

NEW ZEALAND'S RETIREMENT INCOME FRAMEWORK: trends, continuity, change

**Background paper prepared for the 2013 review of retirement
income policy**

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1.0 Purpose and context

1.1 The purpose of this overview

The New Zealand Superannuation and Retirement Income Act 2001 requires the Retirement Commissioner to review the retirement income policies being implemented by the Government at three yearly intervals (s.83). The next review is to take place in 2013.

The Commission believes that the review will be more effective if participants have a good sense of the history of retirement income policy: understanding the history will inform the debate about future directions. The history in this report is not intended to be overly academic or descriptive. It looks at the policy objectives, principles and operational characteristics that have evolved over time, to provide some policy context for those who want to participate in the review.

1.2 A well-trodden path

The history of New Zealand's retirement income framework, or parts of it, have been analysed by many erudite scholars¹. There is an unavoidable level of repetition in a report that goes over old ground. This report tries to synthesise existing documentation and stand back to focus as much on the durability of retirement income policy settings as the detail of who did what and when to tinker with it.

1.3 Retirement income policy framework

The paper:

- describes the history of the main structural changes in New Zealand's retirement income framework
- reviews the policy principles that have guided debate on it and
- canvasses initiatives to change it that have not endured

It is possible to look at the retirement income framework through (at least) three different "lenses"

- what it is designed to achieve
- the instruments through which objectives can be pursued
- the criteria against which it is evaluated

1.3.1 Objectives

The 2010 review of retirement income policy identified eight partly overlapping and potentially competing objectives:

- encourage voluntary savings (individual responsibility, individual choice and control)

¹ The definitive work in this area was an update on an earlier version and was written by David Preston in 2008 <http://www.cflri.org.nz/sites/default/files/docs/RI-Review-BP-Retirement-Income-History-2008.pdf>. Richard Hawke covered similar ground in developing his prescriptions for a new policy approach when working out of the Institute of Policy Studies at Victoria University of Wellington. Lisa Marriott drew extensively on historical material for her Ph.D. thesis comparing the politics of retirement savings taxation in Australia and New Zealand. Susan St John, Michael Littlewood and their associates have published extensively on their work carried out at Auckland University's Retirement Policy and Research Centre. Roger Hurnard worked for decades at the Treasury in the field of social policy, and has written on the evolution of retirement income policies. To cap it off there have been officials and other groups that have formed various Periodic Reporting Groups and Taskforces. I am walking in the footsteps of giants, and at great risk of tripping over the imprints they have left behind.

- alleviate poverty in old age
- promote wellbeing
- pool longevity risk
- deliver a “citizenship dividend”
- smooth consumption over the life span
- cohorts self fund
- exercise fiscal restraint (economic growth and efficiency)

There are exceptions, but by and large these objectives are “additive” in terms of the amounts of money needed to achieve them. Cohort self-funding stands apart from the level of retirement income adequacy and fiscal restraint runs counter to adding new blocks of provision.

1.3.2. Instruments

The instruments available through which to achieve the objectives involve either public provision or individual arrangements (with some overlap where, for example, the government makes private savings compulsory and/or subsidises them).

Public provision can involve a mix of social insurance, social assistance or universal pensions.

Private arrangements tend to be based on occupational pensions of one sort or another, savings through other individualised vehicles (retail products), or by accumulating private assets (such as houses, shares, and bank deposits). Governments can prescribe private savings through legal compulsion, and/or assist them through direct subsidy, or favourable tax treatment of designated instruments.

These factors suggest that the lenses are likely to produce a kaleidoscopic picture of our retirement policy history.

In fact they do not.

At the risk of oversimplification, it is useful to see that history as having moved through two long and stable phases, followed by a search for policy stability and now settling into fine tuning to achieve affordability and sustainability in the longer term.

The first phase followed the passage of the Old Age Pensions Act in 1898. Policy focussed almost entirely on the alleviation of poverty and hardship in old age, and although the generosity of provision changed with changing social mores and with economic circumstances, policy never sought to do much more than cover the necessities of life. Strict income and asset testing and the application of a good character test narrowed the focus to the “deserving poor.”

A shift of emphasis occurred in the wake of the 1938 Social Security Act. It too shaped the basic policy for another forty years, but now there was more attention to wellbeing and delivering a citizenship dividend, within the constraints of competing demands on public finances. Within four years, the level of the (means tested) benefit was increased by 71 per cent, even though (see 2.1.1 below) universal entitlement was slow to catch up.

The mid to late 1970s saw a fracture in the framework. A brief excursion into compulsory retirement savings was followed by a swing in the pendulum back to historically very generous universal public

pensions (where the universal pension for a couple applied from age 60 and effectively delivered the equivalent of 89 per cent of the after-tax average wage). There then followed two decades of constant tinkering (perhaps more than that at times) to shift universal provision back to some level of perceived affordability, and a new consensus settled at or around existing universal provisions (paid on the basis of a residency test, from age 65, at roughly two-thirds of the after-tax average wage for a couple).

[There is a tendency in the political debate to focus on this “couple” rate, whereas in fact entitlements are paid to individuals. This distinction is important in the context of the discussion of the “citizenship dividend”. If individuals are the recipients of a pension, it accrues more directly to citizens: if the household is the recipient, there is more of a focus on the needs, income and assets of a social group, and for other welfare benefits there is, in fact, means testing.]

The basic tenets of the Social Security Act – universality, alleviation of hardship, wellbeing and paying a citizenship dividend – remained in force. The pooling of longevity risk was effectively a by-product of universality.

Running alongside (or in truth underneath) the universal, state funded pension was a regime that supported (mainly through tax advantages) private provision for additional (not replacement) retirement income. The level of support was eroded by inflation, and was interrupted in 1988, when all tax preferences for private savings were phased out. The lack of support for private savings continued until the introduction of KiwiSaver in 2005, but supports also declined soon after that regime was introduced.

At least since 1938 (and to a lesser degree before that), retirement income has never had to “fully fund” the services that older New Zealanders needed, because the state has separately funded health care and disability services (which are disproportionately consumed by those in retirement age ranges) and has provided a default safety net of residential care.

1.3.3 Evaluation

The overall effect of these measures is that poverty among older New Zealanders is low, especially compared to other age groups, BUT unlike the regimes in other countries, there is a low replacement rate of incomes earned during working life. A fuller evaluation of the effects of the structure is developed in section 4 of the paper.

Two features that are distinctly (and at times uniquely) New Zealand are that:

- (a) compulsory savings have never been favoured, and the brief experiment with it lasted about one year of our 114 year retirement income history and
- (b) at no stage have governments sought to replicate in retirement the incomes individuals earned during their working lives (this being seen as an essentially personal responsibility, albeit assisted at times with capped tax advantages and subsidies)

At this stage, the policy debate centres on the longer term sustainability of the universal New Zealand Superannuation, and where KiwiSaver provisions and supports may end up.

The remainder of this paper discusses the finer detail of this framework.

2.0 The World Bank’s “three pillars”

A common approach to describing and assessing retirement income policy is to apply the World Bank’s concept of “three pillars” (Hawke, 2005, p.27):

- state pensions (funded out of social security or general revenue), not linked to individual contributions, typically with an anti-poverty objective and (therefore) often means tested
- compulsory, individual savings,(usually employment related) mandated by the state and invariably subsidised by it
- voluntary individual savings, using a variety of investment vehicles

This classification is by no means universally accepted. Others (Holzmann and Hinz for example – also from the World Bank) split the first pillar into a minimum support base and some partial earnings related top-up, and then add another pillar built around informal intrafamily and intergenerational supports (Holzmann & Hinz 2005). The risk of making any framework more and more complicated is that “big pictures” become obscured by fussy detail. With necessary caveats, it is still possible to describe New Zealand’s retirement income regime within a three pillar construct.

2.1 The first pillar: universal pensions²

Old age pensions were introduced in 1898, and were set at one-third of the average wage, payable from age 65. For the first forty years they were income and asset tested, and a good character test applied. Asians were excluded. Māori were effectively excluded from access through the way in which communally held land was treated under the asset test.

