dwellings, the tax-free nature of most capital gains by individuals deemed

Figure 2. Net Wealth of Households ($bill as at December 2003)



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not to be traders, and the tax regime for rental income that allows deductibility of full nominal mortgage interest and other write-offs such as depreciation.[12]

New Zealanders have proportionately more of their savings tied up in housing than in other countries (Skilling & Waldegrave, 2004). Since the tax changes in 1990, the value of housing assets has increased markedly relative to net financial assets as shown in Figure 2 (Bollard, 2004).

4. Recent or Proposed Reforms to Public and Private Pensions

Background[13]

After a period of political turmoil in superannuation policy in the late 1980s and early 1990s, a taskforce was appointed to sort out options for private provision (Report of The Taskforce on Private Provision for Retirement, 1992). The outcome of that exercise, the multiparty agreement known as The Accord (appended to the Retirement Income Act 1993), was signed in 1993 by the three major parliamentary parties: National, Labour and Alliance.[14] This cemented in the voluntary tax neutral arrangements for private saving and New Zealand Superannuation as a flat rate, taxable pension of between 65 to 72.5 per cent of the net average wage for couples, linked to private saving by a surcharge or by progressive taxation with similar effect (St John, 1999: 285; St John & Ashton, 1993: 168).

The surcharge restored a degree of progressivity to the tax system for better-off pensioners especially when the tax scale was further flattened in the late 1980s. In contrast to the income test for other social welfare benefits, based on the joint income of a couple, low thresholds and high abatement rates, the surcharge was generous. It was best described as an 'affluence' test based on individual income with a generous exemption and low abatement rate (St John 1999). In its last year of operation, it affected only around 10-15% of the retired. Nevertheless the surcharge was the focus of much political contention from the time of its introduction in 1985.

The security and stability offered by the Accord was challenged in 1996 by the formation of a coalition government. The emerging coalition document between New Zealand First and National agreed to the abolition of the surcharge and a referendum on compulsory saving. Compulsory saving was however overwhelmingly rejected by the public in 1997 by 92.8 per cent of voters (St John, 1999).

In the meantime, the framework set out in the Accord was endorsed by a

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comprehensive review (Periodic Report Group, 1997a). This review, the first of the periodic reports required under the Retirement Income Act 1993, suggested that parametric changes to the age and the level, and the introduction of some kind of integration such as formerly had been provided by the surcharge, should be considered in the medium term. It also suggested that the Accord process needed to be revived and suggested a framework for political stability to be re-established (Periodic Report Group, 1997b).

The abolition of the surcharge in 1998, even if the support of all the political parties was finally obtained, was a critical factor in the demise of the Accord. The surcharge had been the glue holding the left and right together. It represented a hard won compromise between, on the one hand, a universal pension for all, as desired by the left, and on the other hand, a means-tested, subsistence benefit as desired by the right. The pension became vulnerable to attack, as abolition of the surcharge left lowering the level or raising the age of entitlement as the only feasible mechanisms to save costs.

That vulnerability was well demonstrated in late 1998. The indexation provisions under the Accord had required that New Zealand Superannuation be adjusted by prices, but once the floor of 65 per cent of the net average wage (for a couple) was reached then price indexation should be replaced by wage indexation to maintain the 65 per cent relativity. In a surprise move, just when the wage-band floor had been reached, the National government announced the reduction of the wage band floor to 60 per cent.

