V1 – 24 July 2017

The Missing 2016 Review

- building trust for life beyond work

by

Michael Chamberlain
Michael is an actuary and is the principal of MCA NZ Limited. MCA is an actuarial and strategic investment consulting firm. Before forming MCA in 1998, Michael was the senior consultant at what was Watson Wyatt when it was in New Zealand and is now Willis Towers Watson globally. Michael has over 35 years' superannuation and investment consulting experience and currently advises a range of charities, community trusts and institutions on strategic investment policy matters to help them achieve their goals. Michael was a founder of the SuperLife superannuation and KiwiSaver schemes. SuperLife is now part of the NZX Group and was sold by Michael and his business partner to NZX in 2015. As part of that sale process, Michael is a part-time contract-employee of NZX until the end of 2017.

Michael Littlewood
Michael was a pension consultant for 25 years in London and Auckland for what is now Willis Towers Watson. He was then Employee Benefits Director at Fletcher Challenge Limited, founder-director of what is now SuperLife and, in 2006, helped start the Retirement Policy and Research Centre. He was a member of the government's 1991-92 Task Force on Private Provision for Retirement, is the author of *How to create a competitive market in pensions – the international lessons* (IEA, 1998) and is the principal editor of www.PensionReforms.com. Michael retired as co-director of the RPRC in June 2015.

Disclaimers
This report is entirely the work of the authors in their personal capacities and has nothing to do with their present or former employers. Although this report draws on work done by the Retirement Policy and Research Centre at the University of Auckland, the RPRC has made no direct contribution to the report.

The authors have given their time *pro bono publico*. No-one has asked them to produce the report and no-one has paid them for their time.

Introduction

We were very disappointed with the Retirement Commissioner's 2016 review of retirement income policies. The findings, cloaked in a jokey, cartoon-like presentation on the web site of the Commission for Financial Capability (CFFC - accessible here), amounted to a series of 34 recommendations and observations with little to no supporting evidence for most of them[1].

For example, 15 of the 34 recommendations or observations were about KiwiSaver. The underlying message was that the KiwiSaver regime needed 'strengthening' (more restrictions, fewer options, higher contributions etc.). However, there was no supporting evidence that KiwiSaver is 'working' – in fact, that question was not even asked; nor was the more fundamental question: does New Zealand even need KiwiSaver? We do not know the answer to that question. We list the questions that should have been addressed in section 14 (KiwiSaver in the new environment).

Another example: the 2016 Review recommended increasing the pension age from 65 to 67 and increasing the length of residency to qualify for New Zealand Superannuation from 10 years to 25 years. The implicit assumption was that New Zealand Superannuation is 'unsustainable' – we say 'implicit' because there was no discussion in the Review as to what 'sustainable' and 'unsustainable' mean and why New Zealanders should be even concerned today about what might happen in 30 or 40 years.

Since then, the government has announced two future changes to New Zealand Superannuation – an increase in the state pension age from 65 to 67 and an increase in the qualifying number of years of residence from 10 to 20 – both changes becoming effective in 20 years.

We think the government's decisions are also not founded on a proper, evidence-led policy-making process. It chose just two of 13 possible changes that could have been made to the state pension with little to no justification for ignoring different possible reforms or even modelling the impact of the two reforms it chose. We explain in section 6 (Framing the debate on New Zealand Superannuation) what should have happened.

We conclude that, with respect to retirement income policies:

- There is a range of things that only the government can do – it should do those things.
- There is another range of things that, based on the evidence, the government seems unable to do - it should stop doing those.
- Finally, there are things that the government is doing but, based on the evidence, seem not to be effective – it should also stop doing those.

This is evidence-based policy-making - if it works, based on the evidence, then do it; if it doesn't work, stop doing it. If we do not know whether it works, gather the evidence before deciding what to do. For New Zealand, this approach to policy–making on retirement incomes would be a change but it's time New Zealand tried it. Before that process can even start, there is a lot of information to gather.

The Retirement Commissioner's 2016 Review was a wasted opportunity; an evidence-free zone[2].

---

[1] A written version of the report (to "satisfy the requirements of the New Zealand Superannuation and Retirement Income Act (amended 2005))" is here.

[2] The government has responded to the 2016 Review. In a letter to the Retirement Commissioner of 7 June 2017 (accessible here), it has rejected many of the Review's recommendations in an evidence-free kind of a way. We will comment on those at the appropriate points later in this report.

Asking people what they think about retirement and saving issues is particularly unhelpful; finding out what they do is much more important. That requires the gathering of evidence.

Given that 2017 is an election year, we can't escape the feeling that the government's decisions on the changes to New Zealand Superannuation from 2037 are politically motivated; setting itself up for the horse-trading that might be needed once the election's results are known.

We have decided to fill in some of the gaps because we worry that, in an election year, those gaps will be exploited by politicians wanting to attract attention to their parties' agendas – saying what it takes to get elected. We think the government's announcements on 6 March 2017 about New Zealand Superannuation's age and residency qualification have us heading into once-familiar territory – the politicisation of retirement incomes. The government's decisions have a political overtone that has been illustrated by the responses of other parties (Labour going back on 2014 policy; the Maori Party wanting a lower state pension age; New Zealand First rejecting change).

New Zealand's political history shows that retirement income policies are particularly unsuited to political campaigns. We do not want New Zealand to re-learn that lesson.

Michael Chamberlain

E Michael@mcanz.co.nz
P +64 9 930 7772
M +64 21 890 999

Michael Littlewood

E MichaelR.Littlewood@gmail.com
P +64 9 5200 367
M +64 21 677 160

A footnote about this report: Whoever runs the research-led, national discussion that we think is a necessary next step, will need to address the 125 questions that we identify in this report. As new evidence emerges or additional issues arise, those 125 questions will need updating. This report will be a living document and will be updated by that new information.

Summary

The following summarises the key messages from each section of this report.

Each section concludes with a series of 'Questions that New Zealand needs to discuss'. There are 125 in all.

investment vehicles' (like superannuation) have changed a lot recently. Some of the changes are positive; others negative. Overall, we rate the new environment as 'could do better if tried'. Savers are still not central to regulatory objectives and there needs to be research as to whether the new disclosure regime is improving the understanding of investors.

19. **Regulation – standards of conduct:** The Financial Markets Authority is trying to improve standards of conduct in financial markets. We think the government should take the initiative on the publication of investment performance returns and support better disclosure on fees. We wonder though whether these will make any long-term difference to the management of collective investment vehicles. An old set of problems has been replaced by a new set. 85

20. **Information and education:** One of a government's five roles (section 11) is to gather and disseminate high quality data; another is to use that for information and education programmes. We already do some of the latter but we need to know what's happening – what works and what doesn't. One problem is, again, the absence of high quality data. 89

21. **The review process:** Despite the six reviews since the present retirement policy review framework was established in 1993, very little has actually happened as a result. The present three-yearly review needs to change and the Retirement Commissioner's roles should return to those described in the 1992 Task Force's report. The government may have signalled that the 2016 Review was the last in its current form. We need to discuss what might replace that. 95

22. **Policy nirvana:** The 2017 election campaign will probably see superannuation becoming a political issue. That is an inappropriate environment to resolve retirement income issues. We should aim for a 2020 version of the 1993 *Superannuation Accord*. We need first to strengthen the review process and establish its credibility as a way to facilitate public and political consensus. Again, gathering impeccable, deep data must be at the heart of that. 99

1. Our vision – reforms that really matter

As explained in the introduction to this report, we were extremely disappointed with the Retirement Commissioner's 2016 review of retirement income policies. Sections 2 to 22 below describe the issues and the questions that New Zealand needs to discuss.

So as to put that detail into context, we have picked out the nine key elements that we think should form the framework of a sustainable, flexible, inclusive, successful retirement income framework. We list them in order of significance to us.

1.1 Economic growth: Greater economic growth (than expected) should be central to discussions on every aspect of public policy, including retirement incomes. At the foot of every significant retirement or pension policy proposal should be the question: 'How does this help New Zealand grow more than under current settings?' See section 2 for more.

1.2 Longitudinal household survey: Unless we know what households are doing in their financial lives and what their aspirations are over time, public policy debates will take place in a vacuum. We won't know whether things need changing, nor the chances that any proposed change might actually work. We can't even see whether current policy is working. See section 15 for more.

1.3 Review process: The current triennial review of retirement income policies isn't working and must change. New Zealand should aim to create a world-class centre of research excellence on financial issues at a household level – the Dunedin Multi-Disciplinary Health and Development Study is a model for our recommendation. See section 21 for more.

1.4 First principles review of New Zealand Superannuation: New Zealand needs a research-led review of every aspect of NZS, despite the recently announced changes. We have never done such a review before. NZS is the best Tier 1 scheme in the world but it can undoubtedly be improved. See section 6 for more.

1.5 First principles review of KiwiSaver: We think KiwiSaver was the 'answer' to a 'problem' that New Zealand probably didn't have. New Zealand needs a research-led review of every aspect of KiwiSaver – what exactly are its policy objectives? Does New Zealand need KiwiSaver and, if New Zealand does, how can KiwiSaver be made better? See section 14 for more.

1.6 First principles review of disclosure: Knowing what financial service providers are actually doing and how financial products might suit consumers should be at the heart of regulatory supervision. New Zealand has tried to fix this but we need to return to the beginning. See section 18 for more.

1.7 Uniform income tax system: All 'income' should be aggregated and taxed at the saver's appropriate marginal rate. All 'income' should be used for income-tested welfare benefits. What happens now doesn't come close to those objectives and must change if tax treatment is to be removed as an influence on saving decisions. The present system is illogical, inconsistent, complex and unfair. See section 17 for more.

1.8 Mathematical competence: We think that governments probably cannot improve citizens' 'financial capability' but we strongly believe that encouraging mathematical competence should be at the heart of every aspect of school curriculums, not just mathematics. Mathematical

competence is central to making personal financial decisions about retirement and also to nearly every other part of our lives. See section 20 for more.

1.9 Retirement incomes 'accord': Retirement income policies are particularly unsuited to political contests. The eventual objective of the first-principles review we propose should be a 2020 version of the 1993 *Superannuation Accord*. However, this is not just a matter for politicians. The *Accord* should be supported by an inclusive review framework with impeccable, deep data at its heart. The more we know about what citizens do and what help they actually need, the more confident we can be about the framework's long-term sustainability. See section 22 for more on this.

None of these nine listed key elements, that we think should form the framework of a sustainable, flexible, inclusive, successful retirement income framework, rated a mention in the Retirement Commissioner's *2016 Review of Retirement Income Policies*. They were missing in action.

2. The economy matters; productivity matters[3]

The issues are familiar; so familiar that they scarcely need repeating. New Zealand's population is ageing. Those above the state pension age will about double in number, as will the annual cost of the pensions they expect to receive, if current settings persist. Those under the pension age may increase in number but will reduce as a proportion of the population. That demographic shift could see relative falls in real economic output, tax collections and growth prospects.

Healthcare costs are expected to follow a similar trajectory to pension costs.

It seems that a perfect financial and fiscal storm might unfold over the next two to three decades.

All this has encouraged what might be called 'age catastrophism'. Now that the baby boomers are retiring, it seems like a downhill slide to national penury.

As baby boomers leave the workforce, some suggest that the economy could become caught between rising welfare and health costs with a flat or even a declining workforce and a flat or declining tax take on unchanged policy settings. Something will need to give.

Faced with ageing populations, policy settings that encourage growth are more constructive than settings that encourage or even require particular forms of economic behaviour. Underpinning calls for compulsory private provision ('save-as-you-go' or SAYG) is the feeling that with greater levels of private provision ('savings'), there would be more investment and greater growth[4].

In fact, each of the links between savings, investment and growth is, at best, equivocal. More savings may (but may not) lead to greater investment while greater levels of investment may (but may not) lead to growth.

The direct link then between savings and growth is even more tenuous. The evidence from empirical studies is mixed at best and even the direction of causality is unclear; it may be that higher growth leads to more savings as incomes rise[5].

---

[3] This section is based on a submission by Michael Littlewood for the Retirement Commissioner's 2016 Review: *Ageing populations, retirement incomes and public policy: the four 'first principles' of policy-making - A submission to the Commission for Financial Capability* (accessible here).

[4] *Does New Zealand have a household saving crisis?* (2007) by Trinh Le (New Zealand Institute of Economic Research, accessible here) suggests that both the New Zealand Superannuation Fund (see section 6 below) and KiwiSaver (section 13 below) were unnecessary public policy interventions to, as claimed at the time, help fix an apparent savings 'problem'. "Overall, the reasons that have been used to justify pro-saving policies lack economic underpinnings. If there is a policy that New Zealand needs, it must be one that promotes growth. Pro-saving policies are more likely to be regrettable than not" (page 16). The "regrettable" reference related to the Treasury's *ex post* justification of the large tax breaks delivered to KiwiSaver in the 2007 Budget in *A Synopsis of Theory, Evidence and Recent Treasury Analysis on Saving* (2007 – accessible here). The specific reference is that report's conclusion: "However, in the light of the recent data, evidence and analysis mentioned above, on balance we think that further or stronger pro-saving action is now justified…..This judgement for further or stronger action rests on a least-regrets approach in the light of data uncertainties, persistent macroeconomic imbalances and the possibility that individuals are basing saving decisions on long-run expectations that could turn out to be mistaken" (from page 4 - our emphasis).

[5] For example, an analysis of US data from the U.S. Bureau of Economic Analysis between 1948 and 2015 used by Steve Roth here concludes, among other things, that personal saving and private investment are "very weakly correlated and what correlation there is is mostly negative." Also "Personal saving has a significant and quite consistently *negative* correlation with business investment. Again: more saving, less investment." These are actual data observed, not forward-looking models of what 'should' happen.

On the other hand, excess savings (low consumption) have even been known to lead to economic recession[6].

Growth is central to a country's capacity to cope with growing numbers of pensioners. Whenever there are discussions about retirement income policies, at the bottom of every page that suggests a policy change should be the question: 'How will this policy help the country grow more than alternative strategies?'

However, the 'top-line' growth statistics are only part of the story. There will be, proportionately, fewer people producing things relative to the total population while the total number of consumers (including the retired) will continue to rise. That places improving productivity as a 'front and centre' issue in the debate about the costs associated with an ageing population. Traditional measures of productivity growth have tended to show New Zealand in a poor light and our Productivity Commission has looked at aspects of our labour productivity:

> "Productivity growth is about creating more value by making better use of a country's resources. It is the most important source of income growth and has an important bearing on people's wellbeing."[7]

Economists have worried about New Zealand's relatively poor productivity performance by comparison with our peers. The Productivity Commission acknowledges that more work is needed to understand what needs to be done. The Commission itself describes some of its work as "incomplete and speculative in some areas". We need to fill those information gaps to the extent that is possible and to have a full national debate on the implications of improving productivity in the face of an ageing population.

Put simply, a stronger, more productive economy has a greater capacity to deal with all challenges, including more pensioners and higher health costs.

This is no better illustrated than from New Zealand's fiscal experience of just the five years to 2015. As of 2010, the government's 'primary core Crown operating spending', the starting point for the *Treasury's Long-term Fiscal Model* (see section 5 below for more on this), was 32.2% of GDP[8]. In the space of just five years (2010 to 2015), that starting figure has fallen by 3.8 percentage points to 28.4%, or by about one-ninth[9]. That puts into context the expected 2.9 percentage point rise in the net cost of New Zealand Superannuation from 4.2% to 7.1% over the next 40+ years, before allowing for the government's recently announced changes (pension age and residency period).

Questions New Zealand needs to discuss about the economy:

1. How robust are current projections of New Zealand's economic future?

2. What are New Zealand's economic strengths and how might we develop those?

3. How can we better understand New Zealand's limits to growth, including, specifically, the productivity conundrum?

---

[6] Increasing the size of private claims on the economy, in the absence of growth, may actually worsen affordability issues associated with ageing populations.

[7] *Achieving New Zealand's Productivity Potential*, The New Zealand Productivity Commission, November 2016 – accessible here.

[8] *Affording Our Future – Statement on New Zealand's Long-term Fiscal Position*, The Treasury, Wellington (available here

[9] The Treasury's *2016 Statement on the Long-term Fiscal Position* (available here)

4. What are the key risks to New Zealand's economic future and how might we mitigate those?

5. What specifically is the government's capacity to influence these issues positively and what do the answers to that mean for New Zealand's regulatory environment?

3. On claims against the economy both public and private[10]

It is relatively easy to see that public pensions, like those paid to New Zealanders over age 65, are claims on the contemporary economy, especially if they are financed on a 'pay-as-you-go' (PAYG) basis. A government's capacity to pay those pensions depends on its ability to collect tax and redistribute that to the qualifying old. Economic output is directly connected to a country's capacity to support the old: the stronger the economy, the greater that capacity.

The connection is indirect but just as evident with private provision. Saving for retirement involves setting aside money during the accumulation period. That is invested in the economy and makes claims against the economy each year; returns are added and may again be set aside. At retirement, the collection of economic claims (savings) is converted to cash to support the retiree's income needs. Selling those investments requires a buyer who will pay a price that is related to the value of those claims. Again, there is a deep connection between that value and the strength of the economy at the time they are converted to pay for loaves of bread, milk and the other things that pensioners need.

There is no significant economic difference between public and private provision for retirement. For today's retirees, both types entail claims against today's economic output to support today's consumption by today's pensioners. The overall 'affordability' of any retirement income system is therefore directly related to the strength of the country's economy at the point of payment. For today's pensioners, that means now; for pensioners in 2040, it means the strength of the 2040 economy.

The total size of retirees' entitlements, public and private, represents output that must be effectively delivered to them by workers and other producers of the day. Whether through redistribution (PAYG pension) or by converting financial savings, pensioners must have money in their bank accounts to meet their living expenses.

The economy has ways to adjust the real value of claims that taxpayers (public pensions) or citizens ('private' claims) expect to receive if those claims are deemed 'excessive'. For example, the real value of 'private' claims can be adjusted downwards by unexpected inflation or falls in the value of investments. 'Public' claims can be reduced by changes to the pension rules. Again, those adjustments occur in the contemporary economy, regardless of the way the claims have been accumulated or are accounted for. In that regard, private claims are no more secure than public claims.

Healthcare costs are also claims on the economy and both public and private costs are expected to increase with ageing populations.

A government must balance the competing, contemporary claims of the young, workers, the old and claims for all the other things governments do such as policing, defence, education, infrastructure-development etc. With a stronger economy, more is possible in all these areas.

It may seem that an individual saver can defer consumption (by saving) and so 'store up' claims against tomorrow's economic output. But what actually happens is that the saver converts the possibility of consumption today into a different form of claim on today's economy (a bank account, retirement saving account, a listed share or government bond). Whether that new claim

[10] This section is based on a submission by Michael Littlewood for the Retirement Commissioner's 2016 Review: *Ageing populations, retirement incomes and public policy: the four 'first principles' of policy-making - A submission to the Commission for Financial Capability* (accessible here).

can be realised to support the saver's lifestyle in retirement depends on the strength of the economy in each year up to and in retirement (and standard supply/demand pressures).

Whole countries cannot defer consumption by 'saving' for their citizens' future retirement[11]. What they can do is re-arrange economic claims in *today's* economy. And the way those are re-arranged for retirement incomes doesn't much matter: whether they are public or private, defined contribution or defined benefit, pension or lump sum, pre-funded or PAYG. However, what they are 're-arranged into' matters greatly.

Questions New Zealand needs to discuss on public vs. private economic claims

1. Do more savings in accounts like KiwiSaver schemes and the New Zealand Superannuation Fund improve New Zealand's (not individuals') ability to finance the retirements of increasing numbers of older citizens?

2. What is the international evidence on the economic impact of government-encouraged (or forced) private savings?

3. How do the total claims (private and public) on the economy by older New Zealanders today compare with the equivalents in other developed countries?[12]

4. What are the expected trends in total claims (private and public) in New Zealand over the coming, say, 40 years?

5. How do New Zealand trends in total claims (private and public) compare with the equivalents in other developed countries?

6. How have other countries adapted those total claims (private and public) to changing patterns of work and retirement? What lessons might New Zealand draw from those examples?

[11] A concept proposed by Nicholas Barr in *The Economics of the Welfare State*, Stanford University Press, 1987.

[12] The case of Japan is interesting – Japan's total population is falling with a 330,786 (0.3%) net loss of births over deaths in 2016. The pace of reduction over the last eight years is increasing. The government estimates that Japan's population will fall from 127.1 million in 2015 to 88.1 million in 2065 (see here). We should understand the economic implications for Japan of future pension claims (public and private). New Zealand, on the other hand, expects the current (2016) 4.69 million population to grow to 6.52 million by 2068 – StatsNZ *National Population Projections 2016-2068*, median estimate (accessible here). For retirement incomes, the population's age mix is the significant issue.

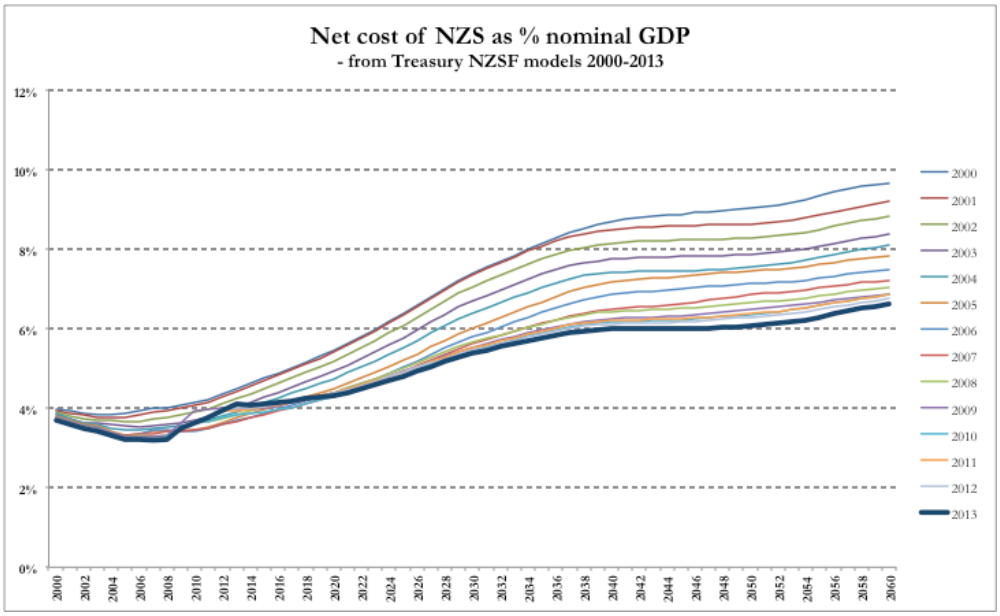
4. How much will New Zealand Superannuation really cost?

The Treasury makes regular projections of expected expenditures and future growth rates of the kind referred to in section 3 above. These must be subject to considerable uncertainties, given the long timeframes involved. It is difficult enough to guess what Budget surpluses/deficits might look like in two or five years, never mind 20 or 40 years away. However, it is possible to analyse trends in current policy settings by making assumptions about the future. For example, we know the current demographic profile and so we know with some accuracy the number of 65 year-olds there will be in 20 years, after making adjustments for deaths and net migration.

The Retirement Policy and Research Centre's 2013 *PensionBriefing*[13] analysed the results of 14 versions of projections made by the Treasury's *Long Term Fiscal Model* (LTFM) between 2000 and 2013 and observed:

> "…it is clear…that the expected future real cost of NZS measured in the 13 years covered by the NZSF models' calculations has actually fallen, benchmarked against future estimates of GDP. In fact, the 2060 estimate of the expected net cost of NZS has reduced from 9.7% of GDP in V1-2000 to 6.6% of GDP in V14-2013 (a reduction of 32%). Most of that is attributable to the improvement in real GDP (+60.8% in 2060)..."[14]

The RPRC's chart illustrates that point:



Note: the cost for years before the year a model was run are 'actuals'; for years after the model was run, the costs are estimates expressed as a percentage of the nominal GDP in those years

[13] *New Zealand Superannuation's real costs – looking to 2060* (accessible here).

[14] More recently, the Treasury has estimated the 2060 net cost of NZS at 7.1% of GDP, based on the 2016 LTFM (*New Zealand Superannuation Contribution Rate Model – HYEFU Update* New Zealand Treasury, November 2016 – accessible here). After 14 versions of the LTFM that saw steady declines in the expected net cost of NZS, the 2016 model shows a relatively significant 7.6% increase (from a net 6.6% in the 2013 model to 7.1% in 2016). The principal driver of this change has been new estimates from Statistics New Zealand of the growing numbers of over 65s. Previously, the growth in this group was set at an average 1.65% a year. That has been revised upwards to 1.85% a year. But for that changed assumption, the estimated net cost of NZS in 2060 would apparently have been 6.6% of GDP – no change from 2013 and down from the 6.7% used in the 2016 Budget NZS model.

The RPRC concluded that the Treasury's projections:

> "…emphasise[] the importance of economic output and, for the security of today's and tomorrow's pensioners, the importance of increasing that output at a faster rate than the latest version of the NZSF model presently projects. For many more reasons than just the affordability of NZS, how to make New Zealand more productive should be at the centre of discussions about the economic implications of an ageing population."

The government, on behalf of all taxpayers, balances competing claims on economic output from everyone, including pensioners. The decisions are made year-by-year and can change from year to year. With growth, governments have more choices but it's important to emphasise that those are choices of the day, not today.

The 'cost' of any retirement benefits scheme is the benefits paid (plus administration costs). That applies to any scheme – public or private; pension or lump sum; defined benefit or defined contribution. That cost has nothing to do with the way the benefits are financed – whether they are 'pay as you go' or fully pre-funded (or a mix).

So, the cost of NZS is the pensions paid in the year they are paid and that is unaffected by the presence or absence of the New Zealand Superannuation Fund (we have more to say on this in section 7 below).

Today's taxpayers and voters cannot bind taxpayers of 2060 (or 2037) to any decisions made about NZS over the next few years. The 2060 government, acting on behalf of tomorrow's taxpayers, could make very different decisions about the claims of pensioners (among others) on economic output and those different decisions could be implemented relatively quickly.

The annual amount of NZS in, say, 2037 will be the total amount that taxpayers of 2037 are prepared to spend on NZS divided by the number entitled to receive it in 2037. To the extent that taxpayers are not prepared to spend as much as is now contemplated (in 2017), the annual amount to each pensioner will reduce. That 'political economy' issue will have nothing to do with the amount in the New Zealand Superannuation Fund; nor the annual amount it can disburse because that will have no bearing on the cost of NZS in 2037.

That does not mean the Treasury's projections have no value but we must understand their significance to retirement income policies in particular. Part of that is building a degree of trust in our future. Part of it is giving us plenty of warning about the trends under current policy settings.

However, today's taxpayers, through the government, decide on today's spending priorities. A similar process will take place in 10, 20 and 40 years and nothing we say today and no institution we develop today, such as the New Zealand Superannuation Fund[15] or the decision in 2017 to increase the state pension age from 2037, can change that.

We develop or refine today's Tier 1 pension (NZS) based on today's conditions (sustainability, fairness etc.) and we leave it to today's savers to make their retirement saving plans based on what we know today. The cost projections show what that might look like in 20 or 40 years so that savers can guess the robustness of their overall expected retirement income provision (state plus private) and the contribution that NZS might make to that. Savers can assess the robustness of their planning and as they get closer to retirement, make appropriate adjustments to private provision.

[15] See Section 7 below for more on the NZSF.

The Treasury's projections do not limit the possibility of changes, even quite rapid changes to public provision. That is and must be the prerogative of taxpayers of the day but we should expect the constant and consistent flow of information to reduce the possibility of disruptive changes such as New Zealand faced over the 20 years from 1975[16].

However, taxpayers of tomorrow might resent having their hands tied in any way with respect to decisions that are theirs to make at the appropriate time and recognising the then appropriate competing demands on their taxes. A decision today about the state pension age in 2037 could be seen, in 20 years, as a constraint on tomorrow's decision-making process.

Similarly, the presence of the New Zealand Superannuation Fund might be seen as a constraint on future governments' ability to make decisions about the size of NZS. Today's taxpayers might say they have paid more than is needed today for NZS (by the amount of the contributions to the NZSF) and might reasonably argue, when they become pensioners, that they have already partly paid for their pensions.

Questions New Zealand needs to discuss on New Zealand Superannuation's cost

1. Are we convinced that the future cost of NZS will be the amounts paid each year and that will have nothing to do with the amount of money in the NZSF?

2. How robust are the Treasury's projections in the 'Long Term Fiscal Model' and what are the main risks to those?

3. Why can't we have an accessible model that allows us to see what the cost implications of different possible changes to the design of NZS? What, for example, are the implications of the proposed changes in the state pension age? What might happen if other aspects of the design changed?

4. Are we clear what the purpose of the Treasury's projections is and their significance to governments' planning and individuals' decisions about retirement saving?

[16] See *A condensed history of public and private provision for retirement income in New Zealand – 1975-2008*, an RPRC *PensionBriefing* (accessible here) for a summary of the sorry history of changes during those difficult 30 years.

5. Is New Zealand Superannuation 'sustainable'?

New Zealand Superannuation (NZS) is one of the simplest, most elegant Tier 1 pensions in the developed world. Every New Zealand resident qualifies for NZS from age 65 as long as they have been resident:

- at least 10 years after age 20[17], including
- at least 5 years after age 50.

NZS provides a net 66% of the net national average wage for a married couple and about 42% for a single person who lives alone[18]. It is adjusted annually to reflect changes in inflation but with an underpinning link to the national average wage. The grossed-up amount is taxed as ordinary income.

The Retirement Commissioner expressed recent concern about the escalating cost of NZS:

> "NZ Super costs were $10.4 billion (net) in 2015/16, which is 14% of core crown expenses and 4.1% of GDP. Treasury predict that it will rise to 7.1% (net) of GDP in 43 years. If we play that scenario today using 2015/16 numbers (7.1% of $251 B) the bill for super would be $17.87 billion, which begs the question, where would we draw the additional $7.43 billion from?"[19]

NZS truly isn't 'unsustainable', if by that we mean it can't survive and must reduce. We should stop saying that. It is even questionable whether NZS, on its present terms and without the two recent changes, is 'unsustainable'.

We know that the population aged 65+ will about double over coming decades[20] and that the costs of healthcare and NZS will increase substantially if current settings remain. These two major government programmes will be the most directly affected by the ageing population. However, we also know that New Zealand's economy will grow and, barring catastrophes, we should as a country be able to afford more than we currently pay for the age-related programmes.

The Treasury makes projections of the impact of all these influences on government spending at least every four years. The most recent estimates from the Treasury[21] show the government's 'primary core Crown operating spending' changing from 28.4%[22] of Gross Domestic Product (GDP) over the 45 years 2015 to 2060. The Treasury looked at two major scenarios:

---

[17] If the government's recently announced changes become law, the 10-year minimum period will become 20 years with full effect from 2037. All immigrants after 2017 must complete 20 years' residence or have qualifying residence from one of the countries with which New Zealand has a social security agreement. It is unclear how existing residents will be treated – whether the new 20-year test will apply from 2017 or be phased in between 2017 and 2037.

[18] Those over age 65 and with equivalent overseas' pensions will receive lower amounts of NZS - see section 8 ('Overseas' pensions and section 70 deductions).

[19] *2016 Review of Retirement Income Policies*, Diane Maxwell, accessible here at page 3.

[20] There were 698,000 over age 65 in 2016. The number in 2068 is expected to be between 1.6 and 2.1 million (depending on assumptions – median estimate is 1.8 million). The increase as a proportion of the population is likely to be lower: at present, 14.9% of the total population is over age 65; by 2068, that is expected to be between 24-33%, again depending on assumptions - StatsNZ *National Population Projections 2016-2068* (accessible here). StatsNZ also expects the number of over-65s to grow by 1.85% p.a. (up from the previous estimate of 1.65% p.a.). That means the number will double in 38 years (by 2054) rather than 43 years (by 2059).

