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Retirement saving choices: challenges for indviduals, industry and public policy

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Abstract

New Zealand and Australia take a unique approach to state pension provision that marks them out from the countries that have been the traditional source of settlers such as Canada, UK, Ireland and the Netherlands. This uniqueness derives from an entitlement solely based on residency and not contributions. Even so, there are stark differences between the Australian and New Zealand state pensions which raise an important set of issues for movements between these two countries.

In an increasingly mobile world, there is more choice of where to live in retirement, but the information on which to base that choice is not always clear. Immigrants reaching retirement age in New Zealand may find to their surprise that even after working many years they do not qualify for the state pension, New Zealand Superannuation (NZS). Under Section 70 of the Social Security Act 1964, NZS is offset dollar for dollar by overseas pensions that are deemed analogous. Recent amendments to New Zealand legislation have improved the ability of pensioners to emigrate with their pro-rata entitlements, but have failed to address the very real inconsistencies and inequities for those who stay, and have intensified Trans-Tasman problems.

The Australian/New Zealand case is covered by a reciprocal social security agreement for retirees that in some respects appears strongly biased in the favour of Australia. A more general solution to New Zealand's overseas pensions problems may require a sharp increase in residency requirements. In this framework, the New Zealand/Australia social security agreement would also require renegotiation if it is to provide consistency and improve choice.

Key Words: Social security agreements, pensions, residency

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1 Introduction

The global trends of population ageing and increasing labour mobility require suitable and equitable policies for public pension portability. An increasing number of New Zealanders spend some years working overseas; and an increasing number of overseas-born citizens immigrate to and retire in New Zealand. Both these groups may have contributed through taxation and/or through compulsory or voluntary payments into superannuation or pension schemes, perhaps in more than one country. Both are affected by the pension policies of the countries where they have contributed, and to which they wish to retire.

The many complex issues surrounding portability of the state pension, New Zealand Superannuation (NZS) and treatment of those with overseas pensions are outlined in several recent publications (Dale, Lazonby, St John, & Littlewood, 2009, p. 35; Dale, St John, & Littlewood, 2009b, 2010; Lazonby, 2007; Smith, 2009b, 2009c). While consistent treatment of all those who come to New Zealand with overseas pensions, as well as of those who retire abroad, is desirable, the amount of NZS accessed should also appear equitable to New Zealanders who have lived all their lives in New Zealand.

This paper focuses particularly on the implications for Trans-Tasman arrangements within the context of New Zealand's overall international policy. This is an important issue, given the proximity of, and historical ties between Australia and New Zealand. There has been concern about the stronger Australian economy attracting New Zealand's skilled working age population. The numbers of New Zealanders who are retired in Australia is also increasing, raising many issues around tax and pensions (The Association of New Zealand Retirees in Australia, 2009).

Recently there have been Trans-Tasman changes that have improved the tax treatment of private pensions so that tax-free pensions from one country are not taxed as income in the other. Curiously however, the social security agreement, last negotiated in 2002, has not been on the agenda for revisiting despite the major change in portability laws made in the 2009 New Zealand Superannuation and Retirement Income Amendment Act.

1.1 *The role of the state in pension provision*

Figure 1 below illustrates that in the modern world there is a complex spectrum of state interventions in pensions, including subsidisation of private provision[3].

Figure 1. Spectrum of state involvement in old age pensions

Pure private

1. Pure voluntary saving
2. Tax-subsidised private saving
3. Mandatory private saving
4. Mandatory public saving
5. Social insurance
6. Earmarked taxes
7. Tax-funded flat-rate universal pensions
8. Tax-funded flat-rate means-tested pensions
9. Social assistance

Pure public

Source: St John & Ashton (1993)

At level one, there is private unsubsidised saving. At level nine of the spectrum, a subsistence poverty alleviation approach is provided by a means-tested welfare benefit,

3 See Dale, St John et al. (2009b) for further discussion of this spectrum.

unrelated to either former contributions or residence requirements. No developed country relies on these extremes exclusively, though New Zealand did briefly appear to in 1991 (St John and Ashton,1993).

Moving from the top end of the spectrum, a government may subsidise or compel private saving, as indicated by levels 2, 3, and 4. In these arrangements there is a close relationship between contributions made and final benefits received, although the state may subsidise contributions even when the scheme is compulsory. Such arrangements require that a fund is built up; and final payouts depend on how successfully the fund is invested. The Australian and Chilean schemes are examples of mandatory private saving (level 3). The Singapore Central Provident Fund is an example of mandatory public saving (level 4).[4]

The next step following the Bismarkian tradition (earnings-related pensions), is social insurance (level 5), which is the main type of pension scheme adopted by many developed countries. These schemes generally require employers and employees to make compulsory contributions and while there may be a reserve fund, benefit payments are made on a pay-as-you-go (PAYG) basis according to a formula that reflects the earnings of the employee. Pensions are paid as of right and are therefore not means-tested.[5]

Social assistance systems (level 9) usually run alongside social insurance schemes to ensure that people who have not earned or saved enough in their working life will not be destitute when they are elderly. Assistance, funded from taxation or other general government revenue, is means-tested, and often has other conditions attached to it. "It is … the lowest cost way of providing public pensions of any given level from taxpayer funds." (Preston, 2008, p. 7)

Variants of social insurance may include the use of an earmarked tax (level 6) rather than keeping a contributions record with no attempt to relate the benefits closely to contributions. In the extreme, a flat-rate pension may be paid on a PAYG basis from general taxation in the Beveridgian tradition (flat-rate pensions) (level 7). If the flat rate pension is means-tested (level 8) as is the case for the Age Pension in Australia, the transition has begun towards a welfare benefit. In the extreme, social assistance (level 9) is a poverty alleviation tool without a connection to contributions.

Different countries adopt a different mix of policies from levels 1 to 9. For example, the US has levels 1, 2, 5, and 9. Since the adoption of KiwiSaver, New Zealand has levels 1, 2, and 7. Among developed countries, universal pensions, level 7, are the least common form of public pension.[6] The link between contributions and the pension is broken so that no tagged contributions are required for New Zealand Superannuation (NZS).

Thus the reason the treatment of overseas pensions is so complex is that different countries adopt different mixes of the 1-9 types of provision in Figure 2, and, in particular the boundaries between social insurance and private occupational pensions are often blurred.

At the top of the spectrum (levels 1 and 2) private provision can be either unsubsidised (level 1) or subsided (level 2). These schemes are a part of all countries' policy mix and they vary greatly in the degree of state subsidy.

[4]This is defined as 'Public' because individual accounts are managed by a public entity. In Chile and Australia, by contrast, members' accounts are managed by heavily regulated private entities.
[5] For more discussion on social insurance refer Preston, (2008) and Smith (2009).
[6] Norway, Sweden, Denmark and Iceland operate modest "part universal" schemes in conjunction with an earnings-related contributory pension. The Netherlands contributory system is also nearly universal.

Whether membership is compulsory or voluntary, both public and private retirement saving plans may be further classed as either "Defined Benefit" (DB) or "Defined Contribution" (DC). A DB private or public retirement plan usually promises a benefit, either a pension or a lump sum, defined on the basis of salary/wages and/or membership prior to retirement. The earnings could be in the years just prior to retirement or even over a working life. A DC retirement benefit plan provides a capital sum based on individual contributions plus the investment return.

Many occupational pension schemes provide for contributions from both employees and employers, and are administered for employers by separate insurance or investment funds. Occupational pensions generally appear to be shifting from a DB basis to DC, a process that will probably be hastened by the dramatic losses suffered by pension funds in the 2008/9 global financial crisis.[7] DC systems work like investment funds: the value of entitlement at retirement depends on the level and timing of contributions and the fund's earnings rate; and pension or lump sum entitlements depend on the amount accumulated in the individual person's account.

The state pension age for the majority of OECD member countries is 65 years. The exceptions are France and Turkey with a pension age of 60. On the other hand, Iceland, Norway and the US are phasing in an age of 67 (OECD, 2005b); and in 2009, Australia[8] and the UK[9] announced their intentions to increase the age of state pension entitlement above age 65.