Figure 3 (opposite) shows the way in which the indexation formula had resulted in a decline in the relative value of New Zealand Superannuation over the 1990s until the floor of 65 per cent was breached in 1998. The revenue formerly provided by the surcharge was about $300m a year (Periodic Report Group, 1997a: 48) and lowering the floor to allow the relativity to drop over time was one way to claw back around the same amount of foregone revenue. Of course the distributional implications of the change to the floor were quite different from that of the surcharge.[15]

The sudden unilateral announcement of the change to the floor was universally condemned. Any vestiges of security that the public had that there was an Accord process for agreed and measured change of retirement income policies disappeared. The change to the floor lacked any underpinning of data about living standards and was made without consultation.[16] There was no longer any secure link to wages as there was nothing to prevent further reductions to the floor once the 60 per cent level was reached. The Asian crisis was cited as the justification, but later the National party accepted that a political mistake had been made.[17]

After election in 1999 the Labour/Alliance government immediately

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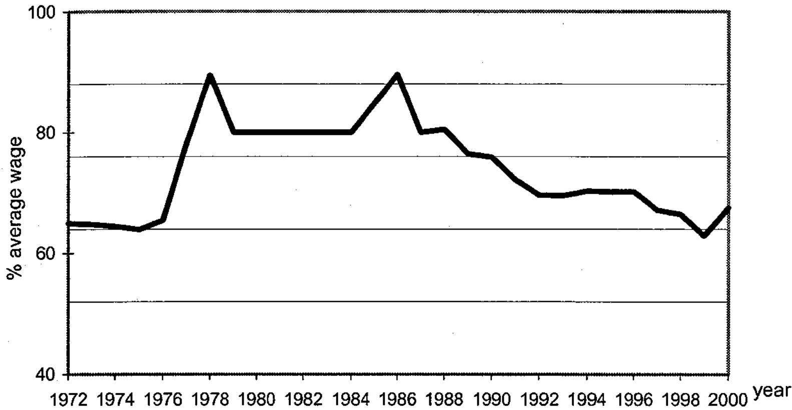
Figure 3. Net Rate of Pension for a Couple, as a per cent of net average earnings (men and women) 1972-2000



Source: Derived from Preston (2001)

reversed the change to the wage band floor, which had seen the pension for a married couple fall to 62.8 per cent of the net average wage as illustrated in Figure 3 . From April 2000 the net pension of a married couple was returned to just over 65 per cent of the net average wage, restoring confidence that the public pension would once again move in tandem with the average wage. While the Labour/Alliance government also raised the top marginal rate of tax on income from 33 per cent to 39 per cent, there was no suggestion of a return to any kind of income testing such as that provided by the surcharge.

The Emergence of the New Zealand Superannuation Fund

The Labour party campaigned on their own superannuation policy in 1999, essentially dismissing any prospects for a resuscitation of the Accord. After the election, their plans for introducing an element of pre-funding into the state scheme culminated in the New Zealand Superannuation Act 2001, Part 2 of which establishes the New Zealand Superannuation Fund.

The Fund is expected to ease the transition from pensions costing a net 3.6 per cent of GDP to a cost of around 8 per cent of GDP by the year 2050 as the demographic profile changes and the proportion of the population aged over 65 doubles (see section 2). The contributions to the Fund are made out of government's fiscal surpluses and there are no individual contributions or additional or earmarked taxes. Assets will build up for around the next 25

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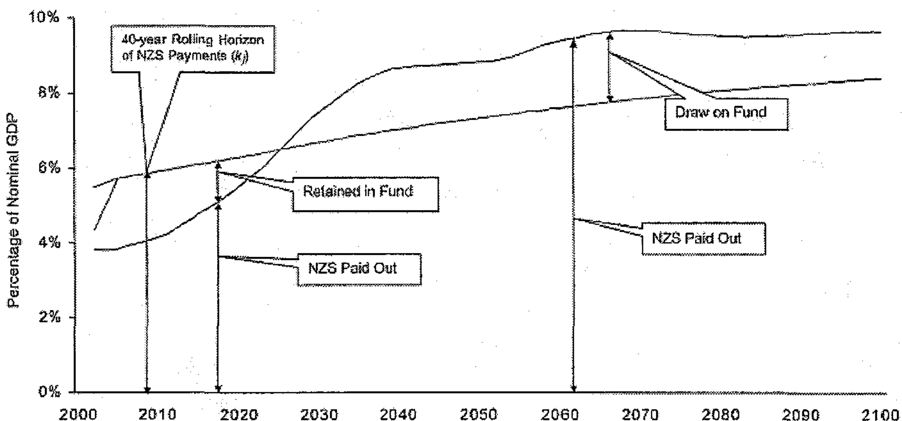
years when they will be run down along with fund earnings to meet part of the costs of New Zealand Superannuation from that time.[18] In the meantime the fund is managed at arms length by a board of appointed trustees called 'Guardians of the Fund' who use professional fund managers to invest the money both domestically and abroad. This precludes the government using the funds for other purposes or directing the portfolio mix.