[21] The Treasury's *2016 Statement on the Long-term Fiscal Position*, Government report, Wellington (accessible here)

[22] The equivalent number in the 2013 analysis as of 2010 was 32.2% of GDP (*Affording Our Future – Statement on New Zealand's Long-term Fiscal Position*, The Treasury, Wellington (available here). In the space of just five years (2010 to 2015), that starting figure has fallen by 3.8 percentage points to 28.4% or by about one-ninth.

- holding total tax receipts at about 29% of GDP (roughly the current level), rising from 28.4% of GDP in 2010 to 36.1% (what the Treasury calls 'Historical Spending Patterns[23]). This would see an estimated fiscal deficit of 1.2% of GDP by 2030, growing to 6.1% of GDP by 2060.
- what the Treasury calls 'Spending Path to Maintain Net Debt'. This says that future trends in spending are constrained to reduce government debt down to about 20% of GDP and then maintain it at that level. It would require the estimated fiscal deficits under the Historical Spending Patterns model to be eliminated by reduced government spending (equivalent to 6.1% of GDP by 2060).

These projections do not paint the grim fiscal future that some predict, but they are large numbers. In 2015, 28.4% of GDP was nearly $68.6 billion (each 1% was equivalent to $2.4 billion).

In 2060 dollars, the Treasury estimates that the net cost of NZS will be $105.4 billion. By 2060, estimated GDP will be a nominal $1,487 billion. Bringing those numbers back to 2015 dollars at the assumed inflation rate of 2% p.a. suggests that the economy will grow in real terms by about 153% over the 45 years[24]. In the meantime, the total population will have grown by about 39%[25].

The difference in the two Treasury scenarios is an expected total government spending of 6.1% of GDP by 2060 (28.4% to 34.5%). We expect to spend a net 7.1% of GDP on NZS alone by then (see section 4 above) so the difference of 6.1% in overall spending is a significant number.

However, none of these numbers establishes a case that New Zealand faces an imminent fiscal crisis, remembering that government spending was 32.2% as of only 2010. We know that an ageing population will require an increase in taxes unless current programmes (not just those directly affecting the old) are cut. We also know that what we have has worked reasonably well and costs less than many other countries currently spend on the old[26].

But here is the real question – looking just at NZS, do we expect that taxpayers in 2060 will be happy to pay a net 7.1% of GDP, shared out amongst everyone over age 65? If we think that 2060's taxpayers might object, then we could expect them to cut benefits and those changes could be made with little warning. New Zealand's own experiences with changes to NZS, the 1985-1998 surcharge and the introduction of KiwiSaver illustrate that clearly.

Rapid changes to a long-term programme like NZS are undesirable because New Zealanders build their private savings arrangements on this 'Tier 1' state pension. If the cost of NZS must be cut, we need to give as much notice as possible so that people can make appropriate changes to their

---

[23] This says that government expenditure will follow historical growth rates, allowing for demographic changes. The base case also assumes that tax collections stay at about 29% of GDP and that deficits will be financed from borrowing so that government debt is unconstrained and will reach 205.8% of GDP by 2060. We know that this scenario is theoretical because a future government would change policies to ensure it did not happen. That has already happened: the government has a fiscal surplus and is focussed on, among other things, reducing debt.

[24] The 2060 estimated GDP in 2060 from the LTFM is $1,487 bn. Discounting that back to 2015 at 2% p.a. (to take inflation out) brings it back to $610 bn. The actual GDP in 2015 was $241.6 bn.

[25] From 4.69 million in 2016 to 6.52 million in 2068- StatsNZ *National Population Projections 2016-2068*, median estimate (accessible here).

[26] As explained in the RPRC's *PensionBriefing 2012-3 We all have to talk about New Zealand Superannuation* (accessible here), of 31 OECD countries that reported pension costs in 2010 and expected costs in 2060, only six countries presently spent less than New Zealand, ignoring the amount those other countries spent on tax subsidies for private provision. That number is very low in New Zealand whereas in Australia, for example, the cost of tax subsidies is about the same as the amount spent on the Age Pension - see *Building super on a fair foundation: Reform of the taxation of superannuation contributions*, Peter Davidson (2012), Australian Council of Social Service (accessible here).

retirement saving plans. That's why we need to talk about NZS now and to run that discussion on a regular basis in the future.

NZS currently costs a *net* 4.2% of GDP and the Treasury says that, without the recent changes, this will increase to a *net* 7.1% by 2060. That's a lot of money today and even more tomorrow. However, let's put those large numbers into perspective. The Treasury expects New Zealand to spend (in 40 years) less than the average of all OECD countries spend on pensions today. The OECD reports that, in 2011 (six years ago), the average cost of public spending on old age and survivor pensions was a net 7.3% of GDP[27].

So what makes our Treasury's 2060 estimate 'unsustainable'? As ever, it will be a question of priorities – will 2060 taxpayers be happy about spending that much on pensions for the old?

Health spending will have a similar trajectory to the cost of NZS. The gross government's health spend was 6.2% of GDP in 2015. The Treasury's 2016 Long Term Fiscal Model expects that to be 9.7% by 2060[28]. We don't say that health spending is 'unsustainable' and must reduce today. What makes NZS different in this regard?

Even if we think that 2060 taxpayers might be unhappy about either the cost of NZS or of health in 2060 (or both), it will still be an issue for 2060 taxpayers to resolve, not 2017 taxpayers. Each year's taxpayers effectively make those spending priority decisions every year and that will be the case in 2060 as it is now.

If we worry about what the cost of NZS might be in 2060, why aren't we questioning today's cost? Taxpayers spend a net 4.2% of GDP today – that's more than $11 billion. Is that a good use of taxpayers' money? Have we got the design of NZS right? The next section 6 suggests not. We should talk about those design issues rather than guess what 2060 taxpayers might think of 7.1%.

And, as explained in section 7, resuming contributions to the New Zealand Superannuation Fund (NZSF) will not help. Putting an extra $27.7 billion into the NZSF between 2021 and 2035[29] really won't matter. The partial pre-funding of NZS through the NZSF does not change the future cost of NZS by one dollar but only slightly re-arranges its incidence (more cost today for possibly, but not guaranteed, slightly less tomorrow). The cost of NZS today (and tomorrow) is the benefits actually paid. If we want to cut the cost of NZS, we must reduce the value of the pension paid. So, even if contributions to the NZSF resumed, that doesn't change the sustainability or otherwise of NZS at all.

We need a research-led discussion to test whether New Zealand has the best Tier 1 pension in the world (nothing less will do) and whether taxpayers get good value for the net $11.1 billion we spend on NZS today. The next section 6 lists all the things we need to talk about in that regard.

So, let's think about the things we can control and not worry about what might happen in 2060 (or even 2037). That's up to those with the power to control things then.

Questions New Zealand needs to discuss on the sustainability of NZS:

1. What is 'unsustainable' today about NZS as it exists today?

[27] *Pensions at a Glance 2015*, OECD at page 181 (accessible here).
[28] Health costs based on the 'historical spending patterns' scenario – accessible here, at page 60.
[29] As the Treasury's 'NZSF Model v34' anticipates – see here.

2. What definition of 'sustainability' should we adopt for today's NZS?

3. Do we need to concern ourselves about the cost of NZS in 2060 or should we leave that for taxpayers in 2060 to resolve?

4. If we need to be concerned about the long-term 'sustainability' of NZS, should we be equally concerned about the 2060 costs of health, education, police, prisons and all the other categories of government spending? In other words, is there something about the age pension that makes it special in this context?

6. Framing a debate on every aspect of the NZS benefit design[30]

New Zealand should start a full review of NZS and the sooner that happens, the better. This is a topic that has been canvassed on many occasions in the last 25 years:

- The Task Force on Private Provision for Retirement (1991-92);
- Periodic Report Group (1997);
- Periodic Report Group (2003, report accessible here);
- Retirement Commissioner's Review of Retirement Income Policy (2007);
- the 2010 Review of Retirement Income Policies (report accessible here);
- the Review of Retirement Income Policies (2013, report accessible here) and, most recently,
- the 2016 Review of Retirement Income Policies (report accessible here).

None of these seven reports has come close to what is now needed.

This section looks at each of 13 design decisions that go to make up NZS as we know that today. Of those, the government chose to change two in its 6 March 2017 announcements – the state pension age from 2037 and the minimum residence requirement from, possibly, 2018. Neither of those changes has been the subject of a research-led analysis[31]. The government also apparently thought about two other aspects of NZS's design:

> "Other settings such as indexing NZ Super to the average wage and universal entitlement without means testing will remain unchanged…" Stephen Joyce, Minister of Finance 6 March 2017[32]

Again, neither of those decisions was the subject of a research-led analysis or consultation.

This kind of *ad hoc* decision-making has not served New Zealand well over the more than 40 years since 1975 when the then-Labour government introduced the compulsory private savings scheme (the 'New Zealand Superannuation Scheme'). These latest decisions have a distinctly political flavour to them, given the upcoming election and the manoeuvring that is an inevitable feature of our MMP environment.

We think that, despite the March 2017 decisions, it is time to have a proper look at the benefit design of NZS.

Here is a summary of the major design decisions that should emerge from the proposed, research-led review[33]:

6.1 Universal or means-tested? Until 1977, the then 'Old Age benefit' was income-tested but 'Universal Superannuation', payable from age 65 was not. In practice, by 1975, this meant there was an income-test between age 60 (when the Old Age benefit started) and age 65 (when Universal Superannuation started)[34]. 'National Superannuation' changed that in 1977. The state pension age was reduced to 60 and the income-test was eliminated.

---

[30] This section is based on the RPRC's 2015 *PensionCommentary 2015-1 – Re-designing New Zealand Superannuation*, Michael Littlewood (accessible here).

[31] And if the government uses the Retirement Commissioner's 2016 review as supporting evidence, our statement stands. That review did not use research-based findings either.

[32] Press release 6 March 2017 *Lifting NZ Super age the right thing to do*, accessible here.

[33] NZS is payable under the New Zealand Superannuation and Retirement Income Act 2001 accessible here. In this section, we refer to that as the 'Act'.

[34] *Retirement income in New Zealand the historical context*, David Preston (2001), Office of the Retirement Commissioner (now Commission for Financial Capability, Wellington) provides a good summary of the history of NZS since it started in 1898 (accessible here).

However, the Labour government re-introduced income-testing without debate from 1985 (the 'surcharge'). It was watered down later and finally eliminated in 1998 by the next National government, again without discussion.

NZS itself has never been subject to an asset-test[35]. Finding out how the asset-test for the Age Pension works in Australia should be an important part of the New Zealand review.

Should NZS be paid to people who don't, on any reasonable basis, need it? If we decide to apply a means-test (on income and/or assets), NZS will no longer be a universal pension. In that case, where should the reductions begin and at what rate should the state pension be withdrawn? What might be the consequences for the economy, particularly to labour force participation rates, and how might New Zealanders react to such tests? How might savers react during both their working and retirement periods? What might the administrative costs be? We have some experience from the days of the surcharge (1985-1998) and there are useful potential lessons to be learned from Australia that has extensive income- and asset-tests.

Governments cannot dictate how much of the economy's total output goes to the old because of private, unmanageable responses to the retirement income framework. We need a better understanding of the present and expected *total* claims on the economy by the old[36]. With the best of intentions, it is almost impossible to regulate private behaviour so as to achieve the desired overall objectives and any discussion of income- and/or asset-tests must recognise that[37].

6.2 State pension age: The state pension age of 65 was first set in the 1898 Old-age Pensions Act (accessible here). We flirted briefly with age 60 between 1977 and 1992 but, by 1 April 2001, it was back to age 65. The government's recent announcements would see that increasing from 65 to 67 between 2037 and 2040.

Why the current age 65? Why the proposed age 67? There is no particular reason (physiological, physical or gerontological) to pick any age because the appropriate age for an individual will be driven by many issues including health, availability of work, family circumstances, income, personal preferences and wealth.

And why does the under-age-65 partner of a person who is over age 65 collect the pension on a means-tested basis (the 'non-qualifying partner option')? The Retirement Commissioner's 2016 Review recommended abolishing this without offering any evidence to support that suggestion, other than that the option exists and how much it might save to remove it[38]. The government rejected that recommendation, in an evidence-free

[35] The Old Age benefit (pre-1977) was the last time New Zealand had an asset-test on an age-related income benefit.
[36] In *Turning silver to gold: Policies for an ageing population* (2014), Retirement Policy and Research Centre (accessible here), Claire Dale collates what we know about public policy-driven state costs of services and support for the age 65+ population through to 2030. For the proposed national discussion on NZS, that analysis needs to be deepened and extended.
[37] In fact, it's even possible that the total (public + private) claims of the old on the economy will be greater in the presence of a means-tested state pension than might be the case with a universal pension such as NZS. Savers might under-estimate the net amount of state provision they will receive and therefore over-estimate the need for private provision in the presence of means-tests. Means-tests are by their nature, complicated and expensive to administer. That could all increase the total economic claims by older people (both public and private) on a demographically ageing economy. Means-tests also have a tendency to provoke avoidance activities that aim to limit the impact of the asset- or income-test on net incomes in retirement. Australia shows how the financial planning industry was founded, in part, on means-test avoidance.
[38] Retirement Commissioner's *2016 Review of Retirement Income Policies* (accessible here) at page 24.

response[39].

Retirement, as a universal 'entitlement', is a relatively recent phenomenon. In 1910, two out of three US men age 65 and over were actively employed. Even at age 72, male participation in the labour market was over 50%[40]. The percentage of US men age 65 and over who worked fell to about 50% in 1950 and then below 20% in 1980. By 1990, it had fallen to 16%[41] and has now (2014) climbed back to 17.4%[42], probably because the state pension age for US Social Security is now 66 and is increasing to 67 by 2027. Of all US citizens over the age of 65, 19% now work[43].

New Zealand's participation rate for all those aged 65+ fell to as low as 6.4% in 1986. It's now (2013) 22.5% and rising[44].

When the government chooses a state pension age, it must balance social issues, labour market efficiencies, voter satisfaction and fiscal considerations[45]. Some suggest that, with improving mortality, we should be seeing a natural increase in the state pension age, certainly by comparison with the position that prevailed in 1898[46]. The state pension age is now, perhaps, one of the most significant single elements of public welfare policy, one that has, in essence, persisted for 119 years. But what is the impact on other programmes such as ACC weekly compensation?

The amount and quality of the information we have on issues associated with the fixing of a state pension age are inadequate. We need to discuss the distortions created by the present state pension age on the work/retirement decision. We do not know fundamental facts such as when New Zealanders stop working (not when they 'retire'), when they can afford to stop working or when they would prefer to stop and finally what the progress is from fulltime work to 'fulltime' retirement. There is more on this in section 16 (When do New Zealanders retire?).

---

[39] In the Minister of Commerce and Consumer Affairs' letter of 7 June 2017 (accessible here), she said "The Government considers that retaining the non-qualifying partner option is necessary to provide low-income couples with the means to smoothly transition to retirement. This is because the majority of non-qualifying partners are people approaching the age of eligibility for NZ Super." This, we suggest, easily qualifies as a statement of the obvious but is no justification for the government's decision.

[40] *Retirement Trends and Policies to Encourage Work Among Older Americans*, Gary Burtless and Joseph Quinn (2000), The Brookings Institution (accessible here).

[41] Monthly Current Population Survey data in the US cited in *Passing the Torch: The Influence of Economic Incentives on Work and Retirement*, Joseph Quinn, Richard Burkhauser and Daniel Myers (1990), W E Upjohn Institute for Employment Research (accessible here).

[42] ILO Key Indicators of the Labour Market (KILM, 7th Edition, 2011) cited in *Comparison of New Zealand and Australian Retirement Income Systems*, Ross Guest (2013) accessible here.

[43] US Labor Department data, Press report, 5 May 2017 here. Any US data about labour force participation rates after age 65 now need qualification because of the increasing state pension age.

[44] See Retirement Policy and Research Centre (2014) *Updating data on older workers*, *PensionBriefing 2014-4* (accessible here).

[45] Other countries' decisions about their state pension ages are not relevant to New Zealand's own decision. The government claimed support for lifting the age to 67 (by 2040) from the experience of other countries (see the Annex to the undated Cabinet paper on New Zealand Superannuation from Minister of Finance of March 2017 at p. 14, accessible here). However, each country's social and workforce positions are different to others and each must make its own decision based on a full analysis of relevant data. That hasn't happened so far in New Zealand.

[46] In 1898, New Zealand males had an average life expectancy of 12.8 years at age 65; females had an average of 16.9 years – *Life Expectancy (ex) by age, sex, and birth cohorts: 1876-1941*, Statistics New Zealand, accessible here. Currently males have an 18.9-year life expectancy at age 65; females will survive, on average for 21.3 years (*New Zealand Period Life Tables 2012-14*, Statistics New Zealand accessible here). Over the 119 years, males at age 65 have added an average 6.1 years; females 4.4 years.

6.3 Residency test: We pay NZS from age 65 to anyone who has lived in New Zealand for ten years after age 20 with five of those being after age 50. The government's recent announcements will see that increase to 20 years, with full effect from 2037 (after some as-yet-unclear transitional provisions for current residents and returning New Zealanders). Why 20 years? Why 10 years and why ages 20 and 50?[47].

6.4 How much? The size of the pension has had a more varied history. The age pension was modest (and both income- and asset-tested[48]) when it started in 1898. By 1940, the single person's pension was about 29% of the then national average wage (on a 'gross to gross' basis). Over the following 35 years to 1975, it fluctuated between, roughly, 27%-35%. The introduction of 'National Superannuation' in 1977 saw a major lift but, in spite of the highly politicised nature of the issue since then, has fluctuated over the last 30 years between about 40-47% of the national average wage (which was $58,745 before tax as of December 2016[49]). Currently, NZS is 40% on a pre-tax basis[50] for a single person living alone (43% on a net-to-net basis).

In 1989, the then Labour government decided that the after-tax married couple's rate should lie between 65% and 72.5% of the after-tax national average wage[51]. Currently, it is a net 66%. There was no public debate at the time about this and no 'science' to it other than that it was less than the then-current rate and was expected to save a significant amount.

Is 65% enough or too much? One measure of adequacy might be to eliminate poverty in old age; another might be to ensure 'participation and belonging'. New Zealand needs to decide what the welfare objective of NZS should be, how to test that and how to measure changes over time to ensure the objective is reached[52].

6.5 How re-valued? Until 'National Superannuation' of 1977, there had been no formal link between the pension and any measure of real value. National Superannuation made that link with the national average wage in 1977. As a country, we have never discussed whether the pension should be linked to anything in particular though some reviews have recommended that it be changed[53]. Currently the measure is a combination of the after-tax, national average, ordinary-time wage and the Consumer Price Index. Is that the best? Some say it should instead be linked to economic output; others to prices alone; yet others to a mix of prices and incomes. Some say that the CPI does not fairly reflect the prices faced by pensioners and that NZS should be measured against a 'superannuitants' price

---

[47] Before 1937, the qualifying period was 25 years - the Pensions Amendment Act 1937 (accessible here) reduced that to 10 years.

[48] The means-tests were administered by the Magistrate's Court and the weekly amount decided was published in the local newspaper: see *Part of our pensions past: the 1898 Old Age Pension* (an RPRC *PensionBriefing* of 2012, accessible here).

[49] The December 2016 national average wage was used to set the 1 April 2017 NZS rates.

[50] The pre-tax, annual NZS for a single person, living alone is $23,405 a year; $450.10 a week (2017) – see here.

[51] This is now in section 16(1)(a) of the New Zealand Superannuation and Retirement Income Act 2001 (the Act), accessible here.

[52] Given that KiwiSaver is expected to cost taxpayers $738 million for the year ended 30 June 2017 (The Treasury, *Long Term Fiscal Model 2016*), the expected benefits members will receive at the pension age could form part of the discussion about the size of NZS itself. As KiwiSaver is voluntary, that discussion will become complicated.

[53] The Retirement Commissioner's 2013 *Review of Retirement Income Policies* (accessible here) recommended that the Treasury develop a model "…that will show the likely impacts on living standards among older New Zealanders of a new method of indexation of NZS, based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year." (at page 48). Adopting that would mean a long-term reduction in the real value of NZS. There was no sign of that suggestion or of any results in the 2016 report.

index"[54]. We have never had a research-led discussion about the alternatives and their implications.

6.6 How paid for? Until 2001, New Zealand paid for NZS on a pay-as-you-go (PAYGO) basis. There was a 'Social Security Fund' between 1938 and 1964 but that was little more than a bookkeeping arrangement. In 2001, the government decided, without debate, that New Zealand needed to partially pre-fund the expected cost of NZS through contributing to the New Zealand Superannuation Fund (NZSF) that would invest in capital markets. This means that NZS will still be largely PAYGO, but a little bit pre-funded[55].

We did not have a research-led debate when the NZSF started in 2001. Some think the role of the NZSF should be significantly extended[56]; others that the NZSF be dismantled and the proceeds used to reduce government debt. Regardless, New Zealand needs to understand the economic and political considerations of the alternatives. The next section 7 (The place of the New Zealand Superannuation Fund) looks at this.

6.7 Payments to single people: Why is a single person, living alone, entitled to at least 65% of the married couple's combined rate (section 16(1)(b) of the Act accessible here)? Why is a single person living with others entitled to 60% of the married couple's combined rate (section 16(1)(c) of the Act)? Why do we pay a married couple less in total than two single people who live together? Are these amounts adequate (or too much)? When was the empirical work done to see whether the proportions might be other than they are?

6.8 Overseas pensions: The present regime for deducting equivalent overseas pensions from a resident's entitlement to NZS under section 70 of the Social Security Act 1964 is a confused, inconsistent mess. Many commentators have suggested that the treatment of overseas pensions needs an urgent review and that should happen anyway. However, it should preferably be part of the proposed research-led debate on NZS as a whole. Section 8 (Overseas pensions and section 70 deductions) below looks at this issue in more detail.

6.9 ACC entitlements: given that NZS is not income-tested, why can't an ACC recipient receive both NZS and an ACC pension (section 7(2) of the Act, accessible here)? The present law may be correct but the question needs analysis and an answer.

6.10 Periods of absence – VSA or missionary service: Sections 9 and 10 of the Act include periods of absence on Volunteer Service Abroad (here) and missionary service (here) for the residency qualification in section 8 (see paragraph 6.3 above). Why not include other charitable bodies such as the Red Cross and other "recognised aid agencies" as in section 24 (here)? Why include any of these periods of absence?

6.11 No reduction to benefits: Section 15(4) of the Act (here) says that no future CPI adjustments to the amounts payable shall result in the benefits being reduced. Why? If we go through a sustained period of falling incomes, why should the incomes of retired

[54] Statistics New Zealand has started publishing price movements as they affect 13 different household groups, including superannuitants – see *Household living-costs price indexes: Background*, 2016 accessible here. This analyses the impact that price rises have on the different groups, based on their spending patterns. Applying these retrospectively, they show that superannuitants as a group had inflation of about 0.7% p.a. more than the 'all households' group over the period June 2008 to September 2015.

[55] The Treasury estimates that, by 2060, capital withdrawals from the NZSF will be only 6.5% of the net annual outlay on NZS in 2060 (The Treasury's *2016 NZSF Contribution Rate Model*, accessible here).

[56] See, for example, *To Save or Save Not: Intergenerational Neutrality and the Expansion of New Zealand Superannuation*, Andrew Coleman (2014) accessible here.

New Zealanders increase in relative terms (by standing still nominally) while all other New Zealanders are forced to adjust to new, lower standards of living? If 65% of the average wage is the right answer on the married couple's pension, why does it become wrong if average incomes were to fall?

6.12 Hospital rates: Section 19 of the Act (here) says that the amount of NZS should reduce after 13 weeks in a public hospital to, currently, a net $48.49 a week. Why 13 weeks? Why not four weeks? What is the logic of $48.49?

6.13 Payments overseas: A number of aspects of overseas payments of NZS deserve debate:

(a) Why should NZS be payable to anyone who is overseas for up to 26 weeks (section 22 of the Act here)? Why not 13 weeks (as with hospital rates)? Why not four weeks?

(b) Why should the 26 weeks in section 22 (referred to in the last paragraph) become 156 weeks (three years) if the recipient is working (albeit on an unpaid basis) with a "recognised aid agency" (section 24 here)?[57]

(c) Why should someone who lives in a country with no "reciprocity of social security monetary benefits" receive a proportion of NZS (sections 26 here and 26A here of the Act)? Why do they get anything? What welfare obligation do New Zealand taxpayers have towards people who are no longer resident? If we do that, should that proportion be based on years of residence between ages 20 and 65 (section 26A(1)) and why might years after age 65 be excluded? If this is appropriate for emigrants, might that test also be appropriate for immigrants with overseas pensions (see paragraph 6.8 above)? Why must the person be ordinarily resident on the application date (section 26B(b)(i)) here but not before or after? Finally, why do we pay that pension gross? Why not deduct tax?

(d) Why should NZS be payable to people who leave New Zealand and live in a "specified Pacific country" (section 31 of the Act here)? Why is each of the countries listed in Schedule 2 of the Act here included[58]? Why does each person so affected need to have lived in New Zealand for 20 years (section 32(1) here)? Or to receive a proportionately reduced benefit if they have lived in New Zealand for at least 10 years?

The final important step in this process is agreeing transition provisions that move NZS from its present basis to the new 21st Century programme. The benefit design decisions will affect different groups in different ways so the transition will need tailoring to individual needs. Each of the issues described in this section raises benefit design implications that should at least be debated in the

[57] And the extension from 26 to 156 weeks applies only if the Ministry's Chief Executive is satisfied that the applicant "has not deprived another person of paid employment to engage the person to do that work on an unpaid basis". It will be interesting to know how the Chief Executive might arrive at such a conclusion and, indeed, whether the test in section 26(1)(c)(ii) has ever been applied. If it hasn't, this particular test should go.

[58] The countries included in the list of "specified Pacific countries" (Schedule 2 of the Act) are a curious mixture. Some have long-standing relationships with New Zealand (Cook Islands, Nauru, Niue, Samoa, Tokelau and Tonga). For these, the payment of NZS might be considered as part of our aid programmes. However, why does the list extend to American Samoa, French Polynesia, Guam, Marshall Islands, Palau, New Caledonia, Northern Mariana Islands, Pitcairn Island and Wallace and Futuna? All of these are either colonies of or have political ties to other countries (US, UK and France). The case is even more curious for the US and French colonies given that New Zealand does not have social security reciprocity agreements with either country. There is no obvious reason to include the other seven countries (Federated States of Micronesia, Fiji, Kiribati, Papua New Guinea, Solomon Islands, Tuvalu and Vanuatu) other than they are all in the Pacific.

context of good evidence. The debate must acknowledge that today's decisions will be made under conditions of great uncertainty so flexibility will be an important component of those decisions.

New Zealand needs to agree social policy reasons as to why the things described in this section should be so and what might be 'better' ways of achieving common goals. New Zealand has never had such a debate[59].

Each of the benefit design elements should be agreed without, at least initially, regard for the expected cost to taxpayers. What, in each case, is the 'best' answer to each benefit design question posed above?

Costings of a 21st Century NZS should be done only once all aspects of the benefit design have been tentatively settled. It is quite likely that the agreed scheme and the transition arrangements will cost more than might be acceptable to today's taxpayers. The debate on benefit design should then pull back from the 'ideal' so as to bring the new NZS within an acceptable budget. That will probably be an iterative process.

Eventually, we will arrive at a benefit design that achieves the country's agreed objectives at a cost that is likely to be acceptable now and over coming years.

A word about the Accommodation Supplement: For the reasons described in section 12 below (Housing and home-ownership), we do not know what proportion of New Zealanders over age 65 own the home they are living in. Probably about one-fifth do not. Having a paid-off home to live in is an important part of financial preparations for retirement. The state supports those who do not own, or who do own their home but are having difficulty meeting outgoings, by providing an 'Accommodation Supplement for those not living in 'social housing'. Currently that is up to $130 a week for a superannuitant (depending on where the recipient lives) and is income- and asset-tested. Higher amounts are possible if there are dependent children (see here for more)[60].

We flag this as an issue that is related to the review of the state's involvement in financial support for older New Zealanders but do not have the knowledge or experience to analyse its implications[61]. However, as with NZS itself, we need more, better data about those who retire and who do not own a debt-free home.

The Retirement Commissioner's *2016 Review* recommended an increase in the Accommodation Supplement (here at page 21) but in an evidence-free kind of way. There was no discussion or basis for her recommendation, other than "The maximum amount of accommodation supplements were last reviewed in 2005." The 2017 Budget has in fact increased them but we don't know the basis, nor whether the rates from 2018 will be 'enough' but they will be more.

---

[59] Overall, New Zealand is doing these things generally 'well'. That is reflected in 'material deprivation rates' that, for over-65s are amongst the lowest of all social groups within New Zealand. They also compare very favourably in comparisons over over-65s compared with 27 EU and two other European countries – see *The material wellbeing of New Zealand households: trends and relativities using non-income measures, with international comparisons*, Bryan Perry (Ministry of Social Development) 2016, accessible here, at page 19. As explained in this section, our current overall performance is no justification for allowing things to continue as they are.

[60] Rates and the geographic basis for their calculation will change from 1 April 2018 – see here (Budget 2017 announcements) for more.

[61] The total cost of the Accommodation Supplement for the year ended 30 June 2017, at all ages, is expected to be $1.13 billion. The changes announced in the 2017 Budget are expected to increase that to about $1.5 billion from 2018 on – see the *Budget Economic and Fiscal Update 2017* (accessible here). We could not find out how much of that related to 'retired' people.

Questions New Zealand needs to discuss on the review of NZS's design:

Based on the analysis in this section, here are the questions New Zealand needs to discuss on the design of NZS:

1. Should NZS be a universal pension (as now) or means-tested (assets, income or both)? How administratively do the income and asset tests work in Australia and how do Australians respond to those?

2. Should the state pension age be 67 (as currently proposed) or later? What about earlier or, as some suggest, 'flexible'?

3. Should the minimum residency period be 10 years, 20 years or more?

4. How much should NZS be for a couple?

5. How should NZS be re-valued each year? Why is there a floor?

6. Should NZS be pre-funded in full, partially (as now) or paid on a 'pay-as-you-go' basis (as was the case until 2001)? The discussion in the next section 7 (The place of the New Zealand Superannuation Fund) is relevant here.

7. Should single pensioners get more than each of a couple? How should the single person's rate be set?

8. Which overseas pensions should be deducted under section 70? There is more on this in section 8 below (Overseas' pensions and section 70 deductions).

9. Should ACC recipients lose their NZS?

10. Should there be 'approved' absences overseas for the residence test?

11. How much should the 'hospital rate' be?

12. Should overseas residents be entitled to any NZS? Should that be tax-free?

13. How should all this be reviewed? We think the present three-yearly review isn't working – there is more on this in section 21 below (The review process).

14. Then we need to agree the transition between current and future benefits (if changed).

Discussion of any reform should begin with agreement on the principles before the detail of any reform is examined.

7. The place of the New Zealand Superannuation Fund.

The Retirement Commissioner says that the government should resume contributions to the New Zealand Superannuation Fund (NZSF). She says that the NZSF "…helps contribute to the long term affordability of [New Zealand Superannuation]…"[62] The government agrees with the Retirement Commissioner – the only issue being when contributions should resume[63].

The NZSF was set up in 2001 to, in the words of then Finance Minister, Michael Cullen, "…smooth the future increase in the cost of superannuation over time"[64].

The NZSF will not reduce the future cost of NZS by one dollar – it may very *partially* 'smooth' the incidence of that cost but doesn't change it. Re-starting the government's contributions won't change the cost; neither will a stellar nor a poor investment performance by the NZSF's Guardians.

