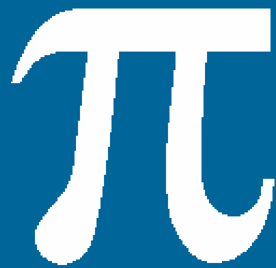

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Pensions taxation and retirement incomes in New Zealand

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Pensions taxation and retirement incomes in New Zealand

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1. Introduction

The New Zealand pension system is perhaps the simplest in the developed world. It comprises a universal state pension, called New Zealand Superannuation, and voluntary unsubsidised private saving. Both of these features mark New Zealand out from other countries and together provide a unique approach to retirement provision.[2] In managing the pressures of the ageing of the population, this combination may offer a cost-effective solution to ensuring an adequate, secure, equitable and sustainable income for all in an uncertain future. In no small part, the decision in the late 1980s to promote tax neutrality for saving in the context of wide ranging reforms to the tax system has been critical to this success. This paper examines how New Zealand was able to achieve this radical tax change and sustain it in the face of strident calls to promote saving for retirement.

The paper first outlines the nature of public and private provision so that the tax treatment of private provision can be seen in the context of the entire retirement package. The background to the current tax treatment of retirement saving is reviewed including a brief account of the difficulties of transition to tax neutrality. In recent times there has been concern that New Zealanders are not saving enough and that the tax neutral regime has led to the virtual demise of employment-based savings. Despite this, the case for the reintroduction of tax-advantaged saving has not been convincing.

A new policy initiative for workplace saving, 'the Kiwisaver' is to be introduced in 2007. While this policy eschews the worse aspects of tax incentives it may also run the danger of being largely ineffective. In this, New Zealand may well learn from the experience of the UK Stakeholder Pension and the Irish Personal Retirement Savings Accounts. More encouraging for the future, the tax neutral regime in New Zealand for the accumulation phase of saving for retirement may pave the way for a rational use of tax incentives to achieve social objectives in the decumulation phase of retirement saving.

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[2] Further background can found in Preston (2001), St John (2005) and from http://www.retirement.org.nz/

2. Retirement income provision in New Zealand

Public provision

The parameters of New Zealand Superannuation (NZS), are set out in Part 1 of the New Zealand Superannuation Act 2001.[3] While the retirement income system in New Zealand has been subject to intense political debate over many years, this part of the Act now enjoys wide political support. NZS is payable at age 65 years to all New Zealanders living in New Zealand who meet the minimal residency requirements of 10 years residency since the age of 20 years and not less than 5 years residency since attaining the age of 50.

The net rate of payment for a couple is legislated to be within the band of 65% and 72.5% of net Average Ordinary Time Weekly Earnings (AWE).[4] For each married person this means a floor of 32.5% of AWE is guaranteed. Each year there is an annual adjustment to reflect movements in the Consumer Price Index, unless the floor of 65% is breached at which point wage indexation restores the floor. The rate for a single pensioner who shares accommodation is 60% of the married rate, or a minimum of 39% of AWE. The rate for pensioners living alone is 65% of the married rate or a minimum of 43.25% of AWE. Each person is taxed in their own right as an individual on total gross income including the gross pension, so that with mildly progressive income tax rates, (see Table 2) the top income pensioner effectively receives a pension worth approximately 72% of the pension of the lowest income pensioner.

The attractive and unusual features of New Zealand Superannuation from the perspective of the individual are:

- The pension is non-contributory and thus recognises both paid and unpaid contributions to society. Women in particular have gained.
- Each person over 65 is treated as an individual and receives the pension in his or her own right. While there are different rates depending on marital status, each individual is taxed as an individual and there is no account taken of a spouse's income.
- The payment is indexed to living standards by the provision of a floor-related to average wages so that protection is afforded not only for inflation but also for a growth in living standards generally.
- The pension protects against the longevity risk.
- The pension is very simple to understand and apply for.

From the perceptive of society there are also advantages:

- As social insurance, the scheme does not require any guarantee period or return of capital on death.
- The general tax base wider than wage income, as it includes taxes on investment income and on consumption. Thus some of the burden of the PAYG scheme is spread from the working age population to include tax contributions from the old as well.
- The level has been effective in largely preventing poverty for the elderly

[3] Superannuation is a term used in New Zealand for savings for or retirement. It does not necessarily imply that the form of saving is a pension.
[4] AWE is weekly earnings averaged for male and female.

- Administration costs are minimised and there are no inherent disincentives to work or save because the pension is not means-tested.

In terms of sustainability, the net cost of paying New Zealanders the NZS is currently 3.6% of GDP and expected to increase to around 7.5-8% of GDP by 2051[5]. While the fiscal pressures of an ageing population are real, the size of the problem seems modest in comparison with other OECD countries many of whom already who face much higher pension/GDP ratios. It must also be remembered that other countries provide subsidies in the form of tax expenditures for private provision that are not reflected in pension/GDP ratios. Ireland for example has a regime of tax expenditure for retirement incomes that if counted as part of the state's pension costs for 2000/1 would increase the pension/GDP ratio by 1.7 percentage points (Hughes, 2005).

Thus it may be argued that the lack of tax incentives assists in the affordability of the relatively generous tax-funded universal New Zealand Superannuation. The New Zealand Government has also begun to pre-fund the state pension by setting aside part of the fiscal surplus each year to provide a buffer against the needed increase in taxation (see Appendix 1).

Private provision

As discussed in more detail below, New Zealand has a simple system of voluntary, unsubsidised supplementary provision for retirement saving. In theory one is free to save in any way that is appropriate, whether that be in acquiring equity in housing, repaying debt, investing in financial assets or even in furthering one's own education or that of one's children. This next section discusses the context of the tax reforms in New Zealand that gave rise to this system.

As in other countries, defined contribution schemes are replacing defined benefit schemes so that far fewer people coming into retirement with either an annuity or a private pension.[6] The tax neutral treatment of superannuation saving since 1990 is acknowledged to be one of the negative factors impacting on private pension and annuity provision in New Zealand. As well as the shift to defined contribution schemes, coverage by employer superannuation schemes has been declining, along with the value of employer subsidies for most earners.

The New Zealand 'two legged' model

From time to time, the New Zealand model has been considered in international debate, but more as an object of international curiosity than as a model to be emulated (see, for example, Johnson, 1999). The New Zealand model may however offer a credible alternative to the three-pillar World Bank model (St John & Willmore, 2001). The first tier universal pension together with the tax-neutral regime for private financial saving may be of interest to other countries because of cost advantages, equity implications, and relative simplicity. One of the little appreciated consequences of the New Zealand approach, however, is that a tax neutral approach precludes the right to regulate retirement saving for social purposes. This means there is no potential, for example, to legislate for the purchase of an annuity from the retiree's lump sum savings.

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[5] See http://www.retirement.org.nz/

[6] An annuity is an annual income stream purchased from a Life Office with an individual's lump sum. Annuities can be paid for life (life annuities) or for a fixed term (term annuities). Pensions are group annuities paid from company, government or group retail schemes.

