pensioncommentary
THE UNIVERSITY OF AUCKLAND BUSINESS SCHOOL
An article from the Retirement Policy and Research Centre

Re-designing New Zealand Superannuation

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PensionCommentary 2015-1[2]

23 February 2015

In 2014, New Zealand Superannuation cost taxpayers, after-tax, about 4.1% of GDP. With the expected doubling of the age 65+ population, that cost is expected to be a net 6.7% of GDP by 2060. Many commentators suggest that we need to discuss how to reduce the cost of NZS because what we have is apparently unaffordable.

If an expected 6.7% of GDP is likely to be unacceptable to taxpayers in 2060, we need to re-design NZS in the next decade or so. For that, the expected cost is a second-order issue. The first priority should be for New Zealanders to decide on the shape of NZS for 2060, based on what New Zealanders might want NZS to achieve in 2060. If the 'ideal' scheme is likely to be too expensive, only then does cost become an issue.

1. Introduction – what we have works, for now

New Zealand has one of the simplest retirement income systems in the developed world. KiwiSaver[3] aside, the main component is New Zealand Superannuation (NZS). Every New Zealand resident qualifies for NZS from age 65 as long as they have been resident:

- at least 10 years after age 20, including
- at least 5 years after age 50.

NZS provides at least 66% of the net national average wage for a married couple and about 42% for a single person who lives alone. It is adjusted annually to reflect changes in inflation but with an underpinning link to the national average wage. The grossed-up amount is taxed as ordinary income.

KiwiSaver aside (again) there are no tax breaks for private provision of retirement income. We should discuss whether KiwiSaver retains its remaining incentives but that isn't relevant to this current discussion; neither is any debate about whether New Zealanders are saving 'enough' privately. Suffice to say that, amongst all the various groups in New Zealand, the currently old (age 65+) have the lowest levels of poverty, indicating that what we have is 'working'.

Many think that we cannot afford the current NZS into the future[4]; that changes must be made; that New Zealanders will have to do more for themselves and that we need to

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[2] An RPRC *PensionCommentary* is an opinion piece designed to provoke discussion on an issue of public significance. The views expressed in this commentary are the author's, not the RPRC's.

[3] KiwiSaver is the world's first national, auto-enrolment, opt-out retirement savings scheme. It started on 1 July 2007 and further details can be found in St John, Littlewood and Dale (2014).

[4] For example: "The combined impact of the baby boomers retiring and the growing length of our lives after 65 will make NZS unaffordable unless we move out the age of eligibility beyond 65 by indexing the age of eligibility with longevity. (The alternative of lowering the level of NZS is unlikely to be acceptable

start talking about these things now. This *PensionCommentary* suggests the reality is more nuanced.

2. What's the real question?

We know that the population aged 65+ will about double over coming decades[5] and that the costs of healthcare and NZS will increase substantially if current settings remain. These two major government programmes will be the most directly affected by the ageing population. However, we also know that New Zealand's economy will grow and, barring catastrophes, we should as a country be able to afford more than we currently pay for the age-related programmes.

The Treasury makes projections of the impact of all these influences on government spending at least every four years[6]. The most recent estimates from the Treasury (Treasury 2013) show the government's 'primary core Crown operating spending' changing from 32.2% of Gross Domestic Product (GDP) over the 50 years 2010 to 2060. The Treasury looked at two major scenarios:

- rising from 32.2% of GDP in 2010 to 35.2% (what the Treasury calls 'Resume Historic Cost'[7]);
- falling from 32.2% in 2010 to 29.7% by 2060 (what the Treasury calls 'Spending Path to Maintain Net Debt'[8]).

These projections do not paint the grim fiscal future that some predict but they are large numbers. In 2010, 32.2% of GDP was nearly $62 billion (each 1% was equivalent to nearly $2 billion).

In 2060 dollars, the Treasury estimates that the net cost of NZS will be $97.1 billion (Treasury, 2013). By 2060, estimated GDP will be a nominal $1,461 billion. Bringing those back to 2010 dollars at the assumed inflation rate of 2% p.a. suggests that the economy will grow in real terms by about 80% over the fifty years. In the meantime, the total population will have grown by about 33%[9].