The effect was that they were paid to only a little over a third of those over 65.³

Universality came later, but the benchmark of two thirds of the average wage payable to a married couple from age 65 was established early and has been remarkably durable. Variations – both above and below – have not lasted, and changes to the relativity for single persons have adjusted the benchmark at its margin, not its core.

This benchmark has survived radical changes in the demographic structure: “population ageing” is not a new phenomenon. People aged 65+ were 2.1 per cent of the population in 1891, and 3.8 per cent by 1901. Currently they make up around 14 per cent of the population⁴ (Preston, D., 2008). This share of the population has therefore increased six fold in the last 120 years and nearly four times

² The name of the universal pension has changed over the years: Old Age Pension, Age Benefit, Universal Superannuation, National Superannuation, Guaranteed Retirement Income, and now New Zealand Superannuation. For ease of reading, no attempt has been made to follow the changing terms. While not strictly accurate historically, this report refers to New Zealand Superannuation – abbreviated to NZS – as being the universal, non-contributory, pension.

³ Intuitively, the access rate appears to be low. No original research has been done to attribute cause. The low uptake is probably a combination of a reasonably stringent means test, the exclusion of Asians, the treatment of communally held Māori land, and a 25 year “residency” test which would have screened immigrants who arrived in mid to later life.

⁴ The cancellation of the 2011 Census because of the Canterbury earthquakes means that a lot of relevant data have to rely on the now somewhat dated 2006 Census. This can be problematic because there are indications that there have been fairly major demographic and economic changes (say with home ownership rates) since then. This is more of a problem for analysis of current issues and should not materially change the overall conclusions about historical trends.

over the last 110 (compared to not quite doubling over the next 50), but that did not dislodge the relativity.

There was the era of instability that followed compulsion in 1975 and excessive generosity in 1977. This is explored in more detail in section 3.2, because the interpretation of history in this report sees that period as an aberration. That judgement may be wrong. In its 2010 triennial review, the Retirement Commission concludes that New Zealand has “a history of volatility in its policy settings” citing this period in evidence. It is up to the reader to determine whether, on balance, the settings that moulded the first tier were stable or volatile!

One thing that did change as a result of the “fracture” was that since 1977, the Age Benefit – payable from an earlier age but means tested – has gone. This could be seen as the poverty relief component of New Zealand’s first pillar, but poverty relief has since been decoupled from the universal pension and relocated within the mainstream benefit system (see 2.1.1 below).

2.1.1. “Split rates”: 1939 to 1960

The 1938 Social Security Act introduced a two tier structure with transitional provisions to merge them into one. The Age Benefit was income and asset tested and applied from age 60. The universal benefit applied from age 65. In the introductory stages, the universal benefit was only 13 per cent of the means tested Age Benefit. The intention was for the universal benefit to be increased gradually until the two were equivalent. In fact equivalence was only achieved in 1960 (Preston, D., 2008). This episode is relevant because in the 2010 Review, the Retirement Commissioner recommended a means tested transitional benefit for those who were disadvantaged by any increase in the age of entitlement to NZS. The lesson is that transitions can last a long time, so in this instance it might take a number of years before anticipated fiscal savings from any increase in the age of eligibility are fully realised.

2.1.2 Is the first tier “stable”?

This paper concludes that the history of state funded first pillar provision has shown a remarkable tenacity in reverting to a durable standard around one-third of the after-tax average wage, per person, payable from age 65. There is a body of work, though, that sees in that very durability an *expanding*, not a *stable* base. The reason is that longevity is increasing.

Andrew Coleman has analysed this effect. He argues that if the trigger point for NZS is chronologically stable, but life expectancy beyond that is increasing, the *policy* is expansive (Coleman, A., 2012). On the evidence, that is certainly true: to a degree. In 1950-52 life expectancy at age 65 was 12.8 years for males and 14.8 years for females. Fifty years later that had increased to 16.7 and 20.0 respectively. Historically, the time that men receive NZS is growing by about 0.8 years each decade and for women by one year.

Coleman cites other projections that see life expectancy increasing by two-three years each decade (Christensen, Doblhammer, et al., 2009): which, if true, would treble the rate at which the “stable” first pillar is expanding.

2.2 The second pillar: compulsion

Compulsory private savings for retirement has never been a durable feature of New Zealand’s policy framework. Ireland and New Zealand are alone among OECD countries in having no second pillar.

Colonial Treasurer Harry Atkinson proposed a compulsory national insurance scheme as early as 1882, but it did not proceed.

During the 1920s, government officials proposed a compulsory scheme, and the initiative went as far as being incorporated into a National Insurance Bill in 1927, but for reasons that are not clear it was never passed into law.

In 1936, visiting British experts persuaded Finance Minister Walter Nash to support compulsion, and he in turn instructed officials to develop proposals for one, but again they came to nothing.

In 1975 the Labour Government did in fact introduce a compulsory scheme that was to be phased in gradually, but it did not survive the next election.

In 1997, a referendum on compulsion was held as a condition of the Coalition Government agreement, but it was roundly defeated.

The issue has therefore been revisited at, on average, 20 to 25 year intervals, but has never gained traction.

There is no strong research base to explain this lack of appetite for compulsion. It may be that the level of, and access to, NZS is sufficient in itself in meeting public expectations of adequacy of retirement income (and the Scobie, Gibson, et al., (2004) research would suggest that that is rational). At least in 1997, the proposal was accompanied by an offset of NZS to accompany increasing personal savings balances, so that in effect compulsion involved individuals saving for the government, rather than for themselves. In that referendum, women's groups in particular argued that compulsion would erode the social consensus that sustained NZS, with adverse effects on equality in retirement and on the socialisation of longevity risk.

A lesser form of (collective) compulsion was the introduction of some sort of social security tax. Even this has failed to dominate New Zealand's retirement income funding structure. Such a tax was introduced alongside the 1938 Social Security Act, but it was supposed to cover both pension and health costs, never met more than half of them, and was ultimately folded back into general income tax scales.

The New Zealand Superannuation Fund can be seen as another type of collective compulsory savings. It was set up in 2003 to smooth the costs of the demographic transition to an older age structure by partially pre-funding emerging NZS (not individual) entitlements (McCulloch & Frances, 2001). Between 2004 and 2009, between 1.1 and 1.4 per cent of GDP was transferred into the fund each year. The 2009 Budget announced that contributions would be suspended until the Crown returns to operating surpluses sufficient to cover them. In that Budget, it was projected to be to 2021. Because contributions are suspended not just until operating surpluses return, but until they are at a size sufficient to fund those required by the NZSF formula, they can be regarded as effectively terminated. (Emerging surpluses would have to be protected and not used to fund other spending – at a time of projected increases in NZS and health costs – or to be distributed as tax cuts).

2.3 The third pillar: private voluntary savings

2.3.1 Savings and tax incentives

Private voluntary savings have had episodic assistance from the government, but as a general rule the effective level of assistance has been low by international standards and it has tended to be eroded after any boost in support.

This conclusion is contentious. Historically, support for voluntary savings has been offered through the National Provident Fund, by tax exemptions for insurance and superannuation savings, by a generous tax treatment of lump sum withdrawals of retirement savings balances, and more recently through KiwiSaver incentives. It is possible to interpret this as New Zealand's "soft" second pillar. The pros and cons of the two interpretations are canvassed below.

There is a major debate in the literature on whether tax advantages do actually raise the level of savings, or

- (a) merely redirect where private savings are made and
- (b) are accompanied by equivalent (or greater) reductions in government savings, with a negative impact on net national savings

Simplifying, empirical studies (Antolin & Ponton, 2007) suggest that tax incentives

- have very little, if any, impact on the net savings of higher income groups, but can increase savings within this group in the years near to retirement
- do tend to increase savings by low and middle income groups
- have a larger impact on lower income groups if they are accompanied by an extra payment from another party, be that the employer or the government
- are more effective in increasing savings if they are delivered in an environment of "soft-compulsion" (such as a compulsory enrolment with an opt-out option)
- are significantly captured by the top twenty, or even ten per cent of income earners, even when attempts are made to cap incentives or pay them as rebates

2.3.2 Occupational pensions in New Zealand

Occupational pensions, and the extent to which they were supported by generous tax treatment of both employer and employee contributions, is an under-researched area of the history of retirement income policy in New Zealand.