While officials have downplayed any significant macro implications from the Fund, The Minister of Finance, Dr Cullen has claimed that the Fund would enable higher national saving compared to the counterfactual of tax cuts and that augmenting national saving should take the pressure off the current account deficit (Cullen, 2000).[19] It was also argued that by allowing the Fund to invest in a diversified way including overseas financial assets, the government would improve the financial position of the public sector as a whole.[20] While it could be argued that the government could diversify its assets without the need to set up the Fund, the Fund was claimed to have the additional benefit that it would 'give people confidence that New Zealand Superannuation could be paid in the future' (Cullen, 2000).

The contributions to the Fund required each year are based on a forty-year rolling horizon, and critically depend on the assumed rate of return in the Fund. The expected tax smoothing is shown in Figure 4 below where a 9.4 per cent gross return is assumed. The lower the projected rate of return, the higher taxes must be until 2025, for lower net gain once the

Figure 4. The New Zealand Superannuation Fund - Projected Contributions



Source: McCulloch and Frances (2001)

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Fund begins to run down.

Any gain from tax smoothing is conditional on strong fiscal discipline so that 'expenditure creep' does not become a problem in the face of an improving balance sheet. It is also dependent on the assumption that government's investment of the surplus will generate returns significantly above the costs of borrowing.

Part 1 of the New Zealand Superannuation Fund Act sets out the parameters of New Zealand Superannuation and locks into place the entitlement of each person, whether working or not, whether wealthy or not, to a generous universal pension at 65. This leaves little flexibility for future modification, yet the age of entitlement and other parameters may indeed need to change over time.[21] While Part 1 has attracted political support in the short term, it is difficult to see how it can be the basis of long-term agreement when the working age population are subjected to a highly targeted welfare state, including, for many, an onerous student debt scheme (St John & Rankin, 2002). While intergenerational conflict is likely, reduction of the pension rate, or making payment of it conditional on social welfare means testing, would raise other problems such as the prospect of increased poverty among the aged and poverty traps.

Part 2 of the Act did not have full political support when it was introduced. The Green, National and Act parties voted against it, and the Labour/Alliance vote was only sufficient to ensure the passage of the Bill with the help of the United and New Zealand First parties. Unexpectedly in late 2004, apparently in the interest of stability around superannuation policy, the National party decided to lend its support by signing up to Part 2. Thus the fund is not expected to be a feature of the political debate in the 2005 election year.

Notwithstanding this unaccustomed political harmony, fundamental scepticism as to the purpose of the Fund and whether it can deliver on the promises claimed for it may be justified. The objectives of the legislation are not found in the Act itself, but have been reflected in numerous speeches and press releases from the Minister of Finance,[22] for example:

> The Fund will allow us to maintain a universal pension that guarantees a basic minimum standard of living for superannuitants. It will finally give superannuitants some certainty about what the government will be able to provide for them. And they will know that they have to provide for themselves if they want a higher standard of living than New Zealand Superannuation offers. *(14/12/00)*