The difference in the two Treasury scenarios is an expected total government spending of 5.5% of GDP by 2060 (29.7% to 35.2%). We expect to spend a net 6.7% of GDP on

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to most New Zealanders.)" Peter Neilson, Financial Services Council presentation 17 August 2012 accessible here.

[5] There were 655,000 over age 65 in 2014. The number in 2061 is expected to be between 1.4 and 1.7 million (depending on assumptions). The increase as a proportion of the population is likely to be lower: at present, about 15% of the total population is over age 65; by 2061, that is expected to be between 22-30%, again depending on assumptions (Bascand, 2012 at page 30).

[6] We looked at the NZS components of these projections in *New Zealand Superannuation's real costs – looking to 2060* in the RPRC's *PensionBriefing 2013-6* (accessible here).

[7] This says that government expenditure, per recipient, will resume historic growth rates after 2015-16, allowing for demographic changes. The base case also assumes that deficits will be financed from borrowing so that government debt is unconstrained and will reach 200% of GDP by 2060. We know that this scenario is theoretical because a future government would change policies to ensure it did not happen. That in fact is happening now: the government already expects that it will achieve a fiscal surplus in the next year or so.

[8] This says that future trends in spending are constrained to reduce government debt down to 20% of GDP and then maintain it at that level.

[9] From 4.5 million in 2014 to 6.0 million in 2060 (Statistics New Zealand, median projections, accessible here).

NZS alone by then[10] so the difference of 5.5% in overall spending is a significant number.

However, none of these numbers establishes a case that New Zealand faces an imminent fiscal crisis. We know that an ageing population will require an increase in taxes unless current programmes (not just those directly affecting the old) are cut. We also know that what we have has worked reasonably well and costs less than many other countries currently spend on the old[11].

But here is the real question – looking just at NZS, do we expect that taxpayers in 2060 will be happy to pay a net 6.7% of GDP, shared out amongst everyone over age 65? If we think that 2060's taxpayers might object then we could expect them to cut benefits and those changes could be made with little warning. New Zealand's own experiences with changes to NZS, the 1985-1998 surcharge and the introduction of KiwiSaver illustrate that clearly.

Rapid changes to a long-term programme like NZS are undesirable because New Zealanders build their private savings arrangements on this 'Tier 1' state pension. If the cost of NZS must be cut, we need to give as much notice as possible so that people can make appropriate changes to their retirement saving plans. That's why we need to talk about NZS now and to run that discussion on a regular basis in the future.

3. What do others suggest might be done?

Since the 1992 Task Force on Private Provision for Retirement, different groups have looked at the long-term implications of NZS on the government's fiscal position and what to do about the benefits. In the last six years, we have seen the following:

(a) The Treasury's 2009 report *Challenges and Choices*: The report tiptoed around recommendations about the future of NZS. It looked at the fiscal implications of different design changes in the context of a discussion about all major aspects of government spending over coming decades, and concluded:

> "Earlier sections have discussed the kinds of adjustments that are likely to be required in other government spending areas to ensure a sustainable long-term fiscal position. Some of these changes will require significant shifts in the way government services are provided and in expectations about what services will be provided. Changes to eligibility and entitlements for NZS that reduce its total cost would reduce the extent to which other public services would have to adjust." (The Treasury 2009, p. 55)

(b) The Retirement Commissioner's *2010 Review*: This suggested three possible concurrent changes to NZS:

i. shift the annual increase from the present CPI adjustments and underpinning link to national average wages to one based on an average of CPI-measured inflation and wages;

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[10] The 2014 projections by the Treasury show a small increase from 6.6% to 6.7% of 2060 GDP – see here.

