



Submission on the Discussion Document:
Flexible Superannuation

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10 October 2013

The RPRC

The Retirement Policy and Research Centre (RPRC) of the University of Auckland is an academically focused centre specialising in the economic issues of demographic change including public and private provision of retirement income, and both the accumulation and decumulation phases of retirement provision.

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Summary of this submission

On 27 August 2013, the government issued an undated Discussion Document¹ ('Discussion Document') that looks at the implications of allowing New Zealand Superannuation to start as early as age 60 or as late as age 70.

Dubbed 'Flexi-Super', the Discussion Document was issued "...as a condition of the Confidence and Supply agreement between the National Party and United Future" (Discussion Document, p. 7). Part 1 of this submission analyses the proposal.

The RPRC suggests that all of New Zealand Superannuation's arrangements need a research-led discussion amongst all New Zealanders. Part 2 of this submission lists the issues that we think need to be resolved.

Flexi-Super should form part of that discussion but does not deserve a separate debate in isolation. We think that Flexi-Super, if implemented, would make the resolution of the debate New Zealand needs more difficult. We hope that the scope of that needed discussion is widened beyond the topics covered in the Discussion Document.



Michael Littlewood
For the Retirement Policy and Research Centre

¹ The Discussion Document is accessible [here](#) but is, interestingly, not on the Treasury's or the Ministry of Social Development's own web sites.

Part 1: The Discussion Document's proposed Flexi-Super

1.1 New Zealand Superannuation (NZS)

New Zealand Superannuation (NZS) is a universal, taxable pension, funded largely on a 'pay-as-you-go' (PAYG) basis from general taxation. It is paid to nearly all New Zealanders who are age 65 and over and who have completed relatively modest residence requirements (10 years after age 20 with at least five of those being after age 50).

The net married couple's rate is set between 65-72.5% of net average 'ordinary time' earnings and is currently 66%. The current annual amounts payable are in Table 1.

Table 1: NZS annual rates (April 2013)

	Gross	Net (Primary tax rate)
Married couple	\$32,275	\$28,594
Single, living alone	\$21,337	\$18,586
Single, sharing accommodation	\$19,607	\$17,156

As the baby boomers move beyond the state pension age (age 65) and longevity continues to improve, NZS will cost taxpayers more. About 612,000 New Zealanders now receive NZS at an after-tax cost in 2013 of \$8.8 billion². The latest estimates from the Treasury³ suggest that the net cost will increase from 4.1% of GDP in 2013 to 6.6% over the period to 2060.

Currently, NZS is payable from a fixed 'State Pension Age' of 65. There is no government proposal to increase that or to even discuss the possibility of an increase.

1.2 Flexi-Super – the proposal in brief

The Discussion Document proposes to allow New Zealanders to choose when they first receive NZS between ages 60 to 70. It is actually unclear what the objectives of this change might be. Dressed up in the language of 'individual choice' there are, potentially, wider public policy issues that should be of equal significance. 'Choice' and 'encouraging later retirement and greater work effort' may be in conflict.

The Discussion Document proposes that the 'early' pension will be less because it is expected to be paid from an earlier date and therefore for a longer period. Conversely, the 'late' pension will be higher to reflect both the deferral and also the fact that the expected payment period will be shorter, once NZS starts.

A number of details are unclear from the Discussion Document including, most prominently, the actual rate of reduction for 'early' pensions and the rate of increase for 'late' pensions. "Illustrative examples" are given of:

- **a reduction** for 'early' pensions of 6% for each year (compounded);
- **an increase** for 'late' pensions of 10% for each year deferred, again compounded.

However, the final rates will be different:

"This is just an example and actual rates could be much different, depending on detailed policy work that would be required before implementing this proposal." (Discussion Document, page 12)

² Because NZS is taxable income to pensioners, the after-tax cost is the only one that matters. The pre-tax cost is \$10.2 billion.

³ We analysed the Treasury's latest forecasts for the next 50 years in *New Zealand Superannuation's real costs – looking to 2060* – accessible [here](#).

This illustrates what we think is the curiously unformed nature of the Discussion Document. Why wouldn't the "detailed policy work" be done before seeking submissions?

As an aside, we did not follow the explanation:

"This means that if a person were to wait until age 70 to first take NZS they could receive around 160% of the rate at age 65. If, instead, they were to take NZS from age 60 they would receive 73% of the rate." (Discussion Document, p.12)

If the reduction for each year early were to be 6% of the pension payable from a year of age later then the age 60 pension should be 74.7% rather than the quoted 73%. Similarly, for later starting ages, if the 10% increase were to be applied to the pension payable from a year of age earlier, the pension from age 70 should be 161.1%, rather than the quoted 160%.⁴

We understand the justification for the reduction and increase in the annual amounts payable. The idea is based on actuarial principles but those principles can have different 'frames', depending on the central philosophy underpinning the calculations. For example, the calculations could be 'purely' actuarial and, based on the actuarial assumptions (mortality, interest rate, discount rate, rates of increase, take-up patterns) are intended to be financially 'neutral' to all pensioners who take that pension from a given age.

Another version of 'neutrality' looks at the question from the perspective of taxpayers as a whole. Given that taxpayers are 'prepared' to spend a given total amount in any year on NZS and some pensioners want to start the pension early (or late), what are the appropriate factors that will balance the fiscal budget amongst all pensioners, including those who started their pension at age 65. Those factors will still be driven by actuarial assumptions but a new factor will be Flexi-Super's experience: the numbers of pensioners who choose to start NZS early (or late). Then they will need to be adjusted by how closely the experience of those pensioners matches the actuarial guesses on which the original adjustments were made. This could be described as 'fiscal neutrality' rather than the 'actuarial neutrality' described in the previous paragraph.