Most government-administered pension arrangements require citizenship or permanent residency. Although Australia has adopted retirement income policies (levels 1, 2, 3, and 8) that are substantially different to New Zealand's, as already noted, the two countries share a similar set of entitlement requirements.

New Zealand has reciprocal Social Security Agreements with Australia, Canada, Denmark, Greece, Ireland, Jersey and Guernsey, the Netherlands, and the UK. The intent is to ensure that immigrants who do not have sufficient residence to qualify for a state pension can use the period of residence in the country that they have emigrated from to qualify (totalisation). Regardless of whether there is an agreement or not, an overseas pension deemed to be similar to NZS will be deducted from that person's entitlement. This policy, described below, was first introduced in 1938 and has been only a little modified in the subsequent amendments 1990 and 2002 (Smith, 2010).

2 The direct deduction policy

In a simpler world, a rule that said a person should not, in effect, be entitled to more than one basic state pension might be operable. In a mobile world characterised by the spectrum of state involvement in Figure 1, defining what is a state pension is more difficult

If a resident receives a 'state pension' from another country, the Chief Executive of the Ministry of Social Development (MSD) may apply Section 70(a)[10] of the Social Security Act

[7] New Zealand's largest DB scheme is the former Government Superannuation Fund for public servants, which has been closed to new members for some years (Preston, 2008, p. 9).
[8] Beginning in 2017, the Australian pension age will increase at 6 monthly intervals from age 65 until it reaches 67 by 2023.
[9] Between 2024 and 2046 the State Pension age in the UK will increase to 68 for men and women. http://www.direct.gov.uk/en/MoneyTaxAndBenefits/PensionsAndRetirement/StatePension/DG_4017919. However, the UK government has indicated that it may accelerate this process and has begun a review of that possibility.
[10] See Appendix 1 of Dale et al (2009) for the relevant parts of sections 69 and 70 of the 1964 Act.

1964 (SSA), the direct deduction policy (DDP), and deduct that pension from the resident's NZS entitlement, provided:

> *the benefit, pension or periodical allowance, or any part of it, is in the nature of a payment which, in the opinion of the chief executive, forms part of a programme providing benefits, pensions, or periodical allowances for any of the contingencies for which benefits, pensions or allowances may be paid under .... the New Zealand Superannuation and Retirement Income Act 2001 ... which is administered by or on behalf of the Government of the country from which the benefit, pension or periodical allowance is received ..."* ("The Social Security Act," 1964, section 70(a))

An overseas pension of the kind that the Chief Executive decides should be taken into account in the calculation of NZS need not be from a country with which New Zealand has a reciprocal Social Security Agreement. It is sufficient, as stated in section 70(a) of the SSA, that the pension is "administered by or on behalf of the Government of the country from which the benefit, pension or periodical allowance is received".

Smith (2009a, p. 16) notes, under the DDP, "the total amount of a pension paid to a claimant will be determined by New Zealand only". It is possible, and it does happen, that an individual retiring in New Zealand with a large public pension from another country receives no NZS, despite having spent a part of their working life in New Zealand. This policy is based on the belief that an immigrant to New Zealand should not be advantaged over a New Zealand resident who has spent their entire life in New Zealand.[11]

The intention is, ostensibly, to ensure that everybody is treated fairly in key areas. If people feel they have not been treated fairly, they can make a complaint. Complaints are referred to the Chief Executive of the MSD, who can order a hearing by the Social Security Appeal Authority (SSAA). If not satisfied with the outcome, the complainant may then take their complaint to the Human Rights Commission (HRC). If the HRC agrees there may be valid grounds for a complaint, an opinion may be sought from Crown Law, and a case may be advanced. Since 2002 the Government itself can be challenged under Part 1a of the HRA when people feel they have been discriminated against in public policy. Numerous cases have been taken against the Ministry of Social Security to the SS appeal Authority in recent years but with little resolution for complainants. The Ministry have argued that they are applying the law correctly.

Table 1 gives the number of immigrants who get a New Zealand benefit/pension from WINZ, and have come to New Zealand with a pension or benefit entitlement from another country. About 51,000 immigrants are affected by the DDP and these are largely retired people with overseas retirement pensions. In 2008, of Work and Income's beneficiaries receiving an overseas pension, 78.4% received a UK pension, 9.3% received an Australian pension, and 6.3% received a Netherlands pension. Of all the beneficiaries in Table 1, 96.3% receive pensions from countries covered by Social Security Agreements.

[11] By preventing "double dipping" (accessing more than one state-funded basic pension), the DDP could be seen to support egalitarianism. For example, in the landmark, High Court's 1987 decision in the Roe Case (see Dale et al 2009b), the appeal was dismissed on two points of law. The first was the representation of US Social Security as 'income maintenance assistance' granted to retired persons by the US Government. The two forms of US Social Security are the Supplemental Security Income (SSI), a minimal amount of government support granted to persons in dire need; and Social Security, a contributory, earnings-related pension, paid only to those who contributed to the program. This was the pension the Roes received. The second point, as stated by the Court: "Governments of countries do not consider it their obligation to pay retirement benefits to a person when another government is already doing so."

The main source of complaints about the Direct Deduction Policy (DDP) is immigrants from the UK, Canada and the Netherlands. No complaints come from Australia for reasons discussed below. It is however the fastest growing category of immigrants with overseas entitlements.

Table 1. Trends in the number of Work and Income beneficiaries receiving an overseas pension of any type, by country the pension is received from

	Number of Work and Income beneficiaries receiving an overseas pension[1]				
	2004	**2005**	**2006**	**2007**	**2008**
Australia	914	2,549	3,960	3,928	4,918
Bulgaria	3	4	10	13	23
Canada	306	387	554	647	795
China[2]	166	153	131	337	427
Denmark	62	71	80	80	84
Fiji	45	56	40	90	111
Germany	87	108	153	171	200
Greece	19	19	12	15	20
Guernsey	49	51	69	78	79
India	24	20	26	43	54
Ireland	91	131	168	159	170
Isle of Man	24	26	37	37	40
Japan	4	5	14	18	26
Jersey	50	63	80	78	79
Netherlands	2,400	2,709	3,027	3,146	3,324
Philippines	20	22	45	53	62
Western Samoa	0	0	4	5	42
South Africa	26	36	14	62	71
Sri Lanka	57	53	22	34	51
Sweden	3	2	7	9	20
Switzerland	82	110	138	150	173
Former USSR	13	22	29	31	44
United Kingdom	37,754	40,193	42,521	40,417	41,359
USA	98	150	223	274	376
Total	**42,336**	**46,996**	**51,464**	**50,019**	**52,756**

Source: Ministry of Social Development (2009, p. 161)[12] Notes: 1. Countries paying fewer than 20 pensions into New Zealand in 2008 are not shown. 2. Chinese pensions, not deductible under S.70 of the SSA, are included in overall totals shown in Table 2.

When New Zealanders are encouraged to have KiwiSaver in addition to NZS, but migrants lose other payments from abroad under the DDP that may appear similar, policy can seem arbitrary and lacking in principle. The extensive subsidisation and attendant inequities of such subsidisation of private supplementation of state pensions has not yet been addressed in the section 70 debate. The seemingly arbitrary distinction made under section 70 assumes the state contributes only to state-delivered pensions, and ignores tax expenditures, including state contributions to private retirement savings.

Other anomalies have been emphasised by the 2009 changes to the NZS entitlements for emigrants. Under these changes, former immigrants who leave New Zealand are not

[12] See: http://www.msd.govt.nz/about-msd-and-our-work/publications-resources/statistics/statistical-report/statistical-report-2008/multiple-sections/overseas-payments.html#foreign.

subject to the DDP. There is now a clear conflict between the treatment of migrant pensioners who live in New Zealand and those who choose to live overseas.

The current DDP with respect to overseas pensions fails to acknowledge these issues and is perceived as increasingly anachronistic and out of step with other countries' policies. Many of the 51,000 who are affected have a strong sense of injustice as to how they have been treated. As populations become more mobile, this group can be expected to grow and instances of multiple entitlements to overseas age pensions of a variety of kinds are likely to increase.