[11] As explained in Retirement Policy and Research Centre (2012), of 31 OECD countries that reported pension costs in 2010 and expected costs in 2060, only six countries presently spent less than New Zealand putting aside the amount those other countries spent on tax subsidies for private provision. That number is very low in New Zealand whereas in Australia, for example, the cost of tax subsidies is about the same as the amount spent on the Age Pension (Davidson, 2012). Even if the net cost of NZS increases by more than 60% (to 6.7%) by 2060, it will be a lot less in 2060 than today's OECD average.

ii. gradually increase the state pension age from 65 to 67, phased in between 2020 and 2033 accompanied by
iii. a transitional, means-tested benefit for those affected by the increase in the state pension age.

The report concluded:

> "The long-term sustainability of NZS needs to be assured by taking a responsible view of the way the major cost pressures that will come onto the public pension system in the 2020s should be handled. The proposed future modifications to NZS in this Review are not focused on helping to correct fiscal imbalances over the next several years. Instead, they anticipate the longer-term structural, particularly demographic, pressures that will arise in the following decade." (Crossan 2010, p.10)

(c) The Savings Working Group, 2011: More generally, and in relation to overall government spending over coming decades, the SWG concluded:

> "The conclusion is that without significant policy change to the relationships between spending and population, or tax rises (with negative flow-on effects on growth), deficits will steadily increase and debt mount further. This will damage growth prospects, and increase the country's external vulnerability." (Savings Working Group 2011, p. 56)

(d) The Retirement Commissioner's 2013 Review: This suggested only one major change to NZS and a 'review'. The state pension age (currently 65) should in future be changed from time to time so that, for the average New Zealander, the proportion of life over state pension age should be a "minimum of 32%". That would see an increase to about age 66 by 2036, 67 by 2046 and 68 by 2056. As life expectancy continued to improve (as predicted), so too would the state pension age continue to increase.

The Retirement Commissioner's 2010 recommendation about the indexing of the annual NZS was effectively endorsed but the Treasury was asked to first develop a model to see its "likely impact on living standards of older New Zealanders".

The report also briefly looked at, but did not recommend means-testing NZS, variable eligibility ages, using KiwiSaver to replace NZS and increasing the number of years of residence to qualify from the current ten.

(e) The Treasury's 2013 report *Affording Our Future*: The report asked a number of questions about the future of retirement income policies and modelled some possibilities including:

i. Increasing the state pension age to 67 and leaving open the possibility of further increases;
ii. Reducing pension adjustments from 2019/20 to increases in the CPI.

The report raised but did not recommend means-testing NZS, 'pre-paying' for NZS, compulsory private savings (like Australia's Superannuation Guarantee scheme), nor did it recommend increasing contributions to the New Zealand Superannuation Fund. The report concluded (on NZS):

> "We might be able to afford [the expected increase to a net 6.7% of GDP], but we would have to either cut other government spending or increase taxes. This approach would raise intergenerational questions – is it reasonable for taxes collected from working-age people to fund the costs of NZ Super indefinitely, given the projected expansion in those costs?" (The Treasury 2013, pp. 53-54)

(f) St John (2015) *Improving the affordability of New Zealand Superannuation*: Susan St John's Working Paper makes more radical suggestions:

i. The nature of the pension would change to a tax-free 'New Zealand Superannuation Grant' (NZSG), payable to everyone over the state pension age.

The NZSG would be equivalent to the current after-tax NZS for a married person.

ii. The higher 'single-sharing' pension rate would be frozen until the married rate caught up while the extra amount payable to a pensioner 'living-alone' would be replaced by a means-tested accommodation supplement[12].

iii. A new tax schedule would apply as an income-test until the NZSG had been clawed back in full for those with high 'other' incomes. Two possibilities for the new tax schedule were illustrated: the first would be a single 39% tax rate on all 'other' income. The second would tax the first $15,000 of 'other' gross income at 17.5% (including a claw back of 7%) and apply the 39% rate to the balance. Based on current tax rates, the NZSG would be fully clawed back at $93,000 of 'other' income with the less generous approach and at $147,000 if the first $15,000 were more favourably treated.

iv. The above changes do not preclude "some raising of the state pension age" but would take the pressure off that cost-lever.

Cost saving comes from the claw-back and from gradually reducing the real value of the single rates ('living alone' and 'single sharing') to the married rate. St John suggests that with the more generous claw back, a saving of around 10% of net NZS costs should be feasible.