Critics have wondered how a scheme that is expected to provide at most

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14 per cent of the cost of the NZS[23] could ever provide such certainty or security. It is also clear that while the contribution to the Fund is the first call on the operating surplus in the government's budget, the need to contribute to the fund means that borrowing for other capital, including student loans, is higher than it would otherwise be. The intent has been, clearly, to implement the fund and entrench it so that it would be difficult to dislodge:

> My view is that the great and enduring consensuses on superannuation policy, like those in the USA and in Australia, have followed rather than led new schemes. They have followed by the law of political gravity. As the funds have grown, and as they have been seen by the population as a whole to be a clear indication of where their pensions are going to come from, they have become too strong a force to try and deny. (Cullen, 2001)

Other critics have pointed to the opportunity costs of the Fund. Money invested in the Fund may be at the expense of many other worthwhile fiscal goals (Donald, 2001; English, 2001). Likewise, high returns to fund earnings have been assumed in the projections that may prove unrealistic. If the promise of not increasing taxes for current payments of New Zealand Superannuation cannot be met, it is questionable whether the public will continue to believe the New Zealand Superannuation Fund enhances their security.

To date there have been no major controversies over the governance of the fund with a clean bill of health pronounced in late 2004 in the first audit of the fund (Eriksen, 2004). The Guardians avoided the worst of the share market declines by not investing externally until 2004, but some caution was signalled in the audit concerning the asset allocation:

> The investment performance of the Fund to 30 June 2004 has been satisfactory. The annualised rate of return for the 9 months ending 30 June 2004 was 10.4%, against a target return of 7.8%. Since the Fund has not been invested for a long period, these returns are not particularly significant and should be regarded as indicative only. For the future I recommend the Guardians increase the benchmark weighting in alternative assets and decrease the weighting in international equities. This should help meet the demanding performance target by spreading investment risks more widely. Extensive research into alternative asset classes is needed to maximise the effectiveness of the implementation of these areas of investment.(Eriksen, 2004)

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New Initiatives for Private Provision

In the state sector itself a new 'State Sector Retirement Savings Scheme' commenced in 2004 as a portable defined contribution scheme in which the government as employer matches contributions up to 1.5% of gross salary in the first year rising to 3% in the second year. There is a wide choice of investment styles, risk/return options and fee structures. Contributions may increase in future years to a target of 12% of gross salary (6% employer, 6% employee), although there has not been a firm commitment at this stage.[24]

Employees of government departments and teachers who are not part of an existing employer-subsidised scheme may join. By 2004, the take-up by more than 40,000 employees had surpassed expectations, raising the possibility that the scheme would be extended to other public sector employees such as nurses.

The government is promoting the new scheme as a role model for private sector employees. But it is not clear how private sector employers can match a subsidy whose source is the general taxpayer. In light of the generous implied subsidy from taxpayers in general, it might have been expected that the state would be looking for some social return in the drawdown phase. While it is true that the sums are locked in until retirement age, the opportunity to link the new scheme to an appropriate new annuity product was not been seized.

In mid 2004 the government appointed a working group to report on the design of a generic workplace savings product. It was taken as given that it was desirable to have such a product even though there were to be no tax incentives involved (Savings Product Working Group, 2004). Submissions were invited on their recommendations and many of these have questioned the need for such a product.[25] There are many difficult issues, such as whether there should be automatic enrolment, how part-time and casual workers might be included, rules around early withdrawal, management and approval of schemes and how all this can be achieved in a tax neutral environment. Announcements are expected in the 2005 Budget.

The proposed work-based generic scheme is based on the premise that people are reluctant to commit to saving regularly and if automatically enrolled in a scheme are more likely to stick with it. Unfortunately many potential low income contributors may have significant debts including mortgage debt and it is dubious whether directing their minimal contributions into high cost managed funds is desirable. Opt-out provisions are likely to add a further raft of complexity, but will be necessary if some people are not to be inappropriately enrolled. As well, employers are likely

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to be loathe to make the call as to where funds should go and individuals may not want to make that call either.

