

What Has New Zealand's Retirement Policy Framework to Offer the International Debate?

Introduction¹

New Zealanders don't realise that they are regularly regarded in other countries as world leaders, not just in sport.

Inaugural New Zealander of the year in 2010, Ray Avery, points to the 'never say it can't be done' attitude that has produced many astonishing results in science. In social policy too we have often been ahead of world thinking. One very under-trumpeted innovation is our retirement incomes policy, which, along with ACC, is unique on the world stage.

New Zealand Superannuation (NZS), the foundation of New Zealand's retirement income system, is a universal, pay-as-you-go (PAYG), taxable age pension, partially pre-funded by accumulated assets in the New Zealand Superannuation Fund. Alongside NZS sits KiwiSaver, the world's first national auto-enrolment saving scheme. New Zealand's success with the 'soft compulsion' of automatic enrolment has been and is continuing to be an influence in the design of opt-out schemes in the UK, Ireland and the United States. Seven years on, this retirement saving scheme both is well accepted by the public and has certain clever design features.

If KiwiSaver is made compulsory, as some powerful lobbies propose, there are large complexities to resolve, including the future role of the universal state pension, NZS. It is timely to reflect on the really good things about our retirement

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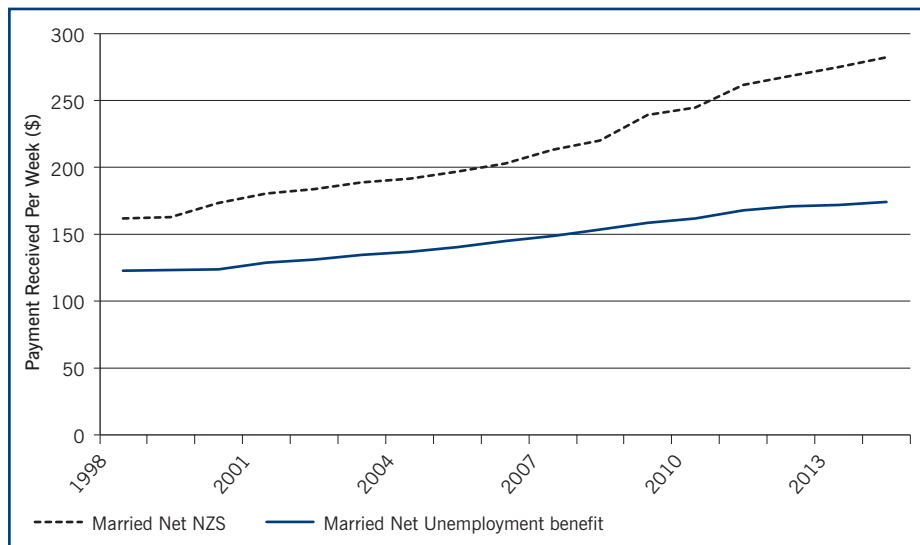
Table 1: New Zealand Superannuation rates at 1 April 2014

Category	% net average wage*	Annual rate NZ\$ (gross)	Annual Net Primary Tax	Annual Net 33% Tax
Single, living alone	43%	\$21,932	\$19,080	\$14,494
Single, sharing	40%	\$20,154	\$17,613	\$13,503
Married person or partner in civil union or de facto relationship (each)	33%	\$16,633	\$14,678	\$11,144

Source: Work and Income website: <http://www.workandincome.govt.nz/>

* Supplementary income- and asset-tested benefits may also be paid.

Figure 1: Married unemployment benefit vs NZS payments



incomes framework before making ill-considered changes. Looking to the future, this article suggests that New Zealand is in a unique position to build on this framework and offer leadership in helping solve some of the intractable issues around decumulation that are plaguing other countries.

New Zealand Superannuation

New Zealand introduced the old-age pension in 1898 to provide some protection for the deserving poor aged over 65. Over 100 years later, the retirement income framework has, at its foundation, a flat-rate, universal, taxable benefit, paid out of current taxation. Eligibility is from the age of 65 years, if modest residency requirements are met.² Under a current political agreement, the combined net NZS rate for a couple has to be at least 66% of the net average wage (33% per married person). Higher rates apply for single people either living alone or sharing accommodation (see Table 1). NZS is indexed annually via the Consumers Price Index until the wage

floor of 66% is reached, then net pensions rise with the net average wage.