3. Tax reform 1987-1990

In December 1987, Roger Douglas, the Minister of Finance, announced there would be a flat rate of personal tax aligned with the company rate. Tax subsidies for saving were to be removed, and the tax base broadened by the closure of loopholes of all kinds. The rationale was largely economic and there did not appear to be any particular concerns about the effects on retirement incomes. The intent was to 'level the playing field' so as to remove, or minimise, the economic cost of distortions that arose from treating different income streams differently. Douglas argued that tax concessions had allowed savings to flow to favoured financial institutions that had not necessarily invested the money in the best ways possible for growth. He claimed that a low, flat tax rate was necessary to encourage saving, reward work and minimise avenues for income splitting. The intent was clearly to underpin the other economic reforms of the 1980s in New Zealand that had emphasised the role of the free market in the allocation of scarce resources (Easton, 1997a, 1997b). He also argued that a flat rate would prevent taxation by stealth as inflation 'pushes people into higher income tax brackets'(Douglas, 1987).

While flat tax itself is not progressive, improving fairness was another strong rationale for the changes. Tax avoidance and tax exemptions had rendered the old tax system of the 1980s far less progressive than the stepped up marginal schedule appeared:

> *[Flat tax] in conjunction with enhanced income support for low income people in the workforce and the abolition of tax concessions that at favour the better-off will also make our tax-benefit system more truly progressive.(Douglas, 1987)*

Higher income people under flat tax would pay more tax, first because they would no longer benefit from a lower rate on the first part of their income and second because of the removal of the major tax concessions and the closing of tax loopholes. The Minister of Finance claimed that the concessions on life insurance and superannuation schemes alone were worth 2.5 percentage points on basic tax rates (Douglas, 1987, p3). The cost of these concessions was estimated to be approximately $800m, representing about 1.2% of GDP.

The rate of the flat tax was not announced in the tax package although later it was revealed that a 23% rate was contemplated and would have been accompanied by the cuts to government expenditure by the introduction of user pays for state provision of many kinds.

Saving for retirement

As in other countries, tax-subsidised private pensions were originally the preserve of employees in large companies and the government sector. The chief beneficiaries in the private sector were characteristically white, male, high-income, long-term employees. In the state sector, a defined benefit scheme (the Government Superannuation Fund) paying inflation-adjusted pensions enjoyed wide coverage in the 1960s and 1970s.

Prior to the tax reforms of the late 1980s, pension schemes had received preferential tax treatment on both employee and employer contributions and on fund earnings. While pensions were taxed as income, up to 25 % of pension savings in these schemes

could be taken as a tax-free lump sum. Pure lump-sum schemes were also tax subsidised, but less generously since the early 1980s.[7]

Under the tax regime introduced between 1988 and 1990 and applying today, contributions to savings plans are made out of after-tax income so that contributions may be described as 'taxed' (T). Income accruing as fund earnings is taxed (T) at the company rate of 33%, while withdrawals from the fund are exempt from tax (E). The traditional expenditure tax treatment involves an Exempt/Exempt/Taxed (EET) regime while the New Zealand income tax treatment of savings involves a Taxed/Taxed/Exempt (TTE) regime (see Table 1).

Table 1 Different Tax Treatments of Superannuation

	Expenditure tax treatment	Income tax treatment
Contributions	Exempt	Taxed
Investment income	Exempt	Taxed
Withdrawals	Taxed	Exempt
	EET	TTE

By 1st April 1990 the new tax regime was fully operational with the Income Tax Amendment Act 1989 and the Superannuation Schemes Act 1989 providing the necessary taxation and supervisory legislation.[8] Schemes became 'registered' by the Government Actuary rather than 'approved' as previously for tax concession purposes.

From this point New Zealand's tax regime for retirement income saving no longer distinguished between pension and lump-sum schemes. With no tax concessions, no restrictions could apply as to how scheme benefits were to be received although the trust deed could specify such details. Also there was no restriction on the amount of the employer's contribution. Rather than tight regulation, New Zealand adopted a full disclosure approach as consistent with free market reforms.[9]

These far-reaching reforms made New Zealand the only OECD country not to treat private savings for retirement differently from other forms of saving.[10] While the intent of removing privileges from certain classes of saving was to encourage investment in more productive areas, the idea of tax neutrality in the treatment of saving has been difficult to realise in practice as discussed below.

The transition to tax neutrality[11]

A complex and uncertain time for private superannuation followed the December 1987 announcement. Arguments that changes to existing schemes involved

[7] For a discussion of the pre-reform tax treatment see St John & Ashton (1993), pp.23-4.

[8] The Superannuation Schemes Act 1989 emphasises the responsibilities of trustees and applies equally to schemes that are sponsored by employers and those offered to the public via retail schemes.

[9] As well as the minimal requirements of the Superannuation Act 1989, schemes must also meet the information and disclosure requirements of the Securities Amendment Act 1996 and the Investment Advisors (Disclosure) Act (Periodic Report Group, 1997a, p. 191).

[10] Both New Zealand and Australia have moved away from the idea that end benefits only should be taxed. Countries with traditional EET models watch the Australasian approach with interest, but it is New Zealand whose model has been the purest.

[11] This section draws extensively on St John & Ashton, (1993), pp21-45.

retrospective legislation fell on deaf ears. The Government could point to many other reforms undertaken in the 1980s that entailed a measure of retrospectivity. A transitional regime for previously tax-favoured schemes was supposed to be sufficient to allow the smooth adjustment to the new tax environment.

A consultative committee was set up under the chairmanship of Dr Donald Brash to hear submissions on the Consultative Document. While the reforms themselves were not supposed to be up for debate, the overwhelming majority of submissions to the committee voiced strong opposition to the direction that the Government had chosen. The Brash committee heard these submissions and reported that, while in sympathy with the concept of neutral treatment of all forms of savings, a different path to the one proposed by Government was to be preferred (Report of the Consultative Committee, 1988).

The committee recommended that an approach that exempted contributions from tax, but fully taxed fund earnings and emerging pension benefits (Exempt/Taxed/Taxed) would be more appropriate. Under certain assumptions, such a regime was tax neutral although the committee was in favour of some degree of concession which they argued could be offset by a lower entitlement to the state pension. Amongst the arguments for this alternative treatment were:

- lower windfall gains for existing pensioners and those close to retirement;
- less disruption to schemes in the short term with implications for the stability of capital markets;
- better ability to impose regulations, especially those relating to preservation, portability and the requirement to take a pension.

The committee claimed that the Government's proposed TTE regime would be more fiscally costly than the equivalently neutral ETT regime that they recommended. This extra cost would arise despite the short-term gains that would accrue to the Government's budget by bringing the tax liability forward to contributions. Not only would the possibility of increased numbers of schemes being wound up mean greater calls on the state pension in the future, but they also foresaw the possibility of a significant loss of tax revenue when all end benefits were paid tax-free compared to their recommendation in which all benefits would be taxed as they emerged (Report of the Consultative Committee, 1988, p 21).

The committee also argued that their preferred tax regime would be perceived to be the more natural by taxpayers rather than the artificial situation where the emerging pension is tax-free. If pensions were tax-free, people were bound to worry that some future government could impose a tax again even though logically this does not make a lot of sense given the capital nature of such flows.

In the event, the Government made only minor changes in line with the committee's recommendations and indicated the intention to proceed with the TTE treatment of superannuation.

There was little over two years between the announcement of the new regime and its full implementation. The absence of any grandfathering clauses to ease transition meant that the impact of the changes on private superannuation schemes was dramatic. All pension schemes had to be reviewed, and pension levels could be reduced to reflect their new tax-paid status. Many occupational schemes were closed to new members, while others were wound up and the funds distributed. Some were changed from a defined benefit basis to a defined contribution basis.

