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RPRC Update

Retirement Policy and Research Centre

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SAYGO vs PAYGO – does it matter?

On 26 June, the RPRC hosted a debate at the University of Auckland on this topical aspect of retirement policy. The amount spent on New Zealand Superannuation is forecast to double as a pecentage of GDP in the next forty years. Should New Zealand start to prepare financially for these higher costs? Some say the government should be emulating private behaviour by setting aside financial assets that can be used to help pay for NZS. Making a difference would require a much larger New Zealand Superannuation Fund than currently allowed for, even if contributions resume in 2019. Such 'Save As You Go' (SAYGO) funding contrasts with 'Pay As You Go' (PAYGO) funding of NZS out of general tax revenues.

Andrew Coleman, Senior Fellow, Motu Economic and Public Policy Research suggests Australia's strategy of compulsory, tax-favoured retirement saving is better balanced than New Zealand's. He is in favour of more SAYGO and less PAYGO, suggesting that this will ease the burden on tomorrow's taxpayers. Under SAYGO, the accumulated physical capital enhances the future economy, and requires a smaller contribution from taxpayers to maintain pensions at the current level. Although they pay twice in the transition, those aged 20-40 today will be twice as well off as today's retirees. Coleman argues that the shift to SAYGO now will result in more saving thus more investment thus higher growth and a bigger pie to be shared. Now is the time for the transition, with a comparatively small number aged 65+.

RPRC's co-director Susan St John argues that setting up more KiwiSaver funds or more contributions to the NZSF does not guarantee increased national saving. Also, more saving does not guarantee more productive investment; and more investment does not guarantee higher GDP growth. It is the strength of tomorrow's economy that will matter. As economist Nicholas Barr pointed out in 'Myths my grandpa taught me' 1979: "you can't eat pound note butties". While New Zealand has a national savings problem of serious dimensions, there is no evidence that KiwiSaver has added to national saving, or resulted in better investment. Moreover the current state of the economy and the world context suggests more saving will simply be contractionary. "The basis of the debate needs to be intergenerational equity" says St John. "Rather than talk about investing in managed funds and imposing a double burden of saving on current taxpayers, we urgently need a debate around investing in the young, the workforce of the future, instead of loading them with debt and resentment."

RPRC's co-director Michael Littlewood also spoke in favour of PAYGO. Littlewood suggests that a much enlarged New Zealand Superannuation Fund will raise New Zealand's risks. He also says the cost of NZS is less of a concern. In 1991, the gross cost was 7% of GDP, so the age of entitlement was increased over the next 10 years from 60 to 65, and the problem was solved. "If New Zealand decides that a gross cost of 8% of GDP is too high by 2050, the remedy is easily implemented and the effects of benefit changes can be very powerful." However, Littlewood acknowledges that while the remedy may be straightforward, the politics of implementing the remedy are another matter. Littlewood also argues that "In the presence of debt, a decision to invest or retain investment is a decision to borrow and invest." With the government's current debt, moving to a SAYGO scheme for NZS is equivalent to borrowing to invest.

The presentations from the debate are available here.

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RPRC's publications in *Policy Quarterly* challenge current public policy

The treatment of ***Overseas Pensions*** is neither fair nor transparent. The increasing mobility of citizens adds to the complexity of determining fair policies for pension eligibility and portability. See *New Zealand's Overseas Pensions Policy: Enduring Anomalies and Inequities*.

This article looks at the interaction between **in-work benefits and the tax system**. A parent's job-loss or reduced work hours may be compounded by loss of entitlement to tax credits. See *Evidence-based Evaluation: Working for Families*.

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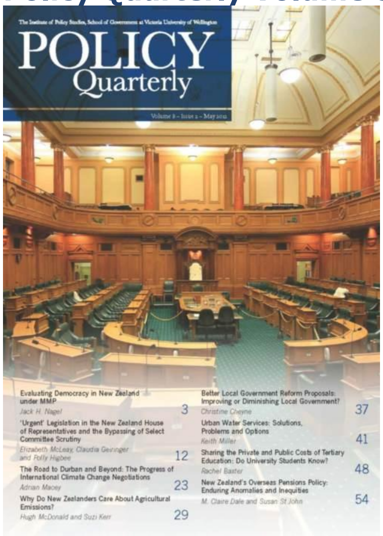

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RPRC in the media and public presentations

5 April NZ Herald Michael Littlewood calls for the default KiwiSaver system to be abolished to level the playing field for all providers and prevent the six financial service providers having an unfair commercial advantage here.

5 April Goodreturns.co.nz Michael Littlewood says the Government "should not give a commercial and marketing advantage to a small group of financial service providers, especially if they do not pay for the privilege" here.

1 April SundayStar Times Following RPRC seminar Sue Newberry quoted in 'Government in $112b barney' here.

5 April Interest.co.nz Michael Littlewood calls for an end to the practice of auto-enrolling employees into KiwiSaver, a move that would effectively eliminate the need for default providers here.