On the other hand, the government might want to weight the calculations to, for example, favour/penalise those at the younger ages or favour/penalise those at the older ages. Those are perfectly legitimate objectives but the Discussion Document gives no indication of those possibilities. We discuss the detail of these calculations below.

1.3 Flexibility a 'good thing'?

Flexibility is, in theory a good thing. As the Discussion Document says:

"Flexi-Super would enable New Zealand residents to manage their retirement income and lifestyle with more flexibility than they currently have by giving them greater choice in when to first take NZS. Flexi-Super would aim to achieve this while being fiscally neutral." (Discussion Document, p 10)

However, choice comes at a cost and we discuss what those disadvantages may be. Some but not all were mentioned in the Discussion Document.

State schemes like NZS are quite different from private workplace schemes and even from workplace schemes administered by the state. While those can be flexible because they are linked

⁴ With defined benefit, workplace superannuation schemes, the reduction or increase is usually a fixed percentage for each year, rather than the compounded basis apparently used in the Discussion Document's "illustrative examples". If Flexi-Super were implemented, we would expect the adjustment factors to be specified for complete months early or late.

directly to employment from which employees derive their entitlements, the same is not the case with Tier 1 schemes like NZS. In the private sector, there is normally a contractual obligation between the scheme member and the pension provider so the ‘price’ of an alternative pension normally balances the financial consequences of the obligation and the entitlement, unless the sponsoring employer wants to encourage or discourage a particular action.

The position is very different with a state pension like NZS. Political considerations aside, the provider can change the rules at any time, including through income tax changes, even after a pension begins. While the changed terms for earlier or later commencement may be influenced by financial neutrality, the government is more likely to be influenced by social or political objectives. That’s when the rules can become complicated.

1.4 International comparisons

The Discussion Document (pp. 13-14) purports to show that a number of countries already have something like Flexi-Super. However, we think that comparison is flawed and the descriptions are also inaccurate for some countries⁵. Only about half of the 11 countries mentioned have arrangements that are comparable with NZS.

Dealing with each of the countries mentioned in Table 1 of the Discussion Document:

- (a) **Australia:** The Age Pension is similar to NZS aside from the income- and asset-tests that, themselves, have an indirect effect on individuals’ retirement ages. The Discussion Document’s comparison table notes: “The financial incentive for deferral is a lump sum payment that depends on how long they have deferred”. The table should have noted that the lump sum is tax-free; that the deferral can be up to five years and the maximum amount claimable is \$A46,131 (single) and \$A34,882 each for a married couple; also, that the ‘Pension Bonus Scheme’ was actually abolished from 20 September 2009. The income and asset tests that apply in Australia should also have been noted. As Table 1 notes, there was no possibility of early payment.
- (b) **Canada:** The Discussion Document’s Table 1 confuses the various layers of Canada’s pension arrangements. The ‘Old Age Security’ pension (similar to NZS but with a limited income-test for higher earners) has no early payment option. The ‘Old Age Security’ does however allow for an increased, deferred pension option (an increase of 0.6% for each month deferred – 36% for five years). On the other hand, the Guaranteed Income Supplement is an income-tested, low-income allowance that can be paid between ages 60-64; also the ‘occupational’ Tier 2 Canada/Quebec Pension Plans (that have no New Zealand equivalent) have an actuarially reduced option from as early as age 60.
- (c) **France:** The French pension is a defined benefit pension scheme that is akin to an occupational pension that is administered by the state. It cannot be compared with NZS. The full pension is 50% of qualifying earnings. It is payable from age 60 (not 56, as the Discussion Document’s table states) and the full pension is available from age 65.
- (d) **Greece:** Again, the Greek pension scheme is effectively an occupational scheme and cannot be compared with NZS. There is an income-tested ‘Old-age Solidarity Grant’ payable from age 60. That performs a different role from NZS.
- (e) **Germany:** Again, the comparison is with an occupational pension scheme and is inappropriate here.
- (f) **Ireland:** This is an appropriate comparator country. The only comment concerns the “standard age”. Under the ‘state pension (transition)’, the pension is work-tested between ages 65-66. However, the ‘state pension (contributory)’ pension starts at age 66, rising to

⁵ Details of other countries’ arrangements were checked against *Social Security Programs Throughout the World* (accessible [here](#)).

67 by 2021 and 68 by 2028. As the table notes there is no ‘early option’ or ‘deferral and increased rates’.

- (g) **Japan:** Its ‘national pension programme’ is equivalent to NZS. Japan’s state pension age is 65 and reduced pensions are possible, as stated, from age 60. Deferral is possible until age 70.
- (h) **Netherlands:** The Dutch ‘old-age pension’ is as represented in the table – payable from age 65 (even if not retired) with no early or late payment options. This is comparable to NZS.
- (i) **Sweden:** The main earnings-related old-age pension is, again, equivalent to an occupational pension scheme and is not comparable to NZS. The underpinning ‘guarantee pension’ is payable from age 65 but is income-tested and, in principle, a welfare backstop, not equivalent to NZS and does not vary for early and late access to the pension.
- (j) **United Kingdom:** The UK equivalent to NZS is the Basic State Pension. The current state pension age is 65 for men and will also be 65 for women by 2018. By 2020, it will be age 66 for both. As the Discussion Document’s table states, there is no early payment option but it can be deferred to age 70 with an increase of 10.4% for each year of deferral. We do not know if the increase for deferral will change with the increasing state pension age. In theory, it should.
- (k) **United States:** The Discussion Document’s references are, in fact, to the Tier 2 ‘Social Security’ pension arrangements. These are work/contribution/pay-related and are, therefore, not comparable to NZS.

