RPRC Update

Retirement Policy and Research Centre

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Improving the affordability of New Zealand Superannuation

A Working Paper by RPRC co-director Susan St John.

New Zealand's unique approach to the provision of retirement income has centred around New Zealand Superannuation (NZS). It is a universal basic income paid out of current taxation, provided on residency grounds not contributions or work periods. It has been outstandingly successful, along with high home ownership rates, in preventing 'after housing costs' poverty among most of those over 65, who have the best living standards profile of all age groups.

However, the costs of retirement income, health, and welfare for the rapidly growing older population lift markedly over the next decade. These costs, without policy changes, will continue to increase both in absolute terms and relative to other state spending until mid-century.

Society may be willing to bear these costs. But they may entail the opportunity cost of other more desirable spending, at least at the margin. If there is a reluctance to tax or borrow for the growing cost, then the 'affordability' of New Zealand Superannuation (NZS) may be improved by using one or more of three main levers: the qualifying age, the level of the payment, and the degree of targeting.

Lifting the age of eligibility for NZS has been the most discussed lever and is widely seen as necessary for fiscal sustainability. Yet this is not the only policy lever available to improve affordability, nor is it necessarily the most equitable: providing an income for those whose occupations mean they are physically worn out by 65 is a critical stumbling block. The qualifying age could be raised gradually to reflect improved longevity but the necessary long lead-in times preclude immediate savings. Reducing the level of NZS for everyone is the least favoured option, carrying the likelihood of increasing poverty among the aged population.

This Working Paper focusses on the degree of targeting, and examines a way the tax system could be used to provide an increased claw-back of some or all of the net cost of NZS from high-income recipients. No one wants to copy the Australians with a full income and asset test.

The innovation in the paper is to offer a much simpler approach through the tax system. The first step is to pay NZS to every 65+ year old as a non-taxable grant or basic income. The paper suggests that the single sharing and married rates of NZS are aligned over time, so everyone gets the same basic amount equal to NZS after tax at the primary rate. This amount is unconditional and does not change. As other income is earned it is taxed on a new scale. The paper suggests 17.5% up to $15,000 and 39% above that will deliver worthwhile savings with very little pain.

The cost saving from this basic income approach could reduce the pressure on the working age population, and may enhance perceptions of intergenerational equity. A tax claw-back is capable of delivering meaningful savings immediately to help address the needs of the working age population without increasing poverty rates among the old.

In his response to the Working Paper in the New Zealand Herald, Brian Fallow wrote:

> *So St John's latest contribution to the debate - the debate we ought to be having, but aren't really - deserves careful consideration and not to be dismissed with craven phrases such as, "Third rail. Touch it and you die."*

RPRC's Working Paper, *Improving the Affordability of New Zealand Superannuation*, will also be published in USA journal *Psychosociological Issues in Human Resource Management*.

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REFORM Featuring Susan St John's article: **Decumulation policy in NZ**

New Zealand's retirement income framework has been widely acclaimed internationally for its simplicity, fairness, and effectiveness in addressing elder poverty. New Zealand Superannuation (NZS), a universal, flat-rate, non-contributory, taxable pension at age 65 is the foundation, with a net rate of at least 33% of the net average wage per married person and higher rates for singles.

Unlike other countries with complex and expensive tax incentives, New Zealand's tax treatment of retirement savings schemes since 1990 has been aligned with that of saving via a bank account. In 2007,… the Government introduced KiwiSaver, the world's first national auto-enrolment, opt-out, fully portable private savings scheme. It is also open to all, not just workers, and its minimal incentives are well designed to limit regressivity…. While the longevity risk is partially addressed by the provision of NZS, middle-income people face the risk of outliving their supplementary capital.

There are no rules around the use of the lump-sum savings from KiwiSaver, which are generally accessible only at the age of 65. New Zealand does not have a tradition of annuitisation and the annuities market is virtually non-existent. Under current tax rules and the lack of government support including inflation indexing or long-term bonds, a viable annuities market is unlikely to emerge. Indeed the collapse of the annuities market in New Zealand shows that with no active state participation, market failure is the likely reality. That experience also shows the danger of setting up a tax-subsidised scheme without attention to decumulation. Although KiwiSaver rules and conditions have been changed regularly since its inception, it would be difficult now to gain acceptance of compulsory annuitisation when people have enjoyed full access to their lump-sums. Some private sector guaranteed income plans & home equity release schemes are emerging but are likely to provide, at best, a partial solution.

New Zealand now has a unique opportunity with a tax neutral regime for accumulation, to design an attractive annuity with few of the disadvantages of traditional tax incentives. One possibility explored by the Retirement Policy and Research Centre is the state provision of a voluntary, limited value, inflation-adjusted, gender neutral annuity to supplement the state pension, purchased out of lump-sum savings and a suitable share of home equity if required.

Well-designed subsidies to reflect the social gains from annuitisation could make the annuity attractive and further social gains might be achieved by incorporating cost-effective insurance for long-term care.