9 April Stuff.co.nz Michael Littlewood questions the need to renew the agreements with the KiwiSaver default providers when the system is reviewed by the Economic Development Ministry before June 2014 here.

11 April Goodreturns.co.nz Michael Littlewood suggests doing away with default providers and giving new entrants to KiwiSaver one year to make up their minds about which fund to join or have their money refunded by the IRD here.

17 April Stuff.co.nz M.Claire Dale quoted on poverty as our biggest growth industry here.

18 April TV3 M.Claire Dale interviewed on poverty industry and child poverty in New Zealand here.

19 April Triangle TV Susan St John, In Conversation with Noel Cheer on 'The State of the Welfare', here.

25 May Interest.co.nz M.Claire Dale and Susan St John recommend minimum 25 year residency to qualify for NZS here.

30 May Stuff.co.nz Michael Littlewood and Michael Chamberlain say KiwiSaver providers should be forced to publicise the returns that end up in people's pockets, not returns before tax and fees here.

1 June Interest.co.nz Michael Littlewood and Michael Chamberlain oppose reporting KiwiSaver gross returns here.

7 June NZ Herald Michael Littlewood and Michael Chamberlain say KiwiSaver providers should not be allowed to publish investment performance returns based on "meaningless" gross figures here.

13 June TVNZ.co.nz Breakfast Michael Littlewood says people will retire later if the state pension age shifts here.

18 June Radionz.co.nz Michael Littlewood answers the Financial Services Council's (FSC) claim that the Government is seriously underestimating future pension costs by saying there is such a thing as saving too much here.

17 June Stuff.co.nz Michael Littlewood says give people a choice about paying off debt, or pouring money into a business rather than FSC's proposal that workers saving 10% of their incomes will lower the future cost of NZS here.

18 June TVNZ.co.nz Breakfast Michael Littlewood says, rather than the FSC proposal that workers save 10% of their incomes in order to avoid future means-testing of NZS, give people a choice about where to put their money here.

18 June WorldTV (in Chinese) Michael Littlewood says if the state pension age shifts, people will retire later here.

18 June Radionz.co.nz Checkpoint Michael Littlewood responds to OECD report on New Zealand's pension adequacy here.

18 June Radionz.co.nz Jim Mora's Afternoons Michael Littlewood says we need a research-led debate on super here.

18 June NBR Michael Littlewood welcomes the Government's decision to abandon the fully-funded model for ACC here.

21 June NZ Institute of Chartered Accountants: Susan St John presents to the investment interest group in Auckland on Intergenerational Equity Issues for Investors.

27 June NZHerald M.Claire Dale and Susan St John OpEd: NZ needs to smarten up Super rules here.

PensionCommentary 2012-1, 4 April 2012

KiwiSaver: changing the default provider process

Michael Littlewood, co-director RPRC, suggests radical changes to the current default provider regime. He says that a small group of financial service providers should not be given a commercial and marketing advantage by the Government, especially if they do not pay for the privilege. He suggests two possible ways forward:

First is to extend the Inland Revenue's involvement with auto-enrolled members from the current eight weeks to a year. If the member has not chosen a KiwiSaver provider by the end of 52 weeks, the member will automatically begin a contributions holiday. The membership will stay in the Inland Revenue's 'holding' scheme until the member chooses a provider.

Alternatively, the government should prescribe a set of minimum standards for default providers (there are none at present). Any KiwiSaver scheme that continuously complied with those standards would automatically be on the Inland Revenue's default provider list.

Littlewood also opposes the Savings Working Group's proposal that would have seen the government become a commercial competitor to private providers: "Aside from size, and the absence of a profit motive, the government has no competitive advantage in delivering superannuation services. On those grounds, the government could justify involvement in any business activity."

In summary, Littlewood concludes the current regime with six privileged providers should stop in 2014.

Link to the *PensionCommentary* here.

PensionCommentary 2012-2, 30 May 2012

Investment performance: publication of 'gross' returns on KiwiSaver schemes should be banned

There is much current discussion about regulatory and reporting regimes for all financial service providers, including the collective investment vehicles used in KiwiSaver schemes: 'managed funds'. Michael Chamberlain, actuary, and Michael Littlewood of the RPRC explain that the complexities of income tax and the structures now used by KiwiSaver providers make the unravelling of investment performance confusing.

Because of tax treatment, reporting of returns is complex and providers naturally pick results and comparisons that favour their particular offerings. So-called 'pre-tax' returns are sometimes 'derived' from net returns. However, the current organisation of the income tax system makes comparison of gross (pre-tax) returns mostly meaningless. Yet some fund managers quote just these gross (pre-tax; pre-fees) returns either to clients or to the public.

Because gross returns are so misleading, the Government's 2012 Budget announcement requiring the publication of those returns for KiwiSaver schemes is unhelpful. If New Zealand is to have open and transparent markets, providers should not be able to advertise their own versions of investment returns. As the Government itself acknowledges, the only return that matters is what's left after tax and fees.

Link to the *PensionCommentary* here.