Home ownership rates are high amongst the ‘baby boom’ generation, and thus housing costs are relatively low. When compared with basic age pensions internationally, and with other welfare benefits domestically, NZS is generous. As a consequence, New Zealand has low rates of pensioner hardship, despite high rates of hardship among those on welfare benefits (Perry, 2013). In the future, however, falling home ownership rates may affect the degree to which NZS is adequate to remove hardship for those who rent.

The level of welfare benefits, indexed only to prices since 1991 when the level of welfare benefits was cut, has fallen well behind NZS over time. Figure 1 illustrates how indexation of NZS to wages has continued to produce a growing gap between NZS and welfare benefits.

At retirement, while low-income earners do fairly well in an international comparison of public pensions, those on average earnings or above have relatively

low replacement rates if just the state pension is considered (OECD, 2011, p.125). Individuals have been expected to save privately, including in employer-sponsored superannuation schemes, to achieve higher effective replacement rates in retirement.

KiwiSaver

KiwiSaver is the world’s first national auto-enrolment saving scheme. It was initially conceived as a purely voluntary saving scheme, with a modest government-provided kick-start and a fees subsidy as ‘sweeteners’. KiwiSaver is fully portable. Thus, when members change jobs or they leave employment their scheme goes with them, providing a valuable simplification over traditional employer-based schemes. With some exceptions, all new employees are automatically enrolled in KiwiSaver if they are not already members. Currently, employees and employers each contribute 3% of wages. Enrolled employees can chose to opt out, or go on a contributions holiday after a year of contributions. (For more detail see St John, Littlewood and Dale, 2014, as in References an U Auckland website)

In 2014 the tax-funded subsidies comprise just the kick-start at \$1,000 for new members and a maximum \$520 government contribution for the first \$1,040 of annual member contributions. By international standards these subsidies are extremely modest, and their unindexed nature implies that they will fall in value quite quickly over time.

KiwiSaver is not designed solely as an employment-based scheme and is widely inclusive in its conception. This interesting feature has helped membership reach over 2.1 million,³ in a total population of 4.3 million.

Purpose of the scheme

The purpose of KiwiSaver has been, at times, confused. Is KiwiSaver’s purpose to benefit the individual in retirement? Is it to reduce the pressures on the economy of an ageing population? Is KiwiSaver supposed to solve the national saving problem? Or is it to expand the managed-fund industry? As long as the purposes are unclear, the scheme is vulnerable to the industry determining the design of the

scheme to meet its own objectives.

When KiwiSaver was first announced, the pivotal problem was seen to be one of low national saving. New Zealand is heavily reliant on foreign saving, with persistently large current account deficits and accumulated overseas debt. However, it was not clear that KiwiSaver was capable of lifting national saving.⁴ By the time the KiwiSaver Bill was introduced there was little mention of the current account deficit problem. The purpose of the KiwiSaver Act 2006 is described thus:

to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits. To that end, this Act enables the establishment of schemes (KiwiSaver schemes) to facilitate individuals' savings, principally through the workplace. (KiwiSaver Act 2006)

A reference to the hope that national saving will improve was buried on p.36 of the bill, and was not included in the act:

If the behavioural changes flow through into increased domestic saving, then economic growth may increase as more funds may be available to fund domestic investment and reduce New Zealand's reliance on borrowing offshore.

Law, Meehan and Scobie (2011) estimated that only about one third of the members' contributions to KiwiSaver are 'new' savings. Even if there is an impact on household saving, there is no guarantee that national saving (the sum of private and public saving) will improve. Importantly, while some of the rhetoric suggests that more KiwiSaver saving equals more investment and growth, in practice more saving from any source does not 'cause' more or better investment.

The Inland Revenue Department (2011) concluded:

It estimated, on the conditions and settings of the scheme at that time, that over the ten years to 2021 the net contribution of KiwiSaver to national savings would be marginal at best in the longer term, and may in fact reduce national savings.

