RPRC Update

Retirement Policy and Research Centre

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RPRC and HRC Overseas Pensions Forum

New Zealand Superannuation and Overseas Pensions: Options for Reform.

At the Overseas Pensions Forum at the Business School on 24 February, co-hosted by the Retirement Policy and Research Centre (RPRC), and the Human Rights Commission (HRC), a packed lecture theatre attested to the topical nature of the issue of abatement of overseas retirement pensions. The distress such deductions cause for many New Zealand immigrants and retirees is evidenced by complaints to the HRC, the Courts, the Ministry of Social Development, the RPRC, the media, and the embassies of the origin countries for the pensions.

Rosslyn Noonan, Chief Commissioner for the Human Rights Commission, opened the Forum and formally launched the RPRC's Working Papers: *2009-1 Literature Review*; and *2009-2 New Zealand Superannuation and Overseas Pensions: Issues and Principles for Reform*, available here. Her opening address included an urge to action for change to the inequitable current pension policy.

Associate Professor Susan St John and Michael Littlewood, Co-directors of the RPRC, and RPRC Research Fellow Dr Claire Dale discussed the legislative and policy frameworks around entitlement to New Zealand Superannuation (NZS) for immigrants and emigrants. Associate Professor Andrew Smith from the School of Accounting and Commercial Law at Victoria University of Wellington, gave the keynote address about the 2009 amendments to the New Zealand Superannuation and the Retirement Income Amendment Act.

The HRC's Principal Legal and Policy Analyst, Sylvia Bell, drew on Human Rights legislation and case law for her presentation: *Discrimination: a Human Rights Issue*. A chaired session of individual viewpoints followed. Bob Stevens, Ruth Humphrey, Tom Foulkes, John Albers, and Peter van Bussel shared their personal experiences. The forum was an opportunity to air some of these issues and look at NZS, overseas pensions and options for reform. "This enormously complex issue is one that New Zealand must sort out urgently so that past migrants are fairly treated and prospective migrants are properly informed," says Susan St John.

Dr Dale then chaired a session examining options for reform of section 70 and the Direct Deduction Policy. The co-directors of the RPRC, St John and Littlewood, presented two possible options. The first option is raising the residency requirement for NZS from 10 years to 25 years, to be achieved between the ages of 20 and 65. The second is to abolish residency rules for most immigrants and take a pro-rata approach to New Zealand residents applying for NZS who are also entitled to an overseas basic pension. These options are set out in the executive summary of the 2009-2 Working Paper, and described in notes for the Forum.

The forum concluded with drinks in Decima Glenn, hosted by the RPRC and the HRC. Other forums in Wellington and Christchurch are planned. Follow-up articles and meetings with politicians are underway.

Forum presentations are available here.

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RPRC Breakfast Briefing 13 April, 7.15am to 8.50am: Bernard Hickey critiques KiwiSaver.

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International issues and reciprocal social security agreements

Associate Professor Andrew Smith, Victoria University, keynote speaker at the RPRC Overseas Pensions Forum, discussed New Zealand's Superannuation and Retirement Income Amendment Act 2009.

If someone spends their working life in more than one country, they may encounter problems with pensions. They may be liable to contribute to a social security (pension) scheme in more than one country; their eligibility to receive pensions in one or both countries may be reduced or terminated; and they may have problems receiving a full pension in the country where they wish to retire.

"One reason why cross-border pension issues can be problematic and difficult to resolve is the wide variation in different countries' retirement income policies. There may be different emphases on Tier I and Tier II pensions and the ways they are funded and administered, making cross-border harmonising of pension arrangements more difficult."

Few countries address all the disadvantages migrants may face. Some countries supplement domestic arrangements for migrants by entering into treaties or reciprocal "social security agreements" (SSAs). Because New Zealand has substantial migratory flows, the international interface of New Zealand Superannuation (NZS) is particularly important.

The agreements are not necessarily symmetrical. While eligibility for NZS for immigrants is dealt with under the 10 year residency rule, if a migrant is eligible for an analagous overseas pension, that pension is deducted from NZS. In some instances, SSAs make retirees worse off than if New Zealand domestic law was applied.

Someone entitled to NZS and retiring outside New Zealand may be affected by an SSA or by a special agreement. Those retiring to the Pacific Islands received a more generous treatment than those retiring elsewhere. Also, NZS is paid outside New Zealand without any deduction of tax.

While the NZS rules are relatively simple, they can be arbitrary in their application, giving rise to major inequities. It is disappointing that the general portability provisions were prioritised while Parliament avoided other inequities.

The ppt presentation is available here.

The New Zealand Herald 29 January 2010: *The level of inequality is not acceptable*

"Our after-tax distribution is one of the most unequal in the OECD."

Dr Susan St John, co-director RPRC says New Zealand has lost its reputation as an international leader in tax.