This study did not have the scope to fill that research gap, but it does not really matter.

The fact was that in the early part of the last century, supports were through policies targeted at lower and middle income groups. A National Provident Fund (NPF) was established in 1910 with generous pound for pound subsidies on contributions. However, it never gained support from a majority of earners. Public policy had a strong bias to "good employer" support for government employees, particularly through the Government Superannuation (GSF) and National Provident Funds. Other occupational schemes tended to be in major industries and large companies. They had a male breadwinner, lifetime career focus, through vesting rules that discriminated against other forms of episodic (read women's) labour market engagement.

The result was they never covered much more than a quarter of the workforce. Employer contributions were capped at a maximum percentage of employee earnings, and employee contributions qualified for income tax deductibility up to a set dollar amount. While this ostensibly had equity objectives, the fact that most employees could not access the deduction anyway (their employers did not provide an occupational pension option) meant that it was effectively a tax preference for the aristocracy of labour. Susan St John estimates that tax preferences equated to 1.2 per cent of GDP. Whether that was substantial or token is a matter of interpretation.

Inflation in the 1970s and 1980s eroded the value of the tax concessions. The government guarantee of inflation indexed defined benefit GSF pensions was an anachronism. Some industry/occupational schemes continued in spite of the lack of tax advantages. These were usually quite generously subsidised by employers, often as the flip side of employees having to maintain defined levels of personal fitness as a condition of continuity of employment (Police, Fire Service, Aircrew as examples).

But in effect, it all came to an end in 1987,(St John, 2007) (except for those with grandparented entitlements under legacy schemes and some attempts to restart replacement schemes such as through the Global Retirement Trust, which was set up as an option for government agencies to use as alternative after the GSF closed to new members).

2.3.3 “Tax neutrality” of savings vehicles

In December 1987, the Government announced that it was moving to a tax neutral treatment of all forms of savings. The logic was that tax advantages had a distorting effect in advantaging some savings vehicles (say registered superannuation schemes) over others (like bank accounts) with subsequent negative impacts on the efficient operation of capital markets.

All forms of savings would, in future, be made out of taxed income (T), earnings on those savings would be taxed (T), but withdrawal of them would be treated like all other forms of capital withdrawals (like from a bank savings account) and would be tax exempt (E).

The TTE regime was fully operational by 1 April 1990 (after a transition period to enable existing superannuation schemes to make necessary adjustments to contribution and benefit regimes).

New Zealand was alone among OECD countries (possibly alongside Mexico) to have no tax preferences for retirement savings. TTE had its supporters. Prominent academic and retirement policy analyst Susan St John described the combined regime of a universal flat rate state pension and TTE for private provision as “well-supported, cost-effective, adequate and highly equitable.”

TTE was endorsed by the 1997 Periodic Report Group

It concluded that “despite ... possible benefits (of incentives), we consider that the reasons for rejecting tax incentives still hold”.

While industry providers of savings products (and some employee advocates) supported a return of incentives (at times backed by compulsion and justified by the alleged successes of the Australian regime) there was never any strong move from official advisors or academic analysts to return to them.

It is difficult to attribute cause, but the record shows that the coverage of occupational schemes declined dramatically during the TTE era. Many schemes closed to new employees and others were folded into Master Trust or retail superannuation arrangements.

Between 1990 (when TTE became fully effective) and 2003 (before the Savings Product Working Group (SPWG) – see later – was set up), the proportion of employees in occupational pension schemes fell from 22.6 to 13.9 per cent (SPWG report, 2004).

A number of observations need to be made. Even with tax incentives (or on a contrary view because tax incentives had been so eroded by inflation), coverage was still less than one in four of the workforce. Access to a scheme was much more likely if the employer was a government agency (through the GSF and NPF) or a large corporate entity. There are no data available on coverage of *new* employees. If schemes are closed to new entrants, there is no effect on coverage on day one. The level of access to a scheme is likely to be radically worse for those entering new jobs or changing jobs after schemes had closed.

There is, though, the “glass half full” perspective. The SPWG noted that:

despite all of the “hostile” elements of the tax and regulatory environments, the fact remains that as at 30 June 2003, some 264,000 New Zealanders were saving through registered employer superannuation schemes, which had combined assets of nearly \$10 billion. That represented 14 per cent of the labour force, with an average personal fund balance of \$37,000.

None of this meant that by 2003 New Zealanders were necessarily saving too little for their retirement⁵, (Grant Scobie, John Gibson and Trinh Le did extensive studies that concluded that very few New Zealanders saved too little when their access to NZS was factored in as an asset (Gibson, Scobie, et al. 2004)), and of course it says nothing about the equity of tax advantages (which, as noted, tend to be captured by higher income groups). However, the decline in coverage did provoke a policy rethink.

2.3.4 KiwiSaver

In 2004, the government appointed a working group to review the design of savings products delivered through workplaces (Cullen, 2004)⁶. The reasons were that access to such schemes was available in a minority of workplaces, savers usually had to leave schemes when they changed employers, and there were advantages of access and scale in using the workplace as the point of entry to savings.

While the group was authorised to look at any tax disincentives that savers might face, tax incentives or subsidies for this class of savings product were explicitly excluded from its terms of reference and “will be considered separately by the Government as part of its consideration of the appropriate tax treatment of savings vehicles” (Press Release. Minister of Finance, Beehive, 14 May, 2004).

⁵ The measure of adequacy they used was replacement income. This did mean, for example, that people with low incomes (beneficiaries, part-time earners, low waged workers) would automatically qualify as saving “enough” even if they saved nothing, because NZS was set above benefit levels.

⁶ The author of this paper chaired that working group.

There were two main strands to the working group recommendations:

- (a) It concentrated on lowering behavioural barriers to savings: addressing evidence that potential savers did not know when to start, how much to save, and where to save, and therefore tended to put off decisions (status quo bias worked against saving).
- (b) The group identified administrative inefficiencies in the savings regimes of various countries: multiple small balances, complicated rules, high fees, “gone no address” account holders and the like.

The recommendations involved a form of soft compulsion (automatic enrolment at point of entry to a job with a right to opt-out), allocation to default providers and default investment options (with options to change) and predetermined contribution rates (with voluntary additional contributions permitted). It also recommended a streamlined administrative structure (one account only at any time, deductions administered through IRD, authorisation of providers).

As the group’s recommendations evolved into legislative support, two levels of optional contribution (4 and 8 per cent of salary) were introduced⁷ and the level of tax subsidy envisaged gradually increased. That policy move had its critics. Susan St John characterised it as a “return to the complexities, inefficiencies and inequities of a hybrid approach”. While the basic architecture of KiwiSaver remained stable, contribution rights and obligations have been changing constantly. The changes are tabulated below.

⁷ It is not clear from Cabinet papers why these levels of contribution were selected. They suggest that the levels were something of a compromise based on “equity, simplicity and practicality considerations” (whatever that might mean!)

Announcement	Effective from	Provisions
Budget 2005	1 April 2007	\$1,000 “kick start” Fee subsidy Standard contribution rate of 4% of income, option to move to 8% Employer contribution optional First home subsidy if conditions met
Budget 2007	1 July 2007	Fee subsidy confirmed at \$40 per member per annum 100% tax credit to match member contributions up to \$20 per week
Budget 2007	1 April 2008	Compulsory matching employer contributions of 1% of employee gross salary increasing by 1% each year until 4% subsidy reached in 2011/12 100% KiwiSaver Employer tax credit up to \$20 per week
11 November 2008. Taxation (Urgent Measures and Annual Rates) Bill	1 April 2009	Minimum employee contribution rate reduced to 2% Compulsory employer contribution reduced to 2%
Budget 2011	1 July 2012	Tax credit for employee contributions reduced to 50% up to a maximum equivalent to \$10 per week
Budget 2011	1 April 2012	Employer contributions to be subject to Employers Superannuation Contribution Tax at employee’s marginal tax rate
Budget 2011	1 April 2013	Minimum employee contribution rises to 3% Compulsory employer contribution rises to 3%

Table 1: Changes to KiwiSaver

The current fiscal year and outyear cost forecasts associated with these changes have altered accordingly. Forecasts and actual outcomes are included in a rolling reproduction of Budget Core Crown Expense tables. Figures are \$ million. From Budget 2012 forecasts include housing deposit subsidies which became available for some KiwiSaver contributors. For purposes of comparison, New Zealand Superannuation benefit expenses are listed in the final row.