While the working group were not able to assume that the government would introduce any tax incentives for the generic product, it is clear that 'sweeteners' as they are called in the report are likely to be necessary. Private providers have argued that any such incentives would undermine existing employment-based schemes and may be a costly mistake, both ineffective in substantially increasing saving and cumbersome to administer.

One unresolved issue is whether New Zealand actually has a genuine savings problem. A net worth survey, showed that mean financial assets for individuals over 65 was only $140,000 (Statistics New Zealand, 2002). The median was $112,000 so that the distribution is highly skewed and on the surface New Zealanders appear less well prepared for retirement than their counterparts elsewhere. Some preliminary research has argued however, that given the substantial wealth implied by the New Zealand Superannuation pension itself, *on average*, people are likely to already be saving enough for optimal income smoothing (Scobie et al, 2004).

Nevertheless, New Zealand is a highly indebted country with persistent large current account deficits, heavily reliant on foreign savings. While this issue is a national savings problem involving more than just the household sector, concerns are increasingly being voiced about New Zealanders' poor personal savings habits. For example, the New Zealand Institute, a new, influential think tank, is arguing for policies to create an 'ownership society' as the way to achieve higher rates of investment, productivity, and growth:

> ... increased household savings will reduce New Zealand's level of external debt and will place downward pressure on interest rates. Given New Zealand's highly indebted position and its high interest rates, this is also a particular priority for New Zealand. These economic benefits provide a powerful case for deliberate action to raise savings by New Zealand households, additional to the social and community benefits that are generated by asset ownership. Together, these social and economic arguments create a compelling case for action to raise the level and broaden the distribution of asset ownership by New Zealanders. (Skilling, 2005)

In the election year 2005, it remains an unresolved task for politicians to produce effective means of raising private savings and increasing wealth ownership. It is far from obvious for example, that the re-introduction of tax incentives would be desirable, as the features that made them undesir-

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able in the 1980s have not changed.

In the debate about private saving, there has been little acknowledgment that tax incentives, by allowing regulations, can be used to secure wider social goals. This may be because New Zealanders are reluctant to revisit the world of rules and regulations that proved so cumbersome pre-1988 (St John and Ashton, 1993). Thus there has been no virtually no discussion of how tax incentives, if accompanied by appropriate regulation, might exert a socially beneficial influence on the nature of the retirement saving. Indeed, the power to ensure regular retirement income as opposed to lump sums may be the only economic justification for such concessions. To date, annuities and pensions and their interaction with the state pension and other aggregated expenditure have received negligible attention.

An attractive annuity product to supplement New Zealand Superannuation for middle income New Zealanders might have all or most of the following features:

- Be good value for money;
- Be inflation-proof;
- Provide flexibility and be less of a lottery than is currently the case;
- Allow, in suitable cases, the use of part of the equity in owner-occupied housing for the annuity purchase;
- Be gender neutral, given that the majority of both men and women do not experience the extremes of longevity;
- Include insurance for catastrophic care costs;
- Insure to some degree against growth in living standards.

It is evident that the private sector cannot provide a product that meets most or all of these criteria on its own. Examination of annuity markets overseas reveals that the state usually plays a substantial role in the successful development of these markets (for example Mitchell & McCarthy, 2002). One of the advantages of the tax neutral approach to retirement saving accumulation in New Zealand is that it leaves open the possibility of transparent government subsidisation of the decumulation phase to meet explicit social goals. This nettle has yet to be grasped.

In the meantime, new products for home equity release are emerging that offer access to part of the equity in an older person's home in the form of a lump sum (St John, 2004b, Davey, 2005). As the baby-boom generation enter retirement and seek to liquidise their housing wealth, it is desirable that the hands-off approach to regulation of such products and the anomalies of the tax regime applied to genuine annuity-based products receive the necessary attention.

https://doi.org/10.1177/103530460501500205 Published online by Cambridge University Press

The Decision Making Process

The original Accord and the regular six yearly reviews provided a process for measured change. An amendment to the New Zealand Superannuation Act due to be passed in 2005 will repeal the Retirement Income Act 1993 and along with it abolish any reference to the Accord and 6 yearly reviews. In the future three-yearly reviews will be conducted by the Retirement Commissioner. While there is to be consultation regarding the terms of reference for these reviews, concerns are not allayed that a robust and independent process of review has been adequately assured.

