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# RPRC Update

Retirement Policy and Research Centre

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## Overseas pensions: Justice delayed?

### An RPRC Forum – 6 June 2013

The RPRC hosted this forum at the Auckland Business School in association with the Human Rights Commission and Victoria University's School of Accounting and Commercial Law. The Forum brought together academics, Ministry of Social Development (MSD) officials, politicians and pensioners, to examine the treatment of retirees in New Zealand who have state-administered overseas pensions.

Qualification for full New Zealand Superannuation (NZS) requires only ten years' residence, with at least five being after age 50. Under the 'Direct Deduction Policy' (DDP), section 70 of the Social Security Act 1964, an applicant for NZS who is deemed to have a state-administered pension from another country, may have that pension offset against their NZS. One problem is that for some, the overseas pension may resemble more of a private savings scheme than a state basic pension. The DDP may also be applied to a spouse's NZS, raising issues of discrimination and inequity based on marital status.

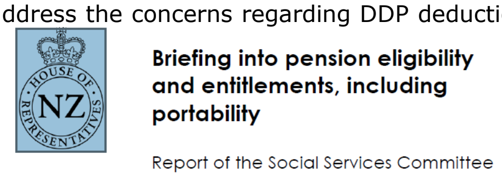
**Ministry of Social Development's 2008 Review**

While the MSD's 2008 Review (accessible here) found that current policies on the treatment of overseas pensions and payment of NZS overseas are operating reasonably well, it identified a number of areas that could be improved.

The Review recommended two proposals that did not require legislative change, also eight proposals requiring changes to Social Security and Income Tax legislation. Most importantly, the recommendations included:

- removing the proportion of foreign state pensions built up by voluntary contributions from the scope of section 70;
- discontinuing the deduction of a person's overseas pension from their spouse's NZS entitlement.

Although the New Zealand Superannuation and Retirement Income Amendment Act 2009 revised the NZS general portability rules for emigrants, it created new anomalies and did not address the concerns regarding DDP deductions of private pensions or spouses' NZS. In April 2013, Parliament's Social Services Select Committee declined to initiate an inquiry into pension eligibility and entitlements, including portability, although it expressed concern about anomalies and unfairness. When will there be action and what should be done now? Justice delayed is justice denied.




**RPRC contributions to the debate**

The RPRC has now run three forums on the DDP, produced a number of Working Papers, academic and media articles. This work is accessible here. The 2013 Forum heard from an MSD representative who described how the DDP is applied; and how many pensioners are affected. Associate Professor Smith from Victoria University's School of Accounting outlined the history of the DDP and possible reform principles and Labour's Jacinda Ardern confirmed that the opposition parties wanted Parliament to look at the issue. Sylvia Bell from the Human Rights Commission explained the legal framework for complaints of discrimination while the RPRC's Dr M.Claire Dale reported on informal legal advice that class actions against the MSD are possible but would be expensive. The Forum also heard from two people who are directly affected by the policy, Vivien Engler and Philip Meguire. Proceedings are here.
Options for reform that were discussed outlined over the page.

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## Forum (cont'd) Overseas pensions: Justice delayed?

The Forum analysed three options to address the major problems with the DDP (each would require legislative change along with transition provisions):

- ***Option 1:*** Associate Professor Susan St John (RPRC) outlined *Option 1* which sees the current ten year residency requirement lifted to 25 years by age 65. New Zealand could then essentially ignore other state pension entitlements and section 70 would no longer be needed.
- ***Option 2:*** Michael Littlewood (RPRC) described *Option 2* that would be triggered by the presence of an overseas pension similar to NZS. Pensioners would receive that overseas pension and NZS would switch to 1/540th of the full benefit for each month of residence in New Zealand (1/45th for each year between ages 20-65).
- ***Option 3:*** Denis O'Rourke (New Zealand First) explained *Option 3.* This would change NZS for all New Zealanders (not just those with overseas pensions) into 1/540th for each month of residence between ages 20-65 (1/45th for each year or 100% after 45 years). Only those New Zealanders who had lived in New Zealand for the full 45 years (with, perhaps, a five year period of grace) would receive the full NZS. Any overseas pension would remain the pensioner's property.