As stated in section 4 (How much will New Zealand Superannuation really cost?), the cost of any pension scheme, private or public, is the benefits actually paid by the scheme (plus administration costs) and that doesn't have anything to do with how it is paid for. So, unless the NZS pension is to reduce, having the NZSF doesn't change the economic implications of an ageing population. On current settings, the Treasury expects the cost of NZS to grow from a net 4.2% today to a net 7.1% by 2060. The NZSF does not affect those numbers.

Separately, the government has decided to reduce the value of NZS by shifting the pension age from 65 to 67 between 2037 and 2040; also by increasing the residence period from 10 to 20 years. The government estimates that would cut the cost of NZS by about 10%[65] but, again, the presence or absence of the NZSF doesn't change that number. Reducing the benefit is a separate issue so, for this discussion, let's leave the benefit as it is.

The Treasury's *2016 NZSF Contribution Rate Model*[66] assumes that the government restarts its contributions to the NZSF in 2021 (at nearly 1% of 2021 GDP or $3.05 billion); that the annual contribution will reduce over the years and will stop in 2035 after a further $27.7 billion has been contributed. That means taxes will need to be $27.7 billion higher than otherwise needed over the 15-year period.

When the drawdowns start in 2036, the total amount in the NZSF, in tomorrow's money, will be about $150 billion, the equivalent of 25.5% of GDP in 2036 or roughly twice today's amount in real terms.

---

[62] The Retirement Commissioner also recommended that the NZSF cease paying tax on its investment income "…while contributions are also suspended." (*2016 Review of Retirement Income Policies* here at page 20. This is probably the worst reason to allow the NZSF to be tax-free and ignores the institutional effect of creating a tax-exempt investor, New Zealand's largest investor, in New Zealand's financial markets. We strongly disagree with this unsupported, throwaway recommendation (also made in the *2013 Review of Retirement Incomes* here at page 56). The government, in its response to that recommendation of 7 June 2017 (accessible here) said "…the Government is still of the position that taxing the New Zealand Superannuation Fund investment returns provides better investment signals for those managing the Fund." We agree.

[63] Letter from the Minister of Commerce and Consumer Affairs of 7 June 2017, accessible here. The letter says it "…is likely to be in 2020/21."

[64] Michael Cullen, Minister of Finance, speech on the first reading of the New Zealand Superannuation Bill (2000) accessible here.

[65] The reduction will be 0.6% of GDP by 2040, according to Steven Joyce, Minister of Finance in a press release of 6 March 2017 *Lifting NZ Super age the right thing to do*, accessible here. Before the changes, the 2016 NZSF contribution model expected that the net cost of NZS in 2040 would be 6.0% of GDP; so 0.6% on 6.0% is one tenth of the cost.

[66] The Treasury's *2016 NZSF Contribution Rate Model* is accessible here. It takes no account of the 2037-2040 changes.

According to the *Model*, the maximum drawdown from the NZSF over the coming 100 years will be 1% of GDP or 12.5% of the net cost of NZS in 2079 and 2080. The simple average of 80 years' drawdowns in the *Model* (2036-2116) is 0.66% of GDP a year or roughly 9.5% of the average net contemporary cost of NZS across the same period.

Most assume that the NZSF was intended to smooth the costs associated with retiring baby boomers but it is actually a 'perpetuity' fund. The Treasury's *Model* shows that there will be more in the NZSF in real terms at the end of 100 years than there is today (31.2% of 2116 GDP compared with 12.3% today). So why precisely do we need such a fund? It will apparently still be with us long after the last of the baby boomers and their children has died.

The most that can be said about the NZSF is that it slightly changes the incidence of the cost of NZS but NZS, without the government's benefit cuts, will cost the same. However, instead of asking tomorrow's taxpayers to foot the full bill, today's taxpayers are paying twice – once for today's NZS and then extra to put in the NZSF. The Treasury's *Model* suggests that today's taxpayers will pay $3 billion more in 2021 (making 2021 taxes $86 billion rather than $83 billion) just so that taxes from 2036 onward will probably be slightly less for tomorrow's taxpayers.

There is a lot wrong with the idea of partially pre-funding NZS - here are the main problems:

(a) Constrains tomorrow's decision-makers: If we think NZS will be too expensive for tomorrow's taxpayers without the NZSF then it should be their decision to cut benefits, not ours to constrain change ('we baby boomers paid more taxes to protect our pension'). Adding the NZSF could be seen as an attempt by us to limit their ability to reduce future NZS pensions.

(b) 100% leveraged: Although the contributions to the NZSF came from higher taxes over the 2003-2009 period (not directly borrowed for the purpose) when we look at the money held in the NZSF from year to year, the argument changes. Investing in the presence of debt is exactly the same as borrowing to invest. In 2017, the government should treat every dollar in the NZSF as effectively a dollar borrowed. That's because, at any time, it could sell those assets and repay debt. The government has effectively raised a mortgage of about $34.5 billion (April 2017) on New Zealand's total assets (including the NZSF's assets) to invest in financial markets. The return on the NZSF's assets must at least equal the most expensive $34.5 billion of the government's borrowings (the 'hurdle rate'), plus the costs of running the NZSF, before there is any net gain to holding those assets rather than repaying the debt.

(c) Leverage magnifies risk: The investment risk is very high with a 100%-leveraged portfolio. Leverage magnifies both good and bad results. This is a financial risk that the government doesn't have to take and shouldn't. Unless the NZSF achieves a return that, over the long term is at least equal to the 'hurdle rate' then the presence of the NZSF will make NZS more expensive than its pure pay-as-you-go alternative. However, just achieving that hurdle rate is not enough. The risks associated with a 100%-leveraged portfolio also need to be paid for. In other words, the 'hurdle rate' should be risk-adjusted[67]. While the NZSF may have its own internal measures of success, the

[67] The NZSF itself compares its performance with 90-day Treasury bills (usually the government's cheapest debt) and, separately, against "…the Treasury Bill return +2.7% p.a. over any 20-year moving period." (see here). Neither of these adequately compensates taxpayers for the risks associated with a 100%-leveraged portfolio. The most recent pre-tax returns since inception (to 31 December 2016) are 10.04% p.a. (see here). The 90-day bill measure was 4.29%

government should separately calculate a risk-adjusted hurdle rate and publish that on a regular basis to justify, or not, the government's policy decision to maintain the NZSF in the presence of debt. The NZSF should not do that calculation because it does not run the risks associated with missing the hurdle rate.

Just looking at the 'equity risk premium' or ERP and putting to one side the issue of 100% leverage, the government's independent calculation of the ERP would put that at between 4 to 7.5 percentage points above the 10-year bond rate[68]. The Treasury itself uses 4% in its assessment of the projected capital returns from the New Zealand Superannuation Fund[69]. Most alternative measures would be higher than the NZSF's own internal measures[70].

(d) Cookie jar economics: The NZSF is a good example of 'cookie jar economics' – if we tuck this money into a jar labelled 'superannuation', we can all save together for our collective retirement. For the reasons explained in section 4 (How much will New Zealand Superannuation really cost?), it's not possible for a country to defer consumption or 'save' in this way. The government's consolidated audited accounts put all of its financial activities into one spot. With the NZSF, the government's financial statements for the period ending 30 April 2017 (accessible here) show that we taxpayers owe the rest of the world $62.7 bn. Without the NZSF cookie jar, that debt would be less than half. Having the cookie jar and higher debt does not improve New Zealanders' future retirement income security which is normally the point of pre-funding.

(e) Total taxes higher over long-term: Long term, total taxes collected will probably be higher in the presence of the NZSF than if it had never started. We know that governments since 2001 have collected too much tax from us to pay for just NZS. Those excess taxes ($14.88 billion[71]) currently sit in the NZSF together with investment income (less tax and expenses). The government says it wants to start collecting more excess tax from about 2021[72].

We need to anticipate what might happen when the capital drawdowns start. The Treasury's *Model* suggests that the first payment from the NZSF in 2036 will be $118m or just 0.02% of GDP in that year. Those drawdowns will average 0.66% a year of nominal GDP in the 80 years between 2036 and 2116, the equivalent of about $1.75 billion in today's terms. For tomorrow's governments, that will look like 'free' money. Unless those governments make a conscious decision to reduce the overall tax take by the amount of the drawdowns, the economic underpinnings of the NZSF concept will disappear (higher taxes today for lower taxes tomorrow). Instead, total taxes will be higher over the long run in the presence of the NZSF.

---

p.a. while the Treasury Bill + 2.7% comparator was 6.78% p.a. over the same period. We suggest that the achieved returns and the two comparators do not adequately compensate taxpayers for the risks.

[68] Bart Frijns in *Equity Risk Premium* (accessible here) suggests that the pre-tax ERP for a New Zealand portfolio should be 4.78%, based on share prices, dividend yields, inflation rates and 10-year government bond yields from 1899 to 2016. A post-tax ERP that the NZSF fund requires would be higher.

[69] *The Market Equity Risk Premium* (2005), The Treasury – accessible here.

[70] As already mentioned, the NZSF's own internal "performance expectation is now NZ Treasury Bills + 2.7% pa" over a rolling 20 year period (see *2015 Reference Portfolio Review* (2015) NZ SuperFund here). The Guardians also compare the NZSF's performance against a self-constructed 'Reference Portfolio'.

[71] Source: Undated Cabinet paper on New Zealand Superannuation from Minister of Finance of March 2017 para 67 at p. 9, accessible here.

[72] "Contributions to the Fund will resume from when core Crown debt falls below 20% of GDP. This is currently expected to occur in 2020/21." Cabinet paper *op cit*, para 67 at page 9.

There are other important, difficulties:

1. **Deadweight cost of tax:** Collecting taxes is not costless to the economy. Higher taxes (including higher taxes than are currently 'needed') impose indirect costs, such as the 'dead-weight costs' on the economy. People change their behaviour as a result of tax changes and that has a direct cost to the economy. Each extra dollar of tax has a measurable direct and indirect cost of collection to the economy[73]. Those extra costs (amortised) should be added to the hurdle rate discussed in (c) above.

2. **No domestic investments; no bonds:** Investing domestically makes no economic sense for the NZSF and not much investment sense unless it leads to genuine higher economic growth. If the NZSF were all invested locally, its performance would echo the country's economic performance. In an economic downturn, when everyone is tightening their belts, negative performances from the NZSF could put the security of NZS payments at risk and magnify the impact of the downturn. The NZSF should effectively be an insurance fund that offers some economic protection against New Zealand's poor performance, relative to the rest of the world. This suggests that all investments should be overseas[74] and none should be invested in fixed interest securities (because the money used for that investment is effectively all borrowed[75]). At 30 April 2017, 15% of the investments were in New Zealand and 11% in fixed interest (see here).

3. **No useful economic impact:** The presence of the NZSF does not increase the capacity of the New Zealand economy to cope with larger numbers of 'non-producers' or to improve the affordability of tomorrow's NZS. The presence of the NZSF can only be justified in this wider context (improving the sustainability of NZS) by increasing output, raising productivity or constraining the output of future workers (to make more consumption available to retirees and other non-workers). If it were entirely invested overseas, the NZSF cannot achieve any of those objectives.

4. **Why pre-fund just pensions?** There are no particular grounds for pre-funding NZS as opposed to pre-funding other government programmes like health, infrastructure, policing or the armed forces[76]. What particularly is it about the age pension that deserves this special treatment?

5. **Behavioural impact:** New Zealanders may be negatively influenced in their own saving decisions by the presence of the NZSF. Its presence might suggest that New Zealanders do not have to save for retirement for themselves – the government is doing that for us all

---

[73] Estimates of the deadweight cost depend on the calculation basis used. In the Treasury's *Guide to Social Cost Benefit Analysis* (July 2015, accessible here) at page 15, it observed that "Attempts have been made at estimating these effects, with estimates varying from 14% to more than 50% of the revenue collected…This guide suggests a rate of 20% as a default deadweight loss value in the absence of an alternative evidence based value. Thus public expenditures should be multiplied by a factor of 1.2 to incorporate the effects of deadweight loss."

[74] Domestic equity-style investments could be justified only on the basis that they will add to New Zealand's economic welfare by creating new jobs or improving productivity, not simply that it is a 'sensible' investment.

[75] Borrowing to invest in equities is risky but has a prospect of returning net gains over the cost of debt. That prospect is reduced or even eliminated if the borrowed money is used to invest in bonds.

[76] On similar grounds, there is no economic or fiscal point in pre-funding the Accident Compensation Corporation's liabilities, nor for re-building the EQC Fund. On the ACC, see the RPRC's *PensionCommentary 2009-1 – Why does the Accident Compensation Corporation have a fund?*, Michael Littlewood, accessible here. On the EQC, see the RPRC's *PensionCommentary 2011-1 – Why does the Earthquake Commission have a fund?*, Michael Littlewood, accessible here.

6. **Politicises sustainability:** The presence of the NZSF politicises the issue of the sustainability of NZS. Everyone thinks they have an investment answer to the future affordability of NZS[77].

Tomorrow's taxpayers will (and should) decide on their government's spending priorities that will, as now, balance all the different claims against revenues, electoral appeal etc. That will be the case for health, defence, policing, prisons, education and all of the government's 'other' activities.

And that should also be the case for pensions, both to the old and to the dependent young.

Nothing that today's taxpayers decide should interfere with that process in 2037 or 2060 – and it will not, even in the presence of the NZSF. That is the essential pointlessness of the NZSF which, if it achieves anything at all, will only get in the way of 'sensible', contemporary decisions.

Some might ask 'what about intergenerational equity?' The baby boomers have benefited from all kinds of things (education, jobs, housing, growth etc.) why shouldn't they help pay for their own state pension through the build-up of the NZSF?

If there is anything in the partial pre-funding argument about intergenerational equity, that doesn't apply to the NZSF. It is an 'in-perpetuity' fund so the higher taxes paid by baby boomers in the years to 2035 will be still there for the grandchildren of the baby boomers. As already mentioned, there will be more money in the NZSF, in real terms, in 100 years than there is today. The NZSF has nothing to do with intergenerational equity.

If effectively borrowing $34.5 billion (as of 30 April 2017) to invest in financial markets makes any economic sense then, rather than resuming contributions in three years or so, why doesn't the government borrow another $34.5 billion today? We hope that's a rhetorical question.

Instead of resuming contributions to the NZSF in 2021, we think the government should wind it up, sell the assets and repay $34.5 billion of its current $62.7 billion in debt (at 30 April 2017). That way, it will also save the $30.54 million in salaries and bonuses that the NZSF's 115 staff received in 2016[78]. They may have deserved those, but New Zealand really doesn't need the NZSF.

We do not necessarily criticise the Guardians or the staff of the NZSF for the job they have done; we just suggest it's a job they should not have been given.

Questions New Zealand needs to discuss on the role of the NZSF:

1. New Zealand needs a complete and independent review of the underpinning logic of the NZSF's existence. How precisely does higher government debt and associated financial assets improve the security of future superannuitants' pensions? What risks might this strategy involve? How should those risks be priced?

---

[77] And asking New Zealanders what they think about the NZSF helps to politicise the issue. In *A Practical Approach to Well-being Based Policy Development: What do New Zealanders Want from Their Retirement Income Policies?* by Joey Au, Andrew Coleman and Trudy Sullivan (Treasury, 2015 accessible here), the authors found that, based on a survey of 1,066 New Zealanders, "…a policy that more aggressively prefunds New Zealand Superannuation by immediately raising taxes is supported by a majority of people of all ages and income groups." From the report, we cannot tell precisely what questions induced this response but we can probably assume it did not include a statement along the lines that the NZSF that receives those higher taxes will not change the future cost of NZS by a dollar. As the report itself says, "One issue that underlies the whole survey is framing. It is well known that the way questions are framed can have an enormous effect on survey responses." (at page 12).

[78] Employee salary data and employee numbers from the *Annual Report 2016* (accessible here) at pages 162 and 67.

2. Even if, despite our recommendation to wind up the NZSF, it continues as now, how well has the NZSF performed against two key measures:
    a. The government's most expensive debt in each measurement period (that could be repaid if the NZSF were wound up)?
    b. On an agreed risk-adjusted basis?

   in either case, allowing for the deadweight costs of extra tax incurred by the contributions.

3. If the NZSF continues, how can we assure today's taxpayers that, by paying more in taxes today (between 2021 and 2036), they will see a reduction in the taxes they will have to pay once the drawdowns begin?

4. Can we assure tomorrow's taxpayers that the presence of the NZSF does not constrain, in any way, their ability to reduce NZS?

5. Does the presence of the NZSF increase the economic activity above the level of growth that otherwise would have occurred?

8. Overseas' pensions and section 70 deductions

Normally, someone is entitled to a full NZS pension after ten years' residence and with at least five of those years being after age 50. However, if someone has what the Ministry of Social Development (MSD) decides is an equivalent state-administered pension from another country[79], the MSD's Chief Executive can reduce NZS by that overseas pension under section 70 of the Social Security Act 1964. This is called the 'Direct Deduction Policy' or DDP.

The Retirement Policy and Research Centre (RPRC) has done a lot of work on the difficulties associated with the administration of section 70 including, most recently, a report for the Retirement Commissioner's 2016 review[80]. That work includes two forums, six working papers, a *PensionBriefing* and a published article. They are listed here.

In summary, there has been no change to the way the MSD administers section 70 despite the significant difficulties highlighted by the RPRC's work. Even Parliament's Social Services Select Committee expressed concern about anomalies and unfairness but, in April 2013, declined to initiate an enquiry.

In brief, the problems with section 70 stem from two aspects of the design of NZS:

- The universality of NZS – everyone over age 65 receives it, regardless of other income or assets;
- The relatively short qualification period (currently 10 years, increasing to 20 years).

The DDP's underpinning principle is that a New Zealand resident should not receive two Tier 1 age pensions and we support that principle. It does not matter if a pensioner has 'contributed' to the other country's pension; nor does it matter if that pension has 'accrued' by years of residence or years of work in that country. As long as that pension performs a similar function to NZS in the other country then we agree that the overseas pension should be topped up to the level of NZS. Another way of expressing that is to deduct the overseas pension from NZS.

At March 2016, 83,982 or 12.1% of all NZS recipients[81] were affected by the DDP with pensions totalling $343 million a year from 70 countries[82]. For the eight countries most affected, the number of pensions has grown by 43% in five years (to 2016). With increasing international mobility, the proportion of pensioners affected by the DDP will grow.

The DDP's principle is correct but the devil is in the detail. Here are the main difficulties with the MSD's current policy:

1. **Spousal pensions:** NZS is an individual entitlement (and is relatively unusual in that regard) – each person who qualifies receives the pension directly – the amounts differ by status (married, 'single sharing accommodation' and 'single living alone'). Currently, if Spouse A (married to Spouse B) receives an overseas pension that is greater than NZS, the

[79] "The benefit, pension or periodical allowance, or any part of it, is in the nature of a payment which, in the opinion of the chief executive, forms part of a programme providing benefits, pensions, or periodical allowances for any of the contingencies for which benefits, pensions or allowances may be paid under ... the New Zealand Superannuation and Retirement Income Act 2001 ... which is administered by or on behalf of the Government of the country from which the benefit, pension or periodical allowance is received ..." (The Social Security Act, 1964, section 70(a) here).

[80] *New Zealand Superannuation and overseas state pensions*, M. Claire Dale and Susan St John, September 2016 (accessible here).

[81] There were 696,803 NZS recipients at 31 March 2016 – see *Description of New Zealand's current retirement income policies*, Ministry of Social Development, May 2016 (accessible here), page 4.

[82] Details cited in Dale and St John, *op cit* at pp16-17.

excess reduces Spouse B's pension even though Spouse B has no direct entitlement to that overseas pension and may have never lived in the other country[83]. However, if the MSD can establish a specific spousal allowance as a component of the overseas pension[84] then we think it can reasonably apply that allowance under the DDP to Spouse B's NZS. The MSD currently makes no such distinction and should.

2. **Occupational entitlements:** The MSD thinks that if a pension is administered by the government in the other country then it automatically performs a similar function to NZS. That is wrong though we can see it makes the MSD's job much easier. Canada illustrates the issue – there are two state-*administered* pensions: Tier 1 (the 'Old Age Security') performs a similar function to NZS and should be subject to the DDP. Tier 2 (the Canada Pension Plan or its mirror, the Quebec Pension Plan) is entirely different. It is wholly funded by members and their employers and is very like the Tier 3 private occupational pensions that are common in many countries[85]. Although the Tier 2 CPP is administered by the Canadian government (and the QPP by the province of Quebec), there is no possible justification for suggesting that it performs a similar public policy role to NZS. The fact that section 70 gives the MSD the power to say it does (as demonstrated by the unsuccessful appeals by affected pensioners) does not justify the MSD's position.

3. **The particular case of Australia:** Australia and New Zealand have similar Tier 1 pensions – nominally universal and currently paid after 10 years' residence. Two things make the Australia/New Zealand pension 'relationship' different:

   (a) Because of the 1994 Social Security Agreement between the two countries[86], residence in either country counts in the other, regardless of nationality;

   (b) The Australian 'Age Pension' is income- and asset-tested.

   Australian residents who fail to qualify for the Age Pension or whose Age Pension is reduced because of their income/assets can retire in New Zealand on full NZS from the day they arrive in New Zealand (as long as they have at least 10 years' residence in Australia)[87]. Conversely, New Zealand superannuitants who retire to Australia, lose NZS and become entitled to the Age Pension and subject to the income/asset tests. On the face, this seems an unbalanced relationship and leaves New Zealand taxpayers vulnerable.

4. **The particular case of China:** There is no national pension in China that is equivalent to NZS. Individual programmes of various kinds have covered urban and rural, salaried

---

[83] The Periodic Report Groups (1997, 2003), the RPRC, Retirement Commissioner's reviews (2004, 2007, 2010, 2013, 2016) and the 2014 MSD Briefing to Government have all drawn attention to the need to remove the spousal deduction provision.

[84] Some countries (such as the UK) pay a pension to Spouse A (in our example) that is specifically increased if Spouse A has a dependent adult (that will stop in 2020 with the new 'Single Tier State Pension'). In that situation, the overseas spousal allowance is analogous to Spouse B's NZS.

[85] A pension that arises from government service is excluded if it qualifies under the definition of a 'government occupational pension' in section 3 of the Social Security Act. That must, however, relate to the person's government service. The fact that it is an occupational pension rather than one that is analogous to NZS should be all that matters. If the pension's derivation drove the distinction as we suggest, Canada's CPP and QPP would be outside the DDP.

[86] The 1994 Agreement was amended in 1998, 2002 and 2009. The Australian agreement is one of eight with different countries – the others are the United Kingdom, the Netherlands, Canada, Greece, Ireland, Denmark and Jersey and Guernsey.

[87] New Zealand's state pension age will be out of phase with Australia's from 2023 (see here) as it shifts from 65 to 67 while we keep age 65 until 2037-40. That process has already started as the Australian qualifying age is now 65½. If the Australian government realises its wish to increase its state pension age to 70 between 2025 and 2035 (see here), that discontinuity will become more pronounced and permanent. Under current rules, those discontinuities will increase the incentives for older Australians to move to New Zealand.

and non-salaried workers separately with different social insurance and compulsory saving accounts that have been enforced and administered disparately. Since 2011, the social security programmes are gradually being unified under a national programme. The government aims to have this completed by 2020[88]. The minimum pension under this 'national' scheme applies only after 15 years of contributions.

The relevance of this patchy and currently deficient arrangement to the DDP debate is that Chinese immigrants arrive with no or very small state pensions and so the major share of the cost of NZS for this group is borne by New Zealand's taxpayers. That seems generous, to say the least.

5. **The particular case of the United Kingdom:** Until recently, the UK had a two-tier state pension – Tier 1 (the 'Basic State Pension') performed a similar function to NZS but was somewhat less generous and depended on a complete contribution record. Tier 2 was a work-related, defined benefit 'State Second Pension' that started in 1978 and was related to workers' pay and length of membership. Together, they can reasonably be aggregated for the DDP[89].

   However, employers could contract-out of the State Second Pension by providing a private scheme that offered benefits that were at least as generous as the State Second Pension. In exchange, both the employer and employees paid reduced 'National Insurance Contributions'. Those private, state-equivalent benefits are currently not caught by the DDP whereas the State Second Pension is. That is inconsistent.

6. **The particular case of the United States:** NZS and most pensions deducted under section 70 are Tier 1 pensions. The US has a Tier 1 pension called the 'Supplementary Security Income' or SSI. However, it is a poverty-alleviation, low level pension that is paid to very few people – less than 20% receive any SSI. It cannot be paid outside the US. The main state pension is at Tier 2 ('Social Security') and that is currently deducted under section 70's DDP. We think that is correct but it does illustrate the need to look at each country's arrangements to see what pension performs a similar role to NZS.

The RPRC has suggested a number of possible reforms and we need to discuss those. The Retirement Commissioner recommended "[r]emoving spousal/partner deductions with immediate effect"[90]. However, the government won't start that discussion. In its response to the Retirement Commissioner, the Minister stated:

> "The Government does not support removing spousal/partner deductions. The purpose of spousal/partner deductions is to ensure that couples with an overseas pension receive the same level of government-administered retirement income as lifelong New Zealand couples."[91]

The Retirement Commissioner and the government are talking past each other, underlying the main message of this report which is that New Zealand needs better information and a proper, evidence-led discussion. We need to agree the DDP's principles before discussing the detail and the government must agree to starting that discussion.

---

[88] Source: *Social Security Programs Throughout the World: Asia and Pacific*, 2016 accessible here.

[89] This two-tiered arrangement was replaced from 6 April 2016 by a single-tier State Pension, with protected rights for accruals under the previous State Second Pension. The special case of the UK will eventually cease to be an issue under New Zealand's DDP because there is no 'contracting out' under the single tier pension.

[90] Retirement Commissioner's 2016 Review of Retirement Income Policies accessible here, at page 25.

[91] Letter from the Minister of Commerce and Consumer Affairs of 7 June 2017, accessible here.

Questions New Zealand needs to discuss on overseas pensions and section 70:

1. Should New Zealand 'look after' (provide NZS benefits for) periods before an immigrant arrives in New Zealand? In other words, is the principle of 'universality' more important than what might be regarded as 'equity' as between the 'obligations' of different countries to their citizens' periods of residence?

2. If NZS is not to be truly universal for immigrants, what is the fairest way of calculating their entitlements to NZS? The main alternatives are:
    a. Top up the overseas pension(s) to NZS – broadly the current DDP policy;
    b. Strengthen the New Zealand residency period and ignore the other countries' pensions;
    c. Pay immigrants a proportionate amount of NZS based on the period of residency between the 'minimum' age (currently age 20) and the state pension age (currently 65) – that means New Zealand would pay no regard to the overseas pensions themselves.[92]

3. If the overseas pension is to form part of the NZS calculation (option 2 a. above), which particular overseas state pensions should be counted?

4. If the DDP continues, why aren't the pension arrangements of every country that provides immigrants examined and a guidance note issued by MSD for each country explaining why that programme is included in the DDP?[93]

5. Again, if the DDP continues, why isn't section 70 moved from the Social Security Act 1964 to the New Zealand Superannuation and Retirement Income Act 2001? NZS is an individual entitlement and needs its own tailored version of section 70[94].

[92] This kind of calculation applies when a superannuitant leaves New Zealand after age 65 – NZS is re-calculated based on months of residence after age 20. The full pension remains payable only after 45 years' residence.
[93] The Retirement Commissioner's *2016 Review* recommended the publication of those details (see here at page 25). The government, for no stated reason, disagrees. In the Minister's letter of 7 June 2017 to the Retirement Commissioner, she said: "While the Government is not in favour of publishing a list of overseas pensions that are deducted from NZ Super and social security benefits, the Ministry of Social Development will consider how to improve the accessibility of information through its website. (letter accessible here). We don't understand why the Minister supports that view, nor why the Ministry hasn't already agreed to publish that information. As a service-provider, it should be thinking about its 'customers'.
[94] This change means that the income-testing measure in the Social Security Act (based on *household* income) could be tailored to the NZS benefit that is an *individual* entitlement.

9. On tax subsidies for saving[95]

While governments can certainly influence the ways in which people save for retirement, they seemingly cannot incentivise people to save more for retirement than they want to save. Tax-favoured Tier 2 (compulsory) or Tier 3 schemes (voluntary and occupational) may see more financial assets accumulated than in the absence of such schemes but again, savers can and do change other aspects of their behaviour.

A set of acronyms summarises the tax treatment of financial assets, particularly in a retirement saving context. There are three main movements of money:

- **contributions**: 'T' means that contributions to the scheme come from after-tax income; 'E' that contributions reduce *taxable* income before tax is deducted (or attract a direct subsidy); also, in the case of occupational schemes, that the employer's contributions are not deemed part of the employee's taxable pay.
- **investment income on the accumulation**: 'T' means that invested assets are taxed with the saver's other income; 'E' that the assets accumulate tax-free.
- **benefits received**: 'T' means that benefits are taxed as income in the year of receipt; 'E' that benefits are exempt from tax in the recipient's hands.

Most countries treat retirement savings on EET principles – contributions are deductible or directly subsidised through the tax system and, for employees, not deemed to be part of pay (E); there is no tax on the saving scheme's investment income (E) and the final benefits (usually pensions) are taxed as income (T). In an *expenditure tax* environment, EET is relatively neutral[96].

That's because if the government relied entirely on expenditure taxes, taxes are collected when the savings and all other assets are spent. However, in a world where most government revenue is collected from taxes on income, EET is highly favoured[97]. Such a strategy must therefore be designed to encourage greater self-provision for retirement and, impliedly, to reduce pressure on future government-delivered age pensions. That last justification would be part of a stronger case if the state pension were means-tested. Few countries' age pensions are so tested.

TTE is a 'neutral' treatment in an *income tax* environment. A bank account is a convenient example: savings into the account come from after-tax income (T); interest earned on the account is added to the saver's other taxable income (T) while withdrawals from the account are exempt (E). They are not really 'exempt'; they are withdrawals of tax-paid capital.

Countries have different shades of these mixtures and usually run both together. Financial savings that are locked up for retirement may be EET while accessible bank accounts (another potential part of the retirement savings fabric) are TTE. There may also be reduced tax on 'retirement'

---

[95] This section is based on a submission by Michael Littlewood for the Retirement Commissioner's 2016 Review: *Ageing populations, retirement incomes and public policy: the four 'first principles' of policy-making - A submission to the Commission for Financial Capability* (accessible here).

[96] They are 'neutral' as long as the marginal tax rates on retirement incomes are equivalent to the rates payable on income during the accumulation period. However, given that retirement incomes are generally lower, average taxes on retirement income will also generally be lower. This means that, even if all withdrawals are taxed under EET (that usually doesn't happen), there is a natural tax bias that favours EET in an expenditure tax environment.

[97] In New Zealand, about 60% of tax revenue was income tax in the 2014/15 year: see *Briefing for the Incoming Minister of Revenue – 2015*, Inland Revenue (accessible here). 40% was through GST and excise duties.

accounts. Australia has 'ttE'[98] which means lower levels of tax than 'normal' on contributions and investment income but, overall, retirement saving schemes are greatly favoured by comparison with, say, bank accounts. On generous assumptions, Australia's ttE is broadly equivalent to the more usual EET.

Of the three money movements, the tax treatment of the investment accumulation is the most significant. This reflects the power of investment earnings (i.e. 'compound interest') over the very long periods involved in retirement saving's accumulation and decumulation periods and the difference between pre- and post-tax returns. Even small differences between pre- and post-tax returns create large differences in the eventual size of the retirement accumulations. Because of the relatively shorter decumulation period in retirement, even if all the benefits were taxed at the retiree's top personal tax rate, the government will never recover the value of the concessions given on contributions to the scheme and investment income earned on the accumulating savings[99]. That makes tax incentives for retirement saving very expensive, especially over the long run[100]. That is not their only difficulty:

(a) Tax incentives are regressive: The rich can afford to contribute more and so capture most of the value of the concessions[101]. Poorer taxpayers, who cannot afford to save, help pay for the cost of the tax concessions ('my tax concession is someone else's tax cost').