Existing schemes had until January 1990 to submit proposals to the Government Actuary if they wished to reduce accrued benefits to compensate for the new tax regime. This once-only legislative provision over-rode the trust deed which would not ordinarily permit this to happen without the consent of all affected members. Existing and newly retiring pensioners were to be compensated for the tax on fund earnings and the subsequent reduction in their pensions by being able to take the pension tax-free.

There was widespread misunderstanding concerning the effect of tax-free pensions on final disposable incomes and why pensions had to be reduced. The renegotiation of the Government Superannuation Fund was particularly acrimonious, with many members seeing the reductions in their benefits as a unilateral attack on their living standards and contractual rights. There were unprecedented marches on Parliament by the police and strikes by prison officers.

Any renegotiated reductions to accrued superannuation benefits were required to be fair between members and to provide no financial advantage to the superannuation fund. Those near or in retirement were to be protected as far as possible. While, strictly speaking, those in retirement or close to retirement would require a much lower reduction in pension benefits than younger members of schemes to compensate for the tax, it was deemed to be equitable to have a uniform rate of reduction across the board if the trustees were so to choose.

As it turned out, many schemes in actuarial surplus did not reduce the pensions already being paid at all so that pensioners received an immediate increase of disposable income from their pensions of up to 49% depending on their marginal tax rate. Typically the level of reduction in schemes where pensions were reduced was between 15-20%. While this was usually more than necessary from the point of view of allowing for the tax on fund earnings, it also represented a considerable windfall gain, especially for those on the highest marginal tax rate.

The Government Superannuation Fund (GSF) was also required to reduce benefits. In this case, existing pensions were reduced as if the pension was taxed as primary income ignoring all other forms of income. There were again windfall gains for the better-off with the largest pensions (St John & Ashton, 1993, p.39). Actuarial projections suggested that it was appropriate to reduce pensions for future retirees on a sliding scale, but it was argued that more moderate changes were justified to bring the order of reductions more into line with what was happening to company schemes. Of course, many of these schemes were in actuarial surplus and therefore it was difficult to compare them with the GSF which was never funded with respect to the employer's contribution. The more moderate approach was adopted so that yet more tax revenue was forgone.

There was another windfall gain for existing pensioners because only 50% of the tax-free pension was to count in the income test (called the surcharge) on the state pension that existed at the time. The significance of the surcharge is further discussed in Appendix 2.

Not only were the distributional consequences unfortunate, but the loss of tax revenue was scarcely appropriate in the light of the fiscal problems the Government was facing. It was estimated that the revenue forgone over time by the granting of tax-free benefits to those who had saved under a highly tax concessionary regime was of the order of around $3-4,000 million in present value terms (Report of the Consultative

Committee, 1988). It should be acknowledged, however, that under the previous arrangements that allowed tax-free lump sums and withdrawals, some of this would have been forgone anyway.

The net result of the renegotiation period was that many of those who had already benefited from the concessionary regime of the past benefited yet again. The losers were taxpayers generally, and future and current members of existing schemes whose entitlements would be considerably less generous. Ironically, the lost revenue may have eliminated any time advantage that there might have been in bringing forward the receipt of tax from the receipt of the pension to the contributions and fund earnings stages.

Douglas argued that long drawn out transitional arrangements are seldom fair, they are usually complex, and they defer the benefits of the changes being implemented. He believed that any dramatic change in which there are winners and losers was best presented as part of an overall package where personal losses in one area are offset by gains in other areas. But political factors disrupted the reform process so that many of the changes originally envisaged by Douglas were not fully implemented. The full reduction in personal taxes never eventuated as the government backtracked from flat tax, and some other significant features of the wider reforms, including a capital gains tax were also abandoned. By the time superannuation schemes were renegotiated to allow for the imposition of tax on investment earnings and contributions, the connection between the lower personal tax rates introduced in 1988 and the removal of concessions was largely lost.

The timing of the reforms could hardly have been worse. The December 1987 announcement came just after the New Zealand sharemarket crash and at the beginning of what was to be a prolonged and deep economic recession. Reduced cash flows and the attempts to shift towards more liquid portfolios on the part of major long-term savings institutions intensified the downturn in the property and equities market. Unlike many other countries, share prices were slow to recover after the share market crash, and the share price index (Barclays Index) fell from a peak of 3,800 in October 1987 to around 1,200 by the end of 1990. Attempts to sell assets by institutions in this period may have contributed to the damagingly high interest rates that persisted despite a rapidly reducing rate of inflation. The Consultative Committee had certainly foreseen this possibility as a consequence of the new tax regime (Report of the Consultative Committee, 1988, p 26).

Political conflict also added to the uncertainty. It was not until June 1990 that the opposition National Party announced its superannuation policy. It had been widely expected that they would try to reverse the tax changes if elected in October and this also delayed decisions on scheme design changes in the private sector[12]. The deep political division surrounding superannuation policy, both with respect to the state pension and the treatment of private schemes, was a major impediment to the attainment of stability in private schemes.

Backtracking from flat tax

The tax regime adopted by New Zealand (TTE) for retirement saving works best if the tax rate system is fairly flat. That way, the contributions tax rate applied to employer contributions, the tax rate on fund earnings (the company rate) and the marginal tax

[12] National won the election and kept the tax changes.

rate of contributors will be similar. Douglas's radical and unexpected announcement in late 1987 caused much political bickering within the government itself, and the full package was never implemented the way it was conceived. The flat tax proposal was abandoned and instead, two statutory rates with a low income rebate were adopted (see Table 2).

Until the mid-1990s, the tax scale was fairly flat and the tax regime of TTE worked tolerably well. But once the middle tax band was lowered in 1996, as shown in Table 2, there were big disparities between taxes paid in superannuation funds and the marginal rates actually faced by low and middle income earners. Employer fund contributions (under a withholding tax SSCWT) and earnings in the fund were taxed at 33% making the regime tax penal for anyone on only a 21% tax rate.[13]

Perversely however, significant tax advantages from saving in employer-sponsored schemes for high-income superannuation fund members were introduced when the top tax rate was lifted to 39% in 2000. Nevertheless the 'salary sacrifice' option for high-income earners to exploit these advantages was not widespread. The Taxation (FBT, SSCWT and Remedial matters) Act 2000 imposed a fund withdrawals tax (FWT) to reduce the ability of high-income people to use superannuation vehicles as a short term means of avoiding the 39% rate.

In another tilt to the playing field, superannuation funds pay tax on capital gains where such funds are deemed to be trading rather than 'passive'. Individuals who invest on their own account are usually exempt from such a tax. In 2004, a report commissioned by government to determine an acceptable tax treatment of investment in New Zealand recommended the removal of capital gains tax on non-passive managed funds to address this anomaly (Stobo 2004).[14]

Table 2 New Zealand Tax Schedule for Personal Income Tax

Bracket	Effective marginal tax rate* 1988-1996	Effective marginal tax rate* from 2000
$0-9500	15	15
$9501-30895	28	21
30,895-38,000	33	21
$38,001-60,000	33	33
$60,000+	33	39

- **Includes the low income earner's rebate**

Despite the best endeavour of a working party (TOLIS, 1997) to resolve the marginal tax rate issues, there were no easy answers. In 2004 a partial solution was introduced so that employers could use the marginal tax rate of the employee for the tax on employer contributions. The option was voluntary and did not address the over-taxation of fund earnings for employees on tax rates of less than 33%. In 2005 it was announced that schemes could also, if they chose, impute investment income to individual members, but again this is voluntary and cannot easily apply to defined benefit schemes.