In summarising the present position, Michael Littlewood (RPRC) suggested there were some things that did not require a change to section 70 but that needed a change in MSD's policy. First, the 'family income test' that affects spousal pensions is probably wrong in law and could provide the basis of a class action. Next, occupational pensions should not be included in the DDP. Finally, there needs to be much better information available on a country-specific basis for future immigrants. These would patch the obvious difficulties but would not address the main issue.

We need a full, research-led debate on all three reform options. However, a major impediment is the current government's reluctance to discuss any changes to NZS. Until we can get past that hurdle, current overseas pension policy looks like 'Justice delayed'.

**Straw poll:** After listening to the three reform options, Forum participants were asked to grade their preferences. Option 3 received most support overall though, from some of the comments, some seemed not to see that Option 3 potentially affected all New Zealanders, not just those with overseas' pensions.

## *PensionBriefing* 2013-4

### Census 2013 – shortcomings in questions about housing

Most New Zealand households live in homes that they own. We find out that number through the five-yearly Census. The headline numbers are used as indicators of changing patterns of housing affordability both now and in the future. It should be easy to find out whether a household owns its home. For a number of reasons it is not. That is not helped by gaps in the Census questions.

Census data for 2006 show that, on Census night, at least 63% of occupied dwellings were owned by the occupants, either directly (51%) or through a family trust (12%). Another 27% paid rent for their homes. That leaves about 10% of occupied dwellings where we do not know what the 2006 relationship was between owners and occupiers.

Then there is no attempt to obtain ownership data for 9% of all dwellings that were unoccupied on census night. Those 'gaps' have the potential to skew any analysis of home ownership rates. In total, we have no information on the relationship between owners and occupiers for 19.4% of all dwellings.

Unfortunately, the questions asked in the 2013 Census were the same as in 2006. The relevant questions for the next Census need changing to provide us with accurate information on the economic status of the relationship between all owners and occupiers. Until then, we cannot really say whether home-ownership rates are changing.

The full *PensionBriefing* is accessible here.

## *PensionBriefing* 2013-5

### KiwiSaver, employer contributions and remuneration

From 1 April 2013, the minimum KiwiSaver contributions increased to 3% from both members and their employers. That saw many employees' 'total remuneration' increase by the employer's additional 1%. Despite this, take-home pay was lower because the employee's extra 1% comes out of their after-tax pay.

In other cases, 'total remuneration' was unchanged from 1 April so that, unless there was also a pay increase, the employee's take-home pay reduced by the 2% (the total of the employer's and employee's contributions). A survey of employers suggests that about 27% of employees are paid under 'total remuneration'.

The *PensionBriefing* wondered how employers might justify paying a higher 'total remueration' to employees who can afford to save for retirement. If they asked that question, it might lead them towards a 'total remuneration' approach to paying all employees.

The full *PensionBriefing* is accessible here

# 2013 Review of Retirement Income Policy

The RPRC made a submission to the Commission for Financial Literacy and Retirement Income's (CFLRI) **2013 Review of retirement income policy**.

The RPRC summarised all its publications and research that it believed were relevant to the CLFRI's review. There were:

- Nine papers on topics associated with the Direct Deduction Policy applied to overseas pensions (see report above on the RPRC's June Forum);
- Working Papers on New Zealand Superannuation, KiwiSaver, tax treatment of savings, the fiscal implications of an ageing population and the financing of long-term care;
- Proceedings from three public forums run by the RPRC;
- Numerous *PensionBriefings, PensionCommentaries* and academic articles;
- Presentations by RPRC people at public meetings;

The RPRC also noted that, of the 17 recommendations arising out of the last (2010) Review, six have been acted on, at least in part, while the other 11 recommendations have been ignored. That should be a matter for concern.

The full submission is accessible here.

# Working papers published

## WP 2013-1
## Save As You Go or Pay As You Go? The age old policy debate

A chapter from her 2004 PhD thesis by Dr Susan St John, RPRC Co-director, is relevant to growing debate on the future role of KiwiSaver and its potential integration with New Zealand Superannuation (NZS). This working paper reproduces Chapter 7: "The economics of pensions" as a contribution to the ongoing discussions as to whether New Zealand should rely more on SAYG and less on PAYG. It provides a critical look at some of the models that have been used extensively in policy debates.