(b) Regulations are complex: Savings that attract the concessionary treatment must be kept under EET for decades so the regulations that control the money's entry, accumulation and exit are necessarily intricate[102]. As individuals game the system, the regulations inevitably become more complex and more expensive to administer.

(c) Distortionary: Tax concessions 'label' a particular form of behaviour as preferable to other equivalent behaviour. EET-approved retirement saving schemes are seemingly better for savers than, say, a bank account that retains the TTE treatment. Advocates for tax incentives should show why locked-up savings are better for a country than accessible equivalents[103].

---

[98] Ross Guest in *Comparison of the New Zealand and Australian Retirement Income Systems* (2013) accessible here summarises the tax treatment: in Australia, contributions are taxed at a flat rate of 15% to an annual cap of $A25,000. Investment income is taxed at a rate that probably averages 8% and benefits are tax-free if withdrawn after age 60. The lowest individual marginal rate of income tax is 19% after a tax-free band of $A18,200. The tax rules changed from 1 July 2017, including reduced concessions for very high earners and deductibility for employee contributions (see here).

[99] In *How to create a competitive market in pensions: the international lessons* (1998), Institute of Economic Affairs, London, Michael Littlewood explains the mathematics behind this suggestion.

[100] Not many countries count the cost of tax incentives for retirement saving. In 2009, Australia spent almost as much on tax incentives ($A24.6 bn) as it spent on the entire Tier 1 'Age Pension' ($A26.7 bn) – see *The great superannuation tax concession rort* (2009), David Ingles, The Australia Institute (accessible here).

[101] David Ingles (*op cit*) suggests that in Australia, "The current concessions provide almost no benefit to low-income earners." Again: "The system has become so skewed that the annual cost of providing superannuation tax concessions to high-income earners is much greater than the cost of simply paying those same individuals the age pension. Providing tax concessions for superannuation as a mechanism to help insulate the budget from the cost of providing for an ageing population is not sensible." In the US, about 80% of the value of tax concessions is captured by the top 20% of earners; the bottom 60% of earners capture just 7% of that value – see *Tax Deferred Retirement Savings*, Seth Hanlon (2011) Center for American Progress, accessible here. Again in the US, the Congressional Budget Office estimates that the top 20% of households receive nearly twice as much in retirement tax subsidies as the bottom 80 percent combined – see *The Distribution of Major Tax Expenditures in the Individual Income Tax System* (2013), accessible here. The total cost of those subsidies to the US tax system was $US137 billion (0.9% of GDP) in 2013.

[102] 'Protecting' the tax concessions in KiwiSaver is relatively less intricate than applies in most other jurisdictions though there is 'leakage' (first home concessions; disability; death, emigrants).

[103] Some suggest, for example, that "The concessional taxation of superannuation [retirement savings] is…intended to address the bias in the current taxation system against long-term saving." *Submission to the Financial System* Inquiry, The Department of the Treasury, Australia, 3 April 2014 at page 44 (accessible here). This presumes a public policy interest in the relative quality of long-term savings ('better') than short-term savings ('worse'). Expected after-tax returns on savings, from a timing perspective, should be for savers and investors to decide, not governments.

Tax incentives also distort 'signals'. Fund managers should aim to deliver real returns (more than inflation) to savers. That task is much easier under EET by comparison with an environment where all 'income' is taxed. Coupled with the fact that EET savings are locked-in until retirement, fund managers do not have to work as hard to achieve real returns or to retain existing business.

Also, savers themselves do not capture the full value of EET concessions. Savers can afford to be less sensitive to the fees charged by managers of EET savings compared with their TTE equivalents. That special treatment increases the risks of capture by managers and promoters. Locking EET savings up until retirement increases those risks.

There is also a suggestion of an unintended consequence of New Zealand's TTE regime. Andrew Coleman[104] thinks it may be a cause of New Zealand's runaway house prices. Housing has a more favourable tax treatment than retirement saving so disadvantaging the latter. Because it seems politically difficult to fix the tax treatment of housing it may be preferable to move to the internationally more usual EET for retirement savings. The trouble with this argument is the absence of direct evidence of the linkage, as the author himself acknowledges. There may be a correlation or even a coincidence of timing but, unless a direct link is established, this seems a poor justification for re-introducing the distortions of EET to retirement savings. New Zealand may be the only country to have TTE but is not the only country with significant recent increases in house prices.

(d) Inequitable: As with compulsion at Tier 2 (see the next section 10), a retirement income policy driven by work-based income necessarily favours higher income earners. This is a separate point from the regressive nature of tax concessions (paragraph (a) above). Those with higher rates of pay increases and more complete working lives tend to save more when saving rates are set in relation to pay. They arrive at retirement with larger retirement accumulations both in money terms and as a proportion of pay. Tax concessions that favour occupational saving schemes tend to institutionalise these inequalities.

(e) Deadweight costs: There are 'deadweight' losses to the economy of collecting the extra taxes needed to finance the more fiscally expensive, front-loaded EET environment. These costs reflect the value of the opportunities that are effectively lost when taxation diverts labour and capital from their best uses[105].

(f) Loss of flexibility: Next, individuals face costs through a loss of flexibility. Savings might be better spent from a lifetime perspective on an earlier financial crisis (such as a health condition or housing issue) or on a more productive investment, such as buying and building a business or reducing debt. Compulsory private provision at Tier 2 faces parallel difficulties.

(g) Do they work? Given that all countries have tax concessions for retirement saving, we might expect studies that demonstrate the 'value for money' test. Do tax incentives actually increase savings? The answer is 'possibly not' despite very large sums that accumulate in tax-favoured schemes. It's very difficult, perhaps impossible, to work out because we do not know what might have happened in the absence of the incentives; what economists call the 'counter-

[104] *Housing, the 'Great Income Tax Experiment', and the intergenerational consequences of the lease*, Andrew Coleman, 2017 University of Otago Business School, accessible here.

[105] This is the same point as referred to in section 7 above with respect to the extra taxes needed to pay for contributions to the NZSF.

factual'[106]. Some studies suggest the overall impact on the quantum of savings and national saving rates is doubtful[107].

In fact, if households as a whole were *perfectly* rational, they would allow for the value of tax concessions when setting target retirement saving levels. The annual amounts required to meet a given target are less if those savings are subsidised through favourable tax treatment. We should therefore expect lower annual levels of household saving in a tax-favoured EET environment than under TTE because of the large value of the concessions given by taxpayers to the saver's lifetime saving project. Given that tax breaks seem not to 'improve' the quantum of savings (along with the other difficulties described above), the expensive, complex concessions in an EET environment arguably become pointless.

As a result, while tax policy (or a matching contribution that has similar characteristics to a concession such as KiwiSaver's 'member tax credit') encourages contributions to a retirement saving vehicle (public, occupational or retail), we should expect EET-based incentives to have little, long-term effect on national saving. There have been remarkably few studies as to whether tax breaks work to improve national saving levels and we have offered some international evidence on that issue. Further work is needed both to identify overseas studies and to understand the effect of KiwiSaver subsidies on New Zealanders' recent behaviour. We have more to say on this in section 11 (The role of the government).

There is no doubt that the financial services industry favours tax incentives for retirement saving and that alone should give us pause for thought. It is so much easier to generate new business when there is a time-dependent amount paid for by taxpayers.

Given that tax breaks for retirement saving are expensive, complex, inequitable, distortionary, regressive and seemingly don't work, it's difficult to understand why the government might be interested in using tax to increase subsidies to savings. The Minister of Finance, Steven Joyce answered a reporter's question about that in the 2017 Budget lockup as follows:

> "That's an issue that, from my perspective, would repay further work," Mr Joyce said in the yesterday's pre-budget media and analysts' lockup at the Beehive…
>
> "I literally didn't have time to have a look at it in the current cycle but I'd like to have a look at it in future years – if I get the opportunity."[108]

It might be too much to ask that any review of that issue addresses, let alone answers, any of the problems we have identified with tax breaks for saving but we will suggest the questions anyway.

---

[106] Spain introduced tax incentives for retirement saving in 1988. A report on household behaviour across their introduction concludes that "at most" only one quarter of the contributions were 'new' savings: see *The Effects of the Introduction of Tax Incentives on Retirement Savings* (2007), Juan Ayuso, Juan Jimeno and Ernesto Villanueva, Banco de España (accessible here). That analysis took no account of the cost to the tax system of lost revenue.

[107] Alicia Munnell in *Current taxation of qualified pension plans: has the time come?* (1992) Federal Reserve Bank of Boston (accessible here) suggests that the costs of deferring tax on pension accumulations aren't justified. Instead, the "taxation of benefit accruals should be shifted to a current basis." In *Tax Incentives to Saving and Borrowing* (2003), Tullio Jappelli and Luigi Pistaferri (accessible here) say "…there is considerable empirical debate as to the effectiveness of tax incentives in promoting saving: most studies conclude that tax incentives affect the allocation of household portfolios, but the effect on the amount saved is less clear-cut." In *The Effects of 401(k) Plans on Household Wealth* (2000 – accessible here), Eric Engen and William Gale suggest that, without regard for the fiscal and regulatory costs, "between 0 and 30 percent of 401(k) balances represent net additions to private savings." If the fiscal and regulatory costs were also included, we think those percentages might turn negative.

[108] From the *National Business Review*, 26 May 2017, accessible here (paywall in place).

Questions New Zealand needs to discuss on tax subsidies for saving:

1. Why does our government have a particular interest in the way New Zealanders save for retirement? That 'interest' is currently expressed through KiwiSaver (that we discuss in section 14 below) and through tax breaks given both to KiwiSaver (estimated cost in the 2017 year: $738 m, rising to $840 m by 2019/20) and to the concessionary tax treatment of 'Portfolio Investment Entities' – there is more on that in section 17 (Income tax and saving vehicles). Where are the cost/benefit analyses to support these direct, costly interventions in New Zealanders' saving behaviour?

2. Are we correct that tax breaks for retirement saving are complex, distortionary, expensive, regressive and inequitable?

3. Are we further correct that tax breaks for retirement saving probably do not 'work' (if by that we mean that they probably do not raise savings overall)? Where is the evidence that costly incentives for KiwiSaver (an accumulated cost to taxpayers of $8.5 billion to date) have increased household savings? We describe what evidence there is on KiwiSaver's impact in section 14 below.

4. If the answers to either question 2 or 3 above are 'yes', can we agree that the government should not try to 'incentivise' people to save particular amounts in a particular way and in particular investment vehicles for a particular purpose?

5. Does the presence of tax incentives increase economic growth above the level that it would have been if they had not been there?

10. On compulsory private provision[109]

Many New Zealanders think we should all be forced to save for retirement in compulsory saving accounts. Others go further and suggest that all welfare spending in New Zealand should be financed through compulsory saving accounts, such as happens in Singapore[110].

The compulsory, defined contribution, Tier 2 retirement savings scheme, adopted by Chile in 1981, copied by Australia in 1986 and by many other countries since, tries to force citizens (and their employers in some cases) to set aside financial claims and to lock those up until the state pension age[111]. From then, there are varying degrees of control on what Tier 2 savings can be used for and usually close links between the Tier 2 benefit and the Tier 1 pension. These vary from a direct offset (Sweden) to a complex array of income- and asset-tests that embrace most financial assets, including the proceeds of the Tier 2 accumulation itself (Australia)[112].

There are three main sets of difficulties with the kinds of arrangements promoted most notably by the World Bank in 1994[113]:

- Controlling human behaviour over as many as seven decades - from first employment to death in retirement – seems too difficult. It starts with convincing everyone to join. Success here seems correlated to a country's overall governance standards: the higher those standards, the more likely it is that 'compulsion' means 'everyone joining'. The World Bank itself concludes that this defining characteristic of Tier 2 schemes seems not to be working in most of Latin America[114].
- 'Compulsory' Tier 2 schemes inevitably require thickets of regulations that become more complex over time. There is so much to control and so many who might prefer to do something else; and they are constantly thinking of new ways to avoid Tier 2 or to mitigate its effects.
- Tier 2 schemes must be directed by the government even if, as in Australia, they are not actually run by the government. 'Privately' managed schemes cannot avoid the constant oversight of regulatory authorities. Australia is currently engaged in such a review by its Productivity Commission to "assess the competitiveness and efficiency of the superannuation system"[115]. It is far from the first review. The government has delivered a lucrative business to the financial services industry and must inevitably, on the members' behalf, be deeply involved in the oversight of all aspects of that business, especially as it also indirectly affects the future cost of Tier 1.

---

[109] This section is based on a submission by Michael Littlewood for the Retirement Commissioner's 2016 Review: *Ageing populations, retirement incomes and public policy: the four 'first principles' of policy-making - A submission to the Commission for Financial Capability* (accessible here).

[110] See *Welfare: Savings Not Taxation,* Roger Douglas and Robert McCulloch (2016) accessible here.

[111] In fact, Australia allows access to the compulsory savings before the state pension age. Currently the 'preservation age' is age 55, increasing to age 60 by 2024. This 'gap' encourages Australians to retire before the state pension age (currently age 65, increasing to age 67 between 2017 and 2023). The Australian government announced in the 2014 Budget that the state pension age will further increase to age 70 by 2035 (see here).

[112] Australia's asset-test was toughened from 1 January 2017 (see here). The threshold for the test was raised but the 'taper rate' (the reduction in pension for each $A1,000 of assets) was doubled from $A78 a year to $A156. For a home-owning couple, there is now no Age Pension with 'qualifying assets' of more than $A816,000.

[113] *Averting the Old-Age Crisis – Policies to Protect the Old and Promote Growth* (1994) The World Bank accessible here; later refined into a 'five pillar' model in *Old-Age Support in the 21st Century – the World Bank's Perspective* (2005) by Robert Holzman and Richard Hinz.

[114] "…nearly half the countries have coverage rates below 30%" - from *Closing the Coverage Gap – Role of Social Pensions and Other Retirement Income Transfers* (2009), Robert Holzman, David Robalino and Noriyuki Takayama (accessible here).

[115] The Australian Productivity Commission has published an 'issues paper' *Superannuation: Assessing Competitiveness and Efficiency* (July 2017) accessible here.

- Given the natural propensity of individuals to set their own objectives and timetables, even if the Tier 2 scheme successfully captures the memberships and mandated contributions, the rules cannot prevent members' changing their other behaviour to compensate. Australia provides some good examples of this. First, the income/asset-tests that link Tier 2 (and all other assets) to Tier 1 are numbingly intricate and intrusive[116]. Next Australians seem to arrive at retirement with greater debt, having effectively 'pre-spent' their retirement savings[117]. Australians also seem to retire early to collect their Tier 2 saving accounts[118] and spend those before the means-tested Tier 1 pension starts[119]. Finally, the necessary means-tests directly affect post-'retirement' labour force participation rates. We have more to say on this in section 16 below (When do New Zealanders retire?). In 2010, the participation rate for age 65+ in New Zealand was 17%[120]; in Australia, it was 10.7%[121]. It's not possible to put all of that difference down to means-tests but it is likely to be a significant influence.

  There is no way governments can control offsetting financial behaviour. If governments want the Tier 2 scheme to increase self-provision for retirement, we should expect evidence that is in fact happening. Counting the money in the Tier 2 scheme's accounts (an approach favoured by financial service providers) does not tell us what is happening to household wealth[122].

Whether or not existing compulsory, pre-funded Tier 2 schemes increase household savings (or even national saving) should be a central question asked by countries that are considering such a scheme. Countries *with* such a scheme should ask the same question. The answer is very likely to

---

[116] Australian authorities require information from each pensioner on a regular basis: see here for the assets test and here for the income test. There is even a 'deemed rate' of return on financial assets for the income test, regardless of the return actually earned (see here). Centrelink is the agency responsible for implementing the tests in Australia. Its website lists eight different kinds of income (including some deemed income) and nine different types of assets that have to be considered twice a year. The potential for bureaucratic mistakes is significant. For more on means-tests in Australia, South Africa and the UK, see *Means Tests: an evaluation of the justice of imposing high rates of clawback on those of modest* means, Anthony Asher (2006) accessible here.

[117] People should normally try to reduce overall debt as they approach retirement. That seems not to be the case in Australia. In the eight years to 2012, retirement savings among 50 to 64-year-olds grew 48%, other financial assets by 3% and real estate assets by 58% *but* property debt increased 123% and other debt by 43%. By ages 60-64, debt was 42% of retirement saving balances: see *Household savings and retirement – where has all my super gone? A report on superannuation and retirement for CPA Australia* (2012), Simon Kelly (accessible here).

[118] The OECD estimates that Australia's 'effective retirement age' in 2009 was 64.8 (males) and 62.9 (females). By contrast, New Zealand's was 67.1 (males) and 65.0 (females): see *Average effective age of retirement in 1970-2009 in OECD countries* (2010) accessible here. The Australian Bureau of Statistics reported in December 2013 that the "…average age at retirement for recent retirees (those who have retired in the last five years) was 61.5 years." Men's average was 63.3 and women's 59.6 (see here).

[119] The post-retirement asset test in Australia also leads to an 'over-consumption' of housing services as the primary residence is exempt under the test: see *Residential Transition Amongst the Australian Elderly* (2007), John Piggott and Renuka Sane, Australian Institute for Population Ageing Research (accessible here).

[120] By 2015, the labour force participation rate for age 65+ in New Zealand had increased to 22.1% - source: Statistics NZ accessible here.

[121] *Comparison of the New Zealand and Australian Retirement Income Systems*, Ross Guest (2013) accessible here at page 15 (citing ILO data).

[122] A 2006 household wealth comparison between Australia and New Zealand shows that Australians have higher proportions of wealth in retirement saving accounts (19.1% in Australia and about 4% in New Zealand) but much less in 'business investment' (7.6% in Australia and 22.2% in New Zealand): see *Household wealth in Australia and New Zealand* (2010), RPRC *PensionBriefing 2010-5* (accessible here). Aggregating just these two components of household wealth produces 26.7% of total household wealth in Australia and 26.2% in New Zealand. We have more to say on this comparison and the New Zealand data in section 14 below (Households' financial position).

be equivocal and will probably fail to justify compulsory private provision as a public policy plank[123].

Governments need clarity around the objectives of such an intrusive strategy. If the real problem is the likely future cost of the Tier 1 pension, that should be addressed directly, leaving citizens to decide what cuts might mean for them. Compulsory Tier 2 schemes may improve the depth of capital markets and that may have been a justification for Chile's scheme in 1981, but the downside is that Tier 2 will be captured by the financial services sector. The current level of compulsory contributions is unlikely ever to be considered 'enough' by that sector as the messages in Australia that now call for a lift from the new limit of 12% to an eventual 15% of pay[124].

Compulsory private provision has similar versions of the difficulties described for tax concessions (section 9, paragraphs (a) to (f) above). They are complex (by definition), distortionary (again, by definition), expensive to administer and constrain flexibility (by definition). They also suffer from the fundamental flaw that compulsion may not 'work' (raise overall saving levels, not just savings in compulsory accounts).

We have more to say on this wider issue below in section 15 (Households' financial position – a proper longitudinal survey needed).

Just as individuals adjust their behaviour in response to public policy interventions, so too do financial service providers. However, what's good for providers is not necessarily good for savers or for the country[125].

We need more and better information about the effects of compulsory Tier 2 retirement saving schemes in other countries, but particularly in Australia. Most of our financial institutions are owned out of Australia and there is no doubt that the compulsory 'SG' regime has been good for financial service providers in that country since it was first introduced in 1986. That is not a reason to support the introduction of compulsory retirement savings in New Zealand or an extension of KiwiSaver to that effect.

Part of the public policy justification for such an intervention in Australia is the direct linkage between private assets/incomes (including from compulsory superannuation savings) and the Tier 1 Age Pension through the income and asset tests[126]. No such linkage was considered with

---

[123] *Pensions and Saving: New International Panel Data Evidence* (2006) by Ricardo Bebczuk and Alberto Musalem, CEF Policy for Financial Stability (accessible here) was a 48-country study from 1980 to 2004. It examined the impact of pension saving on gross national saving rates and concluded that the changes made by 'reforming countries' (that introduced compulsory Tier 2 schemes) to 'improve' their national saving rate don't seem to have had much effect on this number.

[124] In *Don't Increase The Super Guarantee* (Centre for Independent Studies, 2016 – accessible here) Michael Potter argues that an increase to 15% would cut wages, discourage workforce participation, prejudice appropriate responses to population ageing, worsen the efficiency of the financial services system and increase risks to households and the economy. "One important goal of the SG increase is to increase retirement incomes. However, it is not clear that retirement incomes are inadequate". And, as the author details, that is just the starting point of problems for the proposal.

[125] In *Reassessing the impact of finance on growth* (2012), Stephen Cecchetti and Enisse Kharroubi of the Bank For International Settlements (accessible here) suggest that "…the level of financial development is good only up to a point, after which it becomes a drag on growth. Second, focusing on advanced economies, we show that a fast-growing financial sector is detrimental to aggregate productivity growth." The tipping point seems to be about 6.5% of real GDP per worker. Australia's is more than 11%.

[126] Australia seems to have only recently formally decided that reducing future Tier 1 payments is actually a primary objective of the compulsory Tier 2. A bill currently being considered by the Australian Parliament suggests that "the aim of superannuation is to provide income in retirement to substitute or supplement the Age Pension" – Clause 5(1) of the Superannuation (Objective) Bill 2016 (accessible here).

KiwiSaver's introduction but that will become an obvious issue if KiwiSaver ever were to become compulsory as was suggested, for example, by Michael Cullen in a November 2016 speech[127].

If we force citizens to save for retirement, we are really saying that, when they reach the state pension age, they will receive a smaller state pension. Means-tests are an almost inevitable consequence of compulsion. If New Zealand really wants to talk about compulsion then we also need a conversation about how to reduce the age pension by those compulsory savings.

Questions New Zealand needs to discuss on compulsory private provision:

1. What precisely has been the effect of Australia's SG Tier 2 retirement savings scheme on:
    a. Australians' overall (not just retirement) saving and wealth accumulation patterns?
    b. Public policy?
    c. Retirees' income levels?
    d. The Australian financial services industry?
    e. Households' business investments?
    f. Labour force participation patterns (before and after the state pension age)?

2. How do the income and asset tests work in Australia (and elsewhere, like Mexico, Chile etc.) and what have been the effects of those tests on Australians' financial behaviour?

3. Is there any international evidence that compulsory Tier 2 savings schemes 'work' by increasing overall household savings and by improving the security of retirement income claims against the economy?

4. And what is their impact on economic growth?

[127] *KiwiSaver: where to from here?*, speech to the Workplace Savings conference (November 2016), accessible here, at page 4. Michael Cullen does not discuss a means test but does suggest something he called a "hypothecated superannuation tax" as a "return for the current level of subsidies and an easing of [Employer Superannuation Contribution Tax]" (at page 5). This new tax would be payable to the NZSF on the death or payment of a benefit to the member. The author thought this "could have a dramatic impact on the long-term levels of other taxation required to fund New Zealand Superannuation." In other words, it would effectively be a tagged 'tax cookie jar' along similar lines to the NZSF itself.

11. The role of the government[128]

Sections 9 (tax incentives) and 10 (compulsory private savings) might suggest that governments are relatively powerless when trying to directly affect individual behaviour with respect to retirement incomes. That is far from the case. We suggest that, when governments think about public policy issues associated with retirement incomes, they should focus on things they have a unique capacity to influence. We suggest there are five main 'capacities':

11.1 Reducing poverty in old age: Only governments can directly reduce or even eliminate poverty in old age through public policy interventions. Only they have the power to tax and re-distribute. Collecting tax from everyone today and spending that on pensions for the current old is an example. A government cannot rely on private markets to satisfy this basic objective of public policy, or even 'force' private compliance with strategies that attempt to achieve that objective. Section 6 above summarises the issues New Zealand needs to discuss with respect to the design of NZS.

11.2 Taxation: Investment vehicles with similar characteristics should be taxed similarly. What they are called or the legislation under which they operate should not be relevant to their tax liability, nor to the tax liability of those who use them. Section 17 below (Income tax and saving vehicles) looks at this.

11.3 Codes of conduct: Next, only governments can regulate to enforce codes of private (and public) conduct. For example, in a retirement saving context:

- There should be minimum reporting standards so that investors are told about their investments in a complete, comparable, accessible and timely manner. Again, there must be consistent treatment across different investment classes. Section 18 below (disclosure requirements) discusses this.
- Investment offerings to the public need regulating to ensure investors and experts know what they need to know. Similar offerings should be regulated similarly. There is more on these issues below in section 19 (Regulation).

11.4 Impeccable, accessible data: Next, only governments can demand access to data that are relevant to behaviour and issues connected with financial preparation for retirement and with the living standards of the old. The government must collect, produce and disseminate impeccable, deep, accessible information on population trends, saving and investment behaviour, labour force participation rates and poverty issues associated with ageing.

Section 12 (Housing and home-ownership) below discusses the problems with Census data on home-ownership.

Section 15 (Households' financial position) discusses a crucial information gap – the absence of a proper longitudinal study of households' financial behaviour.

11.5 Information and education: Lastly, a government can help citizens understand the issues through information and education programmes. For private provision, these should cover both the saving ('accumulation') and spending ('decumulation') periods of individuals' financial lives. The programmes can be part of a school-based curriculum, work-based

[128] This section is based on a submission by Michael Littlewood for the Retirement Commissioner's 2016 Review: *Ageing populations, retirement incomes and public policy: the four 'first principles' of policy-making - A submission to the Commission for Financial Capability* (accessible here).

initiatives and public campaigns[129]. League tables of comparable investment performance data[130] and 'best buy' consumer comparisons should be part of those. Citizens are more likely to believe information from a disinterested party, like the government, than from financial service providers. To build confidence, the government should openly review the retirement income framework on a regular basis, covering both public and private provision. Such reviews will depend on the data described in paragraph 11.3. We have more to say on the current review process in section 21 below.

Section 20 (Information and education) below looks at aspects of this central-government role.

Governments have other, more general responsibilities that affect retirement incomes: for example, selling price-indexed bonds or following policies that keep inflation low so that savers can be more confident of earning after-tax, real returns during the long deferral periods involved with private provision for retirement.

With specific regard to retirement income policies, governments that use the five tools outlined above will build a policy framework to support citizens' decisions about whether they need to save more for retirement, when they should do that and finally, help them answer the 'when?', 'how?' and 'how much?' questions. Those are not questions for governments to answer; only individuals, perhaps with their employer's direct help, can do that. Section 13 below looks at the role of occupational saving schemes.

The suggested framework will also help build and maintain public confidence in the government's strategy. That confidence must survive over decades as citizens make saving and investment decisions and eventually draw down their savings in retirement.

Any deeper government involvement must make assumptions about what individuals 'need'. It also makes a retirement income framework more complex and so builds barriers to understanding. That increases the risks of policy failure. For example, the line between saving and greater retirement income security should be clear and direct. Savers need to be confident they will be better off if they decide to save[131]. They must trust the information they use in their decisions and be confident that the ways they choose to administer those savings are what they say they are and do what they say they do.

A word about 'behavioural economics': Governments should stay away from policies that derive from so-called 'behavioural economics'[132]. The central idea is that someone else knows better than, for example, the saver what might be in the saver's best interests. Savers need a 'nudge' in the direction of decisions that are in the saver's best interests. In that particular case, that

---

[129] Financial literacy programmes can be part of this: see, for example *Financial Literacy and Retirement Planning: New Evidence from the Rand American Life Panel* (2007), Annamaria Lusardi and Olivia Mitchell, Michigan Retirement Research Center (accessible here). Such programmes have much wider potential uses than helping people understand their retirement planning needs.

[130] For example, investors should have ready access to net, real returns across all comparable offerings on a regular, say, monthly basis over the last 5, 10, 15 and 20 years as well as for the current year. Similar comparisons of fees would also be informative. A public agency will be the most effective source of that data and the collection and comparisons should be subject to regular, public review.

[131] One major difficulty with income and asset tests of the Tier 1 pension (as in Australia and in most countries with a Tier 2 scheme) is that savers must necessarily doubt whether they will receive any of the Tier 1 pension. That doubt directly affects decisions about private provision for retirement and may lead to 'over-saving'.

[132] See *Behavioural economics: a brief introduction to the saving literature*, Andrew Coleman (2010) accessible here. This gives "a very brief introduction to a vast literature".

'someone else' thinks that consumption should be deferred to a retirement age and the amount set aside should be invested this way rather than that[133]. The evidence shows that people undoubtedly make mistakes about whether to save and how to save. So, the argument suggests that the environment should be structured to protect people from themselves. That doesn't necessarily resolve things:

> "...while consumers suffer from information asymmetries, so of course do proxy decision makers – in fact, their information deficits are likely to be worse than that of consumers, leading to greater error in decision-making."[134]

'Behavioural economics' is a seemingly seductive concept, one that might be appropriate for providers of goods and services or even to help understand what is happening 'out there'. However, we think it has no place in public policy issues associated with retirement saving. Issues such as the mix between immediate and deferred consumption should be a matter for individuals to decide. Not everyone needs to save for retirement; on the other hand, they may need to save for retirement but not now. Others may never retire so the concept of requiring them to put part of their income aside for retirement is at odds with their particular preferences.

Governments may help financial service providers understand the implications of choices (through research and information/education programmes) but it is a step too far to presume that anyone knows better than individuals what they should do with their own money; or better than employers how much, how and when they should pay their employees.

Questions New Zealand needs to discuss on retirement income policy settings:

1. Should the government concentrate on things that only governments can do?

2. If 'yes', are there any other things that only governments can do (in addition to the five key areas described above) and that might contribute to the setting and maintenance of retirement income policies?

3. If governments should focus on other things, what might those be? What specifically would those add to the setting of public policy on retirement incomes? What might be the direct and indirect costs of those and can those costs, if any, be justified?

---

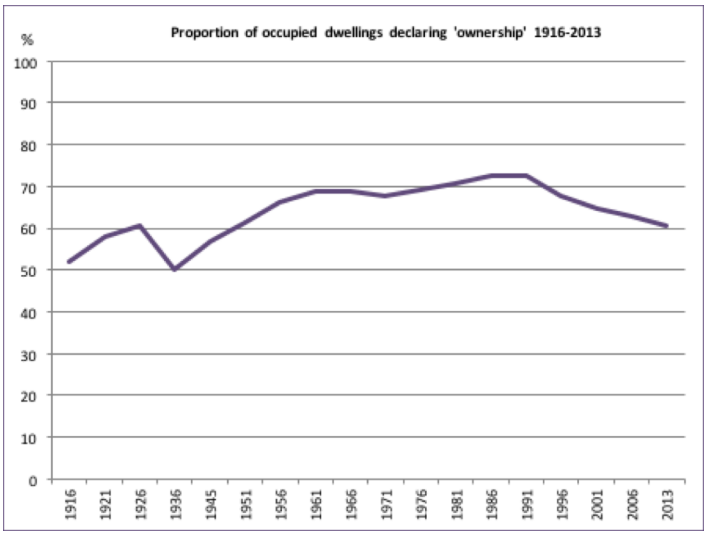
[133] This is the underlying premise of the design of KiwiSaver that was based on a flawed 2004 report from the Savings Product Working Group, *A Future for Work-based Savings in New Zealand* (accessible here). It was flawed, because its recommendations were unsupported by any evidence of under-saving by New Zealanders and, in fact, ignored what evidence there was. We have more to say on this in section 14 below (KiwiSaver in the new environment).