4. Do we need to re-design New Zealand Superannuation?

All of the reviews noted (and other reviews that preceded them) have started from an assumption that taxpayers of 2060 will object to paying an expected net 6.7% of GDP for an NZS that is available to everyone over age 65 on much its current terms. With that assumption, the task of reviewing NZS is really about reducing the expected costs to a level that taxpayers of 2060 might find acceptable. It is a 'cost-first' approach to the issues.

That is not how to re-design a pension scheme (public or private) even though that is how NZS has evolved to date. This *PensionCommentary* recommends the 'benefit-first' alternative.

In the needed debate about benefits, it must be remembered that the NZS is not the only cost to the economy of income-support for the old by 2060. Aside from other government programmes, the old will also be realising private claims on the economy (liquidating private savings) to support their standard of living in retirement. In economic substance, those are no different from the claims on taxpayers that NZS will represent. This point becomes significant when we discuss means-testing possibilities.

Thinking just about NZS, we first need a serious debate, backed with the best available information, that the currently expected 6.7% of GDP will be unacceptable to taxpayers in 2060. That debate should extend to all the 2060 government's expected spending that the Treasury estimates could add as much as 3% of GDP to taxes by 2060. We have the Treasury's calculations on those but we need to test the robustness of the underpinning assumptions and projections, remembering that even the Treasury suggests we might be able to afford NZS in its current form.

[12] In 2010, the number of single pensioners who live alone or who share accommodation was about 40.5% of all NZS recipients (St John, 2015 p.6).

Next, those estimates about future required levels of tax assume that what we have - the current design of NZS, for example - delivers the benefits that fit a 21st Century economy. NZS is the latest version of a state pension that started 117 years ago and elements of that original scheme are still part of the benefit design. The 1938 and 1976 reforms brought it closer to the present overall shape but in more than a century of changes, New Zealand has never had a research-led, public debate on any of the key design features of NZS as set out below.

If an expected net 6.7% of GDP for NZS alone might be unacceptable to taxpayers in 2060, the next step is *not* to discuss what cost-level might be acceptable and then trim the benefits to fit the new limit. The correct first step is to pick apart each of the components of the benefit and test whether they achieve the government's and society's objectives (and we need to establish those first).

Even if we think that 2060 taxpayers might accept a net 6.7%, we should still undertake the proposed review. Any government policy and its fiscal and economic consequences should be subject to regular review, no matter how politically damaging that might be. Superannuation has been a difficult issue for more than 40 years. This and a follow-up *PensionCommentary* argue that New Zealand needs to think of a new way to discuss the design of NZS. The present process is not working.

5. Resolving the design elements of NZS

New Zealand needs to start a full review of NZS and the sooner that happens, the better. None of the reports referred to in in paragraph 3 above has come close to what's needed.

Here is a summary of the major design decisions that should emerge from the proposed, research-led review:

5.1 Universal or means-tested? Until 1977, the then 'Old Age benefit' was income-tested but 'Universal Superannuation' was not. In practice, by 1975, this meant there was an income-test between age 60 (when the Old Age benefit started) and age 65 (when Universal Superannuation started)[13].

'National Superannuation' changed that in 1977. The state pension age was reduced to 60 and the income-test was eliminated. However, the Labour government re-introduced income-testing without debate from 1985 (the 'surcharge'). It was watered down later and finally eliminated in 1998 by the next National government, again without discussion.

NZS has never been subject to an asset-test[14]. Finding out how an asset test works in Australia should be an important part of the New Zealand review.

Should NZS be paid to people who don't, on any reasonable basis, need it? If we decide to apply a means-test (on income and/or assets) NZS will no longer be a universal pension. In that case, where should the reductions begin and at what rate should the state pension be withdrawn? What might be the consequences for the economy, particularly to labour force participation rates, and how might New Zealanders react to such tests? How might savers react during both their working and retirement periods? We have some experience from the days of the surcharge (1985-1998) and there are useful potential lessons to be learned from Australia.