The Tax Working Group (TWG) recommended a tax on property to help tax those in similar positions more equitably, but were unable to address the broader aspects of equity as measured by the fairness of the overall post-taxes and transfer of income distribution.

They modelled impacts of different scenarios of tax cuts and base broadening on child poverty and inequality, but did not ask if the level of inequality and poverty is acceptable.

New Zealand's unequal after-tax distribution impacts most heavily on children. The Ministry of Social Development's 2008 survey of living standards reports 19 % of children are experiencing "serious hardship" and "unacceptably severe restrictions on their living standards". The design of the income tax system is a crucial influence on these outcomes.

To address distributional questions the tax/transfer system needed to be considered as a whole. The TWG, neither set up nor funded to undertake this, called for a comprehensive review of the tax/welfare system.

The TWG highlighted the 53-58 % effective marginal tax rates faced by middle and higher income parents. It also modelled the poverty-trapping Minimum Family Tax Credit, with its 100 % abatement of extra income and rigid number of work hours requirements. But the plight of people on a partial welfare benefit who earn extra income was ignored.

St John says: "The tax/welfare system is inequitable, inefficient, and administratively complex, and requires much more attention than the TWG could give it. We hope the Government listens to TWG's call for an adequate review."

The full article is available from Herald archives here.

RPRC's Working Paper 2010-1: Taxing CIVs and investors

RPRC's Working Paper 2010-1, *Towards a more rational tax treatment of collective investment vehicles and those who invest in them*, suggests that the tax treatment of collective investment vehicles (CIVs) like superannuation schemes and unit trusts is both illogical and unfair. 'Income' earned by individuals through CIVs is taxed in different ways and, when it comes to considering the interaction of individual income with state payments and levies, some is counted but some is not.

The Portfolio Investment Entity (PIE) regime, started in 2007, aimed to make it more attractive for savers to make portfolio investments through CIVs, and to align those marginal tax rates with those of some individuals.

The PIE regime was also intended to reduce the need for many with investment income to make an annual tax return to the Inland Revenue. Instead, complexity and distortions have increased without solving the problems of the past.

This paper recommends a broad framework that does not require the invention of artificial definitions of income. That principles-based framework would recognise the true economic nature of the transactions involved, and would make the interaction between 'income' and income-tested state payments and levies more coherent and fairer.

The Working Paper is available here.
Comments are welcome and should be directed to Michael Littlewood: michael.littlewood@auckland.ac.nz

Overseas Pension Timebomb: a reality-based scenario

A hard-working New Zealand male meets a wonderful German woman in New Zealand on an overseas trip. She likes him too, and eventually accepts his offer of marriage and makes New Zealand her new home. He has worked hard on a modest wage and looks forward to a less pressured time in retirement. His friends are retiring and seem to be happy with their New Zealand Superannuation (NZS). He ponders on the pleasure of an inflation-adjusted pension, supplemented with part-time work without penalty.

He understands he is entitled to half the NZS married rate, and his wife is entitled to nothing despite living here for more than 10 years, because she has a good German state pension. The magic day of his 65th birthday approaches and he visits the WINZ office. A WINZ employee looks through his application and after some probing tells him he's not entitled to any NZS: his wife's German pension is too large.

He is shattered and angry when he leaves the office, and even angrier when the verdict is confirmed by an official letter from WINZ. His protests to MSD, the Social Security Appeal Authority, and MPs are answered with: "the government expects married people to share resources and support each other"; and "the policy is designed to ensure that a couple with an overseas pension is not in better-off than a couple that has spent all their lives in New Zealand".

Had he fallen in love with a successful, professional New Zealand woman with an inflation-adjusted pension from a large company or the Government Superannuation Fund, plus KiwiSaver and other tax-subsidised funds, they would both enjoy the full NZS. If she was a new immigrant with no pension who never worked here, after 10 years residency she would qualify and they would both get full NZS.

Suddenly divorce looks like good option. Fortunately, he thinks of a better solution. Under the 2009 Amendment to retirement legislation, he can take his gross NZS with him if he goes to live in Germany (or most other countries); and in some he will not have to pay tax on his NZS. Leaving his home, grandchildren and friends is preferable to a life with no income of his own and apparent dependence on his wife after a lifetime of earning and paying tax.

The February Overseas Pensions Forum at the University of Auckland, co-sponsored by the RPRC and the HRC, explored these and other inequities and anomalies affecting about 50,000 pensioners. The venue could not accommodate all who wanted to attend and be heard. These are not wealthy people. Many have suffered ill-health from the stress and injustice they have experienced. Many have spent years fighting their cases with officials, appeal authorities, and the courts. These strategies have been blocked and have left an increasing feeling of alienation, bitterness and despair.