The goals of improving retirement incomes and expanding national saving are inherently contradictory. Unless there is attention to the decumulation issues discussed below, KiwiSaver may simply

Benefit (DB) employer-based pension schemes to Defined Contribution (DC) or lump sum schemes and a decline in coverage. Importantly, even public sector DB schemes were closed to new members. The lack of impediments from a strong, tax-incentivised, employer-based superannuation culture allowed a clean roll-out of KiwiSaver as the new auto-enrolment national saving scheme in 2007.

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facilitate extra consumption by the better-off cohorts of a larger retired population, imposing more pressure on the working-age population.

Tax reforms and success of auto-enrolment

New Zealand is fortunate to have reformed its tax treatment of saving for retirement many years before KiwiSaver was introduced. Based on the principle of tax neutrality, the New Zealand tax reforms of 1988–1990 abolished all tax concessions for private retirement saving (St John, 2005, 2007). Contributions, whether by employer or employee, are out of after-tax income (T); fund earnings were taxed at a rate that proxies the individual's marginal rate (T); but withdrawals are a return of tax-paid capital and hence tax-exempt (E). Under TTE, saving for retirement the same as saving in a bank account contrasts with the heavily-subsidised EET treatment conventional for retirement saving in other developed countries, including Australia.

The removal of all tax concessions accelerated both the shift from Defined

when subsidies were greatly extended and enhanced on the eve of the introduction of KiwiSaver in 2007, there was never any intention of a return to the regressive tax concessions of the past. In the last few years these subsidies have been cut back, as detailed in St John, Littlewood and Dale (2014). Interestingly, it appears that once sweeteners have helped establish KiwiSaver they can be reduced with little impact, at least on the formal membership numbers.

In contrast to the ease of introduction in New Zealand, the UK and Ireland face two impediments in introducing their auto-enrolment schemes. First, they have retained their over-generous, unreformed DB schemes for public sector employees. Second, they have a proliferation of employer-based DC schemes. These diverse and poorly-regulated schemes are the beneficiaries of new auto-enrolment proposals. The OECD notes: 'much can be done to improve the design of DC pension plans and to strengthen retirement income adequacy in these plans' (OECD, 2012). In their *Ready for Ageing?* report

(2013) the House of Lords observed: 'the current DC pensions system is not fit for purpose for anyone who is not rich, or who moves in and out of work', and the need to 'tackle the lack of certainty in DC pensions and address their serious defects'. Compounding these issues, the very generous tax incentives for both DB and DC schemes are widely viewed as regressive, expensive and unnecessary. They are, however, difficult to remove, making a more rational framework like that in New Zealand near impossible to adopt.

Administration

A clever feature of KiwiSaver is the administration by a central collection agency, the Inland Revenue Department, with a unique tax identifier for individuals, who have one provider, that they chose, and

Monitoring and regulation

As a generic product, KiwiSaver has facilitated the umbrella regulation and oversight provided by the newly-established and fit-for-purpose Financial Markets Authority. While individual providers can offer separate products, they do not have to do the marketing and branding of KiwiSaver itself.

The flaws in KiwiSaver

Lack of a decumulation policy

Despite clever features, there are nevertheless substantial flaws in the New Zealand approach if it is assumed that income supplementation is the point of KiwiSaver. Currently, there are no rules as to how lump sum KiwiSaver funds accessed at age 65 must be run down over the retirement period. The danger is that funds will be dissipated far too early in

DC retirement schemes. However, the Conservative–Liberal Democrat coalition government announced in 2010 that it intended to end the requirement for DC pension scheme members to purchase annuities by the age of 75 (Blake, Cannon and Tonks, 2010). Noting that 'the annuities market is currently not working in the best interests of all consumers. It is neither competitive nor innovative and some consumers are getting a poor deal', the government has recently announced

a radical set of reforms which will allow people more choice over how they access their defined contribution pension savings. From April 2015 the government proposes to change the tax rules to allow people to access these savings as they wish at the point of retirement, subject to their marginal rate of income tax (rather than the current 55% charge for full withdrawal). (HM Treasury, 2014)

While it is clear that the market for annuities suffers many aspects of market failure, this decision is an extreme response, akin to throwing the baby out with the bathwater, and is causing great uncertainty within the industry. There may be a stronger case for better annuities rather than no annuities at all if the risks retirees face are to be addressed.