		<i>Year</i>								
		<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>2015</i>	<i>2016</i>
<i>Budget</i>	<i>2008</i>	1,013	1,370	1,441	1,502	1,507				
	<i>2009</i>		1,420	919	940	956	982			
	<i>2010</i>			1,045	1,179	1,054	1,028	1,063		
	<i>2011</i>				1,039	656	614	596	631	
	<i>2012</i>					719	701	686	682	706
	<i>NZS</i>	7,348	7,744	8,290	8,830	9,587	10,243	10,867	11,583	12,369

Table 2: Budget Core Crown Expenses

It is important not to make too much of these comparisons: NZS payments are annual Pay as you go (PAYGO) amounts whereas KiwiSaver subsidies will accumulate over time in individual accounts.

However, the table shows that at the time of the 2008 Budget, tax supports to KiwiSaver were projected to rise to \$1,507 million, but by 2012, the expected level of subsidy had more than halved to \$706 million. By contrast, NZS payments are projected to increase by 68 per cent from \$7.3 billion in 2008 to \$12.4 billion in 2016. The first pillar is once again asserting its predominant position in the retirement income framework as tax supports for private savings recede.

As time goes on, KiwiSaver supports as a percentage of the first pillar NZS are likely to decline further. This works on both the numerator and denominator side of the equation. There are now roughly two million KiwiSavers (FMA, 2012), so the catch-up access to kick-starts and the motivation to start to qualify for first home subsidies will now be confined to the residual, and to new entrants to the labour market. On the other side of the equation, NZS will cost more and more as the baby boomers reach 65.

Once again, the inexorable reversion to the policy centre of gravity is evident: universal PAYGO first pillar; voluntary, minimally assisted third pillar. Susan St John's misgivings may have been alleviated by subsequent responses to the supports that KiwiSavers got!

An interesting feature of this episode, though, is the dominant figure of two million! A *quarter* of a million workers were in occupational schemes in 2003: the equivalent numbers in KiwiSaver schemes has increased almost eight fold. It is true that 45 per cent of KiwiSaver schemes are

dormant (children, those taking contribution holidays etc.⁸), but even then there is a five fold increase in *participation* (but at this stage not the same multiple of account balances).

2.3.5 Overall impact of savings for retirement income

Private savings have been substantially uneven across the over-65 population. The bottom 40 per cent of them have virtually no income other than NZS. (Perry, 2010 Review). The next twenty per cent still depend on NZS for 85 per cent of their income. At the other end, the top third more than double their total income (compared to NZS) from other sources.

It is difficult to predict what will happen over the next twenty years. There was a big drop off in numbers saving through registered superannuation schemes during the “tax neutral” decades of TTE. It may be that the proportion with no or little other income will increase as the cohorts that entered the labour market during this period retire. However, they may have saved through other vehicles (such as rental properties). KiwiSaver has boosted numbers in formal savings vehicles, but again this might simply reflect a switch in the form that retirement saving takes

2.3.6 Housing

Home ownership has historically been the primary mechanism through which individual New Zealanders have saved to promote well-being in retirement. In 1991, 84 per cent of the 65+ age group effectively owned their own homes. This had declined to 80 per cent by the time of the 2006 Census, and while the decline is noticeable, the norm is still for retired people to own the homes they live in (Preston, 2008).

It has been argued by the OECD and various tax policy reviews that housing investment is tax advantaged because various costs (interest, maintenance and depreciation) have been deductible and there has been no tax on capital gains when the properties are sold, but this advantage is mainly captured by investors in rental property. Mortgage interest payments are not tax deductible for owner occupiers.

This form of savings has been advantageous to the retired. As shown later, there is a distinct and substantial variation in the well being of those 65+ depending on whether they own their own home or are renting.

While home ownership levels have dropped by four percentage points for the 65+ cohort, they have dropped by more than that for younger age groups. By way of example, 82.1 per cent of those 40-44 owned their own homes in 1991, but only 68.5 per cent of that age group owned them in 2006. For the 45-49 age group the percentages are 84.4 and 73.7.

It may be that people are buying homes later in life, but the risk is that a generation that is about to retire in the next twenty plus years will have the double disadvantage of having substantially higher proportions renting, and substantially higher proportions with no or limited occupational savings (the TTE generation). This will increase dependency on NZS as the sole or main source of income at roughly the time that the demographic transition plateaus at the peak of the dependency ratio!

⁸ The Financial Markets Authority notes that a number of these could be self-employed account holders who tend to make lump sum contributions at the end of their tax years to capture the tax rebate. This would lower the effective incidence of dormant accounts.

3.0 The policy fracture and the quest for stability

3.1 The 1972 Royal Commission on Social Security

There is a common perception that the 1972 Royal Commission on Social Security report ushered in an era of increased generosity within the existing pension system by changing the overarching objective of social policy. The Commission had looked at four high level objectives for social policy. (Hurnard, 2012) The first was “subsistence”, which it rejected as being inadequate. “Continuity” (of incomes) was not seen to be the proper role of the community (i.e. of public policy). “Equality” was assessed as not being a widely held value. That left “belonging” as the objective that the Commission recommended, and it set “belonging” as requiring an income of 80 per cent of a labourer’s wage.

There is no convincing evidence that the Royal Commission report was a watershed event in New Zealand’s pension policy history.

This conclusion is an interpolation of David Preston’s history and an interpretation of post-Commission political interventions.

"As late as 1972 the Age Benefit for a couple was around 68 per cent of the net ordinary time wages" (all quotes from Preston). Note that on a relative definition of poverty this was more than simple poverty alleviation, and it was at the time of, not a response to, the Royal Commission.

"However, the gradual decline in the relative incomes of many older people in a time of general prosperity created pressure to reconsider public pensions. Pensioners considered they had not shared in the growth of living standards to the same extent as wage earners or other employed groups". Relativity, not poverty alleviation, was part of the active political discourse. "Some of the pressure was relieved by providing more special assistance in the 1950s and 1960s..." (i.e. pre Royal Commission). "The better off group among the retired had also gained from the continuing rise in payments for Universal Superannuation". If it was targeted at poverty, the universal payment would have continued to be asset tested. "The abolition of the asset test on the Age Benefit in 1960 also benefitted some of the older group". A poverty alleviation regime would retain an asset test, yet this went 12 years before the Royal Commission.

After the Commission "...by 1976 the Age Benefit for a couple had risen to over 72 per cent of net ordinary time wages". So a more generous provision through policy followed the Commission, but with hindsight this was temporary, not structural. It is also questionable whether that was because of the Commission or simply that the New Zealand economy went through a brief period of relative prosperity shortly before the “oil shocks” of the mid-seventies. The structural benchmark of two thirds of the net average wage was entrenched pre Royal Commission. It included provisions that reflected relative prosperity not absolute poverty alleviation, and it was not disturbed in a permanent way by the Royal Commission.

We then have the distortion, firstly of Labour's compulsory scheme and then Muldoon's unsustainably generous "80 per cent of gross wage at age 60" universal scheme, which took 20 years to be disgorged.

Roger Hurnard notes that in his 1972 Budget speech, Minister of Finance Robert Muldoon said that the Royal Commission report could be read as an endorsement of the basic principles of the existing

system. Although pension rates were adjusted, Hurnard concludes that “despite the influence of the 1972 report, it is salutary to note that the 1972 Report’s views on superannuation appear to have been ignored by both the Labour Government’s 1975 NZ Superannuation Scheme (compulsory contributory saving) and the National Government’s 1977 National Superannuation (universal, wage-linked rate of payment from age 60)”.

Overall, the 1972 Report was overwhelmed by the structural disruption to a settled policy framework, and it took twenty more years to construct a more stable framework (which was, ironically, very much like that one that had been destroyed!).

3.2 The aftermath of the 1975 diversion into compulsion

While compulsion was only a fleeting experiment, its repeal ushered in a period of considerable instability of policy.

