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Can New Zealand and Australia Get Closer On Retirement Income Policy?

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- Australia has an income and asset tested age pension and since 1992 the Superannuation Guarantee with compulsory contributions.
- New Zealand has NZ Superannuation that is not income or asset tested and since 2008, voluntary KiwiSaver.
- What are the prospects of the two systems becoming more similar and what is the feasibility of including a base level of life and income protection cover in KiwiSaver?

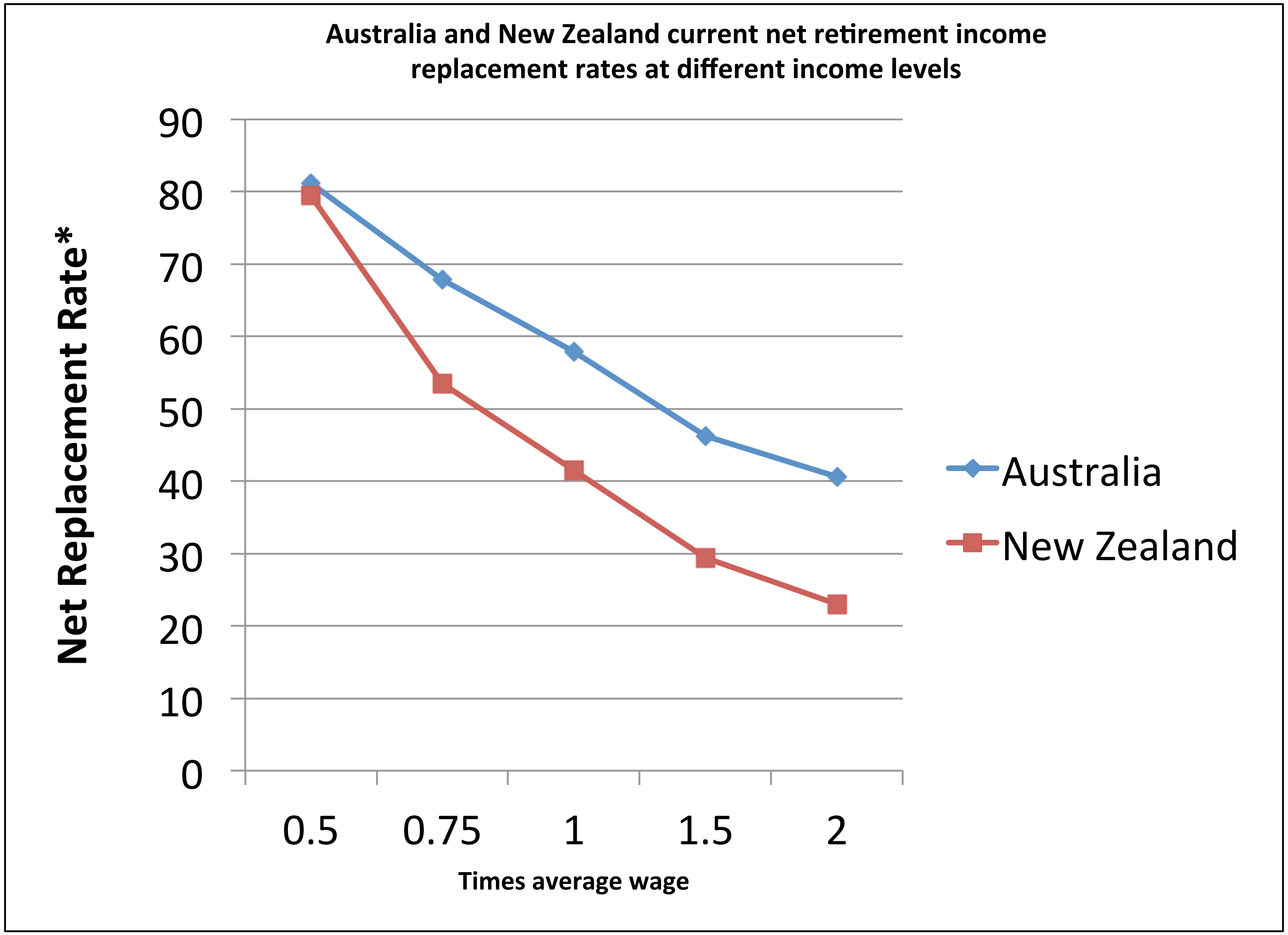
Some numbers to put the current vulnerability of New Zealanders into focus

- For New Zealanders:
  - Only 15% say they have sufficient savings to last six months if they were made redundant.
  - 26% would not be able to pay their bills after just one week.
  - 54% have insufficient savings to last 4 weeks after being made redundant.
- Only 9% of New Zealanders think NZ Super ($349 per week maximum after tax for an individual and $537 for a couple) is sufficient to retire on. (Horizon Dec 2012)
- Only 15% of New Zealanders have income protection insurance. (Horizon Oct 2012)

The majority of New Zealanders are financially living close to the edge and unemployment, sickness or retirement could put them quickly over that edge.