New Zealand's unique opportunity

With the provision of initially generous, tax-funded subsidies, the government might have been justified in imposing restrictions on spending the maturing KiwiSaver lump sums. That option was ignored, indeed not even discussed, and the opportunity was lost. It is hard to imagine that, retrospectively, compulsory annuitisation could now be imposed. New Zealand's annuities market is virtually non-existent, and under current tax rules and lack of government support, including inflation indexing or long-term bonds, a viable annuities market is unlikely to emerge (St John, 2009).

However, there are now opportunities for innovative thinking. New Zealand has a unique opportunity, with a largely tax-neutral TTE regime for accumulation, to design an explicit subsidy to recognise the

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one account. This has avoided the problems found in Australia, where many individuals have small sums in multiple accounts.⁵ In the UK, the National Employment Savings Trust (NEST) auto-enrolment plan has required a separate infrastructure for administration. Auto-enrolment can be into the employer's existing DC schemes, so that the NEST scheme is not a generic national saving plan.

Similarly, in the US auto-enrolment for employer-based 401(k) plans is voluntary, and no national clearing house is proposed. The WorldatWork and American Benefits Institute (2013) notes that: 'Ultimately, companies without auto enrolment are more likely to report lower employee participation rates than those with automatic enrolment.' When employees change jobs, 401(k) plans must be either retained with the former employer or transferred, giving an additional complexity not faced by KiwiSaver members.

retirement, with many people finding they live much longer than they anticipated. While New Zealand was an early adopter of the worldwide trend to shift risks from employers to individuals in private superannuation schemes, lump sum or DC schemes, including KiwiSaver, do not currently assist with the management of risks in retirement, as noted in the three-yearly review by the Commission for Financial Literacy and Retirement Income (2013). Specifically, these are the longevity risk that may see an individual outliving their capital; the risk of loss through poor investment; and the inflation risk (Cooper, 2014). Older people using capital too early in retirement and requiring a state subsidy for long-term care is also a risk for society.

In other countries there are emergent issues with the risks of the period of decumulation. The UK has until recently required mandatory annuitisation of lump sum savings from subsidised

gains to society from annuitisation, with few of the disadvantages of traditional tax incentives. One of several possibilities is the provision of a tax-subsidised limited value, inflation-adjusted, gender-neutral annuity to supplement NZS, purchased out of lump sum savings, including a suitable share of home equity if required (St John, Dale and Ashton, 2012). Let's call this annuity 'KiwiSpend' and imagine it as a generic product like KiwiSaver where private providers may play a role. Like KiwiSaver, KiwiSpend would be regulated by the Financial Markets Authority. It would require considerable state oversight, maybe even state provision, and subsidies to ensure that the annuity is inflation-protected, has low fees and the same capital cost for women and men, and includes long-term care insurance. As outlined in St John, Dale and Ashton (2012), a retiree's private saving, including KiwiSaver, could be used to buy an inflation-adjusted annuity of up to \$10,000 per annum, with an insurance rider that provides a trebling of the annuity if the recipient is assessed as needing residential long-term care. Success in New Zealand in designing such a product would once more attract considerable international attention.

The dangers of compulsion

The economic success of Australia is often attributed to the fact its superannuation scheme is compulsory. This is purported to have added to the capital base and encouraged domestic investment and strong growth (Brogden, 2013).⁶ Most KiwiSaver schemes by volume of members are owned by Australian-based financial service providers which have profited from Australia's compulsory retirement savings scheme. Despite the fact that KiwiSaver has been in place only since 2007, there are many calls, especially from the industry, to make it compulsory (Financial Services Council, 2014). In the lead-up to the 2011 election, and now in the lead-up to the 2014 election, the

Labour Party, the Māori Party and New Zealand First have suggested that making KiwiSaver compulsory would create more household saving and help solve New Zealand's economic problems. The framework for compulsion is in place; the major changes needed would be to remove the opt-out and the contributions holiday provisions.