It is impossible to disentangle policy from politics, but the 1975 scheme became a major feature of the 1975 general election debate. The then opposition campaigned on a promise of repeal, and its replacement, with an enhanced universal pension, payable out of general taxation, taxable, and set at 80 per cent of the gross average wage for a couple.

The effect was a substantial increase in the fiscal cost of the first tier.

A number of factors coincided to push up pension costs in the 1970s: the abolition of the income test on the Age Benefit, increases in pensions in response to the Royal Commission’s proposals, the increase the rate of the universal pension to 80 per cent of the average wage, and the reduction of the age of eligibility to 60.

Pension costs rose from 3 per cent of GDP in 1971-72 to 6.9 per cent by 1978-79: a more than doubling of the relative cost in only seven years (Preston, 2008). Projections based on demographic trends indicated that this formula was unsustainable.

A battery of changes followed. These are summarised in the table below:

Year	Changes made or proposed		
	<i>Wagelink/indexation</i>	<i>Age of eligibility</i>	<i>Means testing</i>
1979	Changed to equate NZS with 80 per cent of the after tax equivalent of the average wage. Effect to drop from 89 to 80 per cent of the average wage ⁹ . Because of inflation the nominal value of the pension did not change.		
1985			Tax surcharge on the other income of superannuitants. Effect was that 10 per cent paid all NZS back, 13 per cent partial payment. No effect on 77 per cent.
1986	CPI adjustments ahead of wage movements. NZS goes above 80 per cent of net average wage. Ratio returned by 1987.		
1990	Single living alone payment increased to 65 rather than 60 per cent of married rate.		
1991	Adjustments cancelled for 1991 and 1992. From 1993 rates to be adjusted by prices alone.		
1991			“Mother of all Budgets” proposes major increase in surcharge, effectively reintroducing a fully means tested pension. Withdrawn in response to major public reaction.

⁹ With progressive income tax scales, 80 percent of gross is a higher percentage than it is of net wages. By reverting to a net comparison this escalation of the comparative figure is removed.

1991			Surcharge raised to 25 per cent. Income exemption lowered.
1992		Increased to 61, phased in to 65 programmed for the period 1993 to 2001.	
Late 1990s	Public pension cost reduced from 8 per cent of GDP in early 1980s to 5 per cent by late 1990s as a result of the cumulative effects of these measures.		
1993			Accord. Transitional Retirement Benefit to smooth impact of increasing age of entitlement, phasing out by 2004.
1997			Impact of surcharge reduced.
1998			Surcharge abolished.
1998	65 per cent wage floor removed. NZS to be adjusted on basis of CPI only until it reached a new 60 per cent pension-wage floor ratio.		
2000	Restoration of 65 per cent wage floor ¹⁰ .		
2005	Wage floor raised to 66 per cent as part of coalition agreement.		

Table 3: Changes to NZS from 1979

¹⁰ The actual wording of the act is “not less than 65% or more than 72.5% of the average ordinary time weekly earnings (males and females combined).”

This roller coaster policy ride can be interpreted in a number of ways. In the early stages policy rolls back both the 80 per cent of gross wage and the lower age of eligibility. The surcharge then creates an impression of moving away from universality and back to a means tested benefit, and the reduction of the wage floor indicated a move back towards a poverty alleviation objective. However, neither of those “extreme” roll backs survived. By 2005, policy has settled back at the “two thirds of the average wage at age 65” benchmark that had existed (with variations as to eligibility criterion) since 1898!

Initiatives to raise it had been rolled back, but equally steps to lower it did not survive.

3.3 The 1986-88 Royal Commission on Social Policy

For the record, retirement income policy in the context of wider social policy was also examined by the later Royal Commission, but that Commission’s recommendations were overwhelmed by other, higher level, policy initiatives.

The Commission recommended setting NZS at parity with other benefits. What was left undetermined was how generous those “other” benchmark benefits would be on the spectrum of alleviation of distress to enabling full participation in society. Roger Hurnard notes that at the time this was not a major dilemma: the two rates were not radically dissimilar. In 1991, though, benefits were cut fairly substantially, and NZS was not, so a gap opened up, and “equalising” the two meant either a reversion of NZS to subsistence levels, or a boost to other benefit levels. In the event, it was the policy on *benefits* that shaped the relativity. The NZS “benchmark” reverted to a different path towards its unrelenting historical centre of gravity.

3.4 Emerging pressures on sustainability of the first pillar

There is a widespread perception that New Zealand will confront the financial sustainability of NZS “when the baby boomers start to retire” (Weaver). There is no doubt that as the boomers retire there will be sustained pressure on the costs of NZS over a prolonged period of time, but it is important to recognise that the so-called demographic transition is not only (or even mainly) about the baby boom generation. If it was, the cost increase would be temporary. The boomers would retire, live for another twenty-something years, and die out.

Statistics New Zealand is clear that “population ageing is not caused by the baby boomers but by the transition to lower birth rates and lower death rates” (Statistics New Zealand, Population Projections) In other words, it is a permanent structural shift in population dynamics, albeit with its most dramatic transitional impact being evident when the boomers retire.

Statistics New Zealand’s median projections show that the 65+ population will increase from its current 14 per cent of the total population to 23 per cent by 2035 and 26 per cent by 2061. The increase plateaus as lower birth and later death rates work their way through to a new equilibrium.

3.5 The elephant in the room: health costs of the elderly

The Commission for Financial Literacy and Retirement Income will publish a companion report to this one, prepared by David Preston, discussing the contribution that wider policies and programmes make to the living standards of older New Zealanders. These can be seen as “needs based” supports that are not intended to be met out of retirement incomes. The programmes cover issues such as health, housing, disability supports, transport, mobility, personal security, communications and the

like. Because this paper is focussed on the retirement *income* policy framework, and to avoid duplication with the Preston paper, much of those (important) contributors to the well being of older new Zealanders have not been documented here. Note that more detail on these costs is to be found in the Preston paper.

Two programmes are mentioned here: health costs and residential care. This is because without public provision, these can be a major factor in shaping just how much retirement income is required.

The costs of health care are rising across the globe. In part this is because of advances in medical technology, and in part it is simply a consequence of economic growth: international evidence shows a strong positive link between per capita income and per capita spending on health.

There is also, though, a link between health cost and age. Those over 65 consume a disproportionate share of the health dollar, and per capita health costs increase exponentially with age. This means that for the “old old” (those over 85) per capita health costs are ten times as high as for those in the 15-64 age bracket (Hawke).

The evidence is somewhat ambiguous about why this is so. One strand of research suggests that the largest part of health spending is in the last year before death – at whatever age that occurs. The implication is that as people live longer, this “cost of dying” will increasingly be concentrated among older age cohorts. A key variable is how well people age: if they remain healthy longer, disability services will not be as expensive as if they do not.

The policy question is what this has to do with retirement income. At one level, health can be seen as a separate issue. Because access to and use of health services depends on health status not age, health care can be seen to be quite separate from *retirement* policy. On the other hand, because *as a group* older people use more health services, health services are associated with, even if not caused by, “retirement”.

Retirement income and health care costs would be much more closely linked if individuals had to pay directly for health services. In those circumstances, retirement income would need to cover both longevity and health status risk. In New Zealand, health risks are largely socialised, so this part of the income adequacy equation is removed from retirement policy. Health cost is still an important part of the wider fiscal policy challenge, and on some projections is more substantial than the sustainability of NZS, but that matter is beyond the scope of this report.

What matters for retirement income policy is meeting the costs of aged residential care.

3.6 Aged residential care

The costs of providing residential care for the elderly is different from health because policy in this area does determine the extent to which other income and assets of users have to be used to meet the costs of care.

This policy has changed dramatically in a relatively short period of time. Qualification for subsidised care is based on an assessment of need for care, and an asset and income test. Generally, where one of a couple entered care, the assets of the other (house, car) did not count towards eligibility for a state subsidy. It was when both are in care, or (more usually) when the surviving spouse enters care

that the test impacts. Until 1994, relatively few assets were exempted (\$13,000 per person), which meant that most aged care residents had very limited assets or paid for their own care. (NZS is paid to providers by those in care, and depending on classification, this can be seen as a private contribution or simply a redirection of universal retirement income).