In summary, of the 11 countries used in the table of international practices, only six have pensions that can be compared with NZS. Of those six:

- only one (Japan) offers a reduced early payment option;
- only three (Canada, Japan and the United Kingdom) offer an increased deferred pension option.

It is not therefore possible, as the Discussion Document suggests, to offer Table 1 as a “sample of other countries’ likeness to Flexi-Super”. If Flexi-Super is to be introduced as proposed, New Zealand would be an outlier with respect to equivalent Tier 1 state pension schemes. On the other hand, we can gain some useful data from countries that allow state pensions (not just Tier 1 pensions like NZS) to be claimed early or late, with actuarial adjustments.

1.5 Intersection with other state benefits

Table 2 compares NZS with other state benefits.

Table 2: Pre-tax annual payments

Age	NZS -example rates (Flexi-Super adjusted)	Other state benefits - single	
60	\$15,944	Jobseekers	\$11,980
61	\$16,901	Invalids	\$15,058
62	\$17,915		
63	\$18,990		
64	\$20,129		

Note: NZS based on the before-tax single living alone rate of \$21,337 a year from age 65.

The Discussion Document acknowledges that many New Zealanders already collect benefits between ages 60-65. There are already “34,000 60-64-year-olds receiving a social security benefit” (Discussion Document, p.15).

Based on the Discussion Document's "example" rates of reduction for early payment, NZS will look to welfare beneficiaries like an attractive alternative to an intrusive, income-tested, work-tested welfare benefit. We should therefore expect many of the 34,000 welfare beneficiaries to shift, especially the single, unemployed or disabled. That will cost taxpayers more than now but also imposes a relatively complex choice, more so than for non-beneficiaries. For this group, each extra dollar of income is very significant. Also, a dollar today is more significant than a dollar tomorrow, even if that has been adjusted to achieve financial neutrality. So this group will tend to make decisions that will be right for them in the short term but may be significantly disadvantageous in the long term.

We suggest that this complex choice will be in the hands of those who are probably least able to pay proper regard to the long-run financial consequences and least able to afford the negative consequences of making the wrong decision. Flexi-Super should not be addressing income needs for the 60-64 year-olds who are on benefits. The better alternative is to address the design of the welfare benefits themselves.

1.6 NZS will become more expensive

In theory, the rates of reduction (for early payment) and increase (for late payment) could be set so that, for example, the reduced pension from age 60 will have the same actuarial value as the 'normal' pension from age 65. To achieve fiscal neutrality over the whole population of pensioners who chose to receive the pension from, say, age 60, it should be possible to make the overall cost to the state equivalent to the larger pension for the group starting from age 65.

However, while equivalence across a whole population of 60 year olds might be possible (so that the bargain is financially neutral to those pensioners as a group), it will of course not be neutral to an individual pensioner whose own mortality experience, *ex post*, will almost certainly differ markedly from the group's.

Despite the Discussion Document's objective, once the adjustment rates are settled, it will be virtually impossible for the changed NZS to be "fiscally neutral". There are several reasons for this:

(a) Human behaviour: We must expect people to react in, perhaps, unexpected ways to the choices they will face.

Dealing first with the younger old, from this vantage point, we do not know precisely what those aged 60-65 at the date of change will do. Overall, we should expect the younger old to maximise their entitlements. Those with life-threatening illnesses will naturally choose to start their pensions early. If their illness proceeds as anticipated, there will be more NZS paid under Flexi-Super than under present rules.

(b) Existing beneficiaries: If a 60 year old is already a welfare beneficiary, a reduced NZS may see an immediate improvement in income. Switching from the welfare benefit to NZS will actually save the government money in the long run. If the beneficiary was likely to be on a benefit until age 65, the government will probably pay more until age 65 because NZS will be more generous for many, even if reduced for early payment. However, in exchange for that relatively small increase in cost, the government will save through the reduced NZS for the whole of the beneficiary's remaining lifetime after age 65. For a beneficiary who was likely to remain on a benefit until age 65, the reduction factor should be somewhat smaller than for 'ordinary' early receivers because they are giving up their welfare benefit.

(c) Older, richer pensioners: Those who can afford to defer receipt of NZS will tend to be the better-off (higher incomes and wealth) who usually have better mortality statistics than the lower-paid. There is clear overseas evidence of the positive relationship between income and mortality; also between wealth and health.

A US study looked at incomes and mortality across all causes and ages:

“Variations between states in the inequality of income were associated with increased mortality from several causes.”⁶

Another US study looked at the relationship between health and wealth:

“We find a very strong relationship between health when last observed and the level of assets just before death. Those in poor health have much lower assets than those in good health.”⁷

There are also clear links between health and labour force participation rates:

“At age 65, the predicted probability that males in good health are in the labour force is 70% (using a relatively objective measure of health). This falls to 53% for those in ill health, a decline of 17 percentage points. For females, the corresponding drop is 15 percentage points.”⁸

Income, wealth and health at retirement are likely predictors of mortality rates in retirement so larger pensions will tend to be payable for longer and cost more for this group if the increased rate of NZS were based solely on actuarial equivalence when the pensions begin.