[13] A complexity is noted for many middle income earners whose marginal tax rate is effectively much higher than 21% due to the abatement of family assistance payments.
[14] Despite the expense, the government has indicated a willingness to address this issue by 2006.

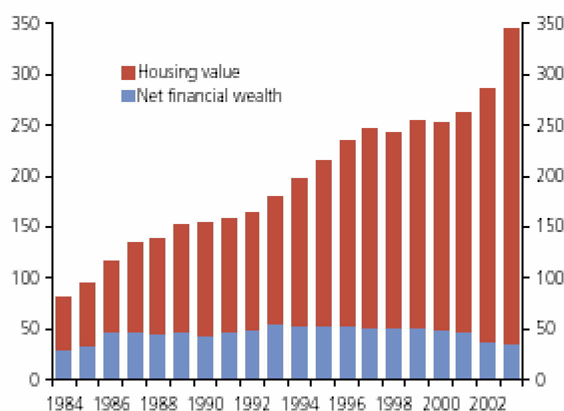
The 'level playing field'?

> *New Zealand's tax system is soundly based and among the most neutral in the OECD. Thus, it already provides a good supporting framework for an efficient allocation of resources.(OECD, 2002)*

Despite praise from the OECD[15], the New Zealand experience shows that the pursuit of tax neutrality in the treatment of savings has not only been difficult to achieve in the absence of flat tax, but is also illusory when other savings vehicles such as housing are taken into account. Significant biases towards investment in housing arise from the non-taxation of the imputed rent in owner-occupied dwellings, the tax-free nature of most capital gains by individuals deemed not to be traders, and the tax regime for rental income that allows deductibility of full nominal mortgage interest and other write-offs such as depreciation.[16]

New Zealanders have proportionately more of their savings tied up in housing than in other countries (Skilling & Waldegrave, 2004). Since the tax changes in 1990, the value of housing assets has increased markedly relative to net financial assets as shown in Figure 1 (Bollard, 2004)

Figure 1: Net wealth of households ($billions as at December)



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While the OECD has consistently endorsed the New Zealand approach to tax reform, more recently it has criticised the lack of a capital gains tax. Housing, especially, has remained tax favoured. Despite the best endeavours of the McLeod Committee who examined the case for taxing imputed rent and discussed advantages that might flow from a Risk-Free Return Method (RFRM), there has been no political interest in levelling the playing field for housing (McLeod, 2001).

4. Reintroduction of tax incentives?

Review taskforces during the 1990s and 2000s supported the voluntary, tax unsubsidised retirement savings regime in New Zealand (Periodic Report Group, 2003; 1997a; Report of The Taskforce on Private Provision for Retirement, 1992).

[15] The tax neutrality of the New Zealand tax system has found favour with the OECD since 1989.(St John & Ashton, 1993, p22).
[16] Note the depreciation claimed may eventually become taxable on the sale of the rental property.

Nevertheless, there has been widespread anxiety about whether New Zealanders are saving enough, both individually for retirement and as a nation. New Zealand is heavily reliant on foreign savings with persistently large current account deficits and accumulated overseas debt. While this issue is a national savings problem involving more than just the household sector, concerns have increasingly been voiced about New Zealanders' poor personal savings habits.

A net worth survey showed that mean assets for individuals over 65 was only $186,000 (Statistics New Zealand, 2002). The median was $113,000 so that the distribution is highly skewed, and on the surface New Zealanders appear less well prepared for retirement than their counterparts elsewhere.[17]

In 2001 the Government reviewed the basis on which private savings are taxed or otherwise encouraged within the parameters that:

> *...any incentives would have to meet the requirements that they were fiscally affordable, did not crowd out other government spending and added to overall savings levels, rather than merely shifting the form of savings'. (Cullen, 2001b)*

A range of complex suggestions was made. The Minister of Finance, Dr Cullen initially proposed a 'parallel option' to the current taxation regime for superannuation, under which contributions continue to be paid from taxed income, investment earnings are tax free, and benefits are partially taxed. This was referred to as TEt (or Taxed, Exempt, and partially taxed) compared to the current TTE. There was to be a limit on the annual contributions and a limit on the amount that could accumulate within the scheme. The scheme would be required to lock in the benefits for a period or until a specified age is attained and to provide a portion as a pension.

There were concerns in the industry that compliance would be difficult and would require new schemes distinct from existing schemes. A major, concurrent review of the tax system examined the case for tax incentives in depth, and recommended that they not be reintroduced(McLeod, 2001).

A report of officials noted that it was difficult to ascertain the exact goals government wanted to achieve and that none of the options examined (tTE,TET,Tet) were able to meet all the objectives the government sought (The New Zealand Treasury, 2001). As in the past when tax incentives have been considered it has been difficult not to conclude that the advantages are likely to go to the people who least need an incentive to save, and that overall savings are unlikely to be enhanced. Figure 2 shows the skewed distribution of financial saving that persuaded the committee that tax concessions would be both highly regressive and ineffective.

On balance the Treasury report indicated that if a tax incentive were to be reintroduced then a very limited one (with a cap on contributions of $1000-2000) with an upfront incentive was best:

> *Officials do not suggest that an upfront incentive is likely to make savings more realistic for many low to middle-income households. Such an incentive*

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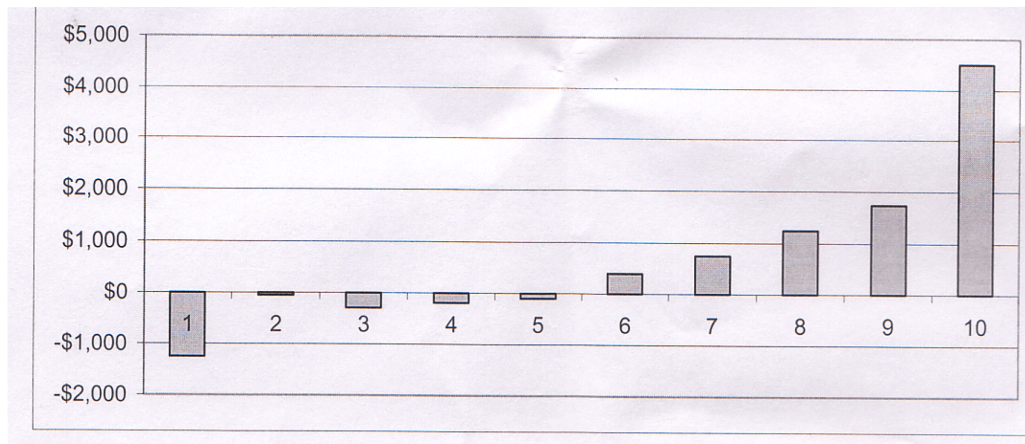
[17] Some preliminary Treasury research has argued however that given the substantial wealth implied by the New Zealand Superannuation pension itself, *on average*, people are likely to already be saving enough for optimal income smoothing (Scobie, Gibson, & Le, 2004) The results however are based on averages and rely on particular definitions of what constitutes savings and a range of assumptions such as perfect annuitisation

scheme is simpler to promote and explain however, which may increase its utilization amongst households with little to no current savings. While no incentive may be likely to appreciably increase savings, Officials prefer a tTE scheme to a TET or TEt incentive because it would result in fewer harmful distortions to investment patterns, it would have a lower fiscal cost and it would create less room for avoidance and tax planning behaviour. (The New Zealand Treasury, 2001b, p.1)

In other words, Treasury were not enamoured of the idea of reintroducing tax incentives at all.