Governments cannot dictate how much of the economy's output goes to the old because of private, unmanageable responses to the retirement income framework. We need a

[13] Preston (2001) provides an excellent summary of the history of NZS since it started in 1898.
[14] The Old Age benefit was the last time New Zealand had an asset test on an age-related income benefit.

better understanding of the present and expected *total* claims on the economy by the old[15]. With the best of intentions, it is almost impossible to regulate private behaviour so as to achieve the desired overall objectives and any discussion of income- and/or asset-tests must recognise that[16].

5.2 State pension age: The state pension age of 65 was first set in 1898. We flirted briefly with age 60 between 1977 and 1992 but, by 1 April 2001, it was back to age 65.

Why age 65? There is no particular reason (physiological, physical or gerontological) to pick any age because the appropriate age for an individual will be driven by many issues including health, availability of work, family circumstances, income, personal preferences and wealth.

Retirement, as a universal 'entitlement', is a relatively recent phenomenon. In 1910, two out of three US men age 65 and over were actively employed. Even at age 72, male participation in the labour market was over 50%[17]. The percentage of US men age 65 and over who worked fell to about 50% in 1950 and then below 20% in 1980. By 1990, it had fallen to 16%[18] and has now (2014) risen to 17.4%[19], probably because the state pension age for US Social Security is now 66 and is increasing to 67 by 2027.

New Zealand's participation rate for all those aged 65+ fell to as low as 6.4% in 1986. It's now (2013) 22.5% and rising[20].

When the government chooses a state pension age, it must balance social issues, labour market efficiencies, voter satisfaction and fiscal considerations. Some suggest that, with improving mortality, we should be seeing a natural increase in the state pension age, certainly by comparison with the position that prevailed in 1898[21]. The state pension age is now, perhaps, one of the most significant single elements of public welfare policy, one that has, in essence, persisted for 117 years.

The amount and quality of the information we have on issues associated with the fixing of a state pension age are inadequate. We need to discuss the distortions created by the present state pension age on the work/retirement decision. We do not know fundamental facts such as when New Zealanders stop working (not when they 'retire'), when they can afford to stop working or when they would prefer to stop and finally what the progress is from fulltime work to 'fulltime' retirement.

5.3 Residency test: We pay NZS from age 65 to anyone who has lived in New Zealand for ten years after age 20 with five of those being after age 50. Why ten years? Why five years and why ages 20 and 50? In the past, the qualifying period was 25 years.

5.4 How much? The size of the pension has had a more varied history. The age pension was modest (and both income- and asset-tested) when it started nearly 117 years ago. By 1940, the single person's pension was about 29% of the then national average

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[15] In *Turning silver to gold: Policies for an ageing population* (Dale, M. Claire, 2014), Claire Dale collates what we know about public policy-driven state costs of services and support for the age 65+ population through to 2030. For the proposed national discussion on NZS, that needs to be deepened and extended.

[16] In fact, it's even possible that the total (public + private) claims of the old on the economy will be greater in the presence of a means-tested state pension than might be the case with a universal pension such as NZS. Savers might under-estimate the net amount of state provision and therefore over-estimate the need for private provision in the presence of means-tests. That could increase the total economic claims by older people (both public and private) on a demographically ageing economy.

[17] Burtless G. and Quinn J. F. *Retirement Trends and Policies to Encourage Work Among Older Americans*, Center for Retirement Research at Boston College, Working Paper 2000-03.

[18] Monthly Current Population Survey data in the US cited in *Passing the Torch* by Quinn, Burkhayser and Myers 1990, W E Upjohn Institute.

[19] ILO Key Indicators of the Labour Market (KILM, 7th Edition, 2011) cited in Guest, R. *Comparison of New Zealand and Australian Retirement Income Systems*, 2013 accessible here.

[20] See Retirement Policy and Research Centre (2014) *Updating data on older workers*, *PensionBriefing 2014-4* (accessible here).