The DDP has been subject to scrutiny as part of numerous MSD reviews of superannuation policy as outlined in Appendix A (Ministry of Social Development, 2003b, 2004b, 2005), but it was not until 2009 when the Social Assistance (Payment of New Zealand Superannuation and Veteran's Pension Overseas) Amendment Bill was introduced on 31 March 2009[13] that any serious changes were proposed. The preamble to that Bill acknowledged that there were many DDP problems and portability of NZS issues, but the actual drafted legislation did not in fact change the DDP for immigrants.

3 Pensions in Australia and New Zealand

In most countries, state pensions are calculated by reference to individual contributions, or periods of employment and/or years of residence. The unique approach taken by New Zealand and Australia to state pension provision marks them out from the countries that have been the traditional source of settlers to New Zealand such as Canada, UK, Ireland and the Netherlands. This uniqueness derives from an entitlement to a basic flat rate pension derived solely from residency and not contributions. Even so, there are stark differences between the Australian and New Zealand pension arrangements which raise an important set of issues for movements between these two countries.

Figure 2. Social pensions in OECD countries

Country	Resource tested	Basic	Minimum
Australia	X		
Austria	X		
Belgium	X		X
Canada	X	X	
Czech Republic		X	X
Denmark	X	X	
Finland			X
France	X		X
Germany	X		
Greece	X		X
Hungary			X
Iceland	X	X	
Ireland	X	X	
Italy	X		
Japan		X	
Korea, Rep. of		X	
Luxembourg		X	X
Mexico		X	X
Netherlands		X	
New Zealand		X	
Norway		X	X
Poland			X
Portugal	X		X
Slovak Republic			X
Spain	X		X
Sweden			X
Switzerland	X		X
Turkey	X		X
United Kingdom	X	X	X
United States	X		

Social pensions are those pensions which aim to provide at least a minimum living standard and the state pensions in New Zealand and Australia meet this requirement. There is no international benchmark for a 'Basic Pension' however. Figure 2 (Holzmann, Robalino, & Takayama, 2009) provides a snapshot of the complexity of attempting an inter-country comparison of social Basic Pensions. The purpose of the Basic Pension in most countries is to satisfy a country's welfare obligation to its retired citizens, and to prevent or ameliorate poverty among senior citizens.

[13] Select Committee hearings were held in July 2009.

3.1 *New Zealand Superannuation (NZS)*

The retirement policy framework in New Zealand comprises a flat-rate universal taxable benefit, NZS, and KiwiSaver, a subsidised voluntary retirement savings scheme. NZS is paid out of current taxation but there is some prefunding provided by the New Zealand Superannuation Fund as set out in the New Zealand Superannuation and Retirement Income Act (2001).

NZS is at least 66% of the net average wage for a married couple, and provides a reasonable replacement rate for low-income people, if a relatively low rate for those with middle and higher incomes. Individual entitlement applies, and NZS is payable to each superannuitant in his/her own right. Although there is a specified 'couple rate', each partner of a married couple receives a pension that is taxed along with other individual income.[14] When compared with basic pensions internationally, and with other welfare benefits domestically, NZS is relatively generous, and New Zealand enjoys very low rates of pensioner poverty and hardship in contrast to many other countries (Perry, 2009). There are some supplementary benefits, for example for accommodation, and there is now a 'Gold Card' which provides discounts and subsidised transport, but overall there is little reliance on third tier welfare supplements.

To qualify for NZS, only 10 years of residence in New Zealand after age 20 are required, with at least 5 of those after age 50 (the '10(5) rule'). The residence requirements can also be met after the State Pension Age of 65 years, and through "totalisation", where residence in countries with which New Zealand has a reciprocal Social Security Agreement counts as residence in New Zealand. The limited years-based qualifications establish an 'all or nothing' threshold, so the amount of NZS payable is not dependent on the number of years a resident has lived in New Zealand. Those who do not qualify for NZS may be entitled to an Emergency Benefit.

These key aspects of NZS make retirement in New Zealand relatively attractive by comparison to other countries for some immigrants. They also contribute to fiscal risks that need to be managed in light of significant population ageing (The New Zealand Treasury, 2009).

As noted in the RPRC Literature Review (2009), New Zealand's pension arrangements are unusual, yet a universal, non-means-tested pension has the advantage of administrative simplicity; it directly addresses the poverty issues faced by the old; it does not discourage work effort after 65, and it is transparent.[15] While the modest qualification requirements make NZS an easy pension to understand and administer, some significant difficulties emerge when coordinating it with entitlements arising from overseas pension arrangements. There is also the potential problem of adverse selection: the modest qualification requirements for NZS may attract retirees from overseas and create a fiscal 'black hole' for pension and healthcare costs.

3.2 *Supplementary saving in New Zealand*

In the post-war period, private superannuation schemes, largely the preserve of long-serving, high-income male employees, were highly tax-subsidised (Ashton & St John, 1988,

[14] Even when an income test operated prior to 1998, it was not a joint income test, nor is the entitlement taxed on a joint income basis.

[15] Only nine countries, including New Zealand, and one city, pay a universal pension with no test other than citizenship, residence and age: Mauritius, Namibia, Botswana, Bolivia, Nepal, Samoa, Brunei, Kosovo and Mexico City. "These universal non-means-tested pensions automatically protect an entire population, in a way that contributory, earnings-related pensions never can." (Willmore, 2007, p. 24)

p. 27). This tax-favoured environment for retirement saving was removed between 1987 and 1990 so that New Zealand became the first country to treat private retirement saving in the same way as other forms of financial saving (Littlewood, 2008; St John, 2007).

The first tax break for private saving since 1990 was introduced in 2000 when the top personal marginal tax rate was raised to 39% and the Employer Superannuation Contribution Tax (ESCT) rate, applied to employers' contributions for employees, remained at 33%. Then the Labour government announced in the 2005 Budget that KiwiSaver, a contributory, tax-favoured, employment-based, retirement-saving scheme, with a $1,000 government-funded kick-start and $40 p.a. fee subsidy would be introduced in 2007.

The original framework for KiwiSaver as set out in the 2005 Budget and the 2006 KiwiSaver Act, raised only modest distributional concerns, with government incentives restricted to the one-off $1,000 'kickstart' payment and a small annual contribution towards fund management fees. Just before the KiwiSaver Act was passed, the government announced the further incentive of exemption from ESCT for employer contributions of up to 4% of gross pay to KS and other superannuation funds matching KS's minimum requirements (St John, Littlewood, & Meehan, 2008, p. 5).

On the eve of its introduction in the May 2007 budget the government announced further extensions to take effect from 1 July 2007. With the 'soft compulsion' auto-enrolment, opt-out system, an employee could choose to contribute 4% or 8% of their wage. The tax-exempt compulsory employer's contribution, initially of 1%, was to increase to 4% over four years. A generous employer tax credit and member tax credit were also introduced. In addition KiwiSaver funds could be Portfolio Investment Entities (PIEs) and be taxed concessionally for higher income taxpayers.

The Retirement Commissioner was wary of the possible consequences of the changes which were a distinct break with the past hands-off approach:

> *..the biggest change of all for retirement provision has been the 2007 introduction of KiwiSaver. New Zealand now has a second major policy plank in retirement living standard provision. The KiwiSaver contributory cash accumulation schemes assisted by government and employer contributions are a distinct break with the policies of the previous two decades. Further, the changes in the taxation laws applicable to investment funds classified as Portfolio Investment Entities (PIEs) has made these managed funds much more attractive investment options for many investors. (Crossan, 2008, p. 2)*

However these generous arrangements did not survive the change of government in 2008. The newly elected National-led government dropped the state-provided $40 p.a. fee subsidy; reduced the minimum employee contributions and employer's compulsory contribution to 2%; limited the ESCT tax-free contribution to 2%; and abolished the employer tax credit. The savings were to be applied to tax cuts.

Nevertheless, in 20 years, KiwiSaver is likely to be an important component of retirement income for many. In May 2010, there were 1,431,255 KiwiSaver members, net of opt outs and closures.[16] Under its current design, in direct conflict with the egalitarian principles that underpin NZS, the greatest advantage, and the largest tax benefits, will go to the wealthiest (Retirement Policy and Research Centre, 2009).