Figure 2 Annual household financial saving by income decile 197-98



Source: (The New Zealand Treasury, 2001)

The Labour/Alliance government continued to discuss saving incentives, but in January 2002 it decided that tax incentives for private saving would not proceed in the current year after all citing reasons of fiscal tightness.

[Those consulted] agreed that the best option was a tTE system under which fund contributions would be taxed at a reduced rate. But Treasury estimates that the costs of introducing this would range from $50m to $171m a year depending on the design details. The government simply does not have this kind of money available in the 2002 Budget. (Cullen, 2002)

In February 2002, the National party announced its policy to reintroduce tax incentives. The shape of these would appear to reflect the minimal tTE model proposed by Treasury. But in the May Budget, the Labour government endorsed the status quo of no upfront tax incentives, and later went on to win the election.

The government is not considering upfront tax incentives. These are likely to have to be very large - with fiscal costs running to many hundreds of millions of dollars a year - before they have any desirable effect on overall savings. Their abolition in the mid-1980s represented sensible tax policy on both equity and efficiency grounds. (Minister of Finance, 2002a)

5. Retirement incomes in New Zealand today

For New Zealanders of modest means and with limited lifetime earnings, New Zealand Superannuation provides a replacement income sufficient in most cases to keep pensioners out of the poverty statistics. Using the Ministry of Social

Development's definition of the poverty line[18], 51.2 % of economic units[19] supported by an income-tested benefit are in poverty but only 7.6% of those reliant on New Zealand Superannuation (Ministry of Social Development, 2005).

For the few who do experience hardship, and there will always be some, especially if there is ill-health and housing problems, the poverty is not higher among women than men (Fergussen, 2001). This is in stark contrast to the UK pensioner poverty picture where one on five is under the poverty line and women are disproportionately affected. A similar picture emerges for Ireland, where pensioner poverty is higher than for the population as a whole and higher again for pensioner women (McCashin,2005).

As discussed in Appendix 1, the government has sought to protect New Zealand Superannuation with legislative assurance that it will be secured for everyone in the future. Nevertheless the 65% floor represents an historically low rate for the pension as Appendix two discusses.

Although not the topic of intense debate to date, middle-income people may find their ability to secure a reasonable replacement rate significantly compromised by the demise of private pensions as a fundamental component of the retirement income mix. In part this is the outcome of the general decline in membership of occupational superannuation schemes which in turn reflects the changed tax environment since 1990.

Active membership of private sector employer and government employee schemes dropped from 22.6% of the employed labour force in 1993, to 14.1 % in 2003 (see Table 3).[20] Coverage in private employer schemes shrank from 18.5% to just 11.4% while coverage in the public sector dropped from 4.1% to 2.7% largely reflecting the closure to new entrants of the Government Superannuation Fund (GSF) in 1992. A new scheme introduced in July 2004 for state sector employees, discussed below, lifted this figure to around 4.6% in 2004.

Table 3 Active Membership of Occupational Schemes 1993-2003

Year	**Private 000's**	**Government 000's**	**Labour force, 000's**	**Private**	**Total**
1993	273	61	1,475	18.5%	22.6%
1995	254	58	1,608	15.8%	19.4%
1997	244	52	1,731	14.1%	17.1%
1999	222	49	1,741	12.8%	15.6%
2001	218	45	1,806	12.1%	14.6%
2003	217	51	1,898	11.4%	14.1%

Source: Government Actuary (Government Actuary, 2004)

Within this overall decline, membership of employer-sponsored registered defined benefit schemes fell markedly more than membership in defined contribution schemes,

[18] The poverty line is 60% of disposable household income after housing costs.

[19] Economic Family Unit: consists of an adult, a partner (if any) and/or dependent children (if any). A household may contain more than one economic family unit

[20] Retail superannuation schemes expanded at this time, as individuals were encouraged to take responsibility for themselves. Between 1990 and 2000 retail membership increased from 236,062 to 447,858. The accumulated assets in occupational schemes continued to rise, but very slowly and the balance shifted away from defined benefit to defined contribution assets. (Government Actuary, 2001)

reflecting not just the changed tax environment in New Zealand, but a world-wide trend (Disney & Johnson, 2001, pp 23-27). Labour market changes probably make this shift inevitable. As Barr (Barr, 2001) for example argues, albeit reluctantly, the new realities of the modern world, increasing globalisation, labour market mobility, and different family structures including more divorce, all act to make defined contribution plans more practical.

The growing problem of to do with the lump sums generated in defined contribution schemes is driving increased international attention to the annuities market. This interest has not yet been manifested in New Zealand and the private annuities market continues to stagnate (St John, 2003).

Along with a sharp decline in occupational schemes generally, 'total remuneration' packages became more common in the 1990s. In these, income is grossed up and the employee chooses the nature of the savings instrument and how much to save in it, while the employer's role may be limited to facilitation and/or administration only. However, the Minister of Finance signalled some dissatisfaction with this approach portending changes discussed below:

> *I do detect a change of attitude. The 1990s were a high watermark for individualism. A part of that was the rise of the idea of the total remuneration package. Employers recruited on a set fee for service and the worker did what he or she decided they wanted to with the wage. While this is fine in theory, there is a growing body of research that suggests that the hands-off approach works against some of that total remuneration going into long term saving.(Cullen, 2003)*

New initiatives for private provision

In the state sector itself a new 'State Sector Retirement Savings Scheme' commenced in 2004 as a portable defined contribution scheme in which the government as employer matches contributions up to 1.5% of gross salary in the first year rising to 3% in the second year. There is a wide choice of investment styles, risk/return options and fee structures. Contributions may increase in future years to a target of 12% of gross salary (6% employer, 6% employee), although there has not been a firm commitment at this stage.

Employees of government departments and teachers who are not part of an existing employer-subsidised scheme may join.[21] By 2004, the take-up by more than 45% of eligible employees had surpassed expectations, raising the possibility that the scheme would be extended to other public sector employees such as nurses.

The government has promoted the new scheme as a role model for private sector employees, but it is not clear how private sector employers can match a subsidy whose source is the general taxpayer. In light of the generous implied subsidy from taxpayers in general, it might have been expected that the state would be looking for some social return in the drawdown phase. While it is true that the sums are locked in until retirement age, the opportunity to link the new scheme to an appropriate new annuity product was not seized.

[21] Existing schemes that were set up to replace the old Government Superannuation Fund scheme will integrate over time with the new scheme.

In mid 2004 the government appointed a working group to report on the design of a generic workplace savings product. It was taken as given that it was desirable to have such a product even though there were to be no tax incentives involved (Savings Product Working Group, 2004). Submissions were invited on their recommendations and many of these questioned the need for such a product.[22] There were many difficult issues, such as whether there should be automatic enrolment, how part-time and casual workers might be included, rules around early withdrawal, management and approval of schemes and how all this could be achieved in a tax neutral environment.

While the working group assumed that the government would not introduce any tax incentives for the generic product, it was clear that 'sweeteners' as they are called in the report were likely to be necessary. Private providers argued that any such incentives would undermine existing employment-based schemes and would be a costly mistake, both ineffective in substantially increasing saving and cumbersome to administer.

The Kiwisaver

The 2005 budget finally announced a work-based generic scheme, the Kiwisaver, to be introduced in 2007 (see Box 1). This scheme based on the premise that people are more likely to commit to saving regularly if they are automatically enrolled rather than deciding whether to opt in.