[21] New Zealand males currently have an 18.8-year life expectancy at age 65; females will survive, on average for 21.2 years (*New Zealand Period Life Tables 2010-12*, Statistics New Zealand accessible here).

wage (on a 'gross to gross' basis). Over the following 35 years to 1975, it fluctuated between, roughly, 27-35%. The introduction of 'National Superannuation' in 1977 saw a major lift but, in spite of the highly politicised nature of the issue since then, has fluctuated over the last 30 years between about 40-47% of the national average wage (which was $54,685 before tax as of December 2013[22]). Currently, NZS is 40% on a pre-tax basis[23] for a single person living alone (43% on a net-to-net basis).

In 1989, the then Labour government decided that the after-tax married couple's rate should lie between 65% and 72.5% of the after-tax national average wage[24]. Currently, it is a net 66%. There was no public debate at the time about this and no apparent 'science' to it other than that it was less than the then-current rate and was expected to save a significant amount.

Is 65% enough or too much? One measure of adequacy might be to eliminate poverty in old age; another might be to ensure 'participation and belonging'. We need to decide what the welfare objective of NZS should be, how to test that and how to measure changes over time to ensure the objective is reached[25].

5.5 How re-valued? Until National Superannuation of 1977, there had been no formal link between the pension and any measure of real value. National Superannuation made that link with the national average wage in 1977. As a country, we have never discussed whether the pension should be linked to anything in particular though recent reviews (noted above) have recommended that it be changed. Currently the measure is a combination of the after-tax, national average, ordinary-time wage and the Consumer Price Index. Is that the best? Some say it should instead be linked to economic output; others to prices alone; yet others to a mix of prices and incomes. Others say that the CPI does not fairly reflect the prices faced by pensioners and that NZS should be measured against a 'superannuitants price index'. We have never had a research-led discussion about the alternatives and their implications.

5.6 How paid for? Until 2001, New Zealand paid for NZS on a pay-as-you-go (PAYGO) basis. There was a 'Social Security Fund' between 1938 and 1964 but that was little more than a bookkeeping arrangement. In 2001, the government decided that New Zealand needed to partially pre-fund the expected cost of NZS through contributing to the New Zealand Superannuation Fund (NZSF) that would invest in capital markets. This means that NZS will still be largely PAYGO but a little bit pre-funded.

We did not have a research-led debate when the NZSF started in 2001. Some think the role of the NZSF should be significantly extended; others that the NZSF be dismantled and the proceeds used to reduce government debt. Regardless, New Zealand needs to understand the economic and political considerations of the alternatives.

5.7 Payments to single people: Why is a single person, living alone, entitled to 65% of the married couple's combined rate (section 16(1)(b) of the Act)? Why is a single person living with others entitled to 60% of the married couple's combined rate (section 16(1)(c) of the Act)? Why do we pay a married couple less in total than two single people who live together? Are these amounts adequate (or too much)? When was the empirical work done to see whether the proportions might be other than they are?

5.8 Overseas pensions: The present regime for deducting equivalent overseas pensions from a resident's entitlement to NZS under section 70 of the Social Security Act 1964 is a confused, inconsistent mess. Many commentators have suggested that the treatment

[22] The December 2013 national average wage was used to set the 1 April 2014 NZS rates.

[23] The pre-tax, annual NZS for a single person, living alone is $21,932 a year; $421.76 a week (2014) – see here.

[24] This is now in section 16(1)(a) of the New Zealand Superannuation and Retirement Income Act 2001 (the Act).

[25] Given that KiwiSaver cost taxpayers $901 million for the year ended 30 June 2014 (The Treasury, 2014 at p.54), the expected benefits members will receive at the pension age could form part of the discussion about the size of NZS itself.

of overseas pensions needs an urgent review and that should happen anyway. However, it should preferably be part of the proposed research-led debate.

There is a further list of less significant but still important elements of the current benefit design that need testing in the proposed research-led debate:

5.9 ACC entitlements: given that NZS is not income-tested and that the ACC legislation is in the nature of an insurance scheme, why can't an ACC recipient receive both NZS and an ACC pension (section 7(2))? The present law may be correct but the question needs analysis and an answer.