1.7 Regressive implications

Regardless of the way in which the adjustment factors are established, giving choices mean there will inevitably be winners and losers. That can be established only once a pensioner has died so that we can compare:

- (a) on the one hand, reduced ‘early’ pensions payable for a longer period, and
- (b) on the other hand, increased ‘late’ pensions payable for a shorter period,
- (c) with both alternative pensions compared at a macro level across the whole NZS ‘system’ with the ‘standard’ pensions payable from age 65.

Public policy is ‘regressive’ if it tends to redistribute in favour of those with higher incomes. For example, tax breaks for retirement saving tend to be regressive partly because a tax exemption has a higher value for a high-rate taxpayer but also because a taxpayer with a higher disposable income can save more to take a greater advantage of the concession. In the meantime everyone, including those who cannot afford to save, pay higher taxes to meet the cost of the concession.

We suggest that Flexi-Super will also be regressive. Those choosing the early, reduced pensions will (the very ill aside) tend to be people with low incomes or who have been forced out of work through unemployment or a disabling condition. The alternative income-tested state benefits in the period to age 65 will look relatively less attractive than NZS. So, Flexi-Super will tend to be regressive (by comparison with the current position) because the people for whom the change to NZS looks attractive compared with the welfare benefit will be locked for life into an NZS that

⁶ Bruce Kennedy, Ichiro Kawachi, Deborah Prothrow-Stith *Income distribution and mortality: cross sectional ecological study of the Robin Hood index in the United States*, 1996, British Medical Journal accessible [here](#).

⁷ James Poterba, Steven Venti, David Wise *Were They Prepared For Retirement? Financial Status at Advanced Ages in the HRS and AHEAD Cohorts*, 2012, National Bureau of Economic Research accessible [here](#).

⁸ Emma Gorman, Grant Scobie, Andy Towers *Health and Retirement of Older New Zealanders*, 2012, New Zealand Treasury accessible [here](#).

will be less than the true actuarial cost to the government of the conversion from the current welfare benefit.

The next influence will result from self-estimates of likely mortality. Assuming there is no economic imperative of the kind illustrated in the preceding paragraph, people who choose to take either early, reduced pensions or late, increased versions are making guesses about their likely mortality experience. For example, with US Social Security, the decision whether the pension should start at, say, age 64 rather than 65 or 66 appears relatively straightforward (one entitlement is swapped for another equivalent pension, starting from a different age). Despite this, most retirees seem to make the wrong decision by starting it earlier than they should, if maximising lifetime value is the measure⁹.

In 2010, 43.6% of men and 49% of women claimed the US Social Security pension at age 62; only 25.8% of men and 21.3% of women waited until age 65 or later. Those proportions have all fallen since 1998 when 50.8% of men and 55.9% of women claimed the pension at age 62 (see [here](#) for more). It remains a very large share of retirees.

Unsurprisingly, those who seem to choose the early payments of Social Security in the US are those "...with limited education, who are at greatest risk of falling into poverty. For example, hardship rates for adults who did not complete high school and leave the labor force before Social Security's early eligibility age fall from 54 percent at ages 60 to 61 to 24 percent at ages 63 to 64 to 18 percent at ages 66 to 68."¹⁰

This 'sensitivity' to Social Security's earliest pension age poses problems for US policymakers who might be thinking about raising it from 62. In the round, such a change might be justified as the 'Full Retirement Age', now 66, will increase to 67 by 2027 with more older Americans working until later ages.

This is all as might be expected. Increasing US poverty rates in the 52-62 age group probably explain Social Security's high claim rates at age 62. On the one hand, the declines in poverty rates after age 62 show that Social Security is doing its job; but on the other hand, those who claim from 62 are denied the extra accruals of pension benefits that could have been earned after age 62 and that is a lifetime 'sentence' because their retirement pensions are permanently reduced. As ever, such a 'penalty' bears heaviest on those who are least able to afford it and who live longer than expected.

1.8 Labour force impact

US experience also suggests that having an early state pension age option will have a significant, negative impact on labour force participation rates by older citizens¹¹. The question is whether we should be willing to import such changes to the New Zealand labour market and so reverse the positive changes to labour force participation rates over recent years¹². That would be a backward step.

⁹ See *How Do Subjective Mortality Beliefs Affect the Value Of Social Security and the Optimal Claiming Age?*, by Wei Sun and Anthony Webb, 2011, Center for Retirement Research accessible [here](#).

¹⁰ Richard Johnson, Gordon Mermin *Financial Hardship Before and After Social Security's Early Eligibility Age*, 2009, Center for Retirement Research accessible [here](#).

¹¹ See Brendan Cushing-Daniels, Eugene Steuerle *Retirement and Social Security - a Time Series Approach*, 2009: "We also find that whether we specify the empirical model by age or by RLE, the ages 62 and 65 both have strong negative effects on participation, confirming the enormous role Social Security plays in labor supply decisions of older workers." Center for Retirement Research accessible [here](#).

¹² The latest estimates from the Ministry of Social Development (*The Business of Ageing, Update 2013* accessible [here](#)) suggest that, by 2031, 31% of all over-65s will be participating in the labour force and, of the total labour force, 12% will be over 65.

1.9 The factors used to adjust the ‘standard’ age 65 pension

A given pension of, say, \$10,000 a year, payable from any age other than age 65 has a different capital value from the standard pension payable from age 65. To be actuarially neutral, the pension taken at different ages must have the same lump-sum value (on the chosen guesses) as the current pension payable from age 65. One way of looking at the adjustment factors is to place a value on the age 65 pension and then work out what the annual pension would be if that capital value were spread out over a longer period (early starting age) or a shorter period (later starting age). The ‘commutation factor’ at age 65 is applied to the \$10,000 pension to turn that annual amount into an equivalent value lump sum.