Retirement in the 20th Century	Retirement in the 21st Century
Funding retirement incomes in 1955 Over 65 population less than 300,000 Life expectancy at 65 - 12.8 years for males and 16.9 years for females. Seven working age people support one pensioner. Age pensions cost 3% of GDP when the universal pension was available from 65.	***Funding retirement incomes in 2055*** Over 65 population reaches almost 1.7 million. Life expectancy at 65 – 31.3 years for males and 33.9 years for females. Two working age people support one pensioner. Age pensions will cost 9-10% of GDP if the age of eligibility for NZ Superannuation stays at 65.

The Current Pensions Gap with Australia



Source: MOTU

@The replacement rate is the percentage of your previous earnings that your pension delivers from the compulsory system in the respective countries

The Pension Gap with Australia in 2055 Assuming No New Zealand Policy Change

	New Zealand NZS pension in 2055	Australia pension for someone retiring in 2055 having earned the median income	Ratio (AU/NZ)	Australia pension for someone retiring in 2055 in Australia having earned the average income	Ratio (AU/NZ)
	Retirement income				
Dollars	$NZ 31000	$A60800	2.31*	$A69000	2.67**
% per capita GDP	34%	52%	1.50	59%	1.70
	Contributions				
2011	4.3%	7.2%	1.66		
2055	7.4%	9.9%	1.34		
Average 2011-2055	6.4%	9.2%	1.44		

**This table compares the compulsory retirement systems in both countries. Australia has its age pension and its Superannuation Guarantee whereas New Zealand has New Zealand Superannuation and no compulsory retirement savings scheme.*

***The ratio of Australian and New Zealand incomes assumes an exchange rate of $NZ1 = $A0.85, close to average value since 1990.*

Source: Coleman (2012)

Source: Australian Treasury

Table 1.1 Summary of design features of retirement income systems

Design feature	Australia	New Zealand
The pillars – Pillar 1	Means-tested public age pension (PAYGO)	Universal public age pension (PAYGO): NZS
– Pillar 2	Compulsory private superannuation (SG)	KiwiSaver is a hybrid of Pillar 2 and 3 schemes. Minimum employer contributions is a pillar 2 feature, and the employee opt out along with optional higher contribution rates is a pillar 3 feature
– Pillar 3	Voluntary private superannuation	Voluntary private superannuation separate from KiwiSaver
Minimum contribution rates	Employer contribution The SG: 9%, gradually rising to 12% over 7 years from 1 July 2013. Applies to employees up to age 70 (75 from July 2013)	Employer contribution Minimum 3% Employee contribution KiwiSaver: 3%, 4% or 8%. Can opt out and otherwise choose rate Applies to employees aged 18 to 65. Total minimum of 6%

Source: Comparison of the New Zealand and Australian Retirement Income Systems – Ross Guest 2013

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Table 1.1 Summary of design features of retirement income systems

Design feature	Australia	New Zealand
Taxation rules	Age pension: Taxable but liability may be eliminated by tax offset for seniors Super contributions: Taxable at flat 15% up to cap of $25,000; excess contributions taxed at marginal rate Super fund earnings: Notional 15% but actual rate is around 8% due to imputation credits and capital gains Super withdrawals: Available at age 60, tax free	Age pension: Taxable at marginal rate Super contributions: KiwiSaver Contributions: Employee contributions made from net pay (after taxation at employee's marginal rate) and employer contributions taxable according to ESCT schedule[5]. Super fund earnings: Generally 28% Super withdrawals: Available at age 65, tax free

Source: Comparison of the New Zealand and Australian Retirement Income Systems – Ross Guest 2013