[134] Chris Field in *Having One's Cake And Eating It Too – An Analysis Of Behavioural Economics From A Consumer Policy Perspective* (2007) Australian Productivity Commission, accessible here (chapter in *Behavioural Economics and Public Policy*).

12. Housing and home ownership - data shortfalls and need to fix those

Most retired New Zealanders and those over a 'retirement age' own their own homes[135]. Having a paid-off home by the time regular employment income stops should be a first step for financial security in retirement. Statistics about home ownership levels are therefore directly relevant to any discussion about retirement income policies. There was no detail on this issue in the Retirement Commissioner's 2016 Review.

At first sight, the most recent Census data (from 2013) suggest that home-ownership rates have fallen substantially since a peak in 1986.



Source: StatsNZ[136]

Census 2013 tells us that 60.7% of all occupied dwellings were owned by the occupying households. The equivalent in 1986 was 72.6%.

There is a significant problem with the Census data on home-ownership. There are too many gaps in the questions asked in the 2013 Census (and earlier equivalent questions) for us to be certain about any recent trends in home-ownership rates. The gaps mean we have no ownership information for about 362,000 of all dwellings; that's 20.7% of all 1.76 million dwellings on Census night in 2013.

There are two main holes in the data. First, we have no information about who owns the 185,448 dwellings that were unoccupied on Census night (10.6% of all dwellings). Neither do we know why they were unoccupied. They might be holiday homes, between tenants, on the market, under renovation or the usual occupiers (owners or renters) may have been away on holiday or on business. We just don't know and that affects our understanding of the owner/occupier status for more than one tenth of all dwellings.

---

[135] For the reasons stated in this section, Census information on home ownership at any age is incomplete. Of all those over age 65 in 2013 who stated their ownership position, 74.5% 'owned or partly owned' their 'usual residence'. 5.1% gave no or an 'unidentifiable' response – source: StatsNZ *2013 Census Quickstats about people age 65 and over* (2015) accessible here.

[136] *A century of censuses – dwellings and households* (2015) accessible here. The chart shows 'owned' dwellings (including family trust ownership) as a proportion of all *occupied* dwellings, including those where ownership status was unclear.

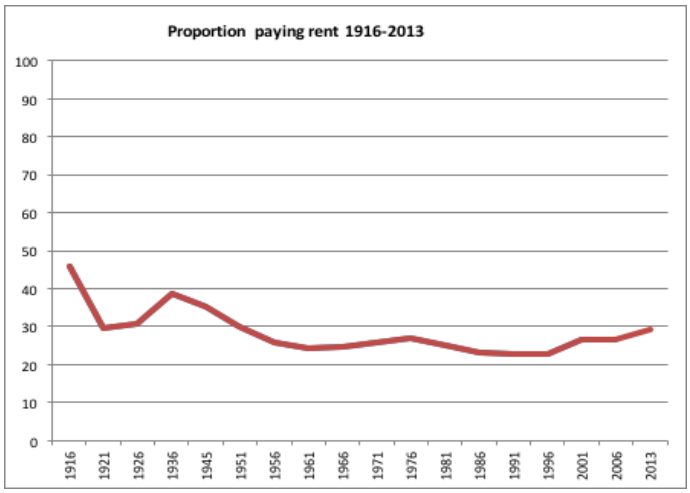
The other major hole is the occupiers who didn't answer the question or who gave an unclear answer. That was another 176,835 dwellings or 10.1% of all dwellings.

These data gaps have been growing in total since the 1986 Census – the total 2013 gap (20.7%) was 19.4% in 2006. Part of that is probably caused by the rise in family trust ownerships, though the Census questions tried to capture these. Gaps in the questions also contributed.

If we turn the examination around and try to deduce home-ownership rates from the proportions of occupiers who pay rent, a slightly different picture emerges. There were also gaps in renters' data in 2013 but 29.2% of all occupied dwellings (453,100) specified the weekly rent then being paid. We can probably assume that these rent-payers were arms-length occupiers, in other words, not connected to family trust ownerships where the occupiers might be nominal tenants.

In 1936, 'rent payers' peaked at 38.6% of occupants - the proportion has fallen in the 77 years to 2013.

Of more recent note is that the proportion of 'rent-payers' has been relatively flat since the early 1950s, as the chart shows:



Source: Statistics New Zealand[137]

Rent-payers were 26.9% of *occupied* dwellings in 1976. In 2013, 29.2% of all occupiers were paying rent to the owner. That's up from a low of 22.7% in 1991. However, rent-payers have been less than 30% of all occupied dwellings since 1956 (simple average over the 12 censuses was 25.3%).

If home-ownership really was falling, we should expect rising, rather than relatively flat rent-paying occupancy rates since 1956. Given the gaps in the data, we cannot draw any definitive conclusions from the two charts.

StatsNZ has tried since 1996 to understand the impact of family trusts on housing tenure. However, uncertainty about the influence of family trusts on ownership statistics has grown over the 17 years to 2013. We do know that the number of dwellings affected by family trust ownership grew by at least 28% in the seven years to 2013 (to 13.7% of all occupied dwellings).

[137] Again, from *A century of censuses – dwellings and households* (2015) accessible here.

The home-owning proportion of the population may have fallen since the 1986-1991 Censuses, when 'declared' ownerships in 1991were 72.4% of all 'declared' occupiers[138]. However, given the gaps in the data, a more reliable indicator of tenure trends may be the proportion of occupiers who are paying an identified amount of rent rather than the so-called 'owners'. That proportion of rent-payers hasn't changed much in the last 60 years.

We cannot draw any particular conclusion about home-ownership trends from Census data. On 'ownership' all we can really say is that, of the 79.3% of all dwellings for which we have some details on tenure in 2013, 60.7% either own them directly or through a family trust. That is not good enough. The questions must change for the 2018 Census if we want to understand the tenure of occupied dwellings and the status of unoccupied dwellings. It may already be too late for that.

No-one really knows whether home-ownership rates are currently falling and, in the context of New Zealanders' financial preparation for retirement, we need better information. We cannot even start a discussion about home ownership issues without answers to some fairly basic questions.

Questions that need answering on home ownership in the next (2018) Census:

1. Do the occupiers own the dwelling they are currently living in? That includes ownership through a family trust, a will trust, a family-controlled company or other indirect ownership.

2. If the answer to question 1 is 'no', how much rent does the occupier pay? If the answer to that is nothing or is a nominal amount, then who specifically owns the home (name and contact address) and what is their relationship to the occupier?

3. How much does the home-owner (including a family trust or other indirect owner) owe on a mortgage of the home?[139] How much of that mortgage is to finance an investment in a family business or in another property?

4. The occupier should also complete a dwelling census return in respect of any dwelling that is owned (directly or indirectly) by the occupier and that is unoccupied on the day of the Census. That should include information on why the dwelling is unoccupied on Census night.

Without New Zealanders' answers to these questions, we cannot have a useful discussion about home-ownership levels and whether there are public policy issues that need addressing in this regard either generally or in specific regard to financial preparation for retirement.

[138] In 1991, unoccupied dwellings were 10.4% of all 1.30 million dwellings and 'unknowns' were 3.4% of all 1.18 million *occupied* dwellings. The 1991 Census was therefore missing data on a total of 162,750 dwellings or 12.5% of all dwellings. That total had risen to 20.6% of all dwellings in 2013.

[139] Loans should exclude intra-family debt to finance the transfer of the asset between family owned or controlled entities.

13. Occupational superannuation – role of employers[140]

In section 11 (The role of governments), we suggest that, when setting public policies on retirement incomes, governments should focus on objectives where they have a unique capacity to influence outcomes.

Governments should avoid trying to influence or direct private provision for retirement by tax breaks (section 9) or through compulsion, 'hard' or 'soft' (section 10). That those common interventions seem not to work is only one of their many shortcomings. Citizens should instead make their own decisions about financial provision for retirement; and employers might have a say in that as well for their own employees.

Tax incentives aim to encourage citizens to behave in particular ways by either a direct subsidy (a 'tax credit'), by allowing a deduction against other income or by giving a more favoured tax treatment of 'income' earned by such savings. It does not matter how they are delivered, tax incentives come with large direct costs to the government's revenue and indirect 'costs' that derive from the other negative effects of tax breaks.

An employer faces similar policy issues when it decides to pay employees in a particular way and to reward 'appropriate' behaviour. Despite some structural similarities, an employer is not the country, writ small. When employers make decisions about financial provision for their employees' retirement and other financial needs, other policy considerations should apply. But the central question remains similar – should an employer directly subsidise an employee's saving programme (for retirement or otherwise)?

'Pay + benefits'

The compensation practices of employers in most countries developed over many years into a 'pay + benefits' patchwork. The price paid by an employer to get a job done is usually divided into two:

- **Direct cash** that can include 'at risk' or bonus elements;
- **Indirect benefits** such as retirement pensions, the use of an employer-owned vehicle, insurance (for health needs, death cover and disability protection), subsidised loans, club subscriptions and so on.

Indirect benefits grew in number, significance and complexity. They were usually driven by:

(a) Tax laws that favoured indirect benefits over cash and some benefits over others;

(b) Personnel (HR) policy that favoured certain types of behaviour over others;

(c) Pressures from other employers that are competitors for labour;

(d) The historical need to distinguish between waged employees (represented by unions) with benefits such as overtime pay and penal allowances, and salaried employees (non-unionised) who tended to receive fixed amounts of pay;

(e) The purchasing power of employers that could gain access to benefits at a cheaper cost than employees were able to obtain on their own.

---

[140] This section is based, in part on Michael Littlewood's *'Total compensation': a new way of doing things*, International HR Journal, Vol. 4/No.3, Fall 1995, 17-2

'Pay + benefits' is one remuneration strategy; an alternative is 'total remuneration' where a cash value is placed on the role and it is for *employees* to decide how that is spent. Any particular employer's actual strategy is normally somewhere between the two alternatives.

Problems of 'pay + benefits'

There are many problems with a 'pay + benefits' approach to compensation. It's important to understand these because, in New Zealand, they are increasingly the old way of structuring remuneration arrangements between employers and employees.

Here are the main difficulties:

(a) Differing tax treatments of benefits: Between 1985 and 2000, New Zealand eliminated the privileged tax treatment of all indirect benefits, including retirement saving schemes. We generally treat retirement savings (TTE) in the same way as other savings, such as through a bank account[141] - see section 9 (On tax subsidies for saving) for more on this. Cash and indirect benefits now have broadly similar tax treatments so one reason for the development of different types of benefits has gone – New Zealand is alone in this regard.

(b) Poor understanding of benefits: Employees tend not to understand (or know how to calculate) the total value of their compensation in a year. They tend to under-value non-cash benefits or even not to value them at all, especially if they are not directly relevant to the employee's particular needs. As a result, the amounts spent by the employer are, in part, wasted. Employers may not have communicated with or educated their employees well so part of this waste was self-inflicted.

(c) Correlation with performance: Benefits can only be indirectly related to an individual employee's performance. Benefits that are based on pay, such as retirement benefits, have some of that linkage but other benefits do not (for example, cars, medical insurance).

(d) Standardisation of benefits: Benefit schemes can be designed only for the average condition or for the average employee. They will, by definition, over-provide for some and under-provide for others. That over-provision can also arise from duplication where, for example, two different employers provide similar coverage for the same family (for example, medical insurance).

(e) Changing tax treatment: As tax laws change, the pre-tax equivalent of 'total remuneration' changes, particularly if inconsistent changes occur across various types of benefit. The employer has no control over tax changes but may end up paying for their impact if taxes, as happened in New Zealand, are imposed on the employer (as proxy) rather than directly on the employee (such as Fringe Benefit Tax).

(f) Obstacles to participation: Employee benefit schemes tend to be unfair, particularly those that require members to contribute (like KiwiSaver). These impose a contribution hurdle so that an element of compensation is available only to those who can afford to join or who think that hurdle is important enough to jump.

(g) Lack of relevancy: Some employee benefit schemes are not relevant to an employee's needs so the price paid by the employer is wasted. An example is the provision of life insurance cover for a single employee with no dependants. In fact, the individual needs of employees cannot be accommodated in a single level of benefits, delivered in bulk to all employees.

---

[141] KiwiSaver is a relatively modest exception to the TTE, tax-neutral treatment. There is an annual subsidy of up to $520 a year if the member alone saves at least twice that amount. Also, investment income in the KiwiSaver scheme is taxed on a more favourable basis than had the investment income been received directly. That applies to all superannuation schemes that are 'Portfolio Investment Entities' (PIEs).

(h) Collective agreements less important: 'Collective' employment agreements are much less common than previously. Union membership in New Zealand is now about 17.7% of employees in the workforce[142] and collective employment agreements apply to about 30% of the employed workforce.[143] The emphasis in New Zealand is now on the individual employment relationship. Traditional employee benefit schemes are difficult to adapt to individual relationships that potentially have an infinite variety. One employee can have a variety of arrangements with one or more employers.

(i) Poor fit with variable pay: Pay-related benefits do not fit neatly into a variable pay environment (for example performance-based pay such as commissions or profit-sharing). Artificial definitions of pay for benefit purposes are usually needed to limit the employer's and employees' exposure to risk and to preserve relativities. Variable pay is usually excluded from counting in a 'defined benefit' (DB) retirement savings scheme or turned into a notional number to reflect the difficulty.

(j) Lack of needs assessment: In the traditional 'pay + benefits' environment, the responsibility for designing and delivering benefits rests with the employer so employees tend not to assess their own needs. Adequacy of coverage tends either to be assumed by the employee or, at least, not questioned, especially when the employee is not required to contribute directly.

(k) Job mobility: Traditional employee benefit schemes tend to act as 'golden handcuffs' and to reward service rather than performance. They can create a positive disincentive to leaving, creating situations that suit neither the employee nor the employer. Examples here include the DB retirement savings scheme and medical insurance where the employee or a family member has an indifferent medical history. Benefits that depend on pay also restrict employment practices such as reduced responsibilities, part-time work and other ways of easing the transition from fulltime work to fulltime retirement, or independent contracting. Again, this potentially disadvantages both the employer and employee.

(l) Regressive compensation component: The annual value of deferred compensation conferred on older employees under a DB scheme is significantly greater than on otherwise equivalent younger employees. Two employees of different ages doing the same job on the same direct pay will receive very different 'total remuneration' because of the favour conferred by the DB scheme on the older employee. If employees understood this process, the employer would find it difficult to explain the different 'total remunerations'. Fortunately for employers, most employees do not understand what is really happening.

(m) Other distortions: DB retirement saving schemes have other unintended consequences that are inherent in their design:

(i) Female retirees advantaged: Because a female pensioner is expected to live longer on average, a given retirement pension has a higher value when compared to the same pension payable to a male. That distortion extends to the annual accrual of entitlements during service.

(ii) Employees with dependants advantaged: If the pension entitlement carries with it an automatic continuing pension to a surviving spouse or partner, again the pension itself and the annual accrual of entitlements favour the partnered employee.

(iii) Star employees advantaged: Employees who have careers marked by rapid pay increases are favoured over those with lower rates of increases. An employer may want to retain and motivate the stars but if annual remuneration is the main retention tool, the employer might wonder why normally uncounted, retrospective increases in today's

[142] *Union membership return report 2016*, New Zealand Companies Office, accessible here.
[143] *Union membership and employment agreements – June 2016 quarter,* Stats NZ, accessible here.

remuneration are delivered through the DB scheme's past service promises when benefits are based on pay near retirement.

(iv) Business risks to employer: Because the employer-sponsor of a DB scheme promises to deliver benefits at the end of long (but uncertain) periods of service and for long, uncertain periods in retirement, the employer exposes itself to uncontrollable business risks that will probably be alien to its normal operations. It acquires an investment management business with potentially large financial obligations if the returns are lower than required. A DB scheme also exposes the employer to an uninsurable inflation risk and to a numbingly complex regulatory environment. DB schemes can become an unacceptable risk of doing business[144].

In summary, a 'pay + benefits' strategy tends to be complex, inflexible, misunderstood, undervalued, inappropriate and unfair. Some of the problems are associated with just DB schemes; others with all subsidised retirement saving schemes, including defined contribution (DC) schemes like KiwiSaver; yet others derive from the inherently complicated nature of all collective saving vehicles and governments' attempts to regulate their generosity (given their tax-favoured status) and their governance.

'Total remuneration' – an alternative approach

Employers need to get jobs done and to pay a price that is acceptable to employees. The two parties must agree on the total price and that may be a mixture of regular cash and an 'at risk' or variable amount that depends on performance.

Having agreed that price, the 'total remuneration' approach suggests there should be no restrictions on the way in which that price is delivered. It can be all cash or a mixture of cash and benefits as the *employee* chooses. In an extreme case, the price could be delivered entirely in benefits.

No employer subsidies: Unless an employer can establish a business case for a particular benefit programme[145], a general move to a 'total remuneration' environment will see the eventual disappearance of subsidised retirement saving schemes. If the government intervenes in this process (as with KiwiSaver and as in Australia with the compulsory SG Tier 2 retirement savings scheme), the committed 'total remuneration' employer should factor that forced contribution into its remuneration costs. Where, as with KiwiSaver, that forced cost applies only to members, employers should, as a matter of equity, allow for the compulsory employer contribution as part of 'total remuneration'. We have more to say on this in the next section 14 (KiwiSaver in the new environment).

So, the employer fixes 'total remuneration' for a position and does not then impose any barrier in the delivery of the element that is delivered as a subsidy in a 'pay + benefits' environment.

Also, the employer will deliver that element to all employees, not just those who choose to join the scheme or who qualify to become a member after an eligibility period or other requirement has been satisfied.

Before the major tax changes to superannuation in the 1987-1990 period, membership of subsidised, occupational retirement saving schemes was low – only 22.6% of employees were

[144] The business risk explains the intervention of accountants in the disclosure requirements for employers' annual accounts.

[145] For example, specialised medical insurance cover for travel to less-developed countries.

'active' members in 1990. That proportion fell as schemes closed in subsequent years. By 2003, only 13.9% were active members[146]. We should expect that number to fall further. Statistics New Zealand's *Household Net Worth Survey* (accessible here) reports that, at 2015, the proportion of the whole population (not just employees nor those under age 65) with a 'non-KiwiSaver' scheme was just 8% but we do not know how that number relates to active, contributing, employed members.

Should employers still be involved?

In a 'total remuneration' environment, employees are responsible for making their own decisions about saving and insurance needs. Arguably, the employer has no direct interest in those decisions, just as the employer has no direct role or interest in the decisions the employees make about the houses they buy, the food they eat or the clothes they wear. Saving and insurance decisions are, or should be, personal and private.

However, employers have historically been involved in saving and insurance arrangements for employees and the reasons for that involvement may still be relevant in a 'total remuneration' environment. Both employers and governments have an interest in whether employees are, for example, saving 'enough' for retirement.

Here are some of those reasons:

- **(i) HR policies:** When the employer wishes to move an employee on to a lesser role or even to terminate employment at an older age, an economic argument might encourage the employer to pay the employee to make the move. The cost of keeping the employee on might be otherwise higher than making the change now and paying the money. That HR need will not disappear in a 'total remuneration' environment but the employer must recognise such *ad hoc* payments are similar in character to the formal retirement saving scheme that is normally part of a 'pay + benefits' policy. One of the reasons that employers introduced subsidised retirement saving schemes was to formalise the retirement process and to make the termination or role-shifting easier to handle for both employees and the employer.
- **(ii) Purchasing power:** In most cases, an employer can buy financial services in bulk at a considerable discount to the costs faced by individual employees. Even if the employer decides that employees should make their own decisions about saving and insurance, the employer can use its superior negotiating position to make those services available through group schemes and a payroll deduction facility.
- **(iii) Information/education:** The employer can help to achieve its HR objective ((i) above) by actively informing employees about the long-term, financial implications of saving for retirement – helping them to make 'appropriate' decisions about spending their 'total remuneration'. It will also help employees to understand what might happen if they do nothing so there are no surprises when the employee reaches retirement. That financial education may help the employer in its own business. We have more to say about improving mathematical competence in section 20 (Information and education) and on the potential role of employers in helping develop the financial literacy of their employees. As that section explains, we have no recent information on what employers as a whole are doing in this area or whether employers might be interesting in doing more.

[146] Source: *Report of the Government Actuary for the year ended 30 June 2006*, accessible here at page 10.

Implications for public policy

Under historic 'pay + benefits' compensation strategies, the public policy focus was on employers and the retirement saving schemes they ran. That meant regulation of offers by employers and trustees, information provided by schemes, preservation of accrued entitlements and their eventual distribution (including on winding up those schemes). Those rules are necessarily (and increasingly) complex.

The 'customers' of public policy initiatives in a 'total remuneration' environment are the savers themselves. Everything the regulator does should focus on the needs of the savers to have appropriate information before committing to a saving programme, on joining, while a member and then on leaving. Some of that communication can be delivered through the employment relationship, given the employer's potential HR objectives (see above) and, for the regulator, the much smaller number of employers.[147]

On 'workplace' superannuation schemes

In 2012, the Ministry of Business Innovation & Employment published the *Financial Markets Conduct Regulations – Discussion Paper* (accessible here). It was a 243-page document that, in summary, lay the groundwork for how the then-new Financial Markets Authority would administer financial markets – we have more to say about the FMA in section 18 (Disclosure – initial and ongoing).

The Retirement Policy and Research Centre made a submission on one aspect of that *Discussion Paper*[148] In summary, the *Discussion Paper* proposed to change the rules on occupational superannuation schemes by denying members' access to their savings until they reached a retirement age. This was seemingly based on a view that 'superannuation' is (or should be) just about 'retirement'. That ignored the fact that since the tax changes in 1987-1990, New Zealand (unlike all other countries) no longer had a regulatory stake in what occupational superannuation schemes' main purpose should be. The then Superannuation Schemes Act 1989 (archive copy accessible here) still had a provision that defined a 'superannuation scheme' as being "…principally for the purpose of providing retirement benefits to beneficiaries who are natural persons… (section 2(1) – definitions). The 2012 *Discussion Paper* proposed, essentially, to define what 'retirement' meant and to say that a workplace scheme had to be about saving for 'retirement' and not about insurance.

In the end, the *Discussion Paper's* recommendations were watered down in the Financial Markets Conduct Act 2013 so that a 'workplace savings scheme' can allow benefits to be paid to an employee "on leaving employment" (section 130(1)(b)(ii) accessible here). However, insurance benefits are permitted only if "they are incidental or secondary to the purposes of the scheme" (section 130(1)(c)(ii)). Saving provisions were included for then-existing 'registered superannuation schemes' that did not comply with the new rules.

Our point here is the same as was raised in the RPRC's 2013 submission:

> "We strongly oppose the proposal to change New Zealand's regulatory requirements with respect to preservation of 'superannuation' benefits by restricting a saver's access to their money when the vehicle is called a 'superannuation scheme'. The Discussion Document does not provide justification for such a regulatory intrusion on members' entitlements. There is indeed no such

[147] As of February 2016, there were 182,277 'business units' with employees but 6,678 of them employed 45% of all employees - source, *New Zealand Business Demographic Statistics*, Statistics New Zealand (2016) accessible here. Even 'addressing' the 182,277 employers is more efficient than dealing with 2.1 million employees.

[148] *Submission to the Ministry of Business Innovation & Employment on the Financial Markets Conduct Regulations – Discussion Paper, 12 December 2012 – the 'problem' with 'superannuation'* by Michael Littlewood, February 2013, accessible here.

justification in the absence of tax incentives on the savings or unless saving for retirement becomes compulsory."

The new rules introduced by the Financial Markets Conduct Act 2013 have caused significant disruption and now need to be unwound. If we really want to encourage employers to engage with their employees on issues covered in this report, we need to make the regulatory environment as friendly as possible.

Questions New Zealand needs to discuss on occupational superannuation schemes:
Some of the following questions are connected to those in the next section 14 (KiwiSaver in the new environment) and also section 20 below (information and education):

1. What are employers currently doing about the retirement saving arrangements of their employees? The most recent, comprehensive information we have on this is a 2003 report prepared for the Periodic Report Group.[149]

2. How have employers reacted to the restrictions introduced for 'workplace savings schemes' by the Financial Markets Conduct Act 2013?

3. How many have a superannuation scheme, other than KiwiSaver, that is currently open to new entrants? What are its main provisions? How does the employer see the future of that scheme in a KiwiSaver environment?

4. What are employers' attitudes to extending their present roles into information/education programmes?

5. What do employers think of KiwiSaver in relation to their own HR objectives? How many employers think that KiwiSaver as it is, will be all that they will do about their employees' retirement saving needs?

6. How many employers have a 'total remuneration' policy, as opposed to 'pay + benefits'? Of the 'pay + benefits' employers, how many have formally adopted that policy, as opposed to having it by default (by doing nothing)?

7. How many employers help employees with information and education on issues associated with saving for retirement? Might they think of doing more? Might those that have no involvement think of starting some kind of information/education programme?

[149] *Tier 2 Retirement Savings: Employers' and Employees' Attitudes and Practices*, 2003 ESR Consortium accessible here. We were two of the three authors of that report.

14. KiwiSaver: in the new environment, what is the role for KiwiSaver?

KiwiSaver started on 1 July 2007. At the time, the government presented it:

> "…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."[150]

Since then, KiwiSaver has been through a number of major changes[151] and through two reviews by the Retirement Commissioner.

The 2016 Retirement Commissioner's Review presented 15 KiwiSaver recommendations or comments. They fall into three main groups: first, there are five recommendations that involve future research and recommendations (participation and reporting data, membership of more than one scheme, default funds, decumulation options and the apparent 'total remuneration disincentive').

Then there are two (the 'Member Tax Credit' for non-contributing members and increasing KiwiSaver coverage) on which more work is needed now before changes can be recommended.

Of the eight 'Change Today' items, two are cosmetic (changing the name of contributions holidays to 'savings suspension' and the 'Member Tax Credit' to 'KiwiSaver credit'); while another (dollar-cost fees) may improve disclosure requirements. A fourth recommendation suggests 'decoupling' the KiwiSaver benefit age from the state pension age that would, among other things, allow over-65s to join[152].

That leaves the following four recommendations for immediate change:

- minimum employer and member contributions increase to 4% each (from 3%) – the government has rejected that suggestion[153];
- an auto-increase option for member contributions – the government also rejected that suggestion;
- two new member contribution options (6% and 10%) to add to the current 4% and 8% - the government has said it will consider that recommendation;
- reduce the contributions holiday from five years to one[154].

---

[150] Section 3(1) of the KiwiSaver Act 2006.

[151] The history of KiwiSaver's introduction is summarised in the RPRC's 2014 report *Now we are six – Lessons from New Zealand's KiwiSaver*, Susan St John, Michael Littlewood and Claire Dale (accessible here). After only 10 years, we are already at KiwiSaver Mark IV and look destined for Mark V.

[152] The changes to the state pension age announced by the government in March 2017 already contemplate that decoupling but not for the reason suggested by the Retirement Commissioner. It is to facilitate the raising of the state pension age rather than specifically allowing older New Zealanders to join KiwiSaver with the contribution rules that follow membership before age 65. That could happen but is a separate issue.

[153] In the government's response to the Retirement Commissioner's recommendation (letter of 7 June 2017 accessible here), the Minister replied: "The Government is not proposing any immediate change to the minimum employer and employee KiwiSaver contribution rates. There is limited evidence that this recommendation would raise savings rates. It could also make it more difficult for low-income workers to contribute to KiwiSaver, while increasing costs to employers.". While we agree that higher KiwiSaver contributions probably won't increase savings, there is actually no evidence that New Zealanders need to save more. So, the government's 'answer' is to the wrong, or rather, the unnecessary question. As we have explained in section 11 above (The role of the government), governments seem to have little influence on citizens' overall decisions whether or how much to save for retirement.

[154] The government's letter of 7 June 2017 (accessible here) said that "The Government is undertaking work to understand the reasons why members are not contributing…"

The underlying theme of the Retirement Commissioner's four recommendations, and also three of the 'further work needed' suggestions, is that New Zealanders aren't saving enough for retirement. They need to be forced, tripped or encouraged into saving more than at present and KiwiSaver should be a vehicle to promote that needed change in behaviour. The Retirement Commissioner gave us no evidence to support her recommendations on that account.

We have incomplete information on what New Zealanders are actually doing about their retirement income preparations but here is a summary of what we knew before the Retirement Commissioner started her 2016 review:

- New Zealanders were probably slightly over-saving for retirement before KiwiSaver started in 2007 (Treasury reports from 2004[155], March 2007[156] and from 2009[157]);
- Of KiwiSaver contributions, about one-third was 'new' savings, the rest being effectively transferred from other financial assets (Treasury report 2011[158]);
- KiwiSaver members seemed to have accumulated less net wealth than non-members (Treasury report 2014[159]);
- Poverty levels amongst the over-65s are the lowest of any of the groups in New Zealand society (MSD reports from 2007 to 2013[160]) and are among the lowest of over-65s in any country (OECD 2008[161]) and also by comparison with 27 EU and other European countries (2009)[162];
- The overall cost to taxpayers of retirement income policies (public and private) is amongst the lowest in the developed world (OECD 2015[163]).

---

[155] *Saving for Retirement: New Evidence for New Zealand*, Grant Scobie, John Gibson and Trinh Le, New Zealand Treasury, 2004, accessible here.

[156] *Are Kiwis saving enough for retirement? Preliminary evidence from SoFIE*, Grant Scobie and John Gibson, New Zealand Treasury, March 2007, accessible here.

[157] *Saving Rates of New Zealanders: A Net Wealth Approach*, Grant Scobie and Katherine Henderson, New Zealand Treasury, 2009, (accessible here).

[158] *KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving*, David Law, Lisa Meehan and Grant Scobie, New Zealand Treasury (2011) accessible here. Care though has to be taken with SoFIE data as participants' recall of basic information seems at variance with IRD data – see *KiwiSaver: Comparing Survey and Administrative Data*, Anton Samoilenka and David Law, New Zealand Treasury (2014) accessible here.

[159] *KiwiSaver and the Accumulation of Net Wealth*, David Law and Grant Scobie, New Zealand Treasury (2014) accessible here.

[160] See *Household Incomes in New Zealand - Trends in Indicators of Inequality and Hardship 1982 to 2004* (2007), Bryan Perry, Ministry of Social Development (accessible here). By 2008, however, the income-based measure had worsened from 7% in 2004 to 14% (see *Household Incomes in New Zealand - trends in indicators of inequality and hardship 1982 to 2008* (2009), Bryan Perry, Ministry of Social Development (accessible here). By 2012, the position had improved again: to 6% of all over age 65 in "low income households" – see *Household Incomes in New Zealand - trends in indicators of inequality and hardship 1982 to 2012* (2013) Bryan Perry, Ministry of Social Development (accessible here). That volatility illustrates the close relationship between the 60% of income 'poverty' measure and the annual amount of New Zealand Superannuation; also that many old people have little private income. We should expect less volatility in deprivation-based measures of poverty.

[161] *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD (2008). New Zealand was one of the three countries that show an overall incidence of poverty in the "mid 2000s" amongst all people "of retirement age" of about 2% (rounded up from 1.53% in New Zealand's case). The other two countries were the Czech Republic and the Netherlands. The report itself is not accessible online but was looked at in the RPRC's *PensionBriefing, 2009-1, International comparison of poverty amongst the elderly* – accessible here.

[162] See *The material wellbeing of New Zealand households: trends and relativities using non-income measures, with international comparisons*, Bryan Perry (Ministry of Social Development) 2016, accessible here, at page 19.

[163] *Pensions at a Glance 2015*, OECD (accessible here) at page 181. Of 34 OECD countries, the net cost of NZS is 7th lowest. However, that ignores compulsory 'private' schemes and also the cost of tax breaks for private provision. Australia, for example, spends about two-thirds as much on tax breaks for retirement saving as it does on the Age Pension itself (*2016 Tax Expenditures Statement*, Australian Government, accessible here).