The full REFORM publication, ***Beyond April 2015: the long view on UK pension reform***, is available here.

International Women's Day: Social policy issues that affect women

Susan St John, co-director RPRC, was keynote speaker at the UN Women National Committee Aotearoa NZ's *International Women's Day Breakfast on the Shore* on 8 March. St John's message was that "more equality for women is good for everyone, especially men and children, and will free us as a society to act for good. In fact it may be the best chance humankind has." An excerpt from her speech follows:

We can hold our heads up in the world when we look at our policies for the retired. One of the policies we have got right for women is New Zealand Superannuation. Everyone is paid the same gross amount. No attachment to the paid work-force is required (in many countries a contributions to the paid workforce is required). Thus NZ Super implicitly recognises that all contributions are equally important. It is based on an individual entitlement—not a joint payment for couples. It goes with you on divorce or death of a spouse. We have been very successful in containing the growth of poverty among older women that plagues many other countries.

Yet there are injustices and archaic thinking. For example, some women find to their horror that even if they have lived all their lives in NZ they may get a reduced pension or even no pension simply because the person they married has an overseas state pension. Another issue is that there are higher rates for singles than married that make no sense in the 21st century of fluid relationships. But thankfully there seems to be little appetite in Work & Income to peer into the bedrooms of those over 65 to see who is committing relationship fraud.

See the full address here.

PensionCommentary 2015-1: Re-designing New Zealand Superannuation

New Zealand has one of the simplest retirement income systems in the developed world. KiwiSaver aside, the main component is New Zealand Superannuation (NZS). Everyone qualifies for NZS from age 65 if they have been resident at least 10 years after age 20, and at least 5 years after age 50.

KiwiSaver aside (again) there are no tax breaks for private provision of retirement income. Whether KiwiSaver retains its remaining incentives, and any debate about whether New Zealanders are saving 'enough' privately, isn't relevant to this discussion. Suffice to say that, amongst all the various groups in New Zealand, those currently aged 65+ have the lowest levels of poverty, indicating that what we have is 'working'.

Many think that we cannot afford the current NZS into the future; that changes must be made; that New Zealanders will have to do more for themselves and that we need to start talking about these things now. This *PensionCommentary* suggests the reality is more nuanced.

New Zealand needs a research-led debate on the ten major benefit design components and the eight minor ones. The Government's reluctance to start that discussion is no response.

The *PensionCommentary* by Michael Littlewood, co-director RPRC, is available here.

Responsible Lending Code released 17 March, covers reverse equity mortgages

The voluntary Responsible Lending Code does not cap interest rates so provides a limited range of consumer protection. It does require lenders to take a more active role when considering the suitability of the loan product and the ability of an applicant to repay; and discusses home equity release in some detail, including Lender Responsibility 'Guidance' notes.

A lender should make more extensive inquiries where the agreement is complex or uncommon, such as a reverse equity mortgage. Such inquiries should include whether the borrower wishes to leave some equity in the home for their estate, or if they may wish to sell the home prior to their death.

A lender should inform the borrower how their net equity in the home can be affected by such a loan, by changes in the value of the home, and by life expectancy; whether the borrower has a right to occupy the home for the rest of their life; whether their liability is limited to the net realisable sale price for the home; their obligations to maintain the home; and the term of the agreement, if any. The applicant also needs to be informed about any establishment or other fees, and given information on any other interest or fees that may be charged over the loan term. Interest rates must be expressed as annual rates, and the total amount of interest payable, if ascertainable, must be stated.

Importantly, a lender must require borrowers to seek independent legal advice when entering into reverse equity mortgages or buy-back transactions.

Dr M.Claire Dale's media release stated: *High interest debt rapidly becomes unmanageable. Unsustainable repayments on debt create stress among family members, take up money needed to buy essentials including food for the children, reduce any remaining assets the family might have, and diminish the wellbeing of the whole community. The consequences of unmanageable debt are an enduring and pervasive poverty trap. The Code requires lenders to be 'reasonable', not to be 'fair'. Reasonableness is determined by the current market, which is far from fair.*

The Responsible Lending Code is available here.

The Ministry of Social Development's Home Equity Release Schemes Code of Standards, available here.

Elder Law in New Zealand launched at AUT University

The first book published in New Zealand to address the wide range of elder law issues in a single reference work is to be launched on 1st April. Kate Diesfeld and Ian McIntosh, General Editors, and publishers Thomson Reuters, have welcomed this book, written by contributors from backgrounds ranging from legal and medical practitioners to elder law advocates and scholars.

The book is timely, given the economic impact of the ageing population in New Zealand, the legal complexities associated with ageing, and the identification of ageing as a government priority.

RPRC's Susan St John and M.Claire Dale contributed the chapter 'Critical Policy Perspectives on the Law Regarding Age Pensions and Benefits'. The book can be purchased online from the publishers here.