Age pension – amount	**Singles** **Indexed to 25% of male average weekly ordinary time earnings (AWOTE)** **Couples** **19% each (or 38% for couple) of male AWOTE, at Sept 2012**	**Singles** **37% of male AWOTE** **Couples** **28% (each) of male AWOTE at 1 April 2012**[6]
Age pension – eligibility	Age 65, increasing to 67 by 2020 Residency test[7]	Age 65, no increase planned. Residency test[8]
Age pension – assets test	Singles (couples) Full pension if assets less than $192,500 ($273,000 for couples) for homeowners and $332,000 ($412,500 for couples) for non-homeowners. Otherwise pension tapers off to zero for assets greater than $707,000 ($1,050,000 for couples) for homeowners and $847,250 ($1,189,500 for couples) for non-homeowners.	None
Age pension – income test	Singles (couples) Full pension if income less than $152.00 ($268.00). Otherwise pension tapers off to zero for income greater than $1,669.20 ($2,597.60).	None

Source: Comparison of the New Zealand and Australian Retirement Income Systems – Ross Guest 2013

Best Attributes of the Australian Retirement Income Policy

- It will at maturity provide Australians with much better pensions in terms of maintaining previous levels of income into retirement with the current 9% contributions rate, lifting to 12% over the balance of this decade.
- It recognises that savings that produce compound returns are unfairly treated without compensating tax changes, that is a lower tax rate on retirement savings within the fund. In Australia, the nominal tax rate on earnings in a superannuation account is 15% and the effective rate is even lower.
- It has made the Australian economy more resilient, less reliant on foreign capital and by increasing the amount of domestic savings, lowered interest rates and the Australian currency, while boosting investment per employee to increase labour productivity and incomes.
- Increased the financial security of Australian employees by including a base level of life cover within the Superannuation Guarantee Scheme.
- Australia has made the decision to move out its age of eligibility for the age pension from age 65 to 67 by 2020.

Worst Attributes of the Australian Retirement Income Policy

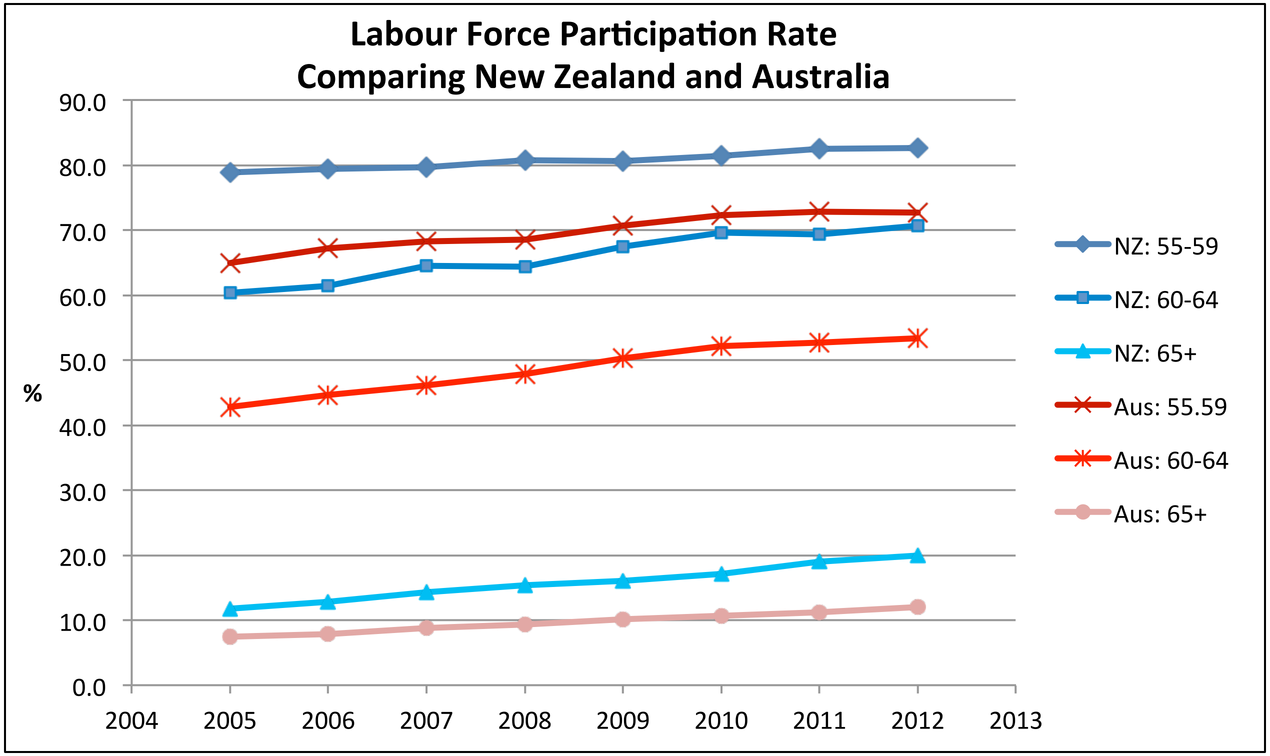
- The basic Age Pension is not sufficient on its own to keep most Australians out of poverty in retirement but over time this will no longer be a problem as the Superannuation Guarantee system matures lifting retirement incomes well above the Age Pension level.
- The income and assets tests on the Australian Age Pension discourages the labour market participation of those after age 65, discourages savings and strongly incentivises moving savings into areas to escape the income and assets tests.
- The overall system has such complexity that it appears to need continuous change.