[16] See: http://www.kiwisaver.govt.nz/statistics/ks-stats-10-05-31.html.

While the first three years of KiwiSaver have been hailed as a great success in terms of coverage, there are underlying design problems that suggest further changes are needed (St John, Littlewood, & Dale, 2010) The fundamental goals of improving national savings and promoting more income for retirees to spend may be in conflict. The OECD (2005a) noted: "the philosophy behind KS has been to encourage people to save for a higher replacement rate than NZS alone can offer to middle income New Zealanders".

There are increasing intergenerational equity issues in paying a universal pension and subsidised KiwiSaver lump-sums to those with already high incomes and wealth at the young age of 65. NZS itself is effectively taxed at the top marginal tax rate applying to the individual. In the past (to 1985) there was a much more progressive income tax scale so that high income earners retained a lower after-tax NZS. For the period 1985-1998, a surcharge applied that provided a modest degree of clawback from higher income people, especially those who were still working. Only about 5% lost all of their NZS Today, erosion of the tax base and the lowering of the top tax rate, as in 2010 to 33%, undermines the integrity and fiscal sustainability of the scheme (St John, 2009).

3.3 *Australia's Age Pension*

In Australia, retirement income comprises a modest means-tested Age Pension; tax-subsidised compulsory superannuation; and tax-subsidised voluntary, private superannuation (state involvement in levels 2,3, and 8, see figure 1). To qualify for the asset- and income-tested Age Pension, payable from age 65 (men) or 63 (women),[17] at the time of application, the applicant must reside in Australia, and must have 10 years of continuous residence or at least 5 continuous years if the total residence period exceeds 10 years. A superannuitant must be a citizen or hold a permanent resident's visa in order to claim the Australian Age Pension.[18] It can be increased by deferring receipt for up to five years.

There is a range of ancillary benefits. Some are means-tested, such as the Senior's Health Card, rent assistance, the Pension Supplement that has replaced the carer payment, utility and pharmaceutical allowances; while others are universal, including discounts available through the Pensioner's Concession Card, and the Remote Area Allowances.

Most Australian benefits are adjusted in line with prices but the single-person rate of the Age Pension is benchmarked at 27.7% of the Male Total Average Weekly Earnings figure. This compares with NZS, which, as already noted, is no less than 66% of the net average wage for a married couple. The Age Pension partnered payment rate is less than twice the single rate reflecting economies of scale[19] and usually adjusted twice a year in line with increases in the cost of living.

Australian Age Pension rates, effective from 20 March 2010,[20] subject to an income- and assets-test, are shown in Table 2 in AU$, beside the current NZS rates in NZ$ and AU$. The Table ignores the Pension Supplement, currently a maximum of AU$56.90 a fortnight for single people and AU$85.80 a fortnight for couples (combined).

[17] The State Pension for women will be 65 by 2013 and an increase in the then common age of 65 to age 67 between 2017 and 2023 has been announced.
[18] Centrelink (2007). "What residence requirements does age pension have." Retrieved 05/02/2007 from http://www.centrelink.gov.au/internet/internet.nsf/payments/qual_res_agepens.htm.
[19] Downloaded 25 June 2010 from: http://www.centrelink.gov.au/internet/internet.nsf/payments/pay_cpi.htm
[20] Downloaded 11 May 2010 from http://www.centrelink.gov.au/internet/internet.nsf/payments/age_rates.htm and see also http://www.facs.gov.au/guides_acts/ssg/ssguide-5/ssguide-5.1/ssguide-5.1.8/ssguide-5.1.8.50.html

Table 2. Maximum Australian Age Pension and NZS Weekly Net payment rates March 2010[21]

	New Zealand Superannuation (NZ$)				Australian Age Pension (Excluding Pension Supplement)	
	Gross	Net	Net (AUSD)	% of Net Weekly Average Wage	Net (AUSD)	% of Male Total Average Weekly Earnings
Married Couple	$561.24	$489.42	$378.86	66.02%	$485.60	41.76%
Single Person	$342.58	$293.65	$227.31	39.61%	$322.10	27.70%

Source: derived from http://www.centrelink.gov.au/internet/internet.nsf/payments/age_rates.htm

3.4 Supplementary saving in Australia

The increasing use of savings incentives and tax expenditures by governments to promote saving as self-provision for retirement demonstrates the indirect role governments play. Subsidisation of private provision may undermine vertical equity, as incentives and expenditures are usually percentage-based, benefiting those with higher incomes more (Spies-Butcher & Stebbing, 2009). These tax expenditures may substitute for basic pensions for higher income people (and do so in the case of Australia's Age Pension) yet be treated differently for the DDP.

Australia's 'Level 3' (Figure 1) employer-funded defined contribution (DC) superannuation is a lump-sum payment, similar in some respects to New Zealand's KS. Both schemes have benefits payable as lump sums, however the Australian scheme allows the benefit to be payable from the preservation age.[22] Another difference is that KS only becomes compulsory for the employer if the employee remains a member. The Australian scheme, is compulsory and requires a 9% contribution from employers, in contrast to the New Zealand employer contribution of 2% with a minimum 2% employee contribution. In addition to the compulsory scheme, the voluntary, tax-subsidised, superannuation schemes may be either work-related or personal.

In the Australian case, despite additional government contributions for low earners, distortions and anomalies are emerging from the significant government tax subsidies for saving that go disproportionately to middle and upper income earners (Denniss, 2007; Ingles, 2009):

> *Superannuation tax concessions will cost the budget $24.6 billion in 2008–09 ..., rivalling the $26.7 billion annual cost of the age pension and constituting a fifth of income tax revenue ($130 billion per annum). Tax expenditures ... of which the super tax concession is by far the largest, are one of the fast-growing areas of total government spending... The paper demonstrates that the tax concessions flow overwhelmingly towards the well-off, with those earning less than $34,000 per annum*

[21] Pension payment rates are shown in AU$ and converted using an exchange rate of $NZ1 = $AUD0.7741as at 31 March 2010.

[22] The preservation age of 60 allows access to the lump sum payment 5 years prior to the Age Pension, thus creating a gap where the lump sum can be spent on upgrading the private dwelling which is exempt from the asset-test, or on overseas travel, etc. A recent government report Henry,(2009) p. 35 has recommended that the current preservation age of 60 years be increased to the State Pension Age of 67 by 2024.

> *receiving almost no assistance and those earning over $180,000 per annum receiving the most.* (Ingles, 2009, pp. 1 - 2)

Ingles (2009) finds the current tax concessions for superannuation provide almost no benefit to low-income earners, including women working part-time; the tax concessions provide substantially greater benefits for men than women; and the top 5% of Australian income earners account for 37% of concessional contributions:

> *The system has become so skewed that the annual cost of providing superannuation tax concessions to high-income earners is much greater than the cost of simply paying those same individuals the age pension.* (Ingles, 2009, pp. 2 - 3)

The Henry Review (2009), also questions the nature of the tax subsidies, and has laid out a direction for reform that includes an expansion of the Superannuation Guarantee Contribution scheme (SG) compulsory scheme. As announced in the 2010 Budget, employers' contributions will be increased from 9% to 12% by 2019.[23] The Henry Review also suggested that the means test be reformed and tightened and that there be one test: an income test with non income-earning assets deemed to have earned a specified return. This represents a shift over time towards more private provision and less state provision and in turn has implications for the Trans-Tasman treatment of the Age Pension.

4 Immigrant Issues today[24]

When the DDP was introduced in 1938, the intention was that a person with an overseas pension would not be advantaged over someone who had remained in New Zealand for their entire working lives. The environment, including the role that government plays is now very different to that of 1938, and in 20 years time, it is likely that the recently introduced tax-subsidised KiwiSaver will be an important component of retirement income for many citizens. As discussed below, Australia has a maturing compulsory private savings scheme, and around the world people are expected to supplement their state pensions with additional private saving. Government involvement in pension provision can, and does, take a wide range of forms, making the relatively simple rules of the past less workable.