The provision of consultation with the signatories as set out in Part 3 of the Act for any proposed changes does not, for example, imply that political consensus will be sought, nor that there is an independent chair for the process. Yet the history suggests that a reasonable degree of consensus must be the firm basis for ongoing stability and certainty. Some clear guidelines for achieving political consensus were set out in *Building Stability*, the report of the Periodic Report Group (1997b), but these were set aside, as the government sought to stamp its own distinctive mark on superannuation policy for the 21st century.

5. Lessons For Other Countries

The strength of the New Zealand approach has been the simplicity and effectiveness of the public universal pension. Wide coverage is assured and poverty concerns among the old have been effectively addressed. The voluntary private saving regime has also had the advantage of simplicity and is more vertically equitable than would be a system based on tax incentives. In all of this there may be lessons for other countries, especially, but not only, developing ones (St John & Willmore, 2001).

However there are also lessons in the emerging concern around the need to promote work-based saving. It is possible that poorly defined debates over savings may lead to pressure to abandon some of the advantages of simplicity and effectiveness of the unique New Zealand model in the illusive pursuit of additional private saving.

There are also potential lessons to be learned around the role of pre-funding. Debates about the division of future output between the old and the young, about the size of shares and the shape of New Zealand Superannuation are not resolved by pre-funding. While it might appear that the Fund and its earnings, by supplementing tax revenue, can reduce the burden on workers, the effect is illusory. Regardless of where funding comes from the cost of the pension is the same as is the implied sacrifice of the working-age population. The cost is the consumption of the old (the pen-

https://doi.org/10.1177/103530460501500205 Published online by Cambridge University Press

sion benefits paid). The revenue of the Fund could be used to meet the needs of the young: a point made clearer by imagining the Superannuation Fund is not ring-fenced for superannuation, but simply represents additional assets on the state's balance sheet (paid for by the sacrifice of all workers). Nevertheless, despite these economic arguments, it must be conceded the New Zealand in the mid 2000s is enjoying a period of unprecedented political stability around superannuation policy.

The decumulation phase of retirement saving has received only cursory attention to date. In a brief section entitled 'The problems of post retirement and the role of annuities' it was acknowledged in the 2003 Periodic Report Group review that:

> Debate about private provision in New Zealand is focused on asset accumulation; there has been little focus to date on converting assets to income. Converting assets to income will become increasingly important in New Zealand as the population ages. (Periodic Report Group, 2003)

It is to be hoped that one day soon there will be a suitable time for this issue to be discussed. The focus on the accumulation phase, while a worthy and necessary one in many respects, may be misplaced. The first reason is that it is too late for many of those in the baby-boom cohorts whose ability to save more is already constrained through job losses, sickness or demands of family. The second is that the use of assets by the retired to support their own retirement is vital if important intergenerational equity issues are to be addressed. More intragenerational risk sharing may also have the potential to relieve the pressure on the working age population so that they too can also save for their own retirement.

6. Concluding Comments

The New Zealand retirement income system provides a largely satisfactory basic income for all citizens regardless of contribution with a high degree of simplicity and cost effectiveness. New Zealand is well placed to grow old but there will be undoubted pressures on the pension system as the baby boomers retire and eventually contribute to rapidly rising costs in general health and for long–term care. There are also warning signs that the expectations of many middle-income retirees for replacement income may be disappointed.

It can be expected that individual savings and how best to encourage them without reverting to the failed tax incentive policies of the past will dominate the pensions discourse for the rest of the 2000s.