That changed dramatically, especially after 2005, when the exempt asset threshold was raised to \$150,000, and was set to increase by \$10,000 a year. In 2012, the government announced that from then on in, the threshold would increase by the CPI only, but even then it has risen to \$213,297 by 1 July 2012 (St John & Dale, 2011).

At this stage, the numbers, and therefore the costs, are relatively small. At the last Census (2006), only 5.4 per cent of those 65+ were in care, but this rises to 21 per cent for those 85+. (80 per cent of the 85+ group are women). Susan St John and M. Claire Dale estimate that in 2009/10, District Health Boards (DHBs) spent \$800 million on aged care. Residents contributed \$650 million (\$250 million of which was from their NZS pensions). 30 per cent of aged care residents paid for their own care. These figures imply a high degree of intragenerational divergence in meeting the costs of aged care out of retirement income.

In itself, that is of no great concern from a public policy point of view: care is provided at public expense when retirement income is exhausted (even if the quality of residential environment may show large variations). Cynically, it could be argued that the rising asset threshold is protecting inheritances, not providing care.

The risk for policy is that as the 85+ cohort increases in relative and absolute size, the policy settings may not be sustainable.

In 2010, the DHBs commissioned consultancy firm Grant Thornton to review all aspects of the future demand for such care. Their report looked at issues such as the need for investment in additional and replacement facilities, workforce challenges, and options for different models of care. All of those are important and difficult policy challenges, but are indirectly relevant to retirement income.

What is relevant is that Grant Thornton found that most of the recent investment in modern aged care facilities has been targeted at those with the financial capacity to make private contributions. 43% of all facilities, and 58% of facilities built in the last decade, charge some of their residents extra fees for additional services. The numbers of facilities charging extra fees have more than doubled since 2006.

Like Australia and the United Kingdom, most of New Zealand's investment in modern aged care infrastructure is targeted at those with the means to make private contributions towards their accommodation and services. This has only developed in the last four years due to legislative change impacting the sector, and differences in how regulations for the levying of additional charges to residents are interpreted have created uncertainty around ongoing user pay arrangements. This has discouraged investment in premium facilities. Approximately half of New Zealand's building stock is now over 20 years old. (Grant Thornton, 2010)

While policy on aged care has moved (quite recently) towards greater generosity of treatment of the assets of those needing it, changes in the settings may be having unforeseen consequences that could press up against adequacy of *supply* (not affordability) in the future.

3.7 “Sustainability”

This paper has an historical focus, and looking forward to the sustainability of existing retirement income policy settings is beyond its terms of reference. However, even in this historical context there was that period between 1977 and 1992/1995 (as the age of eligibility was phased back up to 65) when public pension expenditure was between 6 and 7 per cent of GDP, and the projections in the 2010 triennial review have similar spending ratios re-emerging by 2040 if current policy settings remain.

History cannot tell us much about what the experiences from the late 1970s mean for the next 25 years, because while the higher fiscal costs of that time were not sustained, the policy centre of gravity moved back to its “65 at 65”¹¹ social and political consensus benchmark. It is not clear from that episode whether it was fiscal affordability or perceptions of fairness that ultimately shaped the policy response.

4.0 Evaluating policy against Retirement Commission objectives

At the end of this historical journey (“there and back again”?!), the question needs to be asked if it is meeting the policy objectives that it might reasonably be judged against.

4.1 Personal responsibility, individual choice and control

In many ways, the New Zealand framework maximises personal responsibility, choice and control with the important proviso that this is on top of basic collectivised adequacy. The “extras” that contribute to comfort in retirement are minimally prescribed. Even with KiwiSaver, the individual is able to opt out, take a contributions holiday, divert savings into home ownership, change provider and alter the risk profile of the investment portfolio.

This, of course, is a matter of interpretation. A counter argument is that precisely because there is a guarantee of relief from distress in older age (NZS, public health, in-home care, subsidised and ultimately free aged residential care), the state absolves individuals from responsibility to make provision for an adequate retirement.

Both views are valid: both reflect different philosophical rather than analytical perspectives.

4.2 Alleviation of old age poverty and hardship (income support)

The OECD reflects the conventional view of external commentators on NZS with its bald assertion that it has “eliminated poverty in older generations”.

The low or zero rates of elder poverty tend to derive from a relative measure of poverty. If NZS is set at a level relative to the average wage, and the poverty level is also set relative to it (or at least as a percentage of the median wage), then provided the first is set above the second, elimination of poverty is automatically defined by the measures used!

¹¹ 65% of the average wage (for couples) at 65 years of age.

Bryan Perry points out that it is not quite that simple. He shows that the three critical variables in measures of elder poverty are whether the standard is 50 as opposed to 60 per cent of the median wage, if incomes are measured before or after housing costs, and if the older person is living alone or sharing housing (and other overhead) costs.

In addition, relative income does not necessarily equate with levels of material hardship. The wellbeing of individuals will also be influenced by factors such as their assets, the state of their health, and whether they have individual needs for personal supports.

A high incidence of home ownership among those over 65 means that housing costs will tend to be low for *most*. The majority of those over 65 have very little income in addition to NZS. For the lowest two quintiles, NZS generates 98 per cent of total income. It provides 85 per cent for the third quintile. The risk here is that older New Zealanders retire asset rich (owning their homes) but income poor, but even then, in such circumstances, a rates rebate moderates that important component of housing cost.

The single annuitant not owning a house is exposed to high housing costs and is not protected by the rates rebate (although uptake of the Accommodation Supplement is rising rapidly, albeit from a low base).

Different measures (before or after housing costs, 60 or 50 per cent of the median income, income poverty or other definitions of hardship) will give different results.

An overview is given in the Ministry of Social Development report 'Household Incomes in New Zealand, 1982 – 2011'.

In summary, MSD concludes that:

- 16 per cent of the population are in "income poverty", but this rises to 21 per cent for children and is only 7 per cent for the over 65s.
- That average "7 per cent" splits into 11 per cent for the population over 65s living alone, versus 5 per cent for couples.
- Because of the importance of non-monetary supports and services, there is only a 50 per cent overlap between income poverty and hardship.
- 13 per cent of the total population experience "hardship". It is higher for children, and much lower (4-5 per cent) for the over 65s.

Overall, then, the conclusion that poverty among older generations has been "eliminated" may be somewhat exaggerated. It is perhaps more accurate to say that it has been "confined" – effectively to those who do not own their own homes, who are living alone, who have no or very little other income and/or have experienced adverse life events (redundancy, prolonged illness, matrimonial dissolution, bankruptcy) in the period shortly before retirement.

Among older (85+) groups, income may no longer be the sole driver of deprivation, and needs for personal supports start to enter the equation. Subsidised residential care ensures alleviation of hardship for those who are least able to support themselves for reasons other than income.

4.3 Social cohesion and national identity

This “citizenship” dividend is difficult to measure objectively. However, NZS delivers a higher replacement rate (pension as a per cent of pre-retirement income) the lower the pre-retirement income, falling quite dramatically as pre-retirement income rises, and it is therefore highly equitable in a redistributive sense.

This has increased social cohesion. The Living Standards Report concludes that “New Zealanders aged 65 years and over have the most favourable living standard distribution of all age groups” (Cook, 2006) which Len Cook interprets to mean that “there is less disparity among living standards for this group than for any other age group in New Zealand.” In the period of the living standards study (2000-2004) there was little change in the mean living standards of those aged 65 and over whereas over the same period Cook notes that “disparities in living standards among other groups generally increased.”

Although not explicitly identified as such, a citizenship dividend was effectively paid when the 1938 Social Security Act lifted retirement incomes and substantially raised the relative standard of living of retirees.

Universal superannuation delivers a citizenship dividend if it is provided as a right of citizenship as opposed to being a consequence of contribution, if it is not related to the income and assets of a household, and if it is set at a level that is above that required for relief of distress or avoidance of destitution.

In practice NZS is slightly more generous than a citizenship dividend because it is paid to qualifying residents who are not citizens. The fact that it only requires residence for ten years to qualify for the standard rate of payment establishes a clear break from a contributions link.