There are two principal concerns about compulsion. First, it is undesirable to force those who cannot afford to save into the scheme, but it is difficult to design exemptions that are fair. Second, there will be inevitable pressures to integrate KiwiSaver with NZS. Given the contribution that taxpayers make to the accumulation of KiwiSaver benefits, it would seem logical that a future government might link KiwiSaver and NZS, either directly with the kind of offset suggested recently by Sir Michael Cullen (2013), or through a general means test much as in Australia. This may undermine the advantages of a universal pension, although there is a case that can be made for more claw-back on NZS using the tax system (St John, 2012).

Evidence from Australia suggests that compulsion has not stopped offsetting borrowing that sees retirees reach retirement with more debt. Also, Australians seem to retire earlier and collect their compulsory retirement savings as a lump sum. Compulsion, including of the employer-matching contribution, may please people who work in payroll and in financial service provision, but would also be seen as an additional cost to employers.

Conclusion

The New Zealand combination of universal taxable floor of income, NZS, combined with a voluntary auto-enrolment saving scheme to supplement, not replace, the universal state pension, is a successful model with a lot to offer the rest of the world. If current trends continue, KiwiSaver will continue to

supplant the role of employer-subsidised superannuation and retail schemes. While this may have an ambiguous effect on total saving (Savings Working Group, 2011), the scheme should not be judged on its presumed macroeconomic effects.

One of the clear advantages of KiwiSaver is that it is fully portable. This is facilitated by the unique tax identifier and the Inland Revenue Department acting as the clearing house. It is also inclusive, and the minimal tax incentives have been designed to limit regressivity. The major focus now ought to be firmly on improving the outcomes of security in retirement for those who have not traditionally enjoyed the advantages of work-based plans. If the needs of formerly disenfranchised people, including many women and other disadvantaged groups, are placed at the centre, the decumulation of KiwiSaver must be designed primarily to achieve meaningful amounts of extra, secure income for them to supplement the state pension, regardless of how long they live. New Zealand has a unique opportunity to design a generic KiwiSpend decumulation product that adopts some of the clever features of KiwiSaver, possibly also incorporating long-term care insurance (Retirement Policy and Research Centre, 2012). If successful it would be likely to become a beacon of light in an increasingly complex international pensions' world.

1 This article draws on work done in the Retirement Policy and Research Centre, Auckland Business School, University of Auckland, and in particular St John, Littlewood and Dale (2014). Susan St John was invited to Ireland and the UK in February 2014 to address key stakeholders on the design features of the New Zealand retirement framework. The author thanks Bob Stephens and Judith Davey for comments on an earlier draft of this article.

2 Ten years in New Zealand after age 20, with at least five of those after age 50.

3 See <http://www.kiwisaver.govt.nz/statistics/ks-annual-statistics.html>.

4 The best thing the government did during the upswing of the six years preceding the global financial crisis to improve national saving was to run surpluses.

5 It appears that \$AUD15 billion in Australia's SG scheme is sitting in lost or unclaimed accounts. See <http://www.thorner.co.nz/tag/australian-superannuation-guarantee/>.

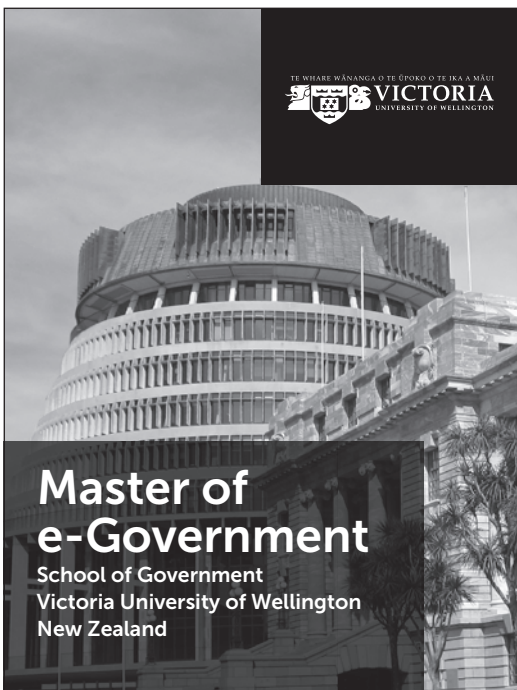
6 The mining boom is often ignored in these analyses. Other voices are more sceptical see (Ingles, 2009).

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