That commutation factor has to use a number of guesses about the future, any one of which can make a large difference to the factor. Here are the main guesses:

- (a) **Interest rate:** \$10,000 a year received from age 64 has a different value to the same pension from age 65 (or from age 66). That’s because of the ‘time value of money’. An interest rate has to be set to put those three pensions on to an equivalent footing. An ‘early’ pension must be discounted by the interest rate’s impact; a later pension should be increased.
- (b) **Tax:** The government’s financial obligation to a pensioner is the net-of-tax NZS. The adjustment factors should therefore be applied to the net pension but what tax rate should be used to calculate that? Should it be the pensioner’s marginal rate at the starting date of the pension or should the adjustment factor be re-applied to the pensioner’s NZS each year to reflect the probably reducing marginal rates over the retirement period? A similar discussion can take place on the tax rate to be applied to the interest rate set in paragraph (a) above. The net discount interest rate will be closer to the gross rate for lower income pensioners than for those on the top marginal rate of 33%.
- (c) **Increase rate:** NZS grows each year by increases in average wages. So we need to set a guess as to the expected rate of increases from the starting date of the pension (early or late) to the expected date of the pension’s last payment (death). A smaller ‘early’ pension gives up a share of those future increases; a ‘late’ pension has not had the advantage of the increases so those need to be factored into the calculation.
- (d) **Payment period:** NZS is a pension payable until death so the next important guess is about the expected lifetimes of those who start to receive the pension. That is not a fixed point for each pensioner. In fact, each pensioner has a chance of dying in each year of payment and that chance increases with age. The actuary puts all these chances ‘together’ when applying mortality rates to the calculation. And that has nothing to do with the actual pensioner involved as the guess can only be based on all New Zealanders of that age. The best guess in this regard will probably use the latest mortality tables from Statistics New Zealand (New Zealand Life Tables 2005-07) but that decision raises a number of issues, such as how to allow for increases in longevity (and further decisions).

So, the adjustment factors for an early payment could take account of the probability that the pensioner would not have survived to age 65 in order to qualify for the ‘normal’ pension. That would reduce the annual amount payable ‘early’¹³.

¹³ This is probably not intuitive. At present, a 60-year old must wait five years to receive NZS. If he dies at any time during that period, there is no NZS so the ‘value’ of the pension will be nil if he knew he would not make it to age 65. Now we are looking at the factors that are actuarially appropriate for a 60-year old in order to ‘price’ the age 60 conversion. Something that he may not have received is turned into something he will start to get now. The ‘price’ of that extra value must reflect the probability of early death in each of the five years. That means NZS should be reduced specifically to allow for that.

On the other hand, the late adjustment factors could allow for the probability that the pensioner might die before the pension starts. That would increase the adjustment factors.

- (e) **Whose pension?** We know that at each year of age, women have a smaller chance of dying than men and that Maori have a larger chance of dying than do non-Maori¹⁴. But not all men die before all women and not all Maori die before all non-Maori. Should the commutation factors take those statistical realities into account? Regardless of attitudes to ‘equality’ and ‘racial discrimination’, the statistical reality is that \$10,000 a year from age 65 has a higher average value at age 65 for women than for men. If the adjustment factors ignore those differences, that is a political, rather than a financial decision. Picking an adjustment factor between the two ‘purely financial’ rates means that men will be disadvantaged over women and Maori will be disadvantaged over non-Maori.¹⁵
- (f) **Which pension?** As explained in Table 1, there are three different rates of NZS, in ascending order by annual amount:
- ‘each of a married couple’,
 - ‘single sharing accommodation’ and
 - ‘single living alone’.

When a person makes a decision about taking an early or late payment, presumably the adjustment factor will be applied to the pension to which that person is then entitled. But what if the pensioner subsequently becomes entitled to a pension at a different rate? The most common reason for this will probably be when one of a couple dies and a pensioner moves from ‘each of a married couple’ to ‘single living alone’. That could be accommodated in one of two ways:

- The actuarial guesses used at the starting date of the pension could allow for the probability of the earlier death of the pensioner’s partner. That introduces another group of uncertainties into the calculations.
- The adjustment factors (for early or late payment) could be preserved as a percentage of the ‘normal’ pension and then applied to the ‘single living alone’ amount normally payable.

But what happens if a ‘single living alone’ pensioner acquires a partner after the pension starts? All the initial guesses would have assumed that the ‘single living alone’ pension would have been payable until the pensioner died. Acquiring a partner means that the pensioner’s NZS reduces by, at present, about 23% (see Table 1). Again, the same adjustment factor could be applied to the reduced pension but it represents another complexity.

1.10 Some actual adjustment factors

The Discussion Document gave two illustrations of what the adjustment rates for early and late starting ages might be (see paragraph 1.2 above). Those simple “illustrative examples” slide past the potential complexities involved. Table 3 looks at some ‘proper’ actuarial numbers.

¹⁴ There is a separate issue as to who, these days, is ‘Maori’ and who is ‘non-Maori’. Statistics New Zealand probably assumes that those who say they are Maori are in fact Maori, regardless of the proportion of Maori in their racial make-up. While that may be acceptable when determining, for example, who is entitled to vote in Maori electorates under the Electoral Act 1993, it seems an inappropriate basis to use if it is to be applied to the adjustment factors for NZS early and late payments. Those who say they are Maori to vote on the Maori roll may prefer to emphasise their Caucasian background when deciding to take NZS before age 65.