One way to look at the citizenship dividend is to compare the universal NZS with unemployment benefit rates. Roger Hurnard (2012) calculates that the net margin of NZS over the married rate for an unemployed couple with children was between ten and 15 per cent between 1977 and 1987, rising to 24 per cent in the 1990s (largely because benefit rates were reduced, not because the NZS citizenship dividend was increased) and to 32 per cent in 2002 (after the rate of NZS was increased). When it is considered that pensioners would tend not to have dependent children, the margin over what may be considered as a socially determined subsistence level of income support is even greater.

On current (as from 1 April 2012) rates the gross NZS benefit for a married couple is 58 per cent above the unemployment benefit rate for a childless couple. That margin needs to be interpreted cautiously. If the unemployed couple have children, their benefit increases. They are also less likely to own their own houses, so would normally qualify for an accommodation benefit. Superannuitants typically have some other income (although for most this is small), so the after tax equivalences will be smaller.

On the other hand, the unemployed couple meet costs associated with raising children.

Unemployment is presumed to be a transient status, and even if beneficiaries are unemployed for reasonably long periods of time, they at least have the life-stage potential to earn income, whereas for the retired, that option is largely closed. [It should be noted, however, that increasingly

beneficiaries are sole parents, or on invalids or sickness benefits, so this “transitional” status may not be a valid consideration].

There is no explicit way to objectively quantify the size of the citizenship dividend, but the weight of evidence suggests that it is real.

Further, it is an explicit element of the policy justification for NZS. This was best articulated by former Finance Minister Michael Cullen (2003) when he stated that “confidence about basic income security in retirement is the least that the citizens can expect in a modern developed economy.” He also noted that this is “the most that citizens can expect” because replicating in retirement incomes enjoyed during working life would be both expensive and inequitable. That important caveat reinforces the “standard rate of dividend” that accrues from citizenship.

4.4 Promote wellbeing (positive and active ageing)

Positive and active ageing is associated with both alleviation of poverty and with receipt of the citizenship dividend. However, it is substantially achieved by direct measures taken outside of, and in addition to, provision of retirement income. These other measures include provision of in-home support services to those who need them, access to social facilities and networks and the like.

A number of policies explicitly support positive ageing. Examples are the rates rebate (to avoid the need to “trade down” when income reduces in retirement but the value of asset on which rates are levied does not), disability support services, and transport subsidies (through the SuperGold Card) which enable the retired to access family, friends, events and community facilities.

4.5 Maintenance of living standards in retirement (consumption smoothing)

The New Zealand system explicitly transfers all responsibility for maintenance of living standards in retirement – again with the important caveat of being above a minimum standard of living – on to the individual. KiwiSaver goes part of the way in assisting individuals to do that (especially through the default opt-out mechanism), but that scheme is still voluntary and tax subsidies and employer obligations are low compared with other countries.

Ironically, though, NZS may have the *effect* of income smoothing for the lower 40 per cent of income earners who are over 65, not because of the generosity of NZS but because of the extent of low incomes received by those under 65! That is certainly one interpretation of the Scobie/Gibson analyses.

4.6 Cohort self-funding (intergenerational equity)

There is a clear split between the first and third pillars of retirement income policy, with the first being explicitly “Pay as you go” and the third being cohort self funding. Partial cohort self funding was introduced with the NZSF, but that is now in suspension. KiwiSaver does facilitate a form of cohort self-funding, but only of the third pillar component of retirement income.

4.7 Protection against longevity risk

The existing regime is very effective at protecting against longevity risk, through a combination of basic adequacy of NZS and state subsidisation of long term residential care. Susan St John has long argued that the lack of an effective annuities market (even if this means more active state regulatory

intervention to improve it) prevents individuals protecting themselves against longevity risk, but pricing, liquidity, industry aversion to adverse selection and difficulties of protecting against the combination of inflation *and* longevity have kept this avenue firmly sealed off.

4.8 Economic and growth efficiency (fiscal restraint and investment)

This is identified by the Commission as equating with fiscal restraint and investment. However, economic efficiency was also identified as a strong justification for the introduction of the tax neutral treatment of all savings vehicles under the TTE regime.

There is a strong and persistent argument, about the fiscal unsustainability of existing NZS arrangements. One example is the presentation to the 2010 Retirement Commission /Institute of Policy Studies forum by the Secretary to the Treasury¹². Some of the assumptions used in those projections have been challenged by Ganesh Nana of economic consultancy Berl, (Conference Proceedings), but regardless of how sustainable *fixed* settings are, there is as yet no consensus on just which variables (indexation formula, age of eligibility, income testing) need to change and by how much.

A contrary perspective on affordability is provided by Cook, who quotes OECD calculations as concluding that “the average per person capital value of a public pension in the OECD countries is...nearly twice as high as for New Zealand.” This low capital value is largely a result of public pensions not attempting to replicate working life earnings in retirement, so the standard rate of NZS is in fact a strength in determining its longer term affordability.

4.9 As others see us...

American academic Kent Weaver has produced a “hypothetical report card” on New Zealand’s retirement income system (Conference Proceedings).

The highest mark (A) is given to the administrative effectiveness and cost of NZS. “Exposure to market risk” rates an A-, which is possibly why poverty prevention also rates highly at B+. “Income replacement is given a C, which in light of the Cullen comments quoted earlier, would be seen as a good grade! The fail grade (D), is “exposure to political risk”. This paper argues that on the historical record that risk – at least for the first pillar – has been more theoretical than actual. On the other hand, the record shows that the political risk around support for second and third pillar savings is very real.

5.0 Conclusion

New Zealand’s retirement income policy history has steadfastly avoided both compulsory individual contribution, and any attempt by the government to replicate in retirement incomes that people earned during working life. State guarantees of returns to private savings have been limited, and are now historical. State subsidies of private savings have never been extensive. “Needs based” policies and programmes – like health, disability and housing support and provision of residential age care

¹² See

<http://igps.victoria.ac.nz/events/downloads/2010/Retirement%20Conference/1105%20Mahklouf%20Conference%20on%20Retirement%20Income%20Policy%20-%20Fiscal%20Perspectives%20Session.pdf>

facilities – have lifted the pressure on the need to generate more substantial retirement income “in case”.

The universal pension has meant that overall, elder poverty is confined, and lower than that of the population as a whole. Inflation and longevity risk have been collectivised, so the regime is relatively advantageous for women.

It is generally seen to be equitable, effective and cost-efficient. The durability of the basic settings implies a high degree of public acceptability.

Whether these historic settings are financially sustainable remains the major matter for policy makers to determine.

Reference roadmap

There are so many potential sources of information that have guided the compilation of this report that the best way to reference them is through a “roadmap” rather than an academic bibliography

Descriptive histories

Preston, D. (2008). Retirement Income in New Zealand: the historical context. Retirement Commission. Wellington.

Preston’s article also contains a broad outline of the forms that retirement income can take, and definitions of technical terms. It has a useful statistical appendix.

Hurnard, R. (2012). The Evolution of Retirement Income Policies in New Zealand, (mimeo) Commission for Financial Literacy and Retirement Income, Wellington.

Hurnard has identified how economic, demographic, social and political factors have influenced policy decision making at various times. A particular strength of the paper is his analysis of how the two Royal Commissions influenced policy, and of political responses to them.

Marriott, L. (2008). The Politics of Retirement Savings Taxation: a trans-Tasman comparison. PhD thesis, Victoria University of Wellington.

Marriott adds the tax treatment of savings and retirement income to the historical record.

Other articles exploring the current tax status of such income is at:

<https://www.victoria.ac.nz/sacl/about/staff/lisa-marriott>

Ashton, T. & St John, S. (1998). *Superannuation in New Zealand: averting the crisis*, Institute of Policy Studies, Victoria University of Wellington.

Official reviews

David Preston’s history is accompanied by a comprehensive bibliography. In it, he has listed the major official reviews of retirement income policy. Each review has itself been informed by commissioned reports on aspects of the topic, so there are about a dozen research papers that accompany each of the episodic reviews.