The unit for taxation in New Zealand is the individual not the couple. The welfare system takes the couple as the unit, but the unit for NZS has always been the individual. While a different base gross rate may apply for the single, married and living alone, the principle that NZS is neutral to marital status is strongly entrenched. It would therefore seem to follow that overseas pensions received by a person's spouse should have no effect on the entitlement to NZS of that person. In short: if a person is entitled to NZS in their own right, they should not have it abated because they are married to (or partnered with) someone who has an overseas pension.

However, MSD has the power to interpret as well as apply the legislation. For example, Mrs R is a New Zealander who qualifies for NZS. Her American husband receives a US superannuation payment amounting to the NZS married couple's rate. There are two different types of US Social Security: fully government-funded; and a contributions-based scheme more akin to a personal annuity and arguably not analogous to NZS. Mr R receives

[23] See also: http://www.voxy.co.nz/business/australia-raises-bar-superannuation-policy-and-boosts-retirement-savings-opportu/5/47260.

[24] This section draws on RPRC's Working Paper, *Passing the Buck* (Lazonby, 2007), the RPRC *Literature Review* (St John, 2009), and the RPRC *Submission on the Social Assistance* (…) Bill (Dale, St John, & Littlewood, 2009a), all of which are available on the website: www.rprc.auckland.ac.nz.

the latter. Mrs R argues that she has a personal right to NZS irrespective of her husband's US pension, and that the abatement of her superannuation entitlement amounts to discrimination on the grounds of marital status. Her right to NZS would not have been affected if she had remained single; divorced or if she had married a New Zealander with any number of annuities, investments and superannuation scheme benefits.

While Crown Law accepts Mrs R's complaint of discrimination, it argues that it is legitimate for the government to expect married couples to financially support each other and therefore it is legitimate to treat them as a single economic unit. Crown Law further argues that without such abatement, couples like Mr and Mrs R would be in receipt of government income in excess of the amount received by married couples who had not lived and worked overseas. Crown Law states that the abatement regime in s.70 and the treatment of married couples as single economic units are legitimate measures, when dealing with limited public funds, to ensure that the New Zealand benefit system is equitably spread across all of those in need.[25]

An increasing number of migrants and their spouses are affected by this treatment. It can be argued that the household income test that applies to other welfare benefits should have no place in the calculation of entitlements to NZS for those over 65. This principle of individual entitlement requires that section 70 or its replacement should also be based on the individual's own position.

4.1 *Emigrants from New Zealand*

The 'general portability provisions', introduced in the 1980s after migration patterns globally increased and diversified, allowed superannuitants to take 25% of their gross NZS with them to countries without a reciprocal social security agreement. The 1999 changes increased this to 50% of the gross NZS (Ministry of Social Development, 2003b, p. 14).[26]

The 2009 amendment to the 2001 New Zealand Superannuation and Retirement Income Act increased the rate of NZS paid overseas for certain superannuitants, under the general portability rules; and allowed people resident in certain Pacific countries to apply for NZS, rather than the current situation where application can only be made by those normally resident in New Zealand. NZS is now payable at a gross pro rata rate based on the number of months between ages 20 and 64 at 1/540th for each month (100% after 45 years).

As noted in Dale, St John and Littlewood (2009a), currently, and under the provisions of the 2009 amendments to the 2001 Act, NZS can be paid to superannuitants outside New Zealand at gross rates. This raises equity concerns for the New Zealand taxpayer, or for New Zealand-based recipients of NZS. In fairness to the current New Zealand taxpayers who are funding current pensions, and the current retirees in New Zealand, all pensions paid outside New Zealand should be taxed at source. Whether or not the country to which the superannuitant is retiring will treat NZS as taxable income is irrelevant. By not taxing NZS when it is paid offshore, New Zealand may merely be conceding tax revenue to a foreign government with no resulting benefit to the superannuitant. Where a tax is fully credited under a foreign tax credit mechanism, there would seem no good reason why New Zealand should not collect it (Smith, 2009c).

[25] This case, and other relevant legal and Human Rights cases in New Zealand are reported in Appendix 5 of Dale et al (2010).
[26] See: http://executive.govt.nz/96-99/minister/shipley/parliament99/super_qa.htm.

4.2 *Trans-Tasman Issues*

In 2010, the situation of immigrants to Australia from New Zealand is determined by the social security agreement and not the 2009 amendment to the 2001 New Zealand Superannuation and Retirement Income Act. Double-tax agreements (DTAs) provide relief against double taxation where two states' domestic laws conflict. Such agreements would normally recognise tax deducted at source by the New Zealand government as allowable in any tax calculation in another tax jurisdiction. Social Security Agreements "appear to go further in that they can create explicit rights by bridging two countries' regimes through totalisation provisions that may not exist in domestic law" (Smith, 2010, p. 7). However, it is also possible that the application of a Social Security Agreement can result in an individual being worse off than they would be if they had remained in New Zealand, as in the situation of a New Zealand resident retiring to Australia and claiming payment of NZS (Smith, 2010, p. 7).

Social security agreement- New Zealand and Australia

The Social Security Agreement was established in 1994, and most recently amended in 2002[27]. The Agreement covers age, disability support pensions and also carer payments (in Australia) and veteran's pensions (in New Zealand). The rules of the country in which the application is made apply. For old age pensions, where residence matters in assessing an applicant's entitlement in New Zealand to NZS, or in Australia to the Age Pension, totalisation applies. For example, an Australian applicant can include the years spent in New Zealand and a New Zealand applicant must satisfy the 10(5) requirement but can include years spent in Australia.

While NZS is potentially payable in Australia, "the amount the person is entitled to receive shall not exceed the amount of Australian age pension that would have been payable to that person if he or she was entitled to receive an Australian age pension but was not entitled to receive New Zealand superannuation"[28]

This means, effectively, that the pension payable in Australia is the Australian benefit with the full application of the asset and income tests (but not counting NZS as 'income').

Prior to 2002, the sharing of the costs was achieved government to government, now individuals are required to apply for the pension in both countries and the share is established on a pro rata basis:

> *The reciprocal Social Security Agreement covers NZS, Veteran's Pensions and Invalid's Benefits for people with severe disabilities. Under this agreement, individual pensioners receive dual payments (one from each government, according to the proportion of the individual's working life spent in each country). People going to Australia can use their periods of residence in New Zealand to help them qualify for the Australian benefits or pensions covered by the agreement. Conversely, periods of residence in Australia will assist people coming to live in New Zealand to qualify for New Zealand benefits or pensions covered by the agreement. Benefit reimbursements from New Zealand to Australia, which were calculated under the provisions of the previous agreement, continue to be made. Reimbursement amounts are set out in the new agreement and should phase out in approximately 2015. The reimbursement for the financial year beginning 1 July 2007 was NZ$60.9 million (AUD$50.9 million).* (Ministry of Social Development, 2009, pp. 156 - 157)

27 Social Welfare (Reciprocity with Australia) Order 2002
28 See Australian Government, (1994), Article 15.

In the 1990s, the number of non-New Zealanders moving to Australia via New Zealand grew from 960 a year to almost 10,000, representing more than one in 10 of the annual migrants settling in Australia in 2000. In 2001 new restrictions required New Zealanders to obtain permanent residence in Australia if they wished to access social security, gain citizenship or sponsor other people for permanent residence. While these restrictions applied to New Zealanders in Australia, the converse did not apply, reflecting the fact that there were eight times more New Zealanders in Australia than Australians in New Zealand.

At 30 June 2009, an estimated 548,256 New Zealand citizens were present in Australia.[29] At the end of June 2008, while there were 4,918 people receiving Australian benefits and pensions in New Zealand, there were 13,922 people entitled to New Zealand benefits and pensions in Australia. Of these, 11,055 people were entitled to NZS, while 36 were entitled to Veteran's Pension and 2,831 were entitled to an Invalid's Benefit (Ministry of Social Development, 2009, p. 157).