¹⁵ This is not the same argument advanced by some in favour, for example, of a higher annual pension to Maori because they are expected to live, on average, for a shorter period. NZS is paid to all, say, single people from age 65 at the same annual rate. That is the pension. However, once actuarial principles are introduced to convert a universal pension from a fixed age to something else, as Flexi-Saver proposes, it is then difficult to ignore the mortality experiences of different groups.

Table 3 is in three sections and puts the factors derived from the key financial guesses into one place. The key guesses are:

- Mortality: New Zealand Life Tables 2005-07;
- Net real return: 2.5% p.a.;
- Inflation: Built into the net real return assumption.

The combined impact of the financial guesses is that the net real return of 2.5% p.a. is added to whatever the inflation rate happens to be in order to calculate the commutation factor and conversion rates for different ages and, potentially, other factors (sex, race etc.). Different guesses will produce different answers.

Table 3: Adjustment factors on different bases¹⁶

Section 1: Places a value on \$1 p.a. of NZS from the starting ages in the left hand column.

Commutation factors at a 2.5% net real interest rate						
Age	Total population		Non-Maori		Maori	
	Male	Female	Male	Female	Male	Female
60	16.343	17.993	16.577	18.237	13.235	14.848
65	13.951	15.616	14.134	15.819	11.17	12.687
70	11.535	13.14	11.661	13.287	9.204	10.63

Section 2: Gives the adjustment factors on the basis that the pensioner would, in the case of early payment, have actually lived past age 65. In the case of late payments, it assumes the pensioner would not die before becoming entitled to receive the enhanced pension. The factors reflect the time value of the early pension and the interest that could have been earned on the deferred pension.

Implied reduction/increase factors if assumed will live until the pension starts						
	Total population		Non-Maori		Maori	
	Male	Female	Male	Female	Male	Female
60	75.45%	76.71%	75.36%	76.67%	74.60%	75.52%
70	136.84%	134.46%	137.14%	134.70%	137.31%	135.03%

Section 3: Gives the adjustment factors that allow for the probability that an 'early' pensioner might have died before reaching age 65. For a 'late' pensioner, it is enhanced to recognise the probability that the individual might have died before the pension was due to start.

Implied reduction/increase factors if assumed might die before the pension starts						
	Total population		Non-Maori		Maori	
	Male	Female	Male	Female	Male	Female
60	66.32%	70.45%	67.08%	71.16%	55.61%	61.01%
70	156.46%	146.71%	155.58%	145.88%	177.27%	163.44%

Note: The factors in Sections 2 and 3 may not seem intuitive. For example, as between all males and all females at age 60, males have a higher probability of dying before age 65. For the reasons explained in footnote 13 on page 10, allowing for that probability means a smaller pension. The better mortality experience of females at older ages does not come into this calculation as the 'normal' pension is payable for life anyway. On the other hand, the age 70 adjustment reflects the fact that the amount not paid from 65-70 will be spread over a longer period, on average, for females over their male counterparts.

The Discussion Document avoids most of these issues of financial detail. We quote again the central explanation:

¹⁶ MCA NZ has kindly supplied the actuarial calculations for Table 3.

“This means that if a person were to wait until age 70 to first take NZS they could receive around 160% of the rate at age 65. If, instead, they were to take NZS from age 60 they would receive 73% of the rate.” (Discussion Document, p.12)

As can be seen from Table 3, 73% from age 60 is closer to Section 2’s value for all males than to the ‘purer’ Section 3’s value. It is roughly at the mid-point for all females. However, Maori would be significantly advantaged by a 73% reduction factor for early payment if Section 3 values were used for early payments. Conversely, Maori would be disadvantaged by the suggested late retirement adjustment factors.

To illustrate:

Table 4: Discussion Document’s net pension compared with Section 3 factors (single living alone pension)

Age	Flexi-Super’s “illustrative examples” (net)	Actuarially-based net pensions					
		Total population		Non-Maori		Maori	
		Male	Female	Male	Female	Male	Female
60	\$13,568	\$12,326	\$13,094	\$12,467	\$13,226	\$10,336	\$11,339
65	\$18,586	\$18,586	\$18,586	\$18,586	\$18,586	\$18,586	\$18,586
70	\$29,738	\$29,080	\$27,268	\$28,916	\$27,113	\$32,947	\$30,377

This returns us to a point made earlier – whether or not Table 3’s factors can be justified actuarially, the choice of adjustment factors will inevitably be a political, rather than a financial decision. Regardless of the financial justification, we cannot see any sensible political explanation as to why Maori males should receive either a lower earlier pension or a later pension that is 14% higher than for non-Maori males (even if we actually knew who a ‘Maori’ was). We suspect that the Discussion Document has already recognised this by suggesting adjustment factors that are more generous for all except (in Table 4) for older Maori.

1.11 Early ‘normal’ pensions

There is another complexity with the suggested Flexi-Super. At present, NZS can start before age 65 and is payable in full in respect of a younger partner of a superannuitant, subject to a household income test.

To illustrate: let us take a couple where the male partner has reached age 65 and he has a spouse/partner who is three years younger (at age 62). The older partner is entitled to, presently, a net \$14,297 p.a. without regard for the household’s ‘other income’. If the household’s total taxable income is less than \$5,200 a year, there is an additional non-qualifying partner’s allowance of the same amount that is added to the older partner’s pension (note: it is not the younger partner’s pension). If the household’s income is more than \$5,200 a year, the non-qualifying spouse’s allowance is reduced by 70 cents for each \$1 of excess income.