The list is:

- Task Force on Private Provision for Retirement (the “Todd Taskforce”). It issued an issues paper in 1991, an options paper in 1992, and a final report at the end of 1992. The main thrust of this task force was to propose an “enhanced voluntary option” for private savings.
- The 2003 Periodic Report Group commissioned a number of background papers to accompany its final report.
- Another Periodic Report Group was convened in 1997, and it issued a interim report reviewing the current framework before its concluding report that was published at the end of the year.
- A “Super 2000” taskforce was set up late in the term of the 1996-1999 National led government but it was disestablished shortly after the Labour-Alliance coalition came to power.

- The Retirement Commissioner issued a review of retirement income policy in 2007.
- The 2010 Review of Retirement Income Policy is a rich source of statistical information and analysis of the finer details of entitlements, and is accompanied by a dozen background research papers.

Details on the various historical reviews are available at: <http://www.cflri.org.nz/retirement-income/policy-reviews>

Background papers to major policy initiatives

New Zealand Superannuation Fund

Frances, J. & McCulloch, B. (2001). Financing New Zealand Superannuation. New Zealand Treasury, Wellington.

This is the standard reference behind the policy rationale for setting up the NZSF and is available at: <http://www.treasury.govt.nz/government/assets/nzsf/release/nzs-wd.pdf>

The full suite of Cabinet papers that provide details on the governance and operations of the NZSF are at: <http://www.treasury.govt.nz/government/assets/nzsf/release>

The announcement by Treasurer Bill English of the suspension of contributions to the NZSF is at: <http://www.beehive.govt.nz/release/new-zealand-super-fund-fact-sheet>

KiwiSaver

The policy justification for establishing the Savings Product Working Group, which designed the broad architecture for KiwiSaver was set out by Minister of Finance Michael Cullen in a Press Statement dated 14 May 2004: <http://www.beehive.govt.nz/?q=node/19684>

The report of the Savings Product Working Group itself is at: <http://www.beehive.govt.nz/Documents/Files/WorkplaceSavings.pdf>

Hurnard R. (2011). Mixed messages: the future direction of New Zealand's retirement income policies. Paper presented at the 19th Colloquium of Superannuation Researchers, University of New South Wales, Sydney, 14-15th July 2011.

This paper sets out the policy logic behind the initiative to further incentivise private provision for additional retirement income and is available at: <http://www.cflri.org.nz/sites/default/files/docs/RI-Mixed-Messages-2011.pdf>

Cabinet papers outlining both the general direction of policy on KiwiSaver and details of policy design are contained on the Treasury website: <http://www.treasury.govt.nz/publications/informationreleases/kiwisaver/background>

There are also papers that explain the rationale for paring back the level of tax subsidy of contributions and of for adjusting contribution rates. These can be found at: <http://www.treasury.govt.nz/publications/informationreleases/budget/2011/kiwisaver>

St John, S., Littlewood, M. & Meehan, L. (2008). *The Distributional Impact of Recent Changes to Retirement Income Policy: a preliminary analysis*. Retirement Policy and Research Centre (RPRC Working Paper 2008 -2), Auckland University.

St John, S. (2007). KiwiSaver and the Tax Treatment of Retirement Savings in New Zealand, NZ Economic Papers, 41 (2).

These researchers, based at the University of Auckland Business School have written on the equity aspect of KiwiSaver subsidies.

Evaluations of policy instruments

The equity and sustainability dimensions of policy settings were debated at a forum on Retirement Income Policy and Intergenerational Equity held as a joint venture between the Retirement Commission and the Institute of Policy Studies on 21 and 22 July 2010. The sustainability debate in particular was captured by the papers presented by the Treasury, and by Ganesh Nana of BERL.

These papers, and others presented are available at:

<http://igps.victoria.ac.nz/events/Upcoming%20events/Retirement%20Income%20Conference.html>

Hawke, R. (2005). Retirement Income Provision in New Zealand: a way forward. Institute of Policy Studies, Victoria University of Wellington.

Hawke's book canvasses the history of retirement income policy, but its main focus is on an evaluation of it. He works from an assumption that "from the individual's point of view, the primary purpose of retirement income provision is consumption smoothing, i.e. that individuals want a guarantee that enables them to consume after they leave employment." He reaches the conclusion that policy is not effective at consumption smoothing, and then proposes additional mechanisms to achieve it.

Cook, L. (2006). Questions for our times about retirement savings and pensions. Retirement Commission, Wellington.

Cook looks at the "quality" of the policy framework and assesses it against standards of adequacy, simplicity, flexibility, certainty, equity, fairness and affordability.

The Retirement Policy and Research Centre at Auckland University has published a number of papers assessing the equity and effectiveness of retirement policies. A list is available at:

<http://www.business.auckland.ac.nz/uoa/home/about/our-research/bs-research-institutes-and-centres/retirement-policy-and-research-centre-rprc/publications-28/pensioncommentary-articles>

Antolin, P. & Ponton, E. L. (2007). *The impact of tax incentives on retirement savings: a literature review*. Proceedings of OECD/IOPS Global Private Pensions Conference, Beijing, November 2007.

This is a summary of the international literature on the effects of tax advantages and subsidies on the level and distribution of savings.

OECD. (2007). *OECD Economic Surveys: New Zealand, Vol. 2007/8*. OECD, Paris.

The conclusion that NZS has "eliminated poverty in older generations, and that it has a much higher income replacement rate for lower income earners comes from the above publication.

Grant Scobie and John Gibson have written extensively on the topic of adequacy of savings. The best summary of that research, with Trinh Le is at: <http://www.treasury.govt.nz/publications/research-policy/wp/2004/04-12/twp04-12.pdf>

Perry, B. (2010). Household incomes in New Zealand: trends in indicators of inequality and hardship, 1982 – 2009. Ministry of Social Development, Wellington.

This is a comprehensive review of equality and poverty among different age groups and distinguishes- between income adequacy before and after housing costs.

2010 *The Social Report*, Ministry of Social Development, Wellington, available at www.socialreport.msd.govt.nz

St John, S, & Dale, M. C. (2011). *Funding the long goodnight: more intergenerational risk sharing*. NZ Association of Economists Conference, Wellington.

This paper discusses intergenerational risk sharing.

Statistical references

Up until 2011, the Government Actuary produced statistical summaries related to registered superannuation scheme details.

These reports and summaries of KiwiSaver scheme details are now produced by the Financial Markets Authority and are available on its website:

http://www.fma.govt.nz/media/368324/kiwisaver_report_for_the_year_ended_30_june_2011.pdf

Statistics New Zealand produces regular updates on the population structure, and projects demographic trends under various assumptions (fertility, mortality, immigration). See, for example *National Population Projections, 2011 – 2061*. July 2012.

The Ministry of Social Development publishes an annual “Social Report” that comments on living standards and income distribution.

Specific studies referred to in the text

Christensen, K., Doblhammer, G., et al. (2009). Ageing populations: the challenges ahead. *Lancet* 374: 1196.

Coleman, A. (2012). *Inter-generational transfers and public policy*. University of Otago and New Zealand Treasury, Wellington.

This examines trends in longevity.

Holzman, R. & Hinz, R. (2005). *Old-age Income support in the 21st Century*. World Bank.

The “evolution” of the World Bank’s three pillar model can be found in the above.

Weaver, R. K. (2002). *NZ: The Supreme Political Football*, Centre for Retirement Research, Boston College. WP 2002-12.

This is an example of attribution of the concern over pension policy revolving “heavily around the aging of the baby boom generation”.

The survey of aged care costs and facilities is in the Grant Thornton report at:

<http://www.grantthornton.co.nz/Assets/documents/home/Aged-Residential-Care-Service-Review-Summary.pdf>

Michael Cullen's comments on the expectations of citizens is from a speech to the ISI Savings Forum in 2003, and is at: <http://www.goodreturns.co.nz/article/976488496/nz-super-fund-close-to-point-of-no-return-cullen.html>

Examples of support for compulsory KiwiSaver are found at:

<http://www.3news.co.nz/Dunne-backs-compulsory-KiwiSaver/tabid/1607/articleID/261111/Default.aspx>

<http://www.goodreturns.co.nz/article/976499760/strong-support-for-compulsory-kiwisaver.html>

<http://www.nbr.co.nz/article/poll-finds-strong-support-compulsory-kiwisaver-rh-121756>

http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10762391