The 1994 Social Security Agreement between Australia and New Zealand as updated in 2002[30] requires each country to be responsible for paying benefits irrespective of the country in which their eligibility was established. Thus, as well as New Zealanders retiring to Australia who are disqualified by means-testing from receiving an Age Pension; Australians who would also be disqualified from receiving an Age Pension can retire to New Zealand and receive NZS, funded by the New Zealand taxpayer (Smith, 2010).

Australians can leave Australia before the qualifying age for an Australian pension and then, on reaching qualifying age, make an application from New Zealand. Any Australian payment they receive is subject to the DDP. Whether they get one payment or two depends on whether they have joined the 'special banking option', in the Social Security (Alternative Arrangement for Overseas Pensions) Regulations 1996. This allows those with an overseas pension to elect to have their overseas pension paid into a special bank account that only the MSD can access to periodically sweep out the funds. The overseas pensioner simply receives the normal full entitlement of NZS. Superannuitants who do not choose this option will be paid their Australian pension directly by the Australian Government. If their Australian entitlement is less than the NZS, they will also receive a top-up payment from New Zealand so that they are on the same position as with the banking option.

After leaving Australia, the amount of the Age Pension a retiree may be entitled to as a result of the Australian income and asset-test is not set based on their income and assets held just at that point. Age pensioners resident in New Zealand must inform the Australian authorities of any changes in their circumstances, including income and assets, which could affect their Age Pension entitlement. The amount of Age Pension may therefore be adjusted for changed circumstances in New Zealand (with the New Zealand government picking up the cost of any reduction in the Age Pension). For example, if a single pensioner married, or received an inheritance while in New Zealand, the Australian authorities would reduce the rate of Age Pension that person received under the means-test.

While the poorest Australian immigrating to New Zealand over age 65 gets the full Australian Age Pension, and this is offset against their NZS, or topped up by the New Zealand government if it is less than NZS, the better-off who could get NZS in New Zealand are ineligible for any NZS in Australia. In a submission to the Henry Review in 2009, the Association of New Zealand Retirees in Australia contrasts their treatment with that of UK

[29] See http://www.immi.gov.au/media/fact-sheets/17nz.htm.
[30] Refer to http://www.facs.gov.au/sa/international/ssa/currentagreements/Pages/nz-nz.aspx and http://www.mfat.govt.nz/Treaties-and-International-Law/03-Treaty-making-process/National-Interest-Analyses/0-NZ-Australia-Social-Security.php

retirees whose UK pension counts only in the Age Pension income test. They also contrast their treatment with those who retire to other countries and who can take their NZS with them.

A recent test case was bought by a Mrs Bredmeyer, an Australian resident (see Appendix 5, Dale et al (2009b) who complained that she did not get any NZS because she did not qualify for the Australian Age Pension because her and her husband's assets exceeded the allowed level. She argued that because she was not trying to claim the Age Pension, he should keep the NZS to which would have been entitled if she had gone to non-agreement country. The court case was lost in 2008. In 2010 she was denied the right to appeal to the Supreme Court

As noted, the richest Australian immigrating to New Zealand with no Age Pension entitlement (because of the income- and asset-tests) gets the full NZS, at the cost of the New Zealand taxpayers, without ever having contributed to the New Zealand tax base.

Smith (2009b) also notes that full payment of NZS at the expense of the New Zealand taxpayer applies to New Zealanders who have spent most of their working lives in Australia and retire to New Zealand with a large Australian private pension (supported by generous Australian tax incentives) and collect NZS at full rates. "The social security agreement with Australia has considerable fiscal risks to New Zealand and it should be reviewed at the earliest opportunity." (Smith 2009b, p. 4) An equitable agreement with Australia is needed to ensure that New Zealanders who retire to Australia are not disadvantaged compared to those who retire in New Zealand; and that Australians who retire to New Zealand are not advantaged over those Australians who retire in Australia.

5 Option for reform

New Zealand's current policy settings and the absence of clear principles have resulted in insufficient weight being given to the right to income adequacy through voluntary supplementation through state-administered (or mandated) arrangements in other countries (Smith, 2009b). As populations become more mobile, these weaknesses in New Zealand's framework will affect increasing numbers of people. Also, given the changing demographics which signal an increasing proportion of the population over age 65; and given a fairly flat tax regime, the current universal pension with very low residency may not be sustainable in its present form (Dale, St John, et al., 2009b; St John, 2009).

New Zealand's current overseas pension and pension portability policies fall short of the principles of equity, transparency, sustainability, economic efficiency and administrative simplicity in a variety of ways. Many of these shortcomings were noted and repeated in the MSD Reviews of pension policy (Ministry of Social Development, 2004b, 2005, 2008b). The salient features of these reports are highlighted in the Appendix.

In extending the debate in response to the lack of action in the 2009 New Zealand Superannuation and Retirement Income Amendment Act, the RPRC indentified two possible broad options for reform of New Zealand's international pensions problems (Dale, et al., 2010). Option 1 (Dale, et al., 2010), outlined in more detail here, identifies that problems arise, not so much in section 70, as in the low residency requirement for NZS. The second option 2 proposed that the 'fair share' issue would be automatically taken into account if each country paid the pension that accrued during the period the pensioner lived/worked in that country. Adding together all those entitlements would give a final "blended" pension without any country 'subsidising' another.

As Ashton and St John (1998, p. 21) note, from the time it was introduced in 1898, until 1937 when it was reduced, "probably to encourage immigration", entitlement to the age pension in New Zealand included a residency requirement of 25 years. The current 10(5) residency requirement for entitlement to NZS sets up potentially perverse incentives for immigrants, and creates an unfair and potentially costly burden for New Zealand taxpayers.

Option 1 proposes raising the residency requirement for entitlement to NZS to 25 years for everyone, to be achieved between the ages of 20 and 65 years. It would not be possible to meet the requirement by using residency after age 65. Where a reciprocal Social Security Agreement exists, totalisation would apply in the residency test for NZS so that years of residence in the overseas country could be used.[31]

Totalisation would mean that only one basic pension is payable. For example, any entitlement to the UK's Basic State Pension may be foregone if those years of residence in the UK were used to qualify for NZS. Where the 25 years of residence is satisfied without totalisation, any other basic pension entitlements would be ignored, other than for tax purposes.

Where there is no Social Security Agreement, any overseas pension to which the New Zealand resident is entitled from that other country is not be taken into account in the calculation of NZS. If NZS required at least 25 years between the ages of 20 and 65,[32] it may then be far less important to identify the kind of overseas pensions that are brought into New Zealand.

Since 85% of the 51,618 NZS recipients caught by the DDP have lived in New Zealand for more than 30 years (Ministry of Social Development, 2005, p. 14), a 25 year residency record could largely eliminate the inequities related to the DDP.

For most New Zealanders applying for NZS, establishing a 25 year residency record should not be much more complex than the present requirement. Where the 25 year residency test is not met at age 65, NZS would not be payable but access to an income-tested benefit, at a level that could be set between a standard social welfare benefit and NZS, may apply. In this case, any overseas pension would be taken into account in the benefit's household income-test. That would reduce the income-tested benefit but not by as much as the existing dollar for dollar section 70 direct deduction arrangement.

The human right to a basic standard of living is protected because all have access to at least a minimum welfare provision. The existing couple rate and single rate for NZS would be retained, but every person's entitlement would be individual: a spouse would not have their pension benefit reduced if a partner's overseas pension exceeded the NZS couple rate. Those qualifying under the tighter residency requirement can supplement their NZS with additional retirement income derived from state and private sources from overseas. Option 1 improves equity and transparency and acknowledges the complexity of state involvement as shown in Figure 1 and Figure 2.

However, If vertical equity considerations formed part of any review, a reform of the taxation of other income and NZS would be required, so that local and overseas retirees with higher incomes, including incomes from lump sum superannuation benefits, pay appropriate taxation.

[31] As noted, 96.3% of the current recipients of an overseas pension are covered by Social Security Agreements.
[32] Perhaps the requirement would include 10 years from the age of 50 years, meaning New Zealand would be likely to benefit from some mature and skilled contribution from immigrants.