Flexi-Super raises a number of questions:

- Presumably, a ‘qualifying’ spouse/partner will now be someone who has reached age 60 and who chooses to take NZS rather than, as now, someone who has reached age 65. What will the rules be for a non-qualifying spouse?
- What happens if the older spouse chooses to defer the pension beyond age 65? Presumably that means the non-qualifying spouse’s entitlement cannot begin. That adds yet another complexity to the financial decision, whether or not to defer receipt.
- If the non-qualifying partner’s allowance is in fact the older partner’s entitlement, do the adjustment factors for late and early payment apply to both partners, regardless of their particular ages/sexes/race?
- And what happens when the non-qualifying partner reaches age 65? In our example case, does she shift to the present net \$14,297 a year?

- The non-qualifying spouse will have the same rights to receive the pension in her own right from age 60 but that will be reduced under Flexi-Saver. In our example, might the couple not be better off asking for the non-qualifying partner's addition to the older partner's pension rather than exercising an early Flexi-Super pension?
- In our example case, regardless of what the older male partner has chosen, are the same choices available to the younger female partner when she reaches age 65?
- Or, does all this mean that the non-qualifying partner's addition will be abolished?

We think that the possibilities in this regard opens up opportunities for people to game the rules and it is probably better for the non-qualifying partner's addition to be abolished. Where individuals can game the rules it becomes harder for the government to achieve the public policy objectives in the retirement income area.

1.12 Incompatible objectives

The Discussion Document suggests that Flexi-Super aims to offer more choices to older New Zealanders by offering actuarially adjusted different values of earlier or later starting ages for NZS. On the other hand, "Flexi-Super would aim to achieve this while being fiscally neutral." We do not think these two objectives are can both be achieved.

Even if it were possible to pitch the adjustment factors to perfectly match the financial and mortality experience for a group of pensioners – say, all those who choose to take NZS from age 60 – it will be impossible to match experience across all pensioners including all who start it both earlier and later than age 65. In other words, we think the principles of actuarial and fiscal neutrality are incompatible.

To illustrate: when Flexi-Super starts, there will be five years' worth of pensioners who would be entitled to start NZS immediately (everyone aged between 60-64). However, after a full year of Flexi-Super, the group who have chosen to defer NZS will be only a fraction of those who turned age 65 in that year. Based on the experience of the US already noted, we might expect up to half of older New Zealanders to choose an early starting age. That cannot be matched, even over decades, by the numbers choosing to take later pensions. So fiscal neutrality as to the annual amounts payable in any year seems most unlikely.

Some might say that neutrality across decades is potentially achievable. In summary, this says that the actuarial value of all NZS pensions will remain roughly the same, aside from the costs associated with the already expected rising number of superannuitants. However, there will be differing mortality experiences of the two groups (early and late starting ages) and many pensioners will make decisions, knowing more about their personal situations than will those who set the factors ('asymmetrical information'). If fiscal neutrality across all recipients of NZS is in fact the dominant objective (over actuarial neutrality for the pensioners themselves), we must expect constant adjustments to the factors as the experience plays out. As the Discussion Document itself suggests:

"In order to compensate for these effects and to achieve the principle of fiscal neutrality, the rates paid to those who choose to take NZS early or to defer could be further adjusted to account for these costs." (Discussion Document, p.18)

The objectives of Flexi-Super in this regard need clearer definition than the Discussion Document gives.

Part 2: New Zealand Superannuation – the discussion we really need

2.1 First things first

Having a ‘flexible’ state pension age is a relatively insignificant potential element of the design of NZS. Despite all the changes that have happened to state-provided pensions, it may surprise many to hear that New Zealand has never had a research-led, national discussion on any of the key elements that drive the calculation of NZS. We suggest that, before we agree to give flexible on the starting age for NZS, there are many more important things to talk about.

2.1.1 State pension age: The state pension age of 65 was first set in 1898. We experimented briefly with age 60 between 1977 and 1992 but, by 1 April 2001, we were back to age 65 again.

Why do we have 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 a whole raft of 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 the age of 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.

When the government chooses a state pension age, it must balance social issues, labour market efficiencies, voter satisfaction, inter-generational fairness and fiscal considerations. With improving mortality, we should be seeing a natural increase in the state pension age, certainly by comparison with the position that prevailed in 1898¹⁹. The state pension age is now, perhaps, one of the most significant elements of public welfare policy. It’s difficult to think of even one other significant aspect of social policy that has, in essence, persisted for 115 years.

We have never debated any of these issues in relation to NZS’s starting age, partly because the amount and quality of the information we have on these is limited, though improving. The Retirement Commissioner’s latest report²⁰ adds to this but does not provide us with the needed backdrop for a national, research-led debate of the kind we contemplate. We’ve never discussed the distortions created by the state pension age on the work/retirement decision. We do have ‘macro’ data on labour force participation rates but 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.

As part of the key decision on what the ‘central’ state pension should be, we could include a discussion about the possibility of early and late starting ages for NZS, with appropriate

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, Burkhauser and Myers 1990, W E Upjohn Institute. Participation rates at younger ages have also fallen in the US. Today, only 65% of men aged 55-64 are in the labour force, down from 83% in 1970 (from *The Wall Street Journal*, 6 May 1996).