Best Attributes of the New Zealand Retirement Income Policy

- The first tier pension NZ Superannuation is the most generous in the developed world and provided you own your own home debt free at retirement, it will keep you out of absolute poverty.
- The absence of an asset or income test on the basic pension provides a strong incentive to continue working, if that is your choice, and to save without reducing your pension.
- KiwiSaver has achieved 2 million voluntary participates, no one has lost a dollar in KiwiSaver during the worst financial market crisis in more than 70 years.
- Overall the system is fairly simple to understand and operate.

Worst Attributes of the New Zealand Retirement Income Policy

- Most New Zealanders will not find themselves on a "comfortable" income by the time they get to retirement on a combination of NZ Superannuation and voluntary KiwiSaver contributions. Only 9% of New Zealanders think NZ Superannuation on its own is enough to retire on, only a little over half of New Zealanders are active KiwiSaver contributors and most are at the 6% level which is insufficient to fund a comfortable retirement income at around 2 times NZ Super.
- Most New Zealanders will get to retirement regretting that they did not save enough for retirement. Procrastination and inertia, along with underestimating our likely longevity means that even the well intentioned frequently end up with inadequate retirement savings.
- New Zealand has the most negative tax regime for retirement savings through intermediated financial products that the FSC has been able to find. The Savings Working Group was advised by the Treasury that the effective tax rate on rental property in New Zealand was 15 to 20% according to the marginal tax rate of the investor, whereas the effective tax rate on KiwiSaver or other PIE products was 50%.



Source: SNZ and ABS, unweighted means of quarterly and monthly data respectively

How the Systems Could Become More Similar

1. On the age of eligibility for NZ Superannuation moving out with longevity, I think most New Zealanders see that as inevitable and will change when there is next a change of Government.
2. There is a less chance that New Zealand would adopt the Australian asset and income tests, although the New Zealand Treasury is looking at gradually replacing NZ Super with KiwiSaver, that would require income testing NZ Super if it was to reduce Government expenditure in the future.
3. There is wide public support for making KiwiSaver universal or compulsory for employees and gradually increasing the contribution rate to 10% of incomes. This level of contributions would enable all New Zealanders to achieve an income in retirement of at least 2 times the level of NZ Super.
4. In New Zealand most people with a mortgage have a life insurance policy to repay their mortgage in the case of their premature death but less than 20% of New Zealanders have income protection insurance. In contrast, we all have ACC cover for accidents when we are 2.6 times more likely to be off work for six months or more because of sickness rather than an accident. When we produced our Pensions for the Twenty First Century report last year, we estimated that life cover and income protection cover could be "bundled" into KiwiSaver for about 1% of income premium. A future Government may decide to extend KiwiSaver in this way if it becomes universal and help avoid hardship claims making withdrawals from KiwiSaver. After age 45 the dispersal of rates across the population would probably make bundling income protection insurance infeasible, but the 1% of income could then be used to purchase more individually tailored coverage, including possibly advanced purchase of supported care.

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How the Systems Could Become More Similar

4. Neither countries' systems currently require part of the retirement lump sum to be taken in the form of a fixed term pension. This will eventually be recognised as essential if we are to have income security in our 20 to 30 year retirement.
5. New Zealand will need to address the tax disadvantages of saving for retirement in KiwiSaver rather than investing in rental property. If we don't address this anomaly we will continue to bid up land prices and under invest in areas that will increase the countries production. The FSC has work underway on how a level playing field could be achieved between KiwiSaver and rental property investments. The "wedge" is made up from the effective exemption for capital gains for most private rental property investments, the deductibility of both the real and the nominal components of interest and the taxation as income of the return of capital from compounding return investment products.