All this probably helps explain why, of all New Zealanders over age 65 in 2014, a Statistics New Zealand survey found that 71% reported having "enough or more than enough money" and 86% reported having "high life satisfaction (7-10 on 11-point scale)".[164]

From this, we could have deduced before the Retirement Commissioner's 2016 review that New Zealand's overall retirement income framework was 'working': people seemed to be saving 'enough'; limited 'poverty' in old age; favourable international comparisons, all at probably the lowest overall cost to taxpayers of all developed countries.

The Retirement Commissioner's review did not discuss or question any of what we already knew but we must assume the Retirement Commissioner thinks New Zealanders aren't saving enough for retirement, given her recommendations. But do we know that? Where is the evidence?

Can we even say that KiwiSaver members are saving more for retirement than their non-KiwiSaver peers? We just don't know but logic suggests they won't be saving that much more, if any more. Given the predictable reduction of occupational superannuation schemes at KiwiSaver's hands, some may even be saving less in total than previously, but we don't know[165].

Since 2007, taxpayers have spent about $8.5 billion on tax incentives for KiwiSaver[166]. Of total KiwiSaver balances in 2016 ($34 billion), as much as 25% came from taxpayers. About $740 million will be spent in the current financial year and another $2.4 billion over the three years to 2020[167]. Where is the evidence that these large sums have actually changed New Zealanders' overall financial behaviour?[168] Citing the number of members or the amount now invested in KiwiSaver doesn't answer that question. Encouraging those numbers to grow won't answer it either. Asking New Zealanders whether they think KiwiSaver is a good idea or whether they think they should be saving more is even less helpful.

Finding out what New Zealanders are actually doing about their financial preparation for retirement is the only way to understand whether KiwiSaver actually helps; even, whether New Zealand needs KiwiSaver. That requires a longitudinal survey of household financial behaviour of the kind New Zealand trialled in 2002-2010 with the Survey of Family Income and Employment (SoFIE). There is more on this suggestion in section 15 (Households' financial position) below.

International evidence suggests that governments are relatively powerless to change savers' decisions to save more or save more in a particular way or for a particular purpose, no matter what

---

[164] *New Zealand General Social Survey,* Statistics New Zealand (2014) accessible here.

[165] A 2015 Treasury review suggests that, even with growing KiwiSaver balances, total 'managed fund' assets owned by New Zealand households (life insurance, other superannuation, managed funds and KiwiSaver), measured as a percentage of GDP, had by May 2014 only just returned to levels seen in November 2006, before KiwiSaver started. Growing KiwiSaver balances had, over the eight years measured, displaced falling levels of 'managed funds', other superannuation and life insurance – see *Review of the KiwiSaver Fund Manager Market Dynamics and Allocation of Assets*, Andreas Heuser and others (2015) here at page 11. As the report notes (page 15), "The evidence also suggests that the effect of KiwiSaver on increasing net wealth is poor."

[166] Sources: Inland Revenue Department, *KiwiSaver Annual Report 6. 1 July 2012 - 30 June 2013* plus costs for 2014-17 from the Treasury's *Long Term Fiscal Model 2016*. This number ignores the favourable tax treatment given to funds in KiwiSaver schemes, given their status as 'portfolio investment entities' (PIEs). We have more to say on this in section 17 below (Income tax and saving vehicles).

[167] Source: *Budget 2016 forecast from 2015/16 onwards; Long Term Fiscal Model 2016*, The Treasury.

[168] A Treasury report (*KiwiSaver and the Accumulation of Net Wealth* David Law and Grant Scobie, 2014 accessible here) looked at changes in net wealth and "various panel regression techniques" and concluded "Neither approach suggests KiwiSaver membership has been associated with any positive effect on net wealth accumulation."

kind of intervention has been used (tax incentives, compulsion or soft compulsion). KiwiSaver might be an exception to that general observation but we need evidence of that[169].

What little we do know about New Zealanders' financial behaviour cannot justify the Retirement Commissioner's four key recommendations to 'strengthen' KiwiSaver.

> **A word on 'total remuneration':** As explained in the last section (Occupational superannuation - the role of employers), under 'total remuneration', the employer sets a total budget for a job. That budget is unaffected by an employee's decision to join KiwiSaver as the employer's required 3% contribution is deducted from 'total remuneration' with the balance paid as direct, taxable income. On the face, this looks negative but the employer ensures that two employees who do the same job are paid the same 'total remuneration'. Otherwise, the employee who joins KiwiSaver will receive more in total by the amount of the employer's contributions. The Retirement Commissioner's 2016 Review said that 'total remuneration' was a "disincentive towards KiwiSaver membership…The intent of KiwiSaver legislation is that compulsory employer contributions are paid on top of gross salary or wages."[170] This is one of the five areas identified as requiring further work to, in this case, "…better understand the effects of allowing a total remuneration approach in regard to the intent of KiwiSaver legislation."
>
> The Retirement Commissioner misrepresents the position. Section 101B of the KiwiSaver Act 2006 (accessible here) states the presumption that the employer's contributions are "…paid in addition to an employee's gross salary or wages" (section 101B(1)) but then allows the employer and employee to agree otherwise (section 101B(4)). The Retirement Commissioner seems to be thinking of recommending the abolition of the right of an employer and employee to agree remuneration arrangements. If that's the intention, we disagree with the purpose of the Retirement Commissioner's reason for 'further work' in this area. The assumptions underpinning that 'further work' must be that an employee is incapable of agreeing appropriate arrangements with the employer and that the employer has no legitimate reason for seeking that agreement. That is why section 101B(1) is in the legislation[171].

Taxpayers will spend $738 million on KiwiSaver in 2017. The Treasury expects that to be $840 million in 2020. The Retirement Commissioner's four key recommendations would increase that subsidy. There are some questions that need answers to support even the current subsidies before we can discuss whether further subsidies can be justified.

Questions New Zealand needs to discuss on KiwiSaver:
Some of the following questions overlap with questions in the last section 13 (Occupational superannuation – the role of employers):

---

[169] As already noted above, the government seems to think that increasing member and employer contributions to KiwiSaver isn't a good idea, given the apparently "limited evidence" that this would raise saving rates. We suggest there is no such evidence.

[170] *2016 Review of Retirement Income Policies* accessible here at page 17.

[171] The government also disagrees with the Retirement Commissioner. In its letter of 7 June 2017 (accessible here), the Minister of Commerce and Consumer Affairs said "the Government is not considering changing the total remuneration approach as it applies to KiwiSaver at this time. The Government considers that the current approach is satisfactory as it provides flexibility to employers and employees." We assume this means the Retirement Commissioner will not now see the need to undertake further work on this topic.

1. Is KiwiSaver working? Subsidiary related questions include: are KiwiSaver members saving more for retirement than their non-KiwiSaver peers? Are the total net *financial* assets of KiwiSaver members greater than the totals of non-KiwiSaver peers? In other words, is so-called 'behavioural economics' working in the KiwiSaver environment?

2. Are New Zealanders saving enough for retirement whether or not they belong to KiwiSaver? If they are, that would undermine the case for 'strengthening' KiwiSaver.

3. What effect has KiwiSaver had on housing ownership patterns and housing debt as between members and non-member peers?

4. What effect has KiwiSaver had on remuneration patterns as between employers with/without 'total remuneration' policies and as between employers with preferred KiwiSaver schemes and those without. What proportion of employers have a 'total remuneration' policy? Has KiwiSaver affected that pattern?

5. What effect has KiwiSaver had on occupational superannuation schemes? What is the overall impact of KiwiSaver on workplace-related retirement saving schemes (including KiwiSaver)?

6. Who specifically benefits from the current tax subsidies to KiwiSaver (occupation types; remuneration bands; distribution by age, sex, work status etc.)?

7. What effect has KiwiSaver had on the financial services industry in the last ten years and who benefits? Should New Zealand be concerned about the aggregation of KiwiSaver savings in the hands of a small number of providers, mainly the major trading banks?[172]

8. If, as suggested in section 11 of this report (The role of the government), the government has no role in forcing or incentivising particular types of financial provision for retirement, what might be KiwiSaver's role in a more rational policy environment? Here are some suggestions that require analysis and debate:
   (a) Remove auto-enrolment;
   (b) Remove 'Member Tax Credits';
   (c) Re-install the 'kick start' government grant for new members;
   (d) Remove default providers (if no auto-enrolment) or open up default status to all 'qualifying' schemes' (if auto-enrolment retained);
   (e) Remove all rules about member contributions;
   (f) Remove compulsory employer contributions;
   (g) Allow access to benefits at any age and for any reason.

Questions 1 and 2 cannot be answered without a proper longitudinal study of household assets, liabilities and incomes. We look at this in the next section.

[172] According to the annual report of the Financial Markets Authority (graph accessible here; report accessible here), the trading banks had 1.8 million of 2.6 million total members at 31 March 2016 (69%) and $21 billion of $29.6 billion in total assets (71%). Eight KiwiSaver schemes have 87% of all members and that concentration will probably increase.

15. Households' financial position – a proper longitudinal survey needed

Sections 9 (tax incentives) and 10 (compulsory private provision) together suggest that governments are relatively powerless to influence directly how and how much citizens save specifically for retirement. Governments can certainly influence, even control, aspects of citizens' decisions especially where there is compulsory private provision at Tier 2, such as in Australia. They cannot control how households respond to public policy settings in the rest of their financial lives. So, the net effect of those policy settings is likely to be a lot smaller than appears superficially.

We can see what New Zealanders are doing at a 'macro' level by analysing total assets and debt available from 'administrative data' – information that the government collects for other purposes. The Reserve Bank, for example, produces a report that 'takes the financial temperature' of New Zealand's households as a whole on a regular basis. The most recent report[173] showed households' gross assets at $1,387 billion[174] with:

- total liabilities of $173 billion (total debt was 12.5% of gross assets[175]);
- all housing and land assets (including rental investments) were 54.2% of gross assets;
- all business investments (unlisted shares and equity in unincorporated businesses) were 20.5% of gross assets[176];
- KiwiSaver balances ($34 billion in 2016) were 5.3% of households' 'financial assets' and 2.5% of all assets.

These 'administrative data' do not tell us enough about what happens to individual households and, in the business of pre-retirement planning, that really matters. The only way to discover what is happening at that level is to ask households themselves what they are doing – what they own and owe; what their retirement aspirations might be and what they might be doing about those now and over time. Talking directly to households, rather than individuals, will also show the influence of things that happen to other household members, such as death, divorce, disability or employment-related changes. Those kinds of changes are significant in the retirement and retirement-saving context but are not discoverable from top-down 'administrative data'.

New Zealand tried to uncover some of this crucial information through the 'Survey of Family Income and Employment' (SoFIE). Longitudinal surveys are complex to organise and analyse but can give rich insights into behaviour, particularly changes in behaviour.

SoFIE was a longitudinal survey conducted by Statistics New Zealand over an eight-year period, 2002-2010. It collected financial data about individual New Zealanders every two years during that period, starting in 2004. Because the same individuals supplied information during the whole period, the collection of 'snapshots' at each collection date could be 'joined together' to give a picture of how participants changed their position over the period[177]. Interestingly, for our purposes, the collection of financial data straddled the introduction of KiwiSaver in 2007.

---

[173] Reserve Bank of New Zealand, *Household balance sheet*, Table C22 as of September 2016 (accessible here). The Reserve Bank notes this was an experimental estimate. Official estimates for March 2017 will be published in June.
[174] The Reserve Bank notes that this is an under-estimate of households' total wealth holdings as it ignores overseas assets and non-life insurance reserves. It also makes no attempt to measure human capital though it does count the student debt ($15.3 billion or 8.7% of all 'financial liabilities') that represents part of the cost of acquiring that capital.
[175] The 'debt to gross asset' number was 12.4% in 2006, virtually unchanged in real terms over the ten years to 2016.
[176] These business investments (20.5% of gross assets) were nearly the same as total assets in bank deposits, securities other than shares, loans, investment fund assets and life insurance/superannuation at 22.4% of gross assets.
[177] The mobility between quintiles of wealth of SoFIE participants was examined in *Wealth Disparities in New Zealand – Final Report* (2017) by Geoff Rashbrooke, Max Rashbrooke and Wilma Malano, Institute for Governance and Policy Studies – accessible here. In summary, about two-thirds of those in the top and bottom quintiles of wealth stayed there over the eight years measured and about two-thirds of those in the other three quintiles moved (up or down).

SoFIE's sample size started in 2002 at more than 22,000 individuals living in 11,500 households.

We have already summarised some of SoFIE's insights into New Zealanders' saving behaviour in the last section 14 (KiwiSaver in the new environment).

SoFIE can also help us to understand how New Zealand's households as a whole compare with Australia's. That's a useful comparison given the very different policy settings in both countries.

The RPRC's *PensionBriefing 2010-2 - What do New Zealanders own and owe? News from SoFIE 2004-2006* (accessible here) looked at 2006 data from SoFIE. This was then the most recent information from SoFIE.

The *PensionBriefing* noted that New Zealanders as a whole had (in 2006):

- a lot less in housing of all kinds than many supposed (about 46% of all net assets);
- less debt than statistics often represented (about 14% of total gross assets);
- more in businesses and financial investments than critics suggested at the time.

Australia has its equivalent to SoFIE – the Household, Income and Labour Dynamics in Australia (HILDA). HILDA originally (2001) covered 7,682 households and 15,127 adults (age 15+). By 2006, the covered population had reduced to 10,085 individuals. The wealth module was added for the first time in 2002 and became Australia's first large-scale survey of household wealth since 1915[178].

In 2009, the Australian Government published a commissioned report on data from the then latest wealth module of the HILDA Survey, conducted in 2006. *Families, Incomes and Jobs*[179] looked at households as a whole in 2006 to see what they owned and owed.

The RPRC's *PensionBriefing 2010-5* (*Household Wealth in Australia and New Zealand*, accessible here) looked at the Australian equivalent numbers to SoFIE's. The *PensionBriefing* used an analysis of the SoFIE 2006 data from a Motu report of "means and medians of assets and liabilities"[180].

Superannuation assets are clearly greater in Australia as a proportion of household's net assets but business and other assets in New Zealand are greater. There are other differences but the overall similarities are striking. Given the comparatively similar makeup of populations and institutions, compulsion aside, the overall similarities should probably be expected.

Comparisons of any kind between any two countries are problematic because of the very different environments. For example, with respect to retirement saving and income issues, New Zealand

---

For such a short period, that seems a relatively high level of mobility. Quintiles of wealth were measured as snapshots in each of 2004, 2006, 2008 and 2010. The groupings are relative to the others at each measurement and do not track overall rises or falls in absolute measures of wealth.

[178] Given Australia's huge intervention in retirement savings with the 'Superannuation Guarantee' that was introduced over the 1986-92 period, it seems that Australia had no idea whether Australians needed a compulsory savings scheme. New Zealand did at least have SoFIE data before KiwiSaver started in 2007; it's just that the government ignored SoFIE's findings.

[179] *Families, Incomes and Jobs: A Statistical Report on Waves 1 to 6 of the HILDA Survey*, Roger Wilkins, Diana Warren, Marcus Hahn and Brendan Houng (2009), Melbourne Institute of Applied Economic and Social Research (accessible here).

[180] *Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family, Income and Employment*, Trinh Le, John Gibson and Steven Stillman, Motu Working Paper, Motu Economic and Public Policy Research 10-09 (2010) (accessible here).

has a universal Tier 1 pension whereas Australia's is both income- and asset-tested. That affects the way Australians make saving decisions over and above those they are forced to make through the compulsory Tier 2 scheme. If comparisons of retirement saving wealth were to be made, the net value of state Tier 1 entitlements would form an important part on both sides of the Tasman but more so for New Zealanders (relatively more generous pension; no income or asset tests).

Even line-item comparisons of asset ownerships between HILDA and SoFIE are difficult because of different data classifications. With those qualifications uppermost, there seem to be lessons from even a cautious comparison.

Analysing SoFIE itself proved problematic as it progressed through the different waves. Some of the difficulties were noted in the Treasury paper that first reported saving and wealth information from 2006[181]. Also, though both SoFIE and HILDA are longitudinal studies, the RPRC's 2010 *PensionBriefing 2010-5* compared just two 'snapshots' – the assets and liabilities in both countries for just 2006.

From a retirement saving perspective, what really matters is the net wealth of a retiree at 'retirement' and through the retirement period. Aside from the primary residence[182], contents and other 'lifestyle' assets (car, boat, etc), the ability to convert other assets to cash (along with state-provided incomes) will drive an individual's standard of living in retirement[183].

The RPRC's *PensionBriefing 2010-5* analysed the broad split in each country (in 2006) of all the assets that might be available to support all respondents' retirement income needs, if retirement had occurred in 2006.

In 2006, those totals were:

- Australia: 50.5% of total net assets;
- New Zealand: 49.4% of total net assets.

The New Zealand number is understated because private superannuation was under-reported (an error in data collection/specification), while family trusts' holdings, except to the extent there is debt owed by the household to the trust, and Maori assets were both ignored. The split also takes no account of the relative differences in the two state pensions. From a total retirement income perspective, New Zealand retirees need relatively lower amounts of private 'retirement assets' than Australians for a given target retirement income.

With those qualifications, as at 2006 (before KiwiSaver started in 2007), the relative similarity of the two overall numbers was notable. Between 1987[184] and 2006, public policy in New Zealand on saving was almost completely 'hands-off' (no compulsion or tax incentives of any significance). The public policy contrast with Australia could not have been more marked and yet the outcomes,

---

[181] *Saving Rates of New Zealanders: A Net Wealth Approach*, Grant Scobie and Katherine Henderson New Zealand Treasury, (2009) accessible here.

[182] We have made the point above that 'administrative data' are not rich enough to capture what is happening at a household level. The 'primary' residence is usually a household's most valuable asset. The most recent Reserve Bank's *Household balance sheet* here says that, across all households, all 'housing and land value' (excluding, for some reason, vacant land) was 54.2% of gross assets. The equivalent number in 2010 was 49.2%. SoFIE data for 2009/2010 (as reported by Rashbrooke, Rashbrooke and Malano (*op cit* here, page 17) had respondents' 'own home' as 36.3% of gross assets. The difference between the two numbers (49.2% to 36.3%) is significant and deserves analysis.

[183] Even the primary residence can enter this equation if trading down to a cheaper retirement home is a realistic option. Lifestyle assets could also be sold. Leaving these possibilities aside is a conservative approach.

[184] When tax incentives for retirement saving started their phase-out (completed in 1990).

at least as a proportion of the total net assets of all respondents, were relatively similar after about 15 years of consistent public policy (to 2006) in each country. Citizens had, as a whole, come to relatively similar decisions about the net amounts they had to put aside for retirement, after making allowances for the impact of state interventions in that particular saving project.

Another, more detailed, two-country comparison (Australia and Germany) came to similar overall conclusions. In *Living Standards in Retirement: Accepted International Comparisons are Misleading* (2011), Melbourne Institute, (accessible here) Joachim Frick and Bruce Headey's conclusion was that:

> "We re-estimate the living standards of retirees in the two countries, following an approach developed by Gruber and Wise... This involves estimating the future lifetime income flows of retirees and integrating these estimates into more conventional 'stock' measures of wealth. Also included are estimates of future income-in-kind, notably homeowner imputed rents. The revised 'present value' estimates of wealth – 'comprehensive retirement asset measures' (CREAM) - suggest that Australian and German retirees are likely to have approximately the same living standards (mean and median), with much the same distribution (Gini).

They observed that "[a]fter many gyrations, our final estimate is that Australian and German retirees have almost exactly the same standard of living [in retirement]."

The differences in public policy settings between Germany and Australia could not be more marked but, again as with the New Zealand comparison, citizens had come to relatively similar decisions overall about the net amounts they had to put aside for retirement after taking account of what the government's policy settings meant to them personally. That seems a logical outcome and we should actually have been surprised if the outcomes had been different.

'Private' decisions about what to save for retirement should be 'net' decisions; made after allowing for the individual impact of the government's policies on the individual's own likely position in retirement. That hypothesis needs testing in New Zealand.

Given the potential significance to public policy issues associated with retirement saving and post-retirement welfare, it is surprising there are so few longitudinal studies of households' financial affairs in other countries. We have already mentioned SoFIE and HILDA. Here is a list of all those we have encountered (and links):

- Europe: the Survey of Health, Ageing and Retirement in Europe (SHARE) – see here.
- New Zealand: SoFIE – see here.
- Australia: HILDA run by the Melbourne Institute– see here.
- United Kingdom: the English Longitudinal Study of Ageing (ELSA – see here)[185].
- United States: aspects of households' financial positions are also covered in the US Health and Retirement Study (HRS)[186] run by the University of Michigan – see here.

That gap in knowledge of what households are doing around the world is notable. What is even more notable is that the Retirement Commissioner's 2016 Review made no reference to any of the material covered in this section; nor to the importance to public policy considerations of filling our information gaps.

---

[185] In *Prepared for Retirement? The Adequacy and Distribution of Retirement Resources in England*, James Banks, Carl Emmerson, Zoe Oldfield and Gemma Tetlow, Institute for Fiscal Studies (2006 - accessible here), the authors used ELSA data to conclude that most (57%) participants aged between 51 and the state pension age in 2001-02, if they retired immediately, would still have 'enough' to live on once they reached state pension age.

[186] The US HRS has a new sample for each survey. While each sample might be representative, it is not a longitudinal survey of the kind we discuss here.

Questions New Zealand needs to discuss on a new longitudinal survey:

Some of the questions that follow relate to questions raised in earlier sections of this report such as sections 9 (tax subsidies), 13 (occupational superannuation) and 14 (KiwiSaver).

1. What lessons have we learned from the design and implementation of SoFIE? How can we do it better next time (we think there must be a 'next time')?

2. What lessons might we learn from the longitudinal studies in Australia, Europe, the United Kingdom and the United States?

3. Do we really know how or how much New Zealanders save for retirement now? Where are they getting advice and what is the extent and quality of that?

4. Do we really know whether New Zealanders need to save more for retirement than they do now? This will not be answered by asking New Zealanders whether they think they should be saving more but rather examining what they are doing about financial preparation for retirement (including buying and paying off the family home; building a business; acquiring skills that might suit post-'retirement' aspirations; potential inheritances etc.).

5. How do New Zealanders respond over time, both financially and behaviourally, to external changes (global and national financial conditions, labour market changes, technological changes, regulatory changes)?

6. Do we really know how New Zealanders and their associated households migrate financially from full-time work to full-time retirement?

7. How does the state pension age of 65 affect New Zealanders' decision-making about financial preparation for retirement and the retirement decision itself? The signalled change to age 67 by 2040 may (should) affect New Zealanders' saving decisions, depending on when they expected to retire, and it would be nice to track those intentions over time.

There is more on the issues associated with questions 6 and 7 in the next section 16.

16. When do New Zealanders 'retire'? The need for labour market data of New Zealanders' labour force participation from age 50 onwards.

New Zealand Superannuation's state pension age has a significant influence on the behaviour of older workers. Aspects of this were covered in the RPRC's 2012 *PensionCommentary 2012-4, A commentary on older workers and some HR issues facing employers* (accessible here).

Internationally, the *state pension age* is the eligibility age for the state pension payable at the 'normal' rates. In some countries (such as the US), state pensions can start at a reduced rate from an earlier age (62 in the US; 63 in Germany) or at an increased rate from a later age (up to age 70)[187].

The *retirement age* is when workers stop their 'main' paid employment and start to depend on income from pensions or other resources. There is often no clear break between 'work' and 'retirement', with some workers gradually reducing their paid hours in the transition from full-time work to 'full-time' retirement. Also, many change 'careers' as part of the work/retirement transition. Nevertheless, some workers have no choice about 'retirement' as sickness, unemployment or family duties force the transition.

In recent decades, the retirement age in the developed world tended to be earlier than the state pension age as labour force participation rates amongst older workers reduced. The gap has narrowed recently[188]. In part, that has been caused by economic conditions but changes to state pension systems have also directly influenced change. Longer healthy lives are also a factor.

As New Zealand's baby boomers are now entering the retirement 'window', what they decide to do about retirement will have very large fiscal, labour force and investment consequences. Baby boomers have had significant impacts on New Zealand's social, economic and fiscal experiences since the first of them were born in 1946. As New Zealand experiences the process of their retirement, we must anticipate similar impacts on pensions, savings decumulation, housing and age-care services.

The RPRC's *Updating data on older workers* (*PensionBriefing 2014-4*, accessible here) summarised data on labour force participation rates of older workers:

> "In 2013, about 130,000 people aged 65+ were labour force participants, about six times the number of 27 years earlier. The population aged 65+ grew by 77% over this period… while the population as a whole increased by only 30% (from 3.27 million in 1986 to 4.24 million in 2013)."

Participation rates of an increasing number of New Zealanders in the age 65+ group should be of interest to policymakers but we do not know enough about this group[189]. We know that New Zealanders are, on average, stopping paid employment at later ages than 20 years ago; also that some of those changes are probably influenced by the changes to the state pension age between

---

[187] Interestingly, even though the US state pension age is increasing to age 67 by 2027, there has been no change to the early payment age (from 62) and the late payment age (70). Details are here.

[188] For example, in Europe, the employment rate of the 55-64 age group increased in the EU-27 from 37.7% in 2001 to 46.3% in 2010 – see *White Paper: An Agenda for Adequate, Safe and Sustainable Pensions*, (2012) European Commission (accessible here). New Zealand's 2010 equivalent was 75.9% - see *Comparison of the New Zealand and Australian Retirement Income Systems*, Ross Guest (2013) accessible here at page 15 (citing ILO data) Australia's 2010 equivalent number was 62.6%. The latest European data (2015, accessible here) show that the age 55-64 employment rate is now 53.3%.

[189] People 'participate' in the workforce if they work at least one hour a week. In 2013, 52% of those aged 65 and over who were employed (about 69,000 people in 2013) worked for at least 30 hours a week. Of the 130,000 in all who worked at least one hour a week in 2013, 62% of men and 40% of women worked at least 30 hours. (Census data accessible here).

1977 and 2001. The anti-discrimination provisions of the Human Rights Act 1993[190] were also likely to have been an influence.

Some work has been done to understand the main drivers for New Zealanders' 'retirement' decisions. Gorman, Scobie and Towers used three waves of data (2006, 2008 and 2010) from the Survey of Family Income and Employment (SoFIE) and concluded:

> "In summary, we find poor health and eligibility for benefits or pensions to encourage exit from the labour force for both males and females; whilst continued employment of a spouse is associated with further participation for males. For females, financial security appears to be a relatively important factor: higher household net wealth is associated with earlier retirement, and the dissolution of marriage with a higher likelihood of participation. Additionally, we find that unobservable effects, specific to the individual, explain a substantial proportion of the retirement decision."[191]

Other influences beyond individual circumstances include:

> "…growth of service industries, increased opportunities for part-time or contractual work, skill shortages and a more buoyant economy in the early years of the new millennium…" (Khawaja and Boddington, 2009, p.75)[192]

United States evidence suggests that the state of the local job market also has an influence. The higher the local unemployment rate, the lower the rate of voluntary retirements. That is possibly because retirees want different or part-time work as part of their transition to retirement and if that isn't available, they prefer to stay put. As a consequence, the lower the rate of voluntary retirements, the higher is the rate of 'forced' retirements[193].

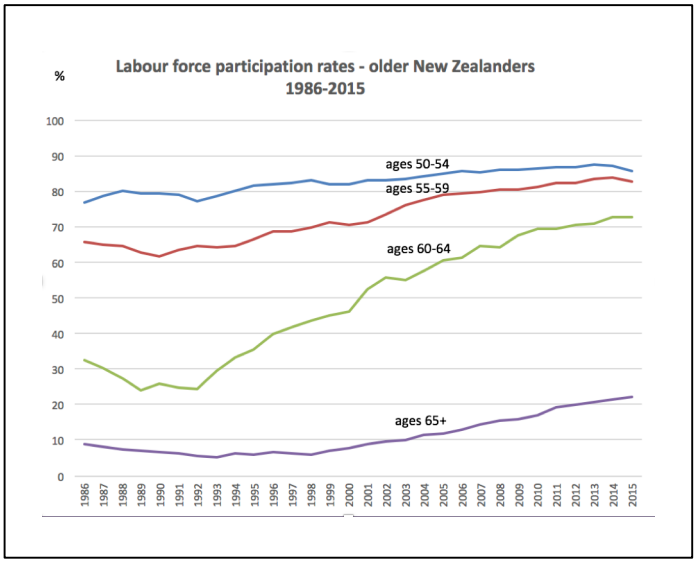
The changes in New Zealand's state pension age between 1977 (reduced from 65 to 60) and 1991 to 2001 (increased back to 65) were a natural experiment on the impact of the pension age on labour force participation rates. Roger Hurnard (2005)[194] found that being becoming eligible for NZS dropped the participation rate for males by about 21 percentage points and by 7 percentage points for females. For females, there is another inflection point that sees another "drop of a further 11 percentage points" a few years before the state pension age. This presumably reflects the typical age difference between partners where the older male reaches state pension age first. Hurnard also suggested that, because of the relative generosity of NZS, the state pension age may have a larger influence on the retirement age than in other countries with a relatively larger private component to retirement incomes.

The state pension age was not the only influence in those changes to the labour force as major economic changes happened in the mid-1980s when New Zealand's economy was opened up. That resulted in significant changes to the labour market. The availability of NZS then from age 60 would have helped many through that transition.

The chart on the next page illustrates the changes in older-age participation rates in New Zealand in the last 30 years:

---

[190] Section 22 of the Human Rights Act (accessible here) outlaws the retirement of an employee on account of age.
[191] *Health and Retirement of Older New Zealanders*, Emma Gorman, Grant Scobie and Andy Towers, New Zealand Treasury Working Paper 12/02 (2012) accessible here at page 34.
[192] *Too Early to Retire? Growing Participation of Older New Zealanders in the Labour Force*, Mansoor Khawaja and Bill Boddington, New Zealand Population Review, 35:75-93 (accessible here).
[193] *Identifying Local Differences in Retirement Patterns*, Leora Friedberg, Michael Owyang and Anthony Webb, (2008) Center for Retirement Research, Boston (accessible here)
[194] *The effect of New Zealand Superannuation eligibility age on the labour force participation of older people*, Roger Hurnard, (2005) New Zealand Treasury Working Paper 05/09, Wellington (accessible here).



Source: StatsNZ data (*NZ Social Indicators*) accessible here.

We know very little about the present transitions of New Zealanders from fulltime work to 'fulltime' retirement. We do know that more New Zealanders, aged 65 and older, are working and that those proportions are still increasing[195]; also, that the men's participation rate is significantly higher than for women: 1.4x at ages 65-69 through to 2.1x at ages 81-85 (for a very small group at these oldest ages).

The ageing workforce carries with it a number of challenges that will have a direct bearing on 'quality of life' issues for older New Zealanders. It also has significant implications for New Zealand's employers as skilled/knowledgeable workers retire. Employers should be thinking of strategies to retain (or retain access to) skilled older employees. It would be interesting to see whether employers are doing anything about that.

Participation rates at older ages affect the debate we need to have on the state pension age and on the size of the NZS pension itself.[196] While some of those challenges are for employers to deal with, the government also has a role. As explained in section 11 (the role of the government) only the government can deliver "impeccable, deep, accessible information on population trends, saving and investment behaviour and poverty issues associated with ageing."

[195] The chart shows that the proportion of all those age 65+ who participate in the workforce has grown from a low of 5.3% in 1993 to 22.1% in 2015. Also, the proportion of those age 60-64 has grown from a low of 23.9% in 1989 to 72.9% in 2015. The state pension age was 60 until 1992 but rose to 65 by 2002.