¹⁹ By 2031, New Zealand males are expected to have a 19.0-year life expectancy at age 65 (presently 14.8 years); females will survive, on average for 22.1 years (presently 18.5 years) – source Statistics New Zealand.

²⁰ Diane Maxwell *Focussing on the Future: A discussion document* 2013, Commission for Financial Literacy and Retirement, accessible [here](#).

actuarial adjustments to the amount paid. That is, however, very much a ‘second order’ issue.

2.1.2 Who gets it? Currently, we pay NZS 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? There has never been a national discussion about any of these things.

2.1.3 How much? The size of the pension has had a more varied history. When the age pension started 115 years ago, it was relatively modest. In 1900 the pension was £18 a year (about one third of the 1900 average wage). That is the equivalent of \$3,190 a year²¹.

By 1940, the single person’s pension had reduced in real terms to about 29% of the then national average 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 20 years between about 40-47% of the national average wage. Currently, it sits at 40% on a pre-tax basis for a single person living alone.

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. There was no debate at the time about this and no science to it other than that it was less than the then rate and was going to save the government money²². Is 65% enough or too much? If it’s right for pensioners living in Invercargill, what about those who live in Wellington or Auckland? We have never debated this issue before or since 1989 and have nothing but anecdotal evidence on these issues.

2.1.4 Single/married/sharing-accommodation: Why is a single person, living alone, entitled to 66% of the married couple’s combined rate? Why is a single person living with others entitled to 60% of the married couple’s combined rate? Are these amounts adequate (or too much)? When was the empirical work done to see whether the proportions might be other than they have been? They may be right but they may not be.

2.1.5 Overseas pensions: The way in which overseas pensions are treated as offsets to NZS under section 70 of the Social Security Act 1964 is long overdue for review. As work carried out by the RPRC over recent years has demonstrated, the treatment is inconsistent and, even on the government’s own stated policy, wrongly applied in some cases.

2.1.6 How to adjust over time? Until National Superannuation of 1977, there had been no formal link between the pension and any particular measure of real value. National Superannuation made that link with the national average wage in 1977. We have never discussed since whether the pension should be linked to anything in particular. Currently it is the after-tax national average ordinary time wage. Is that the most appropriate? Some say it should instead be linked to economic output; others to prices. We have never had a full discussion about the alternatives.

2.1.7 Income and asset tests? Until 1977, the Old Age benefit was income-tested but

²¹ Using the Reserve Bank’s CPI inflation calculator [here](#).

²² The minimum is currently a net 66% of the average wage for a married couple. That was originally the result of a ‘confidence and supply’ agreement between Labour and New Zealand First in 2006. The current government has maintained that as the minimum.

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).

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

Asset tests have not been part of the design of NZS for the last 36 years²³.

We have not had a proper discussion about income or asset testing over the last 40 years. Should NZS be paid to people who don’t, on any reasonable basis, need it? Is that fair to the current working-age population, whose benefits have been left to fall, relative to wages?

2.1.8 How paid for? New Zealand used always to pay for NZS on a ‘pay as you go’ (PAYG) basis. Between 1938 and 1964, we had the illusion of pre-funding but the then Social Security Fund into which the Social Security tax (1/6 in the £1 or 7.5% of taxable income) was little more than a book-keeping arrangement. The New Zealand Superannuation Fund (NZSF) was set up in 2001 to build a fund of financial assets to help pay for NZS. At its peak, despite the NZSF’s size, about 90% of the annual cost will still come from current taxes. That will make it still largely PAYG but a little bit pre-funded.

We did not have a proper debate about the NZSF when it was introduced. At the time, it looked to be a way for the then government to lock-up fiscal surpluses on the government’s balance sheet when there was pressure to lower tax rates instead. We think that the economic, fiscal and practical implications of the NZSF should be subject to a full review as part of the discussion we propose on NZS itself.

2.2 Retirement Commissioner’s 2013 Review²⁴

The Retirement Commissioner’s three-yearly *Review* was released on 9 October 2013. The Flexi-Super proposal was discussed briefly and some of the difficulties we have raised above gave the proposal a generally negative reception:

“However, there is a risk that some people would suffer poor long-term outcomes as a result of making short-term decisions to access NZS early. Thus ironically, the proposal would quite likely reduce fairness within the system as a whole. The proposal is also claimed to be ‘fiscally neutral’ i.e. it would cost no more than the current arrangements. At the time of writing, modelling to show individual and fiscal impacts hadn’t been carried out but if increased numbers were to access NZS early – even at a lower rate – it is difficult to see how this would not cost more. The proposal would also bring about an undesirable increase in complexity. (*Review*, p. 48).

There was no reference to Flexi-Super or to variable pension ages in the *Review*’s final recommendations.

2.3 However, Flexi-Super should be part of the national debate

All the design elements referred to in this section 2 have significant impacts on the behaviour of New Zealanders as they make their saving and retirement decisions and then survive, financially,

²³ The Old Age benefit was the last time New Zealand had an asset test on an age-related income benefit.

²⁴ Diane Maxwell *Focussing on the Future: A discussion document* 2013, Commission for Financial Literacy and Retirement, accessible [here](#).

in retirement. Given that many think NZS will become unaffordable as the baby boomers move into retirement, there are all issues that need a research-led, national debate.

While something like Flexi-Super could be part of that debate, we strongly urge the government to avoid making any kind of decision on it now. New Zealand has many more important issues to discuss first in relation to NZS than being able to choose an earlier or later starting age for the pension.