A flat $1000 government contribution is provided as set out in Box 1. This 'sweetener' eschews the problems of the regressivity of tax concessions and enables the TTE tax regime to remain unaffected. Unfortunately it is both costly, and may be largely ineffective in encouraging saving among those who otherwise would not be saving. Many of the fears expressed prior to the announcement have not been assuaged.

Unfortunately too, many potential low income contributors have significant debts including student loans and mortgage debt. While there are opt-out provisions and possible contributions holidays, these add a further raft of complexity. The detail of who will qualify and on what basis is yet to be released. The government will subsidise fees and compliance costs but whether saving minimal contributions in high cost managed funds is desirable either from an individual or a societal point of view is debateable.

An attractive feature of Kiwisaver is its portability and low employer compliance costs. But employers do not have to contribute so that the Kiwisaver may be no better than a low return bank deposit for many low income savers. The consultation phase for this new initiative is short with draft legalisation expected in November 2005, passage of the Act in 2006 and full implementation in 2007.

[22] Including for example, submissions from the New Zealand Business Roundtable, the Association of Superannuation Funds of New Zealand, Tower Corporation, and private consultant, Len Bayliss.

Box 1 KiwiSaver

- Kiwisaver is a voluntary, work-based savings scheme administered by the Inland Revenue Department using the existing PAYE (pay as you earn) tax system. Employees will be automatically enrolled into KiwiSaver when they start a new job. They will have three weeks to "opt-out" and must advise Inland Revenue of their decision. Scheme enrolment is not automatic for workers under 18, or for existing employees. They will be able to join if they wish. Self employed people and beneficiaries will also be able to join but need to make payments directly to Inland Revenue.
- Employees' contributions will start from the next pay day after eight weeks with an employer. Deductions from wages are at a rate of 4 percent of gross salary, unless the individual opts for the higher rate of 8 per cent. These are held by Inland Revenue for an initial eight-week period during which the employee can seek financial advice and select a fund provider. Savers will be able to select their own fund and can change fund providers, but can only have one provider at any time. Those who do not specify a fund will be randomly allocated to a default provider.
- Savings are primarily for retirement and "locked in" (ie will not be accessible) until the age of eligibility for NZ Superannuation, currently 65, except in cases of: financial hardship, permanent emigration, or after a minimum of three years, to contribute toward a deposit on a first home. However savers can stop contributions for up to five years at a time by applying for a "contributions holiday". Contributions resume at the end of the five years unless the individual applies for a further "contribution holiday".
- Employers do not have to choose a KiwiSaver scheme for their employees but will have responsibility for deducting employees' contributions and forwarding them to Inland Revenue along with PAYE.
- Existing superannuation schemes will have the option of converting to KiwiSaver, subject to certain criteria. Members of other schemes may choose to open a KiwiSaver account, instead of or as well as, their existing scheme.
- The automatic enrolment provisions will not apply in workplaces where the employer is already running a work-based scheme, provided the scheme is: portable open to all permanent employees, and has a total contribution rate (employer plus employee) of at least 4 per cent.
- The Government will: make an upfront contribution of $1000 per person, to be "locked in" until the recipient reaches the age of eligibility for NZS or for five years, whichever is the greater; provide a fee subsidy after three years of saving; offer a first home deposit subsidy of $1000 per year of membership in the scheme, up to a maximum of $5000 for five years.

Source: derived from http://www.ird.govt.nz/kiwisaver/summary/

6. Discussion and lessons for other countries

The strength of the New Zealand approach has been the simplicity and effectiveness of the public universal pension. Wide coverage is assured and poverty concerns among the old have been effectively addressed. The voluntary private saving regime has also had the advantage of simplicity and is more vertically equitable than would be a system of tax incentives. In all of this there may be lessons for other countries, especially, but not only, developing ones (St John & Willmore, 2001). The abolition of tax incentives poses some difficult transition issues as the New Zealand experience has shown and these may prove insurmountable in other countries.

Once tax concessions are removed however, the New Zealand experience shows that it is difficult to mount a rational argument for going back. However it is possible that poorly defined debates over savings may lead to pressure to abandon some of the advantages of simplicity and effectiveness in the elusive pursuit of additional private saving.

Nevertheless it has been little acknowledged in New Zealand that tax incentives, by allowing regulations, can be used to secure wider social goals. This may be because New Zealanders are reluctant to revisit the world of rules and regulations that proved so cumbersome pre-1988 (St John and Ashton, 1993). Thus there has been virtually no discussion of how tax incentives, if accompanied by appropriate regulation, might exert a socially beneficial influence on the nature of the retirement saving. Indeed the power to ensure regular retirement income as opposed to lump sums may be the only economic justification for such concessions.

Arguably, the weakest component of New Zealand's policies for retirement is the lack of any income replacement objective for middle income people. To date, the role of private annuities and how best to encourage socially appropriate drawdown products has received negligible attention (St John 2003). Perhaps New Zealand has a unique opportunity to design and even subsidise such products where social advantages might accrue. For instance, a limited value, attractive annuity product to supplement New Zealand Superannuation for middle income New Zealanders might have all or most of the following features:

- Be good value for money;
- Be inflation-proof;
- Provide flexibility and be less of a lottery than is currently the case;
- Allow, in suitable cases, the use of part of the equity in owner-occupied housing for the annuity purchase;
- Be gender neutral, given that the majority of both men and women do not experience the extremes of longevity;
- Include insurance for catastrophic care costs, including long-term care;
- Insure to some degree against growth in living standards.

It is evident that the private sector cannot provide a product that meets most or all of these criteria on its own. Examination of annuity markets overseas reveals that the state usually plays a substantial role in the successful development of these markets (for example, Mitchell & McCarthy, 2002). One of the advantages of the tax neutral approach to retirement saving accumulation in New Zealand is that it leaves open the

possibility of transparent government subsidisation of the decumulation phase to meet explicit social goals. This mettle has yet to be grasped.

There are also potential lessons to be learned around the role of pre-funding (see Appendix 1). While it might appear that the Fund and its earnings, by supplementing tax revenue, can reduce the burden on workers, the effect is illusory. Debates about the division of future output between the old and the young, about the size of shares and the shape of NZS are not resolved by pre-funding. Regardless of where funding comes from the cost of the pension is the same, as is the implied sacrifice of the working-age population. The cost is the consumption of the old (the pension benefits paid). The revenue of the Fund could be used to meet the needs of the young: a point made clearer by imagining the Superannuation Fund is not ring-fenced for superannuation, but simply represents additional assets on the state's balance sheet (paid for by the sacrifice of all workers). Nevertheless, despite these economic arguments, it must be conceded the New Zealand in the mid 2000s is enjoying a period of unprecedented political stability round superannuation policy.

The New Zealand retirement income system provides a largely satisfactory basic income for all citizens regardless of contributions with a high degree of simplicity and cost effectiveness. New Zealand is well placed to grow old but there will be undoubted pressures on the pension system as the baby boomers retire and eventually contribute to rapidly rising costs in general health and for long–term care. There are also warning signs that the expectations of many middle income retirees for replacement income may be disappointed. It can be expected that individual savings and how best to encourage them without reverting to the failed tax incentive policies of the past will dominate the pensions discourse for the rest of the 2000s.

Appendix 1

The emergence of the New Zealand Superannuation Fund

The Labour party campaigned on their own superannuation policy in 1999, essentially dismissing any prospects for a resuscitation of the Accord (see Appendix 2). After the election, their plans for introducing an element of pre-funding into the state scheme culminated in the New Zealand Superannuation Act 2001, Part 2 of which establishes the Fund.