While there has been remarkably little change to New Zealand's basic universal pension since this thesis was written, the debates around how policy should change have been intense. For example, Andrew Coleman, a Motu and Treasury economist, has written at length about the need to change from a Pay As You Go (PAYG) to a Save As You Go (SAYG) approach for the state pension, using arguments drawing on rates of return and intergenerational equity.

In 2012 the Financial Services Council, the representative body for financial services including KiwiSaver and life insurance providers, produced a report suggesting that "under very conservative assumptions, saving is likely to be at least 60% more efficient than taxation funding for retirement incomes".

Further, at the long-term fiscal projections conference, *Affording Our Future*, held in December 2012, Sir Michael Cullen proposed reducing future spending on NZS to zero by a switch to more SAYG KiwiSaver funds.

While it is difficult to fit a social insurance scheme such as NZS into the context of the overlapping generations model and the related discourse about rates of return, this has not prevented analysts from attempting to do so. Also, at times, there has been an uncritical acceptance of the suitability of these models for policy purposes, compounded by policy objectives that are often unclear, obscure or conflicting, and neglected normative issues.

Debates over SAYG pre-funding versus PAYG, defined benefit versus defined contribution, private versus public delivery, have not delivered clear answers. This working paper argues that the goal of a socially optimal distribution between generations at a point in time (intergenerational equity) has been confused with returns to the individual (individual equity). The latter approach stresses actuarial fairness so that each generation does not get more pensions than they themselves have 'paid for'. This belies concepts of generational interdependence and intergenerational and intragenerational equity that may be more appropriate.

Any enquiry into welfare-enhancing pension reform cannot avoid distributional value judgements. To be sustainable, reforms should be flexible in the light of uncertainties surrounding migration flows and economic conditions. Most importantly, reforms must meet agreed criteria of equity, efficiency and administrative simplicity.

Apart from the simplicity of NZS, one of the advantages of the New Zealand's age pension design and delivery is that it addresses directly the goal of securing a reasonable standard of living for all older people. On that measure, New Zealand's basic pension is a highly cost-effective scheme.

The full Working Paper is accessible here.

## WP 2013-2
## Fiscal Sustainability in An Ageing Population: Adapting universal provision

Raising the age of eligibility for New Zealand Superannuation (NZS) is not the only policy lever available to improve affordability, nor is it necessarily the most equitable. Dr Susan St John, Co-director, RPRC suggests that a subtle mix of the three possible parametric changes: age, level and means-testing, may be preferable.

Recipients of NZS, especially if aged close to 65, may still be in well-paid work, and/or have other large private incomes and assets.

About 40% of NZS recipients have virtually no cash income apart from NZS. The next 20% average only 20% of their income from non-governmental sources. However 35% of all older New Zealanders have more than half of their income from non-governmental sources. For couples aged 66-75, around half have more than 50% of their income from non-governmental sources.

Income for those over 65 is likely to be understated. Income in managed funds taxed under the Portfolio Investment Entity (PIE) regime, or retained in trusts or companies may not be included as 'income', and there is no imputed income for assets such as second homes or cars, or for owner-occupied housing.

In the 1980s, top income earners retained only 34% of NZS (top tax rate 66%). Now it is 67%, or perhaps even more with tax planning. The tax system is providing far less clawback than in the past, leaving much more net NZS with higher income high wealth individuals.

If NZS was removed from the top decile of superannuitants alone, 10% of the gross cost could be saved. The challenge is to design a means-test that achieves worthwhile savings with least pain.

The Australian means test is unlikely to appeal to New Zealanders. Under a New Zealand standard welfare test, a couple would retain only an extra $80 a week between them before facing an effective marginal tax rate of 89.2% (with ACC levy, tax and benefit loss). History suggests this is untenable.

The 'surcharge' that operated for 13 years and was finally abolished in 1998 has political baggage.

The Working Paper suggests that a net NZS could be paid as a 'NZ Superannuation Grant' (NZSG) as a weekly non-taxable payment. To achieve this, the rates for married, single and living alone should be aligned and high accommodation costs for low-income people could be met by a separate payment.