5.1 *Implications for the main countries that are the source of complaints*

To receive NZS, people from the UK would need to spend a total of 25 years between the ages of 20 and 65 years in the UK and New Zealand. They would retain any other level 3 and 4 pensions (see Figure 1) to which they were entitled, with their total income appropriately taxed. If they qualify for NZS without totalisation, they would retain any UK basic pension and any SERPS or state pension 2 which currently is trapped by the DDP.

Canadian immigrants to New Zealand with a total of 25 years or more in New Zealand and in Canada between the ages of 20 and 65 years would get NZS in full and would retain any pension from the level 4 Quebec Pension Plan or the Canada Pension Plan. The Old Age Benefit is only payable abroad if the beneficiary resided in Canada for at least 20 years after age 18. For those using totalisation to achieve 25 years, any entitlement to the Old Age benefit would be used to offset the cost of NZS.

Where New Zealand does not have a reciprocal agreement, such as with the US, Germany, and France, immigrants would need to live in New Zealand for a minimum of 25 years to be entitled to NZS. Immigrants from the US with Social Security pensions do not have an identifiable basic pension component, while those from countries such as France may have a minimum guarantee built in. Under Option 1, they may qualify for NZS in their own right and also be able to keep their overseas pension. Although the overseas pension will usually be relatively small, should larger incomes accrue, a revised New Zealand tax system could be used to promote vertical equity. If the US did agree to an SSA, the SS benefit should be offset against the cost of NZS when totalisation is used, so that only one pension is payable under the agreement.

5.2 *Implications for Trans-Tasman treatment*

As noted, the Social Security Agreement with Australia is unfair to New Zealanders who retire in Australia and receive either no pension at all, or an abated pension. An equitable agreement with Australia would ensure New Zealanders who retire to Australia are not disadvantaged compared to those who retire in New Zealand; and that Australians who retire to New Zealand are not advantaged over those Australians who retire in Australia

Under a new agreement, if any person had fulfilled the 25 years in New Zealand, they would get the full NZS and no Age Pension. If they had not they might be able to use totalisation to get to 25 years, but would not receive NZS at a greater rate than their entitlement to the means-tested Age Pension. A New Zealander retiring to Australia would take NZS pro-rata as for other countries, and that would be used in the income test for the Age Pension. This would acknowledge that NZS is performing a role beyond that of the Age Pension and NZ does not have the developed level 3 (Figure 1) of the Australian retirement income environment.

6. Conclusion

The current section 70 DDP policy is perceived to be unjust; it is increasingly out of touch with the modern immigration trends; and it produces uneven results. The fact that New Zealand has been unable to conclude Social Security Agreements with more than a handful of countries indicates a level of discomfort by our trading partners that needs attention. This paper suggests that to address this problem residency rules could be substantially tightened to ensure greater equity for those from overseas who have been in New Zealand for an extended time, and reduce to the generosity to those who have fulfilled only the

existing bare residency requirements, some of whom have other government subsidised savings from overseas. In any reform of New Zealand's arrangements each person must be treated as an individual and there should be no discrimination on the basis of marriage.

Pending wider reform, it is also vital to recognise that countries are regularly changing their pension systems, and will continue to do so in the face of ageing populations. It is therefore necessary to ensure that the MSD and other relevant agencies remain current with the information they provide to prospective migrants; and that New Zealand's reciprocal agreements reflect this potential for change. As part of this initiative, the Chief Executive of the MSD should maintain a current register of all relevant overseas basic age pensions, and their relationship to NZS; and to publish decisions made regarding overseas pension abatements and entitlements.

The arrangements with Australia seem seriously out of line with sensible principles. In the proposed increased residency option discussed in this paper, the existing Social Security Agreement with Australia would need to be renegotiated.

Appendix A Section 70 of the Social Security Act 1964 (SSA) background

Section 70[33] of the SSA mandates a dollar-for-dollar abatement of NZS entitlements against a superannuitant's, or the spouse's, overseas entitlement. As noted, this treatment dates back to 1938 (Ministry of Social Development 2003a; Ministry of Social Development 2004), and has been increasingly perceived as inequitable by the individuals affected. Application of section 70 has become more problematic as overseas pension systems have become increasingly complex and changeable.

In 1972 a Royal Commission Report on social security made some recommendations for amending the SSA in relation to the deduction of overseas pensions (McCarthy, 1972). At the time, the SSA provided for discretionary deduction of overseas pensions but gave no direction as to how the discretion was to be exercised. The Report recommended that the discretionary authority provided in section 70 should relate solely to determining whether or not an overseas pension or benefit was analogous to a New Zealand benefit.

For a pension to be analogous to a benefit, it need not be identical: the analogy is not destroyed because one is financed by specific contribution and the other by taxation. Section 70 has been amended so that the purpose rather than the benefit is comparable. Over the years the type of overseas pension eligible for deduction under section 70 has been repeatedly tested in the Courts. The case quoted most often, with perhaps the most disputed decision, is *Roe v Social Security Commission* (see Appendix 5, Dale et al 2009b).

It is important to note that section 70 applies, potentially, to all social welfare benefits. In summary, section 70 (1) of the SSA provides that:

- if a person qualifies for NZS and receives or is entitled to receive ... or their spouse or dependent children are entitled to receive a benefit, pension or periodical allowance granted elsewhere than in New Zealand; and
- the benefit, pension or periodical allowance forms part of a programme providing benefits, pensions or allowances for any of the contingencies provided in the SSA; and
- the programme is administered by, or on behalf of, the government of the country from which such benefits, pensions and allowances are received; then
- the New Zealand benefit, pension or allowance shall be reduced by the amount of the overseas pension received.

As well as promoting egalitarianism and horizontal equity, section 70 prevents "double-dipping" if another country is paying an allowance or pension for the same purpose that a person is receiving an allowance or pension in New Zealand. It becomes problematic when, for example, the government or its agent administers private pensions, and they are deducted from NZS as if they were analogous. Deductions are made for foreign public pensions, not private pensions, yet the delineation between such pensions is also problematic. There are issues, as in Australia, of substantial tax preferences for private pensions, yet these are not affected by the DDP. Some public pensions, as in the UK's Second State Pension Scheme (S2P), are built up by earnings-related contributions and administered by a public agency, and are affected by the DDP.[34] However, the privately

[33] See Appendix 1 for the full text of this section of the SSA.
[34] See also Smith (2009a, pp. 15 - 16).

administered "contracted out" equivalent benefit is not affected by the DDP, even though it replaces the S2P scheme for savers in the private schemes.

A stated intention of the 2009 Social Assistance (Payment of New Zealand Superannuation and Veterans Pension Overseas) Amendment Bill is addressing these anomalies, and the current discriminatory and inequitable aspects of pension policy and legislation.

Publicly provided pension portability information

Some of the information available to potential immigrants and emigrants is ambiguous, and yet this is the information on which they will base perhaps the most critical financial and social decisions of their lives. As well as migration decisions, people make savings and retirement decisions based on their knowledge of different pension schemes and their interaction (Munz & Werding, 2005; Wildasin, 1999). Those decisions are made, in some cases, after the migration occurs.

Information for emigrants

The MSD's *Retired and Going Overseas* brochure states that the rules in the destination country may mean that although a person would be entitled to NZS in New Zealand, they may not be entitled to any superannuation pension in Australia because of income and asset testing of the Australian Age Pension (Work and Income, 2008, p. 9). In the *Departures and Arrivals for Australia* brochure, supplied online and in hard copy by the International Services branch of the MSD, it also recommends that New Zealanders check the pension information before leaving, "as what you may be paid in Australia may be less than what you are paid in New Zealand" (International Services, 2008a, p. 3).

While New Zealand's emigrants receive a generic warning in the Australian brochure, in the section called "Receiving a benefit or pension in New Zealand", the *Departures and Arrivals for the Netherlands* brochure states: "The total amount you receive will be similar to the amount you would have been paid if you had spent all your life in New Zealand" (International Services, 2008b, p. 7). Nowhere in that brochure does it state that the Social Security Agreement between New Zealand and the Netherlands ensures those who have lived and worked in New Zealand all their lives are not disadvantaged, so the maximum basic retirement pension an immigrant can receive is equivalent to the NZS; nor does it state that their Netherlands pensions may be offset against NZS.