The Fund is expected to ease the transition from pensions costing a net 3.6 per cent of GDP to a cost of around 8 per cent of GDP by the year 2050 as the demographic profile changes and the proportion of the population aged over 65 doubles. The contributions to the Fund are made out of government's fiscal surpluses and there are no individual contributions or additional or earmarked taxes. Assets will build up for around the next 25 years when they will be run down along with fund earnings to meet part of the costs of NZS from that time.[23] In the meantime the Fund is managed at arms length by a board of appointed trustees called 'Guardians of the Fund' who use professional fund managers to invest the money both domestically and abroad. This precludes the government using the Fund for other purposes or directing the portfolio mix.

While officials have downplayed any significant macro implications, the Minister of Finance, Dr Cullen has claimed that the Fund would enable higher national saving compared to the counterfactual of tax cuts. Augmenting national saving in turn was expected to take the pressure off the current account deficit (Cullen, 2000).[24] It was also argued that by allowing the Fund to invest in a diversified way including overseas financial assets, the government would improve the financial position of the public sector as a whole.[25] While it could be argued that the government could diversify its assets without the need to set up a fund, the Fund was claimed to have the additional benefit that it would "give people confidence that New Zealand Superannuation could be paid in the future" (Cullen, 2000).

The contributions to the Fund required each year are based on a forty-year rolling horizon, and critically depend on the assumed rate of return in the Fund. The expected tax smoothing is shown in Figure 3 below where a 9.4 per cent gross return has been assumed. The lower the projected rate of return, the higher taxes must be until 2025, for lower net gain once the Fund begins to run down.

Any gain from tax smoothing is conditional on strong fiscal discipline so that 'expenditure creep' does not become a problem in the face of an improving balance sheet. It is also dependent on the assumption that government's investment of the surplus will generate returns significantly above the costs of borrowing.

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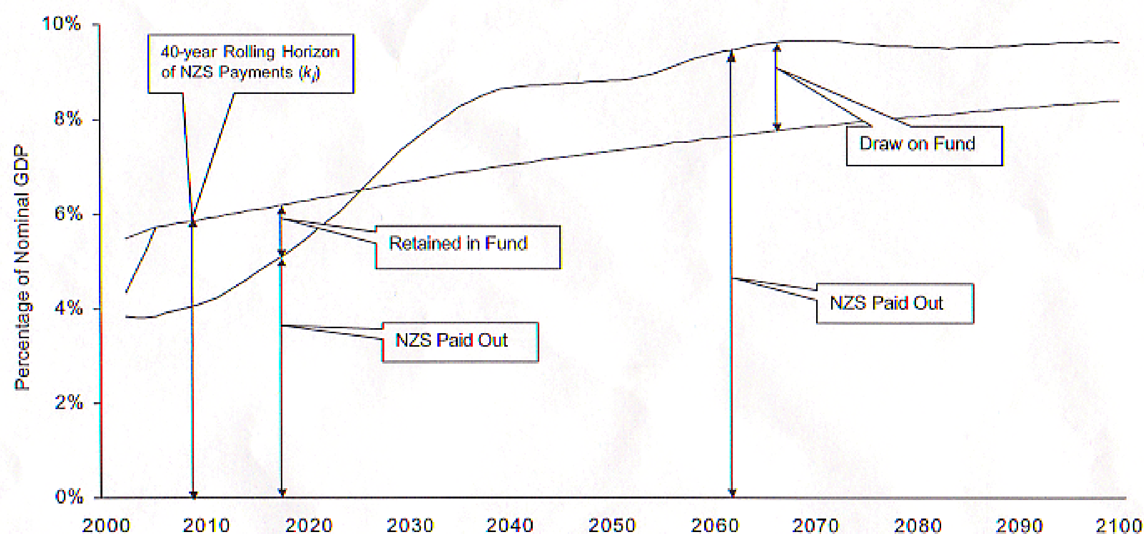
[23] There are a series of working papers that detail the assumptions and the projections for the fund, see for example The New Zealand Treasury (eg The New Zealand Treasury, 2000). Also see the Treasury web site: http://www.treasury.govt.nz/

[24] The concern about the current account deficit and the need to address it with more saving is not however reflected in all Treasury working papers (eg Kim, Hall, & Buckle, 2002).

[25] Already there had been moves to free the Government Superannuation Fund (for state sector employees) from restrictions on international asset holdings.

Figure 3: The New Zealand Superannuation Fund projected contributions



Source: McCulloch and Frances (2001)

The Fund did not have full political support when it was introduced. The Green, National and Act parties voted against it, and the Labour/Alliance vote was only sufficient to ensure the passage of the Bill with the help of the United and New Zealand First parties. Unexpectedly in late 2004, apparently in the interest of stability around superannuation policy, the National opposition decided to lend its support to Part 2 of the Act that sets out the Fund legislation. Thus the Fund has not been a feature of the political debate in the 2005 election year.

Notwithstanding this unaccustomed political harmony, fundamental scepticism as to the purpose of the Fund and whether it can deliver on the promises claimed for it may be justified. The objectives of the legislation are not found in the Act itself, but have been reflected in numerous speeches and press releases from the Minister of Finance[26], for example:

> *The Fund will allow us to maintain a universal pension that guarantees a basic minimum standard of living for superannuitants. It will finally give superannuitants some certainty about what the government will be able to provide for them. And they will know that they have to provide for themselves if they want a higher standard of living than New Zealand Superannuation offers.* (14/12/00)

Critics have wondered how a scheme that is expected to provide at most 14 per cent of the cost of the scheme[27] could ever provide such certainty or security. It is also clear that while the contribution to the Fund is the first call on the operating surplus in the government's budget, the need to contribute to the Fund means that borrowing for other capital, including student loans, is higher than it would otherwise be. The intent

[26] See website of the Minister of Finance: http://www.executive.govt.nz/minister/cullen/index.html

[27] The controversy over the actual saving achieved hinges on how the tax revenue from the fund investments is treated. The Minister of Finance insists that this revenue is part of the return to the fund so that the funds should supply not 14 per cent, but around 25 per cent of financial costs of New Zealand Superannuation. Either figure is conditional on the assumed rate of return being achieved.

has been, clearly, to implement the Fund and entrench it so that it would be difficult to dislodge:

> *My view is that the great and enduring consensuses on superannuation policy, like those in the USA and in Australia, have followed rather than led new schemes. They have followed by the law of political gravity. As the funds have grown, and as they have been seen by the population as a whole to be a clear indication of where their pensions are going to come from, they have become too strong a force to try and deny.* (Cullen, 2001)

Other critics have pointed to the opportunity costs of the Fund. Money invested in the Fund may be at the expense of many other worthwhile fiscal goals (Donald, 2001; English, 2001). Likewise, high returns to fund earnings have been assumed in the projections that may prove unrealistic. If the promise of not increasing taxes for current payments of New Zealand Superannuation cannot be met, it is questionable whether the public will continue to believe the New Zealand Superannuation Fund enhances their security.