[196] Some suggest though that the demographic future might not be as grim for productivity as feared. Ross Guest concluded in *Good News about an Ageing Workforce* (for a 2005 Treasury workshop and accessible here) that there could be a 'dividend' from the change in the age distribution of the workforce that raises labour productivity 'naturally'. "The gains could be sufficient to substantially offset the effect on output per capita of the decline in the worker to population ratio that will occur with no increase in [labour force productivity ratios]." (at page 12). As ever though, the author says we need more information on this issue.

Questions New Zealand needs to discuss on retirement data and experiences:

1. We need to know much more about workforce participation of New Zealanders from age 50 onwards – when does the 'career' stop and the 'retirement' process begin and how does it progress? At those older ages, the analysis should be detailed – say, by each year of age and longitudinal (tracking particular workers).

2. What happens now at about the state pension age? In other words, how does the start of NZS affect decisions about paid employment (and so, how might changes to the state pension age affect those decisions)? This information could form the basis of a model that allows New Zealand to have a proper discussion about the state pension age. A data-driven discussion of this key public policy issue was absent from the recommendations of the Retirement Commissioner's 2016 Review and also from the government's 6 March 2017 announcement about the two-year increase starting in 2037.

3. What influences the choice of work during the 'retirement' period and is that different in different parts of the country, for different groups of New Zealanders and for different 'working life' skills/qualifications?

4. How does paid work post-'retirement' help in financial preparations for 'part-time' and 'full-time' retirement? What lessons might New Zealanders learn from the experiences of current older workers?

5. What, if anything, are employers doing about retaining access to the skills of baby-boomer retirees? Is this an issue of 'public' importance?

6. How might the government help employers and New Zealanders to bridge information gaps?

17. Income tax and saving vehicles – all 'income' should be taxed at the appropriate marginal rates[197]

There was no comment in the Retirement Commissioner's *2016 Review* on tax matters (accessible here).

The following summarise the main issues that New Zealand faces on income tax associated with 'collective investment vehicles' (CIVs):

(a) Different categories of CIV pay different rates of tax;

(b) Different tax regimes apply to different types of asset;

(c) Tax applies to investments differently for CIVs when compared to individual savers.

We think the Retirement Commissioner should have considered the implications of this fragmented and inconsistent approach to the tax treatment of investment income. Instead, there was no mention of this issue in the *2016 Review*.

In 2010, we reviewed the income tax regime of CIVs and the relationship between 'income' and the income-tested welfare benefits. In essence, nothing has changed so what follows summarises our findings of seven years ago.

Until 2000, New Zealand had a relatively simple tax treatment of CIVs where the CIV's income was taxed at the top personal rate of tax (33%) that was also the corporate tax rate and the rate that applied to trusts. Under the TTE regime (see section 9 – On tax subsidies for saving), members' contributions to CIVs that were workplace superannuation schemes were made out of the employee's after-tax income (the employer's contributions were also taxed at 33%) and withdrawals were treated as tax-paid capital.

An Inland Revenue 2005 *Discussion Document*[198] stated:

> "…it is important that the tax rules for investment income operate efficiently and that investors' decisions are not distorted by different tax treatments for income from investments that are similar in nature……
>
> "The proposals outlined in this discussion document aim to resolve these inconsistencies and the distorting effect they have on investor decision-making."

The results of the review sparked by the *Discussion Document* were the 2007 introduction of Portfolio Investment Entities' (PIEs) and the Fair Dividend Return (FDR) approach to the tax treatment of overseas investments. However, as our 2010 Working Paper concluded, "It is clear that the tax regime is complex and distortionary and this seems at odds with the reasons for the 2007 changes."

There are now, broadly, three types of CIV or pooled investment vehicle:

- A **unit trust** type of product where the return is passed through to the investor and taxable income is taxed at the investor's own marginal tax rate.
- A **superannuation scheme** type of product. These can be a PIE where tax is calculated within the scheme at the investor's Prescribed Investor Rate (PIR) that mimics, on a favoured basis, the investor's marginal rate but doesn't tax all income. Returns are

[197] This section is based on our Working Paper 2010-1 for the Retirement Policy and Research Centre: *Towards a more rational tax treatment of collective investment vehicles and their investors* (accessible here).

[198] *Taxation of investment income - The treatment of collective investment vehicles and offshore portfolio investments in shares* (2005) Inland Revenue Department, accessible here.

ultimately distributed to investors as tax-paid capital. A superannuation schemes does not have to be a PIE – in this case, tax is still calculated within the scheme on a 'final basis' but at a standard 28% for the scheme as a whole[199].

- A non-superannuation scheme (which may be a unit trust) that is a **PIE** and that also taxes the income at the investor's PIR.

Separately, the **FDR regime** taxes overseas equities trusts (and direct equity investments) other than certain Australian shares on a deemed income basis. Regardless of the investor's actual returns, taxable income is assumed to be 5% of the asset's opening value on 1 April in the tax year for an individual and some CIVs, though moist CIVs are now taxed on 5% of the average daily value.

In nearly all cases, the FDR regime will either over-tax or under-tax the investor's actual income, measured against the investor's marginal tax rate and also creates potential liquidity issues as tax is based on deemed income, not income actually received.

Contributions by an employer to a 'workplace superannuation scheme'[200] or a superannuation scheme or a KiwiSaver scheme, are subject to a complex 'Employer Contribution Withholding Tax' (ESCT) if the employer has chosen the multi-rate approach that mimics the employee's marginal tax rate for the last tax year but includes the contributions paid as 'income'. Contributions by employers to other types of schemes are subject to Fringe Benefit Tax.

Different combinations of direct and indirect investment will produce different overall tax consequences.

Overseas investments – ownership basis affects tax treatment

Our 2010 Working Paper analysed the practical implications of the 2007 changes by looking at the different ways a New Zealand saver could invest in overseas shares or bonds. We concluded that:

> For an **overseas share** (we used BHP Billiton as an example of an Australian share), there were at least 11 different ways a New Zealand investor can invest in overseas shares and seven potentially different after-tax returns even though the pre-tax return was the same in each case. However, even the four that had similar tax treatments could vary between themselves (and with others) depending on the relationship between timings of dividends and market values relative to the 1 April fixing of market values under the FDR regime. Even currency management options can affect the optimal tax structure.
>
> For an **overseas bond**, there are 13 possible ownership choices with 13 potentially different after-tax returns for the same pre-tax return. The 'best' answer for a New Zealand investor will depend on the investor's marginal tax rate, effective marginal tax rate and issues such as costs, convenience etc. For most, owning overseas bonds through a PIE or registered superannuation scheme that invests in an Australian or overseas unit trust that includes currency hedging bought overseas will probably be optimal.

Tax treatment of CIV's income and distributions

The way in which a CIV's income and distributions are taxed also varies by category. Whether returns are 'income' within the CIV depends on the CIV's classification (registered superannuation scheme, unregistered superannuation scheme, unit trust, PIE, 'group investment fund', family trust or even an ordinary bank account).

---

[199] There is also a trust (such as a family trust) where undistributed income is taxed at 33%, the top personal marginal rate of tax.

[200] 'Workplace saving schemes' are registered under the Financial Markets Conduct Act 2013

Also, the PIE tax calculations for an individual member are complex as the PIR depends on the total of the PIE's income attributable to the member and the member's taxable income in one of the two preceding complete tax years (the lower year). The member must advise the PIE's manager what the correct PIR for each year should be.

Interaction with state benefits

The definition of 'income' matters not just for tax but also for an individual's entitlements to a number of state-provided benefits or obligations that depend in some way on 'income'. These include the Family Tax Credit (FTC), In-work Tax Credit (IWTC), Minimum Family Tax Credit, Parental Tax credit (together referred to as 'Working for Families'), the Independent Earner Tax Credit (IETC), Student Loan payments and allowances, Child Support payments and income-tested welfare benefits such as Sole Parent Support, Job-seeker Support and the Accommodation Supplement.

In all these cases, the 'income' that counts is taxable income[201]. Non-taxable benefits or benefits that are subject to either Employer Superannuation Contribution Tax (ESCT) or Fringe Benefit Tax (such as the private use of a car, low interest loan, etc.) are not counted. Neither are the tax credits (FTC, IWTC, IETC etc.).

'Income' within a scheme (and not effectively distributed) is unlikely to be included and that seems illogical.

Summary of the 2007 changes

There is a variety of ways in which assets and income can be 'sheltered' from direct connection with the economic owners of that income. Income derived through the various tax-based vehicles is not always aggregated for either income tax or for the application of income-tested payments.

The discontinuities between different parts of the CIV regime, the illogical tax treatment of contributions and investment income and the artificial distinctions between directly and indirectly earned income mean, inevitably, that the 2007 rules will be subject to change as advisers test the boundaries. As is usually the case, wealthier taxpayers will benefit the most as they rearrange their affairs to best tax-advantage. They should capture the KiwiSaver-related concessions and invest the rest either in a PIE or in a superannuation scheme that invests in a PIE. They should not invest directly.

Along the way, the tax system seems to have lost the natural meaning of 'income'. In a progressive tax regime, how much total 'income' an individual receives matters to the system's integrity. 'Investment income' needs, potentially, to have no clear connection with the member's economic capacity to pay tax. If this basic principle had been set aside for practical considerations, that might have been justifiable. Regrettably, that was not the case.

As the 2009 Tax Working Group put it:

> "The tax system lacks coherence, integrity and fairness: Differences in tax rates and the treatment of entities provide opportunities to divert income and reduce tax liability. This disparity means investment decisions can be about minimising tax rather than the best business investment. For individuals, the tax burden is disproportionately borne by PAYE taxpayers since many with wealth

[201] Though sometimes capital receipts are deemed to be 'income' if they are received on a basis that will be applied for an "income-related purpose": paragraphs (b) and (c) ("whether capital or not"); also paragraph f(xiv)(C) of the definition of 'income' in section 3(1) if the Social Security Act 1964 (accessible here) can include payments from a superannuation scheme.

can restructure their affairs through trusts and companies to shelter income from taxes or to enable people to receive social support."[202]

A 'first principles' approach

Our 2010 Working Paper proposed the recognition of a number of key points:

(a) Principle 1: Tax should not be the driver.
For an investor in a CIV, it should not matter, from a tax perspective, what that CIV is called or under which legislation that CIV is regulated. In principle, individual investors should be treated similarly for tax purposes in superannuation schemes, PIEs, unit trusts, group investment funds, life insurance funds or companies.

(b) Principle 2: Place of origin should not matter.
For New Zealand tax purposes, it should not matter to an individual investor in which country the CIV is resident. Within reason, international CIVs should be treated similarly for New Zealand tax purposes to New Zealand-based CIVs. How the overseas CIV is treated in its local jurisdiction need not affect its New Zealand status when an investor calculates income tax[203].

(c) Principle 3: The individual's circumstances are important.
Again within reason, the tax the investor pays on the CIV's return should be close to the normal tax the investor would have paid had the investment been held directly. As the original 2005 *Discussion Document* stated, the investor should choose a CIV for reasons other than tax – for example, for convenience, cost, diversification, liquidity, management skills etc.

These principles may need tempering if the cost of collecting the 'correct' amount of tax were uneconomic. Any replacement compromise should, however, recognise the principles and the costs of change.

The three principles form a suggested 'gold standard' against which any proposals should be measured. The old tax regime that governed the different types of CIV violated all three principles. Regrettably, the current regime is not much better in some respects and is worse in others.

Income should be 'income' and should be taxed and benefit-tested accordingly[204]. The current regime does not come close to that objective.

While the tax treatment of CIVs is normally a compromise between principles and practicality, compromise of principle should apply only if there is a combined effect of simplification and increased net returns to investors with no significant loss of tax revenue. Changes in recent years have failed to achieve these objectives and have left a complex patchwork of compromises and significant discontinuities between the income tax and welfare systems.

CIVs should be encouraged and their continued development should be seen as a contribution to a successful financial services industry. They should not be tax-favoured. The current 'proxy-rate' system of taxing CIV members needs reform. As we said in our 2010 Working Paper:

---

[202] *A Tax System for New Zealand's Future* (2009) Victoria University Tax Working Group, accessible here, at page 9.

[203] The relationship between 'income' earned overseas, any tax paid overseas and the New Zealand tax regime will never be simple, especially where imputation credits are involved. The principle should be that New Zealand taxes the gross income and makes allowance for any tax already paid by the investor.

[204] The personal rates of tax are 10.5% on income to $14,500; 17.5% on income between $14,001 and $48,000; 30% on income between $48,001 and $70,000 and 33% on income over 33%. We think all 'income' whether directly or indirectly received should be taxed at these rates.

> "No member of a CIV presently pays the appropriate tax on their full income (both directly and indirectly earned) under New Zealand's progressive tax regime. That distortion is potentially magnified when the tax system is set alongside the income-related aspects of our welfare system…" (page 34)

We suggest that the combination of income tax, income support and the treatment of CIVs leaves an unsatisfactory gap that now needs to be filled.

It is not possible to distinguish, in policy substance, between:

- income tax (where the state takes money);
- income-support (where the state gives back some of that money in different ways to people it decides need that support) and
- income-testing (where the state takes back part or all of the income support).

Those three strands should go to make up the single environment of defining and calculating 'income'. Only in that context can the significance of CIV-derived income be measured and the problems identified and addressed. The reason that CIVs are adding to the inconsistencies derives from the 'silo approach' to tax policy that has treated some CIVs in isolation[205]. That approach must change.

'Income' for all purposes should be defined consistently, no matter how it has been earned.

Questions New Zealand needs to discuss on income tax issues:

1. Should all CIVs be taxed similarly?

2. Should individuals pay income tax on all their 'income' whether that has been directly received (as with pay or interest income) or indirectly received (as with additions to their account within a CIV)?[206]

3. Should the Inland Revenue be calculating individuals' tax (rather than employers and the managers of CIVs)?

4. Should all 'income' count when calculating income-tested welfare benefits?

5. If a CIV investor is tax-exempt (such as a charity) should any tax paid by a CIV be fully recoverable?

6. If the CIV investor has accumulated tax losses from earlier years or from the current year, should any CIV income be offset against such losses?

[205] We suspect that the 'silo' approach to the tax treatment of 'income' was a necessity, born of the Inland Revenue's administration systems. The Inland Revenue effectively contracted-out the calculation of tax to PIEs and superannuation schemes as it could not cope with doing those calculations itself. We think that the Inland Revenue should be calculating tax, not each employer or manager of a collective investment vehicle. Only the Inland Revenue has all the information that is needed to calculate the correct amount of tax for an individual taxpayer under our progressive tax framework.

[206] Tax can still be calculated and paid by the CIV but as a down-payment on the saver's final liability, in a manner similar to the imputation credits that can be added to a company's dividend.

7. If an overseas CIV has paid any tax that can be attributable to an individual investor, should that tax be offset against any New Zealand tax liability on the same attributable income?

8. Rather than trying to define income exhaustively, should the Income Tax Act 2007 state some broad principles, specifying a list of considerations that the Commissioner of Inland Revenue should take into account when deciding what is 'income' and what is not?

9. Should the principles of 'binding rulings'[207] be expanded to include a formal system of 'practice notes' that will give greater certainty of tax consequences and increased flexibility than the current court-based system?

[207] See here for more on 'binding rulings'.

18. Disclosure – both initial and ongoing – the new regime is better in parts and worse in other parts – overall no improvement

A key aspect of saving and investing is the regulatory environment. The Retirement Commissioner's *2016* Review (accessible here) made no reference to the major changes that have been made to the disclosure regime as it affects collective investment vehicles (CIVs).

The new PDS regime: Over recent years, New Zealand has moved from a prospectus/investment statement regime to a licensed adviser, licensed manager and 'product disclosure statement' (PDS) regime.

The objectives of this new regime were to create fair and efficient markets and to put the interests of the investor first.

A PDS has size requirements in that there are limits on the number of pages and the number of words used (no more than 12 pages for a 'collective investment vehicle' or managed fund or no more than 6,000 words[208]). Also, many of the words are prescriptive with issuers having limited opportunities to tailor the disclosure documents to their requirements. The content is prescribed and, therefore, rules-based and not principles-based.

Few would dispute that the old disclosure documents (prospectus and investment statements) were not read by investors, even 'professional' investors. Even if they were read, the level of understanding was probably limited.

We suggest that the new, shorter PDSs are also unread[209]. Likewise, even if read, it is highly unlikely that an investor can gain a complete picture of the investment on offer and the true risks they will be exposed to.

One goal of the new regime was to make it easier to compare products and, to an extent, it achieves that. It is easier to compare fees and features, such as contributions, withdrawal provisions etc. However, it does not make it easy to understand investment strategy and philosophy except at a high level.

Investment categories: A PDS must disclose investment categories but these are artificially constrained, presumably to simplify the PDS. Two examples illustrate the problem with this kind of 'simplification':

- A New Zealand share fund must be disclosed as part of 'Australasian shares' rather than separately by each country. So, the PDS for two separate CIVs might each disclose that, say, 20% of the portfolio is in 'Australasian shares' but one has all of that in Australian shares while the other has it all in New Zealand. Neither has to disclose that difference nor explain whether the portfolio can move from one to the other if, indeed, that might happen.
- An 'emerging markets' fund must be disclosed as 'international shares' but there is a world of investment difference between a fund that invests solely in, say, East Asia compared with one that invests in a fund that tracks the MSCI Index.

---

[208] See here for a consumer-oriented explanation of the PDS from the Financial Markets Authority.

[209] For example, just to pick two KiwiSaver providers: for BNZ, the PDS has a very low priority on the main BNZ KiwiSaver web page (here), being buried as a link in a 'Small print' section at the bottom of the page; the same applies to the ANZ (see here). In other words, the PDS seems to be a compliance document rather than a primary piece of communication.

On these issues, the prescribed PDS disclosure illustrates the dangers of 'simplification' – what looks like 'simple' has become 'simplistic' and has actually got in the way of relevant communication.

Risk indicators: The PDS must show a 'risk indicator' for each of the funds on offer (as an example, see here for the BNZ KiwiSaver Scheme's PDS at page 5). The government forces providers to identify the 'risk' of a product and capture that in a single number (from 1 'lower risk' to 7 'higher risk').

We think the 'Risk indicator' is misleading and unhelpful and should be eliminated. It assumes that the saver's relevant investment timeframe is 12 months (not the actual case). It also uses investment returns that are different from those advised to savers in their fund updates. Finally, it is based solely on volatility and is unrelated to the actual returns earned by the fund. It tries to simplify the issue but ends up as a simplistic label.

Effective communication? The Retirement Commissioner's 2016 Review did not look at the question of how well members were served by the new regime nor whether it had improved the managers' practices. It also did not look at the additional compliance costs imposed on the industry but that are ultimately passed through to the investor.

Research indicates that different people learn and comprehend information in different ways. Logic suggests therefore that having a single, prescriptive disclosure regime targets, at most, only one part of the community. A better alternative would be a principles-based regime where providers of services or the sellers of products are required to achieve 'understanding' outcomes. This would require the regime to identify:

- What investors (the ultimate consumers) **need to know** – this will not be the same for all investors at all stages in their investing lives. Identifying those various categories of requirement should be the first task.
- What investors are **being told now**.

We suggest that it is really unhelpful for the Financial Markets Authority to say "Ask questions and make sure you understand the product before you invest" (from here). That may have satisfied the old disclosure regime[210] but it adds nothing to the new. It's one of those 'comfort' statements that read well but make no practical difference to a saver's information needs.

The FMA has launched its 'Investor Capability Strategy for 2015-2018', in conjunction with the Commission for Financial Capability and the financial services industry (see here). The announcement again seems to be 'top down' – telling savers what the FMA thinks that savers need to know/do. We think it should be focussed on what savers actually know and what they are actually doing. Armed with that information, the FMA should be in a position to build a picture of current shortcomings and possible improvements.

[210] One of the required statements in the old 'Investment Statements' was "Investment decisions are very important. They often have long-term consequences. Read all documents carefully. Ask questions. Seek advice before committing yourself." There is no evidence that prospective investors did any of those things.

The 'Disclose Register' – a step in the right direction

The government has established the 'Disclose Register' (here) that gathers in one searchable spot all the official documents of every CIV. These include PDSs, financial statements, the providers' constitutional documents and the descriptions of key contracts; also, each CIV's 'Statement of Investment Performance and Objectives'. Providers are legally obliged to keep this information up-to-date.

We think this is a constructive step and suggest that it be extended to cover investment returns and fees.

In summary: We think that the overall process started by the FMA six years ago is just a step and the FMA probably accepts there is a long road still to travel on disclosure issues. The old regime was founded principally on legally protecting providers from savers rather than helping savers to make appropriate decisions. The new regime is better in some respects but worse in others. It is still not member-centric.

Questions New Zealand needs to discuss on disclosure issues:

1. Do savers read the PDS and do they understand the key components of the CIV covered by the PDS?

2. Has the PDS improved the quality of disclosure and access by ordinary savers?

3. What are the key things an investor should know about a provider and do all these have to be in a single document? What is the likely pattern of returns in terms of income and market movements?

4. What do savers actually know and what do they need to know about the collective investment products they already use? Where is the evidence?

5. Where precisely can the average saver get the help they need to understand the products they need to use? Saying they should seek advice from an 'Authorised Financial Adviser'[211], a 'Registered Financial Adviser'[212] or a 'Qualifying Financial Entity' adviser[213] (see here) is unhelpful.

6. Does the FMA know what savers need to know and how is the FMA finding out whether providers of managed funds are delivering that information? For example, has the FMA run 'mystery shopper' programmes with providers? Has it benchmarked service standards for common transactions (joining, changing details, changing contributions, changing investment strategy etc)?[214]

---

[211] As of 1 May 2017, there were only 1,844 with an AFA qualification in the whole of New Zealand (see here for the list) and of those, 603 were employed by a KiwiSaver provider.

[212] An RFA is allowed to give advice on simpler financial services such as mortgages and insurance services and so they are not relevant to retirement saving issues.

[213] A QFE is employed by the financial service provider and is only allowed to talk to customers about the provider's own products.

[214] The closest we were able to get on these kinds of questions was the FMA's *Statement of performance expectations 2017-2018* (accessible here). The FMA cited survey results that 63% investors of all kinds (not just managed funds) were "confident in the quality of regulation of New Zealand's financial markets." (at page 6). That was up from 46% in 2014/15 (see here at page 3). That doesn't come close to what we think is needed. There were, however, eight pages devoted in the *Statement of performance expectations* to the FMA's own 'Forecast financial statements'.

7. What are savers currently receiving on a regular basis? What is current 'best practice'? How much do savers understand the things they are being told? How can savers be helped in this communication process? Again, where is the evidence?

8. What are the current costs of compliance (initial and on-going)? Given that members ultimately pay for these, how can the regulatory regime work to reduce these? How can technology help? In other words, why must the key messages be reduced to a single, written document?

9. Why not increase the scope of the current 'Disclose Register' to include other key information about each CIV like investment returns and fees?

19. Regulation – standards of conduct; investment performance comparisons

As stated in section 11 (The role of the government), only governments can regulate to enforce codes of private (and public) conduct. In a retirement saving context, we suggested that this covers minimum disclosure and reporting standards (covered in the last section 18) and also requiring financial service providers "…to ensure investors and experts know what they need to know".

Code of conduct

The Financial Markets Authority (FMA) is:

> "…the New Zealand government agency responsible for enforcing securities, financial reporting and company law as they apply to financial services and securities markets. We also regulate securities exchanges, financial advisers and brokers, auditors, trustees and issuers - including issuers of KiwiSaver and superannuation schemes." (web site accessible here)

The FMA's objectives are "well-informed consumers and investors, healthy and robust businesses, competitive markets, good conduct by businesses and global recognition of New Zealand as a strong business environment." (FMA website here)

It has published *A guide to the FMA's view of conduct* (2017)[215] We will confine our comments to issues associated with 'collective investment vehicles' such as those that might be used by people who are saving for retirement.

The *Guide* says that 'good conduct' matters and that this extends from the initial investment, through additional contributions and regular reporting and on to the benefit payment. It involves providers demonstrating that conduct "in a clear, concise and compelling way." (page 8). It summarises 'conduct' under five headings that, seemingly deliberately, all 'happen' to start with 'C': capability, conflict, culture, control and communication. It provides specific guidelines that ask questions that relate to each of those five areas.

All this seems sound in theory and difficult to challenge in principle. However, we will not really know what it means in practice until the FMA tries to put some regulatory runs on the board. The *Guide* was published in February 2017. So, despite the FMA's six-year history, we cannot tell whether any of this will improve the financial services industry's 'conduct'.

In fact, we go further – with specific regard to superannuation schemes and the other collective investment vehicles used by New Zealanders to save for retirement, has there ever been a case of bad conduct; of a scheme failing or disappearing with the money? We cannot think of any so what precisely will be the measures of 'success' with respect to New Zealanders' interactions with collective investment vehicles?

We agree that the financial services industry can always be 'better behaved' (disclosure, fees etc.) but the retirement savings component of the industry has never suffered from the kinds of failure in finance companies that were the main reason for the FMA's establishment. With specific regard to retirement savings, we remain unconvinced that *A guide to the FMA's view of conduct* will make a material difference to the experience of New Zealanders who are saving for retirement.

Governance of collective investment vehicles

For many decades, 'superannuation schemes' were run under ordinary trust law, as that was developed under the Law of Equity and regulated by the Trustee Act 1956, that applied to all

[215] The FMA's *Guide* is accessible here.

trusts, not just superannuation schemes. Employer-sponsored occupational schemes typically had the employer as sponsor and trustees as the scheme's administrator. Sometimes, a company was incorporated for the purpose of acting as trustee but otherwise, they were usually employees of the sponsoring employer.

Initially, the schemes were regulated by the Inland Revenue, given the tax concessions granted to contributions, investment income and benefits. In 1976, the Superannuation Schemes Act become the governing legislation and the Government Actuary assumed regulatory control[216]. Under the successor act (Superannuation Schemes Act 1989, accessible here) and with the disappearance of tax favours, the regulatory oversight changed from 'approval' by the Government Actuary to 'registration' with the Government Actuary but the trustees'/beneficiaries' relationship remained. There were still no particular regulatory requirements as to the trustees. Under section 2 of the 1989 Act, trustees were "…the persons who were designated as such in the trust deed…"

The point of this brief history is that the arrangements 'worked' from a regulatory viewpoint. No schemes 'fell over'. Broadly, they did what they said they would do with only a light regulatory oversight.

That relatively informal arrangement changed with the introduction of 'Investment Statements' and prospectus-based disclosure under the Securities Act in 1998. That introduced complexity and cost but probably worsened the regulatory environment and contributed nothing to the governance of superannuation. That has now been replaced by the 'Product Disclosure Statement' - see section 18 (Disclosure – both initial and ongoing) for more on this. At the same time, new rules about trustees were introduced. They now had to be the same as every other scheme that solicits investments from the public.

Section 124 of the Financial Markets Conduct Act 2013 (accessible here) now requires all 'managed investment schemes' "…to meet key common governance and reporting standards" and replaces sponsors/promoters and trustees with 'managers' and 'supervisors' who "…owe duties of care to investors'.[217] Supervisors for most schemes (by assets and members) must now be one of a very small group of 'corporate trustees'.

We have now reached the end of the transitional period for the introduction of the new regime (1 December 2016) and we think our suggested review of retirement income arrangements should address the questions we raised at the end of this section. The old superannuation governance regime 'worked' if the test is whether savers did get what they were promised.

On investment performance comparisons

There is a generally accepted principle that past performance does not and cannot indicate future performance. Words to this effect are stated on most investment return disclosures. Yet despite this, many investment decisions by investors are driven by relative past performance and the industry often continues to publish returns in a way that encourages this behaviour. Given this, we think the standards of conduct should focus on making sure that the use of historical performance numbers is not misleading and allows appropriate comparisons between providers.

[216] After a two-year period of regulatory confusion created by the introduction of the compulsory 'New Zealand Superannuation Scheme' and associated 'approved alternative schemes' under the New Zealand Superannuation Act 1974.

[217] 'Trustees' are still possible for 'restricted schemes'.

Historical practice let managers choose to disclose returns on whatever basis they decided. Most chose to disclose 'gross of fees and tax' (bigger numbers) but declared returns had little connection with the return that the investor received.

Investment performance is mostly disclosed on a time-weighted basis, net of fees and before tax, assuming no cash inflows or outgoings. However, many managers continue to publish returns before fees and before tax as well and put the emphasis on these. The important return is the return that the investor gets in the hand, i.e. the return after fees and after tax and allowing for cash flows. This will be a net money-weighted return.

Under KiwiSaver, and now for all CIVs, managers must publish returns net of fees and net of tax at the highest tax rate, using a time weighted basis. These returns must be published on the manager's website and provided to the FMA. KiwiSaver returns are used on the Sorted website's *Fund finder calculator* (accessible here). This is a considerable improvement on historical practices.

What is lacking in the new regime however, is independent and competent analyses of the returns. Given that the central data base has details of the investment strategies and net of tax and fees returns, it would make sense for an independent body to publish league tables of the returns grouped in comparable bands. This has not happened from within the industry and so should have been recommended by the Retirement Commissioner's 2016 review.

Also, the government or the FMA, should contract a university's finance or business faculty to analyse the data and publish regular reports. The government is in the ideal position to organise analyses of the data and should do that. Would it not help savers if we could see whether what managers say they do to achieve returns is what they actually do?

On disclosure of fees

The Retirement Commissioner's *2016 Review of Retirement Income Policies* (accessible here at page 14) recommended that KiwiSaver schemes should be required to disclose "…the total dollar cost of all fees on [members'] annual statements [being]…the total of all administration and management costs, including any underlying management or performance fees."

The FMA has published a 'methodology notice'[218] that will require KiwiSaver schemes to comply with the new disclosure requirement with annual statements for 2018 and later. In the associated *Guidance note* (a 'tracked changes' version of which is accessible here), the FMA says it prefers that providers use the 'cents per unit' (CPU) on the 'valuation day' basis, rather than the 'total annual fund charge' (TAFC) basis but will allow the TAFC basis in the meantime.

The CPU basis will work for funds that have 'units' on which to calculate the fees. For the rest, the TAFC is the only practical basis.

The FMA has suggested:

> "The FMA encourages KiwiSaver members to compare the fees they are paying for their chosen funds with those of other providers and they can do this by looking at the fund updates and the product disclosure statements." (Media release 8 June 2017)

We think this is wishful thinking and won't happen. We support the move to standardise fee disclosure, even to have those expressed in both dollars and percentages but suggest this will not

[218] *Consultation paper: KiwiSaver annual statements – calculation of total fees in dollars* (June 2017) accessible here.

be a game-changer. Also, if this new regime is introduced, it should not be confined to KiwiSaver schemes.

Questions that New Zealand needs to discuss on regulation:

1. The FMA started on 1 May 2011 to, amongst other things rationalise the regulation of financial markets and to "…promote confident and informed participation in New Zealand's financial markets"[219]. With specific regard to superannuation schemes and other similar 'collective investment vehicles' how is it doing? What is it doing? How specifically might these activities promote that confident and informed participation?

2. In the five years to 30 June 2016, the FMA has spent $151 million on all of its activities[220], including the supervision of 'collective investment vehicles'. Has New Zealand received good value against the FMA's stated objectives ("well-informed consumers and investors, healthy and robust businesses, competitive markets, good conduct by businesses and global recognition of New Zealand as a strong business environment.")?

3. Given the large costs involved to schemes (members and sponsors) of the move to the new regulatory regime under the Financial Markets Conducts Act 2013, how is the new regime working? How specifically has the security of savers' entitlements been enhanced by comparison with the previous regime? What have 'supervisors' added to the governance process and what do 'managers' think of the way things work now?

4. If the government is about to intervene on the publication of fees for just KiwiSaver schemes, why not extend that to all 'collective investment vehicles'?

5. Why can't the government require, as a condition of approval, that all 'collective investment vehicles' (not just KiwiSaver schemes) submit quarterly investment performance data to a central clearing agency (perhaps a university's accounting faculty)? This would allow published comparisons to be made on a consistent basis.