Information for immigrants

While the rules and conditions for immigrants contained in the reciprocal Agreements are relatively inaccessible and, as to the detailed effect, uninformative, the Ministry of Social Development does provide some information on its website and in its brochures. This information often suggests that a person may have dual entitlement, that is, they may be entitled to an old age pension from their source country, plus NZS. For example, while the *Departures and Arrivals for the United Kingdom* brochure makes it clear that a person living in the UK cannot be paid New Zealand benefits or pensions, it also states:

> *If you live in New Zealand or intend to, you may qualify for benefits or pensions from both the United Kingdom and New Zealand.... This means you may be paid a benefit or pension from both New Zealand and the UK.* (International Services, 2008c, pp. 3 - 4)

This does not make it clear that the UK pension will be abated against NZS to ensure the total amount paid does not exceed NZS.

Although the available information, rules, and the social security arrangements New Zealand has in place regarding pension policy, eligibility, and residency, suggest that residency requirements must be met prior to financial assistance or entitlement, an Emergency Benefit is regularly paid to people with no prior New Zealand residency.[35] While it is less than NZS, the amounts paid under this benefit are not significantly different to those payable under the other mainstream benefits such as the Sickness and Domestic Purposes Benefits. The Emergency Benefit ensures that no person in New Zealand will be absolutely destitute.

Appendix B: MSD reviews and recommendations 2003-2008

Between 2003 and 2008, on at least four occasions, the MSD reviewed New Zealand's pension system and its relationship to those of other countries, and made almost identical recommendations on the basis of each review (2003c, 2004a, 2005, 2008a, 2008b).[36]

The Background Report provided by the MSD for the 2003 Periodic Report Group listed the following problems regarding pension portability and equity:

- *The rate of portability differs depending on the country in which a person retires;*
- *The rate of general portability is now outdated, as the surcharge was abolished in 1998;*
- *The rate of general portability does not reflect cost-sharing between the countries in which a person has spent their working lives (e.g. a person who has spent 35 years between the ages of 20 and 65 in New Zealand takes only 50% of NZS with them); and*
- *The criteria for a person to be ordinarily present and resident in New Zealand upon application for NZS, and for 5 of the 10 years residence required to be after age 50, impede migration flows, and the former is applied inconsistently because it is overridden by agreements.* (Ministry of Social Development, 2003a, p. 15)

The Direct Deduction Policy (DDP) for immigrants generates the following problems:

- *There is no incentive for people to claim (or declare) their overseas pension, as they derive no real benefit from it;*
- *This generates a high degree of evasion of the policy, at an estimated cost of $150 million per annum to the Government;*[37]
- *Genuine cost-sharing is not achieved between the countries in which a person has spent their working lives, as the New Zealand Government essentially deducts a person's entire overseas pension from their New Zealand benefit entitlement, leaving New Zealand's contribution to be very minimal (if anything) or very large if the person has spent a short amount of time here and has a very small or no overseas pension;*
- *A number of countries balk at the direct deductions policy, and refuse to negotiate a Social Security Agreement … at a significant cost to the government.* (Ministry of Social Development, 2003a, p. 15)

There are also problems with the DDP and employer- and employee-funded pensions. Such pensions are often perceived as part of employees' overall remuneration, thus the argument is made that their character is different from NZS, so the benefit should not be included in the DDP. It is also problematic that the type of institution that manages a Tier 2 pension matters to the DDP. "If it is publicly managed, it counts; if it is privately managed (even if publicly mandated) such as happens in Australia and Chile, the DDP does not apply." (Lazonby, 2007, p. 32)

[35] http://www.workandincome.govt.nz/manuals-and-procedures/income_support/main_benefits/emergency_benefit/emergency_benefit-06.htm
[36] These Reviews are discussed more fully in Dale et al (2009).
[37] The Report does not indicate the source or basis of this estimated cost.

The 2004 Report to the Minister of Finance and the Minister for Social Development and Employment from the MSD reiterated the recommendations made in 2003. They also noted that many of the policies were out of date. For example, in the general portability provisions, developed in 1987 to treat overseas recipients of NZS in the same way as residents in New Zealand, the "rate was set at 50%, to account for the fact that portable pensions were not subject to the surcharge or taxation prior to export. This became inconsistent with domestic policy when the surcharge was abolished in 1998." (Ministry of Social Development, 2004b, p. 10).

The 2004 Review also noted that the direct deduction policy had hardly changed since it was introduced in 1938, but "migration patterns have increased and diversified since then". These changes mean the dollar-for-dollar deduction of an overseas pension from a person's NZS has become "an inexact and often unfair method of sharing social security costs between countries" (Ministry of Social Development, 2004b, p. 10).

The MSD's 2005 Review was equally blunt: "The 'direct deduction' policy results in superannuitants who are living in New Zealand but who are eligible for a public pension from another country, receiving a lower rate of NZS…. Currently the direct deduction policy produces savings for the government of $174 million." (Ministry of Social Development, 2005, pp. 1 - 2). These savings arise from the approximately 51,000 New Zealanders (7% or whom were born in New Zealand) who receive overseas pensions that are captured under the DDP, and most of these people have been in New Zealand for more than 30 years, and live on modest incomes.

Moreover, government officials note a significant amount of evasion of the policy; foreign governments' dislike of the policy impacts on international relations; and "the policy is difficult to administer because it is not always clear which pensions should be deducted" (Ministry of Social Development, 2005, p. 2).

The point was also made that many New Zealanders are unable to retire to the country of their choice because the general portability rules apply and the 50% rate of NZS is insufficient to live on; and the residence rules also restrict movement as application for NZS must be made when usually resident in New Zealand (Ministry of Social Development, 2005, p. 3).

The majority of overseas pensions received by New Zealand residents are paid into New Zealand by:

- the UK (42,976 pensions amounting to $143 million a year);
- the Netherlands (3,754 pensions at a value of $14.3 million a year);
- Australia (2,832 pensions amounting to $8 million a year);
- US, Canada, Ireland, Germany, Jersey and Guernsey, Switzerland and Fiji (a combined total of 1.446. pensions amounting to approximately $7 million a year) (Ministry of Social Development, 2005, p. 14)

85% of the 51,618 NZS recipients caught by the DDP have lived in New Zealand for more than 30 years, and thus feel entitled to NZS in full. 60% of overseas pensioners have incomes low enough to be entitled to a Community Services Card (Ministry of Social Development, 2005, p. 14)

The MSD's recommendations in 2008 were:

- *Allow superannuitants to travel to more than one country and continue to receive their full rate of NZS, rather than having it abated by 50% or 100%;*

- *Allow for application for, and payment of, NZS in Pacific countries;*[38]
- *Remove foreign state pensions built up by voluntary contributions from the scope of section 70 of the SSA;*[39]
- *Clarify the wording of section 70 of the SSA so that it is in plain English, and set out the treatment of each country's pension regulations;*
- *Discontinue the policy of deducting a person's overseas pension from their partner's NZS entitlement, and make a consequential amendment to the Special Banking Option (SBO) so that only one partner needs to choose this option;*
- *Proportional portability of NZS;*[40]
- *Allow superannuitants who are resident overseas and are New Zealand taxpayers to receive full NZS* (MSD, 2008b, pp. 13 - 21).[41]

The preamble to the 2009 New Zealand Superannuation and Retirement Income Amendment Bill outlined the issues but the final legislation only dealt with section 70 as it affected the portability of NZS for those who leave New Zealand and go to a non-agreement country.

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[38] The proposed new rules would allow residents of the Pacific countries of Niue, Tokelau and the Cook Islands, who have met the NZS (10/5) residence rule, to apply for NZS from one of those countries after they turn 65.
[39] Such as is required by the reciprocal Agreement with the Netherlands. See Appendix 4.
[40] Entitlement "based on a 45-year denominator, so that a person needs 45 years of residence in New Zealand between the ages of 20 and 65 to receive full payment" (Ministry of Social Development, 2008b, p. 18).
[41] The MSD also noted the desire for a reciprocal agreement with the US (2008b, pp. 13 - 21).

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