To date there have been no major controversies over the governance of the Fund with a clean bill of health pronounced in late 2004 in the first audit of the Fund (Eriksen, 2004). The Guardians avoided the worst of the share market declines by not investing externally until 2004, but some caution was signalled in the audit concerning the asset allocation:

> *The investment performance of the Fund to 30 June 2004 has been satisfactory. The annualised rate of return for the 9 months ending 30 June 2004 was 10.4%, against a target return of 7.8%. Since the Fund has not been invested for a long period, these returns are not particularly significant and should be regarded as indicative only. For the future I recommend the Guardians increase the benchmark weighting in alternative assets and decrease the weighting in international equities. This should help meet the demanding performance target by spreading investment risks more widely. Extensive research into alternative asset classes is needed to maximise the effectiveness of the implementation of these areas of investment.(Eriksen, 2004)*

Appendix 2

The rise and fall of income testing of the state pension

After a period of political turmoil in superannuation policy in the late 1980s and early 1990s, a taskforce was appointed to sort out options for private provision (Report of The Taskforce on Private Provision for Retirement,1992). The outcome of that exercise, the multiparty agreement known as The Accord (appended to the Retirement Income Act 1993), was signed in 1993 by the three major parliamentary parties: National, Labour and Alliance.[28] This cemented in the voluntary tax neutral arrangements for private saving and New Zealand Superannuation as a flat rate, taxable pension of between 65 to 72.5 per cent of the net average wage for couples, linked to private saving by a surcharge or by progressive taxation with similar effect (St John, 1999, p.285; St John & Ashton, 1993, p 168).

[28] Later, in 1994, these three were joined by the United Party.

When the surcharge was first introduced in 1985 the top tax rate was 66%. Later as the top rate came down to 48% and then 33% in 1988, it could be argued that the surcharge restored a degree of progressivity to the tax system, for better-off pensioners at least. In contrast to the income test for other social welfare benefits, based on the joint income of a couple, low thresholds and high abatement rates, the surcharge was generous. It was best described as an 'affluence' test based on individual income with a generous exemption and low abatement rate (St John 1999). In its last year of operation, it affected only around 10-15% of the retired. Nevertheless the surcharge was the focus of much political contention from the time of its introduction.

The security and stability offered by the Accord was challenged in 1996 by the formation of a coalition government. The emerging coalition document between New Zealand First and National agreed to the abolition of the surcharge and a referendum on compulsory saving. Compulsory saving was however overwhelmingly rejected by the public in 1997 by 92.8 per cent of voters (St John, 1999).

In the meantime, the framework set out in the Accord was endorsed by a comprehensive review (Periodic Report Group, 1997a). This review, the first of the periodic reports required under the Retirement Income Act 1993, suggested that parametric changes to the age and the level, and the introduction of some kind of integration such as formerly had been provided by the surcharge, should be considered in the medium term. It also suggested that the Accord process needed to be revived and suggested a framework for political stability to be re-established (Periodic Report Group, 1997b).

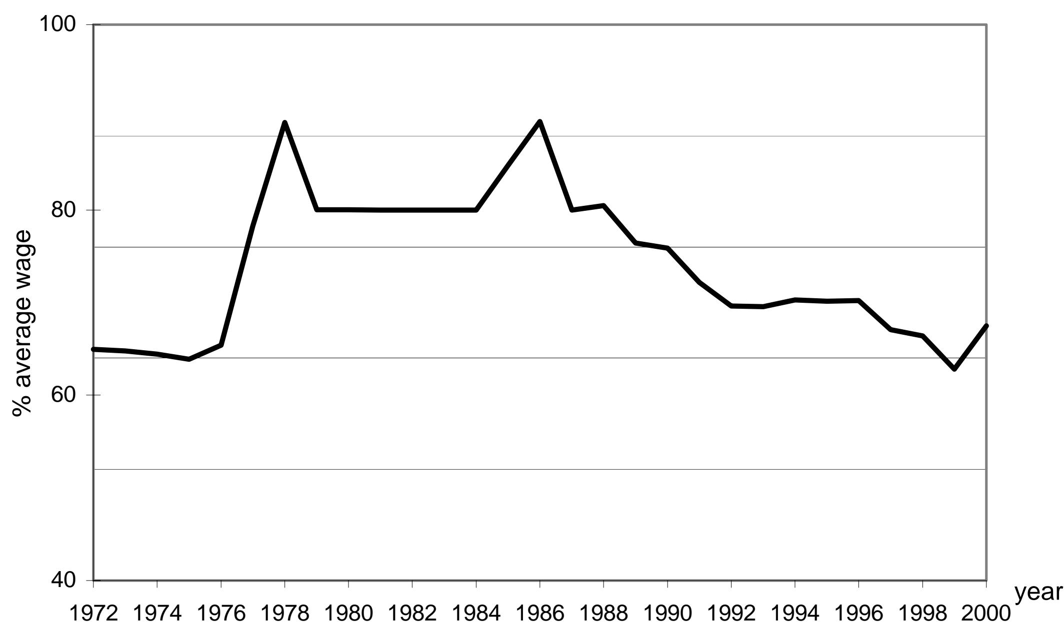
The abolition of the surcharge in 1998, even if the support of all the political parties was finally obtained, was a critical factor in the demise of the Accord. The surcharge had been the glue holding the left and right together. It represented a hard won compromise between, on the one hand, a universal pension for all, as desired by the left, and on other hand, a means-tested, subsistence benefit as desired by the right. The pension became vulnerable to attack, as abolition of the surcharge left lowering the level or raising the age of entitlement as the only feasible mechanisms to save costs.

That vulnerability was well demonstrated in late 1998. The indexation provisions under the Accord had required that New Zealand Superannuation be adjusted by prices, but once the floor of 65 per cent of the net average wage (for a couple) was reached then price indexation should be replaced by wage indexation to maintain the 65 per cent relativity. In a surprise move, just when the wage-band floor had been reached, the National government announced the reduction of the wage band floor to 60 per cent.

Figure 4 below shows the way in which the indexation formula had resulted in a decline in the relative value of New Zealand Superannuation over the 1990s until the floor of 65 per cent was breached in 1998. The revenue formerly provided by the surcharge was about $300m a year (Periodic Report Group, 1997a, p.48) and lowering the floor to allow the relativity to drop over time was one way to claw back around the same amount of foregone revenue. Of course the distributional implications of the change to the floor were quite different from that of the surcharge.[29]

[29] Some evidence of poverty among the elderly was emerging as the relative value of the pension fell (Stephens, Frater, & Waldegrave, 2000).

Figure 4: Net rate of pension for a couple as a per cent of net average earnings (men and women) 1972-2000



Source: Derived from Preston (2001)

The sudden unilateral announcement of the change to the floor was universally condemned. Any vestiges of security that the public had that there was an Accord process for agreed and measured change of retirement income policies disappeared. The change to the floor lacked any underpinning of data about living standards and was made without consultation.[30] There was no longer any secure link to wages as there was nothing to prevent further reductions to the floor once the 60 per cent level was reached. The Asian crisis was cited as the justification, but later the National party accepted that a political mistake had been made. [31]

After election in 1999 the Labour/Alliance government immediately reversed the change to the wage band floor, which had seen the pension for a married couple fall to 62.8 per cent of the net average wage as illustrated in Figure 4 above. From April 2000 the net pension of a married couple was returned to just over 65 per cent of the net average wage, restoring confidence that the public pension would once again move in tandem with the average wage. While the Labour/Alliance government also raised the top marginal rate of tax on income from 33 per cent to 39 per cent, there was no suggestion of a return to any kind of income testing such as that provided by the surcharge.

[30] The Periodic Report Group's 1997 report recommendations were ignored throughout 1998.

[31] National now support the current arrangements for New Zealand Superannuation at no less than 65 per cent of the net average wage at age 65 for a married couple (for example see election speeches at http://www.national.org.nz).

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