RPRC in the media and public presentations and contributions

22 December 2014, Dominion Post, Michael Littlewood quoted in More pensioners hit by super-docking scheme
9 January 2015, New Zealand Herald, Michael Littlewood featured in *Money and me: Michael Littlewood.*
10 January, Daily Mail, UK, Michael Littlewood's *Money and me*.
22 January, Signposts, Encyclopedia of New Zealand, Te Ara blog, Michael Littlewood quoted on home ownership rates in Reflections on Ath.
9 February, Australian Financial Review, cites Michael Littlewood on the null effects of compulsory saving.
17 February, New Zealand Property Investors Federation, cites Michael Littlewood's comments on the Financial Services Council's tax proposal .
18 February, www.interest.co.nz, quotes Susan St John on using the tax system to sustain affordability of NZS.
20 February, Grey Power North Shore, M.Claire Dale presentation *Decumulation options or Safely spending the savings.*
25 February, *Bernard Hickey's Top Ten at Ten*, features Michael Littlewood's *PensionCommentary*, 'Re-designing New Zealand Superannuation'.
25 February, Act Party Blog, cites Michael Littlewood's *PensionCommentary*, 'Re-designing New Zealand Superannuation'.
26 February, Kiwiblog, features Michael Littlewood's *PensionCommentary*, 'Re-designing New Zealand Superannuation'.
6 March, New Zealand Herald, Brian Fallow: Another way to save on super, analyses Susan St John's recommendations in Working Paper 2015-1, *Improving the Affordability of New Zealand Superannuation*.
8 March, UN National Women's Day Aotearoa NZ, Auckland, keynote speaker Susan St John: Social policy issues that affect women.
13 March, *GoodReturns*, features Michael Littlewood's *PensionCommentary*, 'Re-designing New Zealand Superannuation'.

pensionreforms

The PensionReforms website accessible here now has a total of 719 mostly academic reports summarised and that are sortable by topic, author, institution, publication year and countries studied.

Six new summaries have been added in the last three months. One that is currently relevant in New Zealand looked at the impact of public policy decisions on private saving behaviour: Creedy,J Gemmell,N and Scobie,G, *Pensions, Savings and Housing: A Life-cycle Framework with Policy Simulations*, New Zealand Treasury, 2014.

THE TREASURY
Kaitohutohu Kaupapa Rawa

An economic model suggests that, at least in New Zealand, private responses to public policy saving initiatives are likely to be 'relatively modest'. more

Using economic models to test public policy has its limitations but, notwithstanding this, the report suggests "…the model provides a rigorous and internally consistent framework for assessing the direction and magnitude of key responses in saving, consumption, housing and pensions to potential changes in a range of tax and retirement income policies."

Overseas pensioners' complaint to UN

As reported in the Sunday Star Times article, 15 March, "Complaint to the United Nations falls by the wayside", the United Nations Human Rights Council (UNHRC) considered the complaint taken by a senior citizens group from New Zealand in its 16 – 20 February session. The New Zealand Government made a formal response to the complaints.

The Human Rights Council, established in 2006, replaced the 60-year-old UN Commission on Human Rights as the key independent UN intergovernmental body responsible for human rights. The special procedures of the Human Rights Council are prominent, independent experts working on a voluntary basis, who examine, monitor, publicly report and advise on human rights from a thematic or country-specific perspective.

The complainants are among the 60,000+ citizens aged 65+ who qualify for New Zealand Superannuation (NZS) and also qualify for an age pension from another country. The human rights complaint relates to the Government's deduction of overseas-based private 'occupational' retirement savings from their NZS. Justification for this relies on the direct deduction policy set out in section 70 of the Social Security Act 1964.

While it is fair and reasonable that overseas-based age pensions 'equivalent' to NZS should be deducted, it is grossly unjust to deduct pensions that have been accumulated by private saving, including employee and employer contributions.

The RPRC argues that the greater mobility of the workforce demands fundamental, principles-based reform of a law that hasn't changed in substance since 1938, but still determines the treatment of overseas pensions in New Zealand. As the Ministry of Social Development's Briefing to the Incoming Government (p. 32) notes, the Direct Deduction policy is unpopular with other countries, and with those affected by it. *"For example, one of the most unpopular aspects of the policy is that, where one partner of a couple has an overseas state pension that is more than their NZS, the excess amount is deducted from the NZS entitlement of the other partner."*

Such deductions are particularly anomalous and egregious given the rules that apply when including a non-qualifying partner in an individual's NZS. As the Work and Income website states:

If your partner is included in your payments, you can earn up to $100 (before tax) a week between you, before your New Zealand Superannuation is affected. If you earn more than $100 (before tax) a week your payments are reduced by 70 cents for every dollar of income over $100 (before tax).

There is no such allowance made for a partner's overseas age pension. Nor is there recognition that each person must qualify for NZS in their own right: NZS is an individual entitlement. So to deduct from a partner's entitlement offends the economic rights of the individual.

It is most disappointing that the UNHRC dropped the complaint without explanation to the complainants or to the New Zealand Government.

RPRC and other relevant publications on overseas pensions are available here.

Mark your diaries - upcoming event: 10 July 2015 Forum

Future-proofing New Zealand Superannuation

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