5.10 Periods of absence – VSA or missionary service: Sections 9 and 10 of the Act include periods of absence on Volunteer Service Abroad and missionary service for the residency qualification in section 8 (see paragraph 5.3 above). Why not include other charitable bodies such as the Red Cross and other "recognised aid agencies" as in section 24?

5.11 No reduction to benefits: Section 15(4) of the Act says that no future CPI adjustments to the amounts payable shall result in the benefits being reduced. Why? If we go through a sustained period of falling incomes, why should the incomes of retired New Zealanders increase in relative terms (by standing still nominally) while all other New Zealanders are forced to adjust to new, lower standards of living? If 65% of the average wage is the right answer on the married couple's pension, why does it become wrong if incomes were to fall?

5.12 Hospital rates: Section 19 of the Act says that the amount of NZS should reduce after 13 weeks in a public hospital to, currently, a net $43.23 a week. Why 13 weeks? Why not four weeks?

5.13 Payments overseas: A number of aspects of overseas payments of NZS deserve debate:

(a) Why should NZS be payable to anyone who is overseas for up to 26 weeks (section 22 of the Act)? Why not 13 weeks (as with hospital rates)? Why not four weeks?

(b) Why should the 26 weeks in section 22 (referred to in the last paragraph) become 156 weeks (three years) if the recipient is working (albeit on an unpaid basis) with a "recognised aid agency" (section 24)?[26]

(c) Why should someone who lives in a country with no "reciprocity of social security monetary benefits" receive a proportion of NZS (sections 26 and 26A of the Act)? Why do they get anything? What welfare obligation do New Zealand taxpayers have towards people who are no longer resident? If we do that, should that proportion be based on years of residence between ages 20 and 65 (section 26A(1)) and why might years after age 65 be excluded? If this is appropriate for emigrants, might that test also be appropriate for immigrants with overseas pensions (see paragraph 5.8 above)? Why must the person be ordinarily resident on the application date (section 26B(b)(i)) but not before or after? Finally, why do we pay that pension gross? Why not deduct tax?

(d) Why should NZS be payable to people who leave New Zealand and live in a "specified Pacific country" (section 31 of the Act)? Why is each of the countries listed in Schedule 2 included[27]? Why does each person so affected need to have

[26] And the extension from 26 to 156 weeks applies only if the Ministry's Chief Executive is satisfied that the applicant "has not deprived another person of paid employment to engage the person to do that work on an unpaid basis". It will be interesting to know how the Chief Executive might arrive at such a conclusion and, indeed, whether the test in section 26(1)(c)(ii) has ever been applied.

[27] The countries included in the list of "specified Pacific countries" (Schedule 2 of the Act) are a curious mixture. There are those with long-standing relationships with New Zealand (Cook Islands, Nauru, Niue, Samoa, Tokelau and Tonga). For these, the payment of NZS might be considered as part of our aid programmes. However, it is difficult to understand why the list extends to American Samoa, French Polynesia, Guam, Marshall Islands, Palau, New Caledonia, Northern Mariana Islands, Pitcairn Island and

lived in New Zealand for 20 years (section 32(1))? Or to receive a proportionately reduced benefit if they have lived in New Zealand for at least 10 years?

The final important step in this process is agreeing transition provisions that move NZS from its present basis to the new 21st Century programme. The benefit design decisions will affect different groups in different ways so the transition will need tailoring to individual needs.

6. A needed debate

Each of the issues described in section 5 raises benefit design implications that should at least be debated in the context of good evidence. That debate must acknowledge that today's decisions will be made under conditions of great uncertainty so that flexibility will be an important component of those decisions.

New Zealand needs to agree social policy reasons as to why the things described in paragraph 5 should be so and what might be 'better' ways of achieving common goals. New Zealand has not had such a debate.

7. Costing the possibilities

Each of the benefit design elements should be agreed without, at least initially, regard for the expected cost to taxpayers. What, in each case, is the 'best' answer to each benefit design question posed in paragraph 5 above?