PensionCommentary 2012-3, 14 June 2012

We all have to talk about New Zealand Superannuation

After tax, New Zealand Superannuation (NZS) currently costs taxpayers about 3.7% of gross domestic product. If the age 65+ population doubles by 2050, that GDP cost is likely to become a net 6.7%.

Michael Littlewood asks "How much might be 'too much' for age pensions?" Whether or not the expected cost is 'affordable', we all, including the Government, need to talk about that now.

On most measures, New Zealand's retirement income arrangements currently seem to 'work' quite well. NZS provides a married couple with at least 66% and a single person living alone about 47% of the net average wage, adjusted annually to reflect changes in wages (or inflation). The grossed up amount is taxed as ordinary income.

NZS delivers enough income to keep nearly all over-65s out of poverty. In fact, an OECD comparison ranked New Zealand 'top equal' measured by the lowest poverty levels amongst the retired populations of its member countries (OECD, 2008).

Littlewood says "We need to be very careful about imposing any changes, particularly as those approaching retirement will have made their financial plans on the basis of the way things are. Such plans typically have to be made and implemented over a decades-long, pre-retirement period."

The real issue then is that we all need to discuss changing New Zealand's retirement income settings, in particular with respect to NZS.

Link to the *PensionCommentary* here.

M.Claire Dale, RPRC: *Microfinance in developed economies:*

A case study of the NILS programme in Australia and New Zealand.

The RPRC operates under the umbrella of the Centre for Research in Economics (CARE) in the Department of Economics at the University of Auckland. Financial literacy is a topic relevant to both RPRC and CARE. RPRC Research Fellow M. Claire Dale, with Fiona Feng & Rhema Vaithianathan have authored this paper comparing the role of micro-finance schemes in developing and developed country contexts.

Research and reporting on microfinance programmes in developing economies is vast, but there is currently little analysis of similar schemes in developed country settings. The paper contributes a new angle to the burgeoning literature by offering a case study of Australia's Good Shepherd Youth and Family Services' NILS scheme, which was recently invited to be involved in the establishment of New Zealand's first formal microfinance programme, Nga Tangata Microfinance.

Susan St John: *Lessons from Ireland*

In 2010, Susan St John, as guest of the Pensions Group at Trinity College, Dublin, presented *RPRC Working Paper 2010-2, KiwiSaver The first three years: lessons for Ireland?* This followed a visit to New Zealand in 2008 by Professor Gerry Hughes who wrote "In Ireland there is a consensus that the role of the state is to help the social partners to develop a national pension system for workers whereas in New Zealand there is a consensus that the role of the state is to provide security in old age for citizens." See *Working Paper 2008-1: Lessons from New Zealand for Ireland's Green Paper on pensions*.

Revisiting in June 2012, St John found Ireland trying to hold on to what it has got left. The Celtic Tiger's demise and the collapse of the banking sector has created much misery and left the country as whole with unsustainable debt. The crisis has had a lasting effect on private pensions. Fintan O'Toole, in the Irish Times, 22 May 2012, writes: "… pensions policy is in an unholy mess. The National Pension Reserve Fund has been vaporised, largely because of the bank guarantee. Pension policy is based on encouraging people to invest in private pension funds. Their performance is abysmal: the average five-year return of Irish pension funds is minus 2.9%. The average 10-year return is 2.2% – and this is before the fund managers take their huge fees."

This outcome is in spite of the expensive tax incentives for private pensions deplored by Professor Hughes in his paper. Scarily, the Government's amendment to the Pensions Act 2009 allows pension schemes in distress to reduce the benefits of members where no other option is feasible. Private pensions, despite huge tax-subsidies, have not proved a secure way to provide for retirement. Four years into their 11 year window to become actuarially sound, 80% are still technical insolvent and many are expected to fold. In the meantime annuities are proving very disappointing and pension promises are very expensive to honour.

"It now costs about €210,000 to secure an annual pension of €10,000 for a man aged 65. The same pension cost just €140,000 10 years ago. Annuity costs have accelerated in the past three years in particular – by about 40% – as a consequence of the euro zone crisis. Bonds issued by "safe-haven" countries such as Germany and, to a lesser extent, France, have become very expensive." (Irish times, 13 June 2012)

pensionreforms

New Zealand can learn from international experience and research. PensionReforms' website here aims to make that information easily accessible.

PensionReforms added 26 abstracts in the three months to 30 June. In the discussion in New Zealand on lifting the state pension age, the following four reports can aid understanding of the issues:

- HelpAge International has started a web site detailing the 'social pensions' in 85 countries. more
- The OECD has updated *Pensions at a Glance* for the Asia/Pacific region. It has summaries by country of public and private pension systems and suggests that time is running out for reforms. more
- Alarmist headlines are only one side of the story: ageing populations present potential fiscal challenges *and* new opportunities. Coordinating public policies taps into the resource of experienced workers. more
- Comparing pension systems in different countries is difficult. Worse, such limited comparisons are simplistic and misleading as this comparison of the German and Australian systems reveals. more

Mark your diaries for the RPRC symposium:
30 November, the University of Auckland: 'Decumulation, Annuities, Insurance'