[219] *Annual Report* (2012), Financial Markets Authority (accessible here) at page 3.
[220] Expenditure details extracted from the FMA's *Annual reports*, posted here.

20. Information and education – who should do that and how?

Section 15 (households' financial position) and what we have discovered from the Survey of Family Income and Employment (SoFIE) indicate that New Zealanders as a whole seem to have made relatively 'sensible' decisions about retirement saving. That happened, at least until 2006 (before KiwiSaver started), despite the absence of quality, accessible and relevant information at a household level.

The recommendations of section 15 should result in a new longitudinal survey, one designed specifically to follow households' financial lives[221] and that will become a rich source of data[222]. Making that data accessible to savers through an educational programme is a legitimate role for governments, as suggested in section 11 (Role of the government).

We have very little credible information on what individuals know about their personal financial situations, what their retirement aspirations might be and what, if anything, they are doing about those. Surveys on what groups of people think about these issues are pointless and no more helpful than asking those same groups whether they should exercise more or eat less. *Vox pop* interviews are even less useful. What they do is much more interesting than what they think.

Equally, we have little credible current information on employers' attitudes to their employees' information needs, whether employers might be prepared to help plug those information gaps and whether they are presently doing anything about these things.

In a 2003 survey of the largest 100 employers in New Zealand for the 2003 Periodic Report Group (and also a sample survey of employees working for some of those employers)[223]:

> "About 40% of all our employers pay their employees under a "total remuneration" approach. About 80% of the employers (by employee numbers) have a superannuation plan that is open to at least some employees. That is probably more than would be the case for all New Zealand employers.
>
> About half of all employers have a payroll deduction facility that lets employees authorise contributions to be taken out of pay on an unsubsidised basis…
>
> Employers generally thought that they had a role to help employees (scored 3.47 [out of 5]) and the most popular specific option was to provide employees with "information and education" (scored 3.71). Interestingly, employees do not currently see their employers as a source of advice on retirement issues (only 8% recognised employers in this way in a prompted question). Employers became progressively less enthusiastic at their potential involvement as the cost of their potential role increased with subsidies to saving and insurance benefits."

---

[221] Running a longitudinal survey is expensive and there is a natural temptation to add different modules to reduce costs per survey. Though that may be tempting, we think it should be avoided in the case of a household financial survey. It did not really work for SoFIE.

[222] In a different field, the Dunedin Multi-Disciplinary Health and Development Study (see here) has produced outstanding results on a whole range of health and social issues. It started almost informally with a study of 1,000 children born in 1972-3 in Dunedin and has become a world-recognised source of data. We envisage similar possibilities for a proper study of New Zealand households' financial lives.

[223] *Tier 2 Retirement Savings: Employers' and Employees' Attitudes and Practices*, 2003 ESR Consortium accessible here. We were two of the three authors of that report.

The Retirement Commissioner's 2016 Review noted a 2015 survey of Employers and Manufacturers Association members "…that found 28% of senior managers had total remuneration packages and 20% of all other staff"[224].

US reports suggest that financial literacy is a prerequisite for a successful retirement planning information programme. Those with lower levels of financial literacy seem not to plan for retirement as much/well as those with higher levels. That is not very surprising. What it means though is that financial literacy must come first otherwise planning help is probably wasted[225].

We cannot expect individuals to make 'sensible' decisions about their own long-term financial planning unless they know some seemingly quite basic knowledge about the financial environment. That is probably a task beyond a government's capacity to do much about on its own. Instead, the government should engage with employers and financial institutions on the basic precepts underpinning financial literacy as those institutions have an economic stake in their employees' and customers' understanding of some key details.

However, starting that project after citizens become employees and major consumers of financial services may be too late to see real change without some committed hand-holding. Financial concepts and explanations of how markets work and relate to ordinary citizens' lives should be embedded in all aspects of the schools' curriculums at all levels. It goes right back to fundamental issues like the ability to manipulate numbers; to test numerical results for 'sense'; to ask the appropriate 'what if?' questions. We strongly believe that encouraging mathematical competence should be at the heart of every aspect of school curriculums. Mathematical competence is central to making financial decisions about retirement and also to nearly every other part of our lives.

Starting that programme with the teachers themselves might be a good beginning. The international evidence on financial literacy standards amongst 15-year old secondary school pupils is not encouraging – the OECD's PISA comparative study in 2012 tested pupils' levels of 'financial sophistication'. The pupils' results "mimic those from the adult population". Boys seemed to perform better than girls and "a sizeable part of the variation in financial literacy is explained by student socio-economic backgrounds. In other words, inequality in financial literacy is already apparent in high school, and these differences appear to increase later in life."[226]

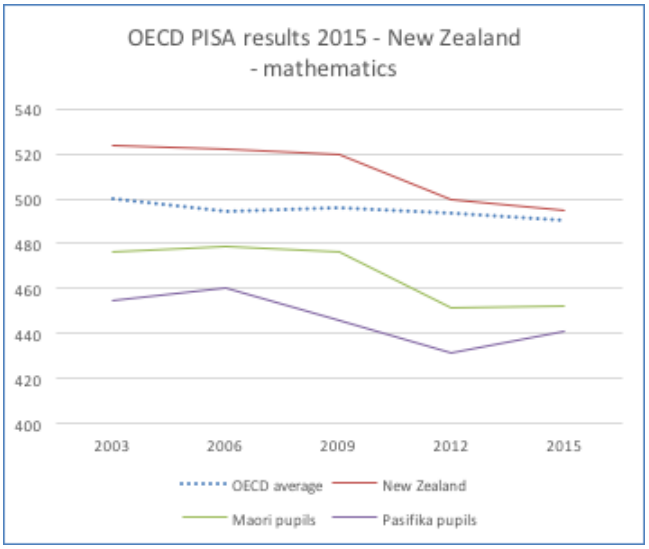
The OECD's 2017 report on New Zealand's economic outlook[227] pointed out falling average PISA scores but, in particular, falling mathematics scores as a specific potential brake on future growth. The chart on the next page shows what has happened in the last 15 years. Of real concern should be the relatively poor performance of Maori and Pasifika pupils.

New Zealand was 16th of 35 OECD countries in mathematics – as discrete groups Maori and Pasifika pupils would have been 33rd and 34th respectively. The OECD emphasises the need to improve this aspect of our education programme:

> "To lift outcomes in the long term, a systemic approach is necessary to improve the effectiveness of mathematics teaching in primary and intermediate schools. Key elements of such an approach include: raising initial teacher education quality and entry standards (current minimum entry standards for teaching programmes are relatively low); supporting professional learning and

[224] *2016 Review of Retirement Income Policies* accessible here at page 17. No source for this was directly quoted in the report so we do not know how the profile of employers compares with the 2003 largest 100 employers already quoted.
[225] *Financial Literacy and Retirement Planning: New Evidence from the Rand American Life*, Olivia Mitchell (2007) accessible here.
[226] *Financial Literacy and Economic Outcomes*, Olivia Mitchell and Annamaria Lusardi (2015), accessible here.
[227] *OECD Economic Surveys – New Zealand* (2017) accessible here at page 52.

development that lifts the capability of the current workforce to teach mathematics; and supporting school leavers to lead a collaborative, data- and evidence-informed teaching culture that emphasises all aspects of the mathematics curriculum." (at page 55)



We agree with the OECD.

For retirement planning generally, in our experience, building a network of trusted mentors would also help. The ordinary citizen is overwhelmed by data and complexity and needs 'hand-holding' help to cut through to relevant information. Most do not need a fee-based 'financial planner'; employers can also help here.

We know that citizens generally have low levels of financial literacy. That certainly seems to be the case in the US for the population as a whole[228] and for older people in particular[229]. Because of this, savers make mistakes that can be expensive, not just about saving and investment decisions but also about debt, state pension benefits (particularly in the US, where there are choices about Social Security pension starting dates) and insurance arrangements.

The US report *Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education Programs*[230] summarised the position in one of the most sophisticated financial markets:

> "The complexity of choices is enormous, and many people are unable to make informed decisions without the help of professional financial advisers[231]. Financial decisions are very personal, and a majority of people want to speak one-on-one with a trusted professional about their own individual situations ... Most workers have not sought advice from online tools or general seminars. But just who are these professionals? What are the standards? How do they make money? What are their incentives? How do we protect clients from bad advice? What actually is good advice? Does advice alone effect changes in personal habits?"

[228] *Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education Programs,* Annamaria Lusardi and Olivia Mitchell, (2007), Pension Research Council – accessible here.
[229] *Financial Literacy and Financial Sophistication in the Older Population: Evidence from the 2008 HRS*, Annamaria Lusardi, Olivia Mitchell and Vilsa Curto (2009), Michigan Retirement Research Center – accessible here.
[230] Annamaria Lusardi and Olivia Mitchell; published in 2012 by the Pension Research Council and accessible here.
[231] Part of the problem in the US (and many countries) is the numbing complexity of tax and regulatory requirements. At one time in the US, there were literally 57 different ways that retirement savings could be affected by tax considerations.

The answer to these questions, according to this report, is a bit dispiriting. Most of those who agree they need help, if asked, seem to think that advisers are unaffordable, conflicted and offer an "unclear value proposition". But the reality is that most retirees have few financial assets.

The US seems afflicted by multiple agencies that supervise varying fiduciary requirements. A uniform set of standards seems essential.

However, it seems the only way forward is better education and so better-informed employees.

> "Accordingly, there is little choice but to mesh advice with more informed participants in the workplace."

We agree with the suggested emphasis on information and education but think there needs to be a clear view on just who can add value in which areas. We think that the government should, however, resist the temptation to regulate[232]. As we have demonstrated in sections 9 (On tax subsidies for saving) and 10 (On compulsory saving for retirement) governments are relatively powerless to direct its citizens to save more, or save more in this way rather than that.

The first priority for the government is the gathering and dispersal of high quality data – only governments have the capacity to enforce disclosure of that information. As already discussed, there is a lot of work to do in New Zealand on this topic. Little can happen effectively at the next step without that high-quality data.

Next, only the government can provide regulatory oversight and enforce appropriate levels of disclosure. The government itself could participate by publishing comparative data, particularly investment performance comparisons.

To the extent the government has a role in establishing school curriculums, we agree that general literacy comprehension, numeracy and financial literacy can provide the necessary tools to gain, eventual financial competency. However, we think that governments should stay away from forcing, incentivising or even 'nudging' citizens of older ages to behave in particular ways.

On the other hand, employers may have different motives for persuading or even forcing employees to save for retirement. We think that may be appropriate, but employers need to be clear about their objectives in promoting a particular form of behaviour.

In the meantime, citizens still need help with important issues that have nothing directly to do with their retirement savings. Gaining appropriate 'retirement job' skills would be one of those; choosing the age from which to 'retire' is another, understanding housing housing-related options yet a third.

Part of the government's regulatory responsibilities with respect to collective saving vehicles (such as KiwiSaver) is to ensure disclosure and reporting requirements are consistent across similar products (see section 18 – Disclosure – both initial and ongoing). That consistency can then

---

[232] For example, we think it is pointless to make investor education a condition of default KiwiSaver provider appointments. When announcing the 2014 appointments, the Minister said: "As a requirement of their appointment, the KiwiSaver default providers will also offer investor education to encourage people to make this active choice [from the default investment option to something more 'suitable]. This reflects the Government's commitment to build on KiwiSaver's contribution to developing a savings culture and lifting New Zealanders' confidence in our financial sector…" Craig Foss, Minister of Commerce 28 March 2014 (accessible here). We think providers will 'tick' that particular box but it will make little measurable difference but it would be nice to find that out.

extend to the collection and publication of statistics on fees and investment performance and those themselves will form the basis of an information programme directed at savers.

New Zealand's Commission for Financial Capability (CFFC) has focussed much of its recent activity on attempting to improve New Zealanders' 'financial capability':

> "In our mission to build financial capability and ensure New Zealanders are prepared for retirement, we are working to deploy some best-practice behavioural economics by considering questions like:
>
> - How do social norms affect behaviour?
> - How do we mitigate people's present bias, where today seems more important than tomorrow?
> - And what do we do about the mentality of scarcity that robs people of their ability to plan for the long term?"
>
> From the Commission's website here.

In 2015, the CFFC published a *National Strategy for Financial Capability* (accessible here):

> "The vision outlined in this National Strategy is to equip everyone to 'get ahead financially'… The term 'getting ahead' holds different meanings for different people, but at its core it is about how we successfully navigate our way through products, choices, demands and needs across a lifetime."

One of the strategy's objectives is to join the financial services industry up with the government, the education sector, NGOs, the Stock Exchange, workplaces, Maori groups, the media and the CFFC itself.

The government supports this initiative:

> "The Minister of Commerce and Consumer Affairs, Paul Goldsmith has issued a government statement to reinforce the contribution financial capability makes to the goal of everyone getting ahead financially.
>
> 'Building the financial capability of New Zealanders is a priority for the Government. It will help us improve the wellbeing of our families and communities, reduce hardship, increase investment, and grow the economy.'
>
> Government agencies will be working more collaboratively, including financial capability outcomes as a consideration in service delivery and will be looking to increase the work with industry and the community for better results. The government statement recognises that building financial capability is a shared responsibility and that everyone has a part to play. It also recognises that financial capability is built at home, at school, in workplaces and elsewhere in the community."
>
> From the Commission's web site here.

In the government's response to the Retirement Commissioner's *2016* Review, the Minister of Commerce and Consumer Affairs also stated:

> "Raising New Zealanders' level of financial capability is a Government priority. The Government is committed to supporting the Commission for Financial Capability and the Ministry of Social Development and encouraging other organisations to provide financial capability programmes that reach New Zealanders of all ages."[233]

This all looks reasonably sound with admirable objectives but we would like to see evidence of what is actually being achieved.

[233] Letter to the Retirement Commissioner of 7 June 2017 accessible here.

An *Annual Report 2012 - National Strategy for Financial Literacy* (accessible here) seems to be the first and only such report since New Zealand's 'National Strategy for Financial Literacy' was launched in 2008. There were passing references to "raising financial capability" in the formal report of the Retirement Commissioner's 2016 Review (accessible here) but seemingly no recent, substantial data that establish whether the National Strategy has changed the way New Zealanders as a whole do things.

The *Sorted* web site

One of the Commission for Financial Capabilities (CFFC's) major initiatives since it started more than 20 years ago has been the web site at www.Sorted.org.nz. That has recently been re-designed and re-launched. It offers a number of calculating tools that are used online; also, guides on issues like planning, budgeting, managing debt, home buying, 'protecting' wealth, KiwiSaver and investing.

The *2016 Review of Retirement Income Policies* (accessible here) made no reference to *Sorted* (other than a passing reference to a calculation done using a *Sorted* calculator). The *2013 Review of Retirement Income Policies*[234] made a total of nine references to *Sorted* but those were confined to what *Sorted* does and not whether it works or whether it might be improved.

The calculators take what we think is an unnecessarily simple view of a user's financial life. The retirement saving calculator, for us, requires too much information before any useful material starts emerging. It also takes account of only some issues.

We support the idea of *Sorted* but suggest that New Zealand needs to understand whether the costs of keeping the web site up to date can be justified. We think that such a review should have been part of both the 2013 and 2016 *Reviews*.

Questions New Zealand needs to discuss on information and education:

1. What is the employer's role in helping employees to understand what to do about retirement saving and other financial preparation for retirement (reducing debt, re-training, new skills etc.)?

2. What is the education system's role in improving mathematical competence and financial literacy? We should start with teachers themselves as a discrete project.

3. What has happened to the 'National Strategy for Financial Literacy? Where is the evidence that it is achieving the objectives established in 2008? Why haven't more 'annual' reports been published?

4. Why isn't the government collecting returns, expense and other data on collective saving vehicles, including KiwiSaver, and publishing that on a regular (say, quarterly) basis?

5. Does the CFFC's web site *Sorted* work? How much does it cost? How successful is it?

6. Can the government make available a more useful on-line tool that would allow ordinary New Zealanders to make reasonable decisions about their retirement saving and other financial planning issues in the context of their household's assets and liabilities?

[234] *Focusing on the Future: Report to Government* (2013) Commission for Financial Literacy and Retirement Income (as it was then known), accessible here.

21. The review process

The 1992 Task Force on Private Provision for Retirement[235] proposed the establishment of a Retirement Commission to manage the then-recommended six-yearly reviews. The suggested responsibilities included:

(a) Completing the proposed changes to implement the recommended "improved voluntary regime and monitoring programme".
(b) Making recommendations to strengthen the regime;
(c) "Encouraging private retirement provision through the continuing programme of public education and information to individuals, employers and others; and
(d) "Managing the work programme of information gathering, research and analysis that is necessary for the reviews to fulfil their purpose of assessing the success of the integrated retirement policy regime."[236]

The report continued:

> "The public, the industry and the political parties would need to have confidence that this body had the expertise and resources to do a thorough job, was independent, and had a brief that spanned the various inter-connected issues involved.
>
> It would be equally important to ensure that the Commissioner's role is focussed on the collection and dissemination of factual information. This would reinforce the idea of policy stability in the period between reviews, rather than the Commissioner being, or being seen as an instrument of continual change." (at page 93)

The government accepted the recommendation for the establishment of the Retirement Commission that started with the appointment of the first Commissioner in 1995.

Since the original 1992 Task Force on Private Provision for Retirement, we have had six reviews - the Periodic Report Group (1997); Periodic Report Group (2003); Retirement Commissioner's Review of Retirement Income Policy (2007); the 2010 Review of Retirement Income Policies; the Review of Retirement Income Policies (2013) and, most recently, the 2016 Review of Retirement Income Policies. None of these reports has come close to what is now needed because, apart from anything else, none had the depth or breadth of data required to support a full review of the kind we think is now needed.

In a 2015 speech, the Prime Minister Bill English said that data and analytics are now an intrinsic part of policy-making:

> "Policy without using these tools won't mean much to us, because our policy is getting better results for customers. We are taking this seriously enough to build this into the process in a way that has not been done before."[237]

Nowhere is this more true than in policies associated with financial preparation for retirement, income in retirement and services associated with older people. This is because of the long-term nature of required planning and protections to limit the potential damage from sudden shocks.

---

[235] Michael Littlewood was a member of the Task Force.
[236] Task Force on Private Provision for Retirement, December 1992 *The Way Forward*, at page 93.
[237] Speech to the SAS Users of New Zealand Group, February 2015. Report accessible in *CIO from IDG* here. This has led to the establishment of the Social Investment Agency that "[b]y crunching the numbers, we're supporting the social system to understand what investments will help New Zealanders get better outcomes" – see the website here. We hope to have demonstrated in this report the need for this kind of analysis as so much of what the government has spent over decades has been wasted or ineffective.

For example, through the Survey of Family Income and Employment (SoFIE), we discovered, in 2006, that New Zealanders seemed to be saving, on average, enough (even, perhaps, more than enough) for retirement[238]. On that basis, KiwiSaver need not have happened and taxpayers could have saved the $8.5 billion spent so far on tax subsidies. We now know that, as of 2010, households in KiwiSaver had, on average, fewer financial assets than those who aren't KiwiSaver members. Those findings came from SoFIE that ended in 2010 (see section 15 above for more on this).

An underlying theme of most of the points made in this report and the questions that New Zealand must discuss, is the crucial significance of impeccable, deep data. Discussions about policy options are necessarily limited in their absence. That is one of the reasons we were so disappointed with the Retirement Commissioner's 2016 Review.

We think the idea of the Retirement Commission (so named) should return to the original objectives laid out in the 1992 report and that its governing legislation[239] should be amended to reflect that.

As we have said in section 11 (the role of government) gathering more, better data is something that only governments can do. We need to be better informed about how New Zealanders are preparing for retirement so that we can see whether there is are policy gaps that governments need to address.

We agree that an important part of a 21st Century NZS is a regular review process of the kind currently carried out every three years by the Retirement Commissioner (under section 83(c) of the New Zealand Superannuation and Retirement Income Act 2001, accessible here). However, if those reviews were more independent[240] and were properly resourced, they need not be every three years: every ten years would probably be sufficient (the 1992 Task Force recommended every six years).

The reviews should also be confined to NZS and its implications to both public policy and private responses. We do not dispute the significance of issues associated with financial literacy, but suggest the Retirement Commissioner has been diverted from the main purpose of the reviews recommended by the 1992 Task Force. Financial literacy seems more naturally associated with school curriculums and 'further education' rather than public policy issues associated with retirement incomes, though the two are related (in much the same way as reading skills and disclosure regimes are connected.

In fact, we wonder if the government has already signalled a change to the current review process. In the undated Cabinet paper on New Zealand Superannuation from Minister of Finance of March 2017 (accessible here), the Minister said with respect to the NZS changes then announced:

---

238 That finding ran counter to much of the contemporary debate that focussed on seemingly dire 'household saving rates', drawn from the 'System of National Accounts'. In *Saving in New Zealand: Measurement and Trends*, Iris Claus and Grant Scobie (Treasury, 2002, accessible here) suggest that households' saving behaviour should be measured by the 'stocks' approach (changes in net wealth) rather than the 'flows' (measured 'income' less measured 'expenditure'). "In fact, we find no evidence that private saving has moved to a lower rate in the past decade when correcting for inflation". Had that been more widely understood at the time, New Zealand might have avoided both KiwiSaver and the New Zealand Superannuation Fund.

239 Part 4 of the New Zealand Superannuation and Retirement Income Act, 2001 (accessible here).

240 Why, for example, can the Retirement Commissioner review only those matters that the Minister of specifies: see section 84(1) of the New Zealand Superannuation and Retirement Income Act 2001 (accessible here)? The answer to that can only be a political one. It makes little sense if we really want to understand policy issues associated for retirement incomes.

> "I propose that there should be a review in 2030 of the impact of the proposed changes to the age of eligibility on different groups, in light of the latest demographic, social and labour market trends at that time, and to consider whether any temporary additional support is needed for people who are not able to continue working beyond the age of 65." (para 18)

That may mean the next Retirement Commissioner's review will be 13 years away. We think that's too far away but our real concern is that data gathering of the kind we envisage will not start until just before that review. That has been the case to date.

One of this report's most significant recommendations (section 15 – Households' financial position) would see the development of a permanent, longitudinal survey of households' financial behaviour. As we said, the only way to discover what is happening at a household level is to find out from households themselves what they are doing – what they own and owe; what their retirement aspirations might be and what they might be doing about those now and over time.

And this is not just about money – work, health, obtaining new skills, moving to a new location, housing, different decisions by household members and family support and responsibilities all play a part in the 'retirement' decision. We have no idea how these influences affect retirees today and we must find out.

SoFIE tried to uncover some of this crucial information and some insights emerged but the longitudinal process did not work well. We understand that matching later tranches of data to earlier required some quite heroic statistical work. That limited both the timeliness and usefulness of the data produced.

New Zealand needs to learn lessons from SoFIE and we must do better next time but it will take at least 10 years, once the new survey starts, for meaningful patterns to emerge. To have a full review in 2030 will be only just enough time, as long as the commitment for the recommended survey is made now.

Part of the national discussion that New Zealand now needs should be a review of the Retirement Commissioner's role. The Retirement Commissioner should contribute to that discussion but cannot run it.

Questions New Zealand needs to discuss on the retirement income review process:

1. What exactly have the six regular reviews of New Zealand's retirement income policies[241] achieved (recommendations made vs. recommendations implemented; quality of recommendations and supporting data)?[242]

2. Should the scope of the Retirement Commissioner's work be returned to the recommendations of the 1992 Task Force?

[241] The Periodic Report Groups of 1997 and 2003 and the Retirement Commissioner's reviews of 2007, 2010, 2013 and 2016.

[242] The government's formal response to the 34 recommendations and observations in the Retirement Commissioner's *2016 Review* (letter of 7 June 2017 accessible here), gave approval to eight, disagreed with 13 and acknowledged more work is needed on the remaining 11. The final two were ignored. However, it's not just a matter of the numbers – the analysis should allow for the substance of the recommendations as well.

3. How can we increase the Retirement Commissioner's influence in the debates on policy issues associated with financial preparation for retirement? Limiting the scope of the Commission's work may be part of the answer.

4. What should be the format of the needed national discussion?

22. Policy nirvana – what a stable retirement income framework might look like[243]

2017 is an election year – policies on superannuation, both public and private, might be headed for the political trenches.

We first try to summarise what the political parties currently think about just NZS:

- **National**: The state pension age will increase from 65 to 67 between 2037 and 2040; the minimum residency period will increase from 10 years to 20; contributions to the NZSF will, if overall debt levels allow, resume in 2020/21. Other provisions of NZS (amount, universality) will remain as is.
- **Labour** (see here): The annual pension would stay as will the state pension age. Contributions to the NZSF will resume in 2018.
- **Greens** (see here): The current rates of NZS will stay, as will age 65 (policies from the 2014 election campaign). Contributions to the NZSF should resume before 2020.
- **New Zealand First** (see here): The current rates of NZS will stay without income or asset tests, as will age 65. However, the full pension will probably be payable only after 45 years' residence in New Zealand between ages 20-65. A proportionate amount will apply for shorter periods (policy from other announcements)[244].
- **Maori Party** (see here – from the 2014 election manifesto): There was no mention of NZS-related policies in the official 2014 policy document. For the 2011 election, the Maori Party said it wanted the state pension age lowered to 60 for "groups whose life-expectancy is lower than average". The pension will be means-tested.
- **Act Party** (see here): The state pension age will be gradually lifted to age 67 between 2020 and 2032. The NZSF will probably be dismantled (see here).
- **United Future** (see here): From the 2014 manifesto, current rates of NZS will continue with an adjustment to the inflation linkage (looking forward rather than back). 'FlexiSuper' will pay rates based on the selected starting age – lower for ages 62-65 and higher for ages 65-70[245].

This summary of the various parties' current varying positions illustrates the policy frustrations of the last 40 years. Political parties seem to think that policy on NZS and retirement saving is 'whatever it takes to get elected this year'. The history of each party's retirement incomes' policies (on both public and private provision) does not bear close examination – Labour's change on the issue of raising the state pension age since the 2014 election campaign is only one example. This is unsatisfactory and the process needs to change so the public can be assured that policy will be guided by principles rather than by political expediency.

As described in section 4 (How much will New Zealand Superannuation really cost?), when governments set their spending priorities, they balance competing claims on economic output by everyone, including pensioners. In theory, those decisions can change every year; in practice, they don't because a stable policy environment allows everyone to make private decisions more 'rationally'. So, decisions about the way in which, for example, unemployment benefits are calculated and who is entitled to receive them do change but remain relatively stable despite being

[243] This section is adapted from the RPRC's *PensionCommentary 2015-2 The coming debate on New Zealand Superannuation – the review process* by Michael Littlewood (accessible here).
[244] New Zealand First also thinks that KiwiSaver should be compulsory.
[245] UnitedFuture also thinks KiwiSaver should be compulsory.

administered by different governments. Similarly, businesses need stable economic policies that allow them to make long-term investment decisions.

NZS is different. We know that "a very large proportion" of retirees currently depend on NZS for most of their retirement income[246]. That position has not changed much since 1989 and is unlikely to change over coming decades. We also know that financial preparation for retirement is a multi-decadal project. That doesn't mean, as some in the financial services industry suggest, that we should be putting money into saving products for 20-40 years but it should mean taking a long-term view of what we want our own retirements to look like, financially.

It should also mean that discussions on policy changes should be research-led and that isn't the case today. None of the political parties' suggestions described above is research-led.

Our suggested review should begin now, not in 2030, despite the government's recent announcements.

Our experience tells us that the more we discover from decent data, solutions become more obvious. The review should actively engage with the political parties to take them along with the public discussion. Superannuation should not be a party-political issue and New Zealand should want to convince parties that it isn't a vote-winner, particularly if we don't actually face a crisis, as we think the Treasury's 'Long Term Fiscal Model' continues to indicate (see section 5 - Is NZS 'sustainable'?).

We think that a political consensus on a framework for both public and private provision for retirement is possible. New Zealand surprisingly achieved a form of political consensus in more difficult circumstances in August 1993 with the *Superannuation Accord*[247]. We suspect that most political parties would probably be relieved to see at least NZS taken out of the party-political contest[248].

The national debate should be open to all, including the political parties. It will be founded on the best available information and its aim will not be to cut costs but rather to:

- test each aspect of the design of NZS (see section 6);
- test the resilience of NZS to changing demographic conditions and to investigate all possible reform options, including 'no change' or just minor reforms.

The review's objective should be nothing short of a consensus on all the key design components of NZS for the 21st Century. If everyone (who wants to) is part of the process, the chance for consensus improves.

There is usually an assumption in calls for a review of NZS benefits that they will have to be cut. That may be required but the review we propose might be needed just to restore New Zealanders'

---

[246] *Household Incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2015,* Bryan Perry, Ministry of Social Development 2016 (accessible here).

[247] An account of the Accord's genesis is recorded in Jeff Todd's *Superannuation Task Forces in the 1990s and the Political Accord*, 2008 accessible here. We need to note that the leader of New Zealand First, Winston Peters, described the Accord at the time as a "cosy little conspiracy" though he did acknowledge the virtue of 'true' consensus rather than an "in-house agreement" with just the political parties.

[248] Some suggest that NZS is a 'third rail' issue – touch it and you die. That may have been true in the 1980s but we like to think that New Zealanders would now welcome a research-led, national discussion of the kind we recommend in this report.

faith in the future sustainability of the simplest, most effective state pension arrangement in the developed world.

We should apply a similar rigorous approach to public policy issues associated with private provision for retirement. Currently, those are inconsistent, directionless and not founded on any defensible research.

Part of the review should also be to establish a basis for ongoing research and engagement with both the public and political parties. Within the 1992 Task Force, we discussed whether the Retirement Commissioner should be an Officer of Parliament[249] but were persuaded by officials that the office should report to the most appropriate government department concerned – the Department for Social Welfare[250]. In the light of the experience of the last 24 years, that was probably a mistake.

If we want proper engagement by the political parties in the ongoing, needed consensus, we think that Parliament as a whole should agree the research and review agendas proposed by the new review team. In the end, governments do the governing but decisions about public and private provision are likely to be more obvious and less controversial in the presence of the data-gathering and public discussion that we envisage.

We see the review team as becoming a world-class research centre, perhaps based at a university but certainly standing outside the political processes and departmental bureaucracy. Political parties should be able to request research on policies that are of concern to their members and those who vote for them and the centre itself should be free to initiate research projects.

New Zealand's taxpayers spend more than a net $11 billion a year on NZS and about another $800 million on KiwiSaver tax breaks. We should surely be at least curious to understand whether we are getting good value for those very large sums or whether New Zealand's interests would be better served by spending some or all of that elsewhere.

We know that NZS can be made better now; our tax and regulatory framework can certainly be improved. It seems difficult to understand why anyone should be reluctant to engage in at least developing a process to make those things happen. At least agreeing to start that process might prevent superannuation from, again, becoming a political football in this election year.

Questions for New Zealand to discuss

1. Do New Zealanders want the political parties to debate and agree on policies associated with public and private provision for retirement? That debate cannot really start until many of the data gaps we have identified in this report have been filled.

2. Might the political parties themselves welcome that possibility (we should not expect that support to be expressed publicly)?

3. What is the appropriate framework for the needed debate on these issues?

[249] See here for details on how Parliament itself sees the role of an Officer of Parliament – we think that something like an Officer is needed on issues associated with retirement and retirement incomes. They are every bit as important to New Zealanders as the responsibilities of the Ombudsmen, and the Parliamentary Commissioner for the Environment.

[250] Task Force on Private Provision for Retirement, December 1992 *The Way Forward*, at page 97.

4. Who should lead that debate and what resources might be needed over what period?

5. How should the research momentum be maintained over decades? Where should the 'stewardship' of the debate and the data rest?