Costings of a 21st Century NZS should be done only once all aspects of the benefit design have been tentatively settled. It is quite likely that the agreed scheme and the transition arrangements will cost more than might be acceptable to today's and tomorrow's taxpayers. The debate on benefit design should then pull back from the 'ideal' so as to bring the new NZS within an acceptable budget. That will probably be an iterative process.

Eventually, we will arrive at a benefit design that achieves the country's agreed objectives at a cost that is likely to be acceptable over coming decades.

8. Projections over 40 years

The Treasury makes regular projections of expected expenditures and future growth rates of the kind referred to in paragraph 2 above. However, these must be subject to considerable uncertainties, given the long timeframes involved.

In *New Zealand Superannuation's real costs – looking to 2060* (Retirement Policy and Research Centre, 2013), we analysed the results of 14 versions of projections made by the Treasury's *Long Term Fiscal Model* (LTFM) between 2000 and 2013 and observed:

Wallace and Futuna, all of which are either colonies of or have political ties to other countries (US, UK and France). The case is even more curious for the US and French colonies given that New Zealand does not have social security reciprocity agreements with either country. There is no obvious reason to include the other seven countries (Federated States of Micronesia, Fiji, Kiribati, Papua New Guinea, Solomon Islands, Tuvalu and Vanuatu) other than they are all in the Pacific.

> "…it is clear…that the expected future real cost of NZS measured in the 13 years covered by the NZSF models' calculations has actually fallen, benchmarked against future estimates of GDP. In fact, the 2060 estimate of the expected net cost of NZS has reduced from 9.7% of GDP in V1-2000 to 6.6% of GDP in V14-2013 (a reduction of 32%). Most of that is attributable to the improvement in real GDP (+60.8% in 2060)..."

We concluded that the Treasury's projections:

> "…emphasise[] the importance of economic output and, for the security of today's and tomorrow's pensioners, the importance of increasing that output at a faster rate than the latest version of the NZSF model presently projects. For many more reasons than just the affordability of NZS, how to make New Zealand more productive should be at the centre of discussions about the economic implications of an ageing population."

The government, on behalf of all taxpayers, balances the competing claims on economic output from everyone, including pensioners. The decisions are made year-by-year and can change from year to year. With growth, governments have more choices but it's important to emphasise that those are choices of the day, not today.

Today's taxpayers and voters cannot bind taxpayers of 2060 to any decisions made about NZS over the next few years. The 2060 government, acting on behalf of tomorrow's taxpayers, could make very different decisions about the claims of pensioners (among others) on economic output and those different decisions could be implemented relatively quickly.

An important part of the 21st Century NZS will be a regular review process of the kind currently carried out every three years by the Retirement Commissioner (under section 83(c) of the Act). However, if those reviews were more independent[28] and were properly resourced, they need not be every three years: every ten years would probably be sufficient. They should also be confined to NZS and its implications.

9. In conclusion

There is usually an assumption in calls for a review of NZS benefits that they will have to reduce. International comparisons of New Zealand's expected pension costs at least question that assumption[29] but should not preclude a full principles-based and research-led, national debate on the size, shape and implications of the current design of NZS. That debate may lead to a consensus that supports a continuation of the present arrangements but it may not. The sooner that debate happens, the better.

All New Zealanders need the opportunity to engage in that discussion. Is the government correct when it suggests that the design of NZS does not need to be addressed until the next decade? This *PensionCommentary* suggests not. The longer that discussion is delayed, the more difficult it will be to start.

A second *PensionCommentary 2015-2* will look at how we have got to the present impasse and why we need to change our approach to reform. The suggested review is needed to

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[28] Why, for example, can the Retirement Commissioner review only those matters that the Minister of specifies: see section 84(1) of the New Zealand Superannuation and Retirement Income Act 2001 (accessible here)?

[29] By 2050, 23 of 31 countries reporting to the OECD will be paying more in pensions than New Zealand – and that takes no account of the amounts countries are spending on tax breaks for private pension provision – see RPRC (2012) *We all have to talk about New Zealand Superannuation*.

restore New Zealanders' faith in the future sustainability of the simplest, most effective state pension arrangement in the developed world.

A separate similar review should look at KiwiSaver.

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