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Notes

1 AWE is weekly earnings averaged for male and female.

2 For a discussion of these reforms which were implemented between 1988-1990 see St John & Ashton (1993): 21-45.

3 The Superannuation Schemes Act 1989 emphasises the responsibilities of trustees and applies equally to schemes that are sponsored by employers and those offered to the public via retail schemes.

4 As well as the minimal requirements of the Superannuation Act 1989, schemes must also meet the information and disclosure requirements of the Securities Amendment Act 1996 and the Investment Advisors (Disclosure) Act (Periodic Report Group, 1997a: 191).

5 Both New Zealand and Australia have moved away from the idea that end benefits only should be taxed. Countries with traditional EET models watch the Australasian approach with interest, but it is New Zealand whose model, at least until recently, has been the purest.

6 Data in this section is drawn from Statistics New Zealand (2003).

7 Based on Statistics New Zealand Projection Series 4 in which it is assumed that New Zealand women will have, on average, 1.85 children each; life expectancy at birth will increase to 82.5 years for males (a gain of 6.4 years) and 86.5 years for females in 2051 (a gain of 5.5 years from 2001); and there will be a long-term annual net migration gain of 5,000 people from 2007 onwards.

8 Note that Figure 1 shows the gross expenditure on NZS, rather than the net figure which allows for the tax paid on the pension.

9 Retail superannuation schemes expanded at this time, as individuals were encouraged to take responsibility for themselves. Between 1990 and 2000 retail membership increased from 236,062 to 447,858. The accumulated assets in occupational schemes continued to rise, but very slowly and the balance shifted away from defined benefit to defined contribution assets. (Government Actuary, 2001)

10 A complexity is noted for many middle income earners whose marginal tax rate is effectively much higher than 21% due to the abatement of family assistance payments.

11 Despite the expense, the government has indicated a willingness to address this issue by 2006.

12 Note the depreciation claimed may eventually become taxable on the sale of the rental property.

13 For a history of superannuation in New Zealand see also Preston (2001)

14 Later, in 1994, these three were joined by the United Party.

15 Some evidence of poverty among the elderly was emerging as the relative value of the pension fell (Stephens, Frater, & Waldegrave, 2000).

16 The Periodic Report Group's 1997 report recommendations were ignored throughout 1998.

17 The National Party now support the current arrangements for New Zealand Superannuation at no less than 65 per cent of the net average wage at age 65

https://doi.org/10.1177/103530460501500205 Published online by Cambridge University Press

for a married couple (for example see election speeches at http://www.national.org.nz).

18 There are a series of working papers that detail the assumptions and the projections for the fund, see for example The New Zealand Treasury (2000). Also see the Treasury web site: http://www.treasury.govt.nz/

19 The concern about the current account deficit and the need to address it with more saving is not however reflected in all Treasury working papers (eg Kim, Hall, & Buckle, 2002).

20 Already there had been moves to free the Government Superannuation Fund (for state sector employees) from restrictions on international asset holdings.

21 The select committee commentary released 12th June 2001 makes the view clear that the fund cannot, and should not, be taken to mean that debate on superannuation is over, or that all the design issues have been resolved.

22 See website of the Minister of Finance: http://www.executive.govt.nz/minister/cullen/index.html

23 The controversy over the actual saving achieved hinges on how the tax revenue from the fund investments is treated. The Minister of Finance insists that this revenue is part of the return to the fund so that the funds should supply not 14 per cent, but around 25 per cent of financial costs of New Zealand Superannuation. Either figure is conditional on the assumed rate of return being achieved.

24 Existing schemes that were set up to replace the old government superannuation fund scheme will integrate over time with the new scheme.

25 Including for example, submissions from the New Zealand Business Roundtable, the Association of Superannuation Funds of New Zealand, Tower Corporation, and private consultant, Len Bayliss.

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