For any additional earnings, a separate tax scale would apply with the tax rate called in the paper 'the NZSG tax rate'. Effective marginal taxes are modest and comparable to the rate faced by many others in the workforce.

Various combinations are possible. If a combination of a tax rate of 20% on the first $15,000 and either 38 or 40% thereafter is chosen, the weekly losses for low income superannuitants are minimal and could be compensated for by other means. This suggestion provides a mechanism to effectively remove NZS from high earners and may be preferable to relying solely on raising the age of eligibility.

To be acceptable there must be integrity in the targeting approach. For example, income in PIEs and trusts should also be taxed at the NZSG rate.

This paper was presented to the Treasury conference "Affording our futures" in December 2012 and the full Working Paper is accessible here.

## *RPRC in the media and public presentations and contributions*

**Sunday StarTimes**, 7 April, Rob Stock quotes Michael Littlewood in *Scary prospects for life-long tenants,* here.
**Sunday StarTimes**, 7 April, Rob Stock quotes Michael Littlewood in *Is NZ Super anough to live on?*
**Nine to Noon**, 11 April, Michael Littlewood is interviewed on home equity release here
**New Zealand Herald**, 12 April, Susan St John and Claire Dale *Putting the bite on a big gap in our aged healthcare* here
**Hauraki Times**, 12 April cites Michael Littlewood in *Kiwis face renting for life* here
**Otago Daily Times**, 16 April, Susan St John and Claire Dale *More teeth needed in dental policy for elderly* here
**UABS Insights**, 16 April, Susan St John *Plugging the gap beyond KiwiSaver* here
**New Zealand Herald**, 19 April, Ben Chapman-Smith quotes Susan St John in *NZ must plug gap beyond KiwiSaver* here
**DominionPost**, 24 April, Eloise Gibson quotes Michael Littlewood in *NZ Super Fund still beating benchmarks* here.
**NewsTalkZB**, 16 May quotes Michael Littlewood in *Budget 2013, wish lists ahead of announcement* here
**DominionPost**, 13 May, Michaelle Duff quotes Claire Dale in *Rest home 'luxury' plan unfair – critics* here
**GrownUps website**, May, cites the RPRC's *PensionCommentary 'A commentary on older workers'* here
**New Zealand Herald**, 10 June, cites the RPRC's *PensionBriefing* in *Employers divided over KiwiSaver in the pay packet* here

## Other presentations:

## Conference presentation:

**Population Association of New Zealand: Population and Policy: Exploring the connections**, Wellington 27-28 June. Dr M Claire Dale's paper: **Some population consequences of age pension policies:**

Although government MPs on the Social Security Select Committee voted against an inquiry into the direct deductions policy (Christchurch Press, 10 April 2013), the Minister of Social Development has announced that her next task is "rewriting and updating the Social Security Act and all the Amendments made to it" (New Zealand Herald, 10 April 2013). This Act governs welfare pensions and benefits, including age pensions. New Zealand's age pension policy has resulted in one of the lowest rates of poverty among the aged in the OECD, reflecting comprehensive and inclusive coverage. But as longevity and mobility have increased dramatically during the past 50 years, the age pension's role, design and cost are questioned as to suitability and sustainability in the 21st century. For example, the overseas pensions policy expressed in section 70 of the Act was designed to support our egalitarian ethos. However, section 70 seems increasingly anachronistic. Current policy can deprive people of overseas-based private retirement savings, while providing others with easy access to our comparatively generous, residency-based age pension (NZS). This paper discusses anomalies, injustices and potential options for reform.

**Myths, misrepresentations and data**
13 June 2013
Michael Littlewood gave a presentation to the Remuera Branch of U3A, summarising what we really know about New Zealanders' financial behaviour.

**Business School presentation to SavY**
Susan St John spoke on the Business School's behalf at the Spark Entrepreneurship award to 'SavY', a financial awareness programme directed at secondary pupils.

**Future events**
A KiwiSaver event is planned for 3 September 2013 and Dr Alison O'Connell will speak at a forum on 23 September on the UK pension changes and the lessons for New Zealand.

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