Successive governments have avoided the issue of immigrants' overseas pensions. The RPRC believes the greater mobility of the workforce demands a fundamental principles-based reform to restore these pensioners as valued citizens. The two possible options for change debated at the forum are set out here.

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New Zealand Economic Papers: Prefunding, the NZS case study

In 2001, the New Zealand Superannuation Fund (NZSF) was established to partially pre-fund future costs of New Zealand Superannuation (NZS). The current government suspended contributions in 2009.

An article by RPRC co-director Michael Littlewood in *New Zealand Economic Papers* raises fundamental questions about the existence of the NZSF. His analysis shows that, over the six years to 30 June 2009, the NZSF reduced the net worth of the government by about $2.6 billion. Even after the investment recovery in the second half of 2009, the accumulated loss was still about $1.4 billion.

"A proper analysis in a 'total accounting context' would probably have avoided the Fund's introduction in 2001" says Littlewood. "The NZSF is effectively 100% leveraged. Every dollar in the NZSF is a borrowed dollar, so New Zealand's taxpayers will be better off only by returns that exceed the cost of debt. That hasn't happened so far." Moreover, Littlewood says, "taxpayers are unlikely to be compensated for assuming that risk. Even if the NZSF recovers the losses, it is unlikely to make any significant future contribution to the security of payments of NZS".

Littlewood concludes that the NZSF raises financial risks for taxpayers and may increase the long-term cost of NZS. He disagrees with the current government's intention to resume contributions when Budget surpluses return. "Unless all government debt has been repaid by 2020, a Budget surplus is irrelevant to the basic investment decision. Every dollar contributed from a fiscal surplus will still be a dollar borrowed. A preferable solution would be to wind up the NZSF and use the $15 billion to reduce debt."

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RPRC in the media

29 January 2010 *New Zealand Herald*: Susan St John in *The level of inequality is just not acceptable* here.
February 2010 After RPRC's ACC Forum, December 2009, St John, S. (2010a). ACC: The lessons from history *Policy Quarterly, 6*(2), 23-29, here.
12 February 2010 *University of Auckland News* V.40 Issue 2, Viewpoint, "What should we do about tax?" Michael Littlewood says "Nothing, for the moment."
22 February 2010, www.scoop.co.nz Opinion: Susan St John challenges John Key's claims on saving money here.
18 March 2010, www.interest.co.nz quotes Michael Littlewood: *Auckland Uni think-tank challenges Tax Working Group's NZ$200b figure for rental properties* here.
19 March 2010, www.landlords.co.nz quotes Michael Littlewood: Not as much tax in residential property as TWG says here.
24 March 2010, www.scoop.co.nz quotes Michael Littlewood: *Government misled over property taxes* here.
26 March 2010, *New Zealand Herald*: Susan St John says *Govt's sums on welfare savings don't quite add up* here.

PensionReforms

Looking into the pensionreforms library

The PensionReforms website now has more than 374 abstracts reviewing mostly academic papers on retirement income policies and the processes of accumulating and decumulating retirement savings.

Reports reviewed cover 45 countries and 4 international groupings, under 67 topic headings, written by a total of 508 individual and seven institutional authors.

Abstracts can be sorted by country, topic, author, institution and publication year. A recent abstract looked at a proposed universal pension for Zanzibar:

> Zanzibar is a very poor part of a poor country (Tanzania). The old seem particularly poor and many are responsible for raising children. A Universal Pension of 20% of per capita GDP would make all the difference. This seems an efficient way to deliver direct monetary aid. more

Sorting abstracts by the topic 'poorer country strategies' shows Zanzibar is not alone in considering the introduction of a universal pension to help tackle poverty issues.

The other 13 reports looking at different aspects of poverty in a retirement income context are available at the links below. The 'more' leads to the PensionReforms abstract:

Baoji City (China). more
International review more
Latin America & China more
Mauritius more
Samoa more
Sri Lanka more
Vietnam more
India more
Kajera, Tanzania more
Lesotho more
Nepal more
Southern Africa more
Vanuatu more

See: http://www.pensionreforms.com/

pensionbriefing How much do New Zealanders actually invest in residential rental properties?

RPRC PensionBriefing 2010-1 investigates a claim in the Tax Working Group's 2010 report that New Zealanders have $200 billion invested in residential rental properties.

It is frequently asserted that New Zealanders have too much invested in residential properties that are held for investment purposes. Apparently, the structure of the income tax system has incentivised New Zealanders to that 'over-investment' so it seems that the tax system may be changed in the next Budget (May 2010).

Part of the reason for the expected change is that owners of these rental assets returned overall tax losses so it looks as though owners as a group are gaming the system.

Michael Littlewood, co-director of RPRC argues that a closer look at New Zealanders' real estate portfolios suggests that the amount invested in rental properties is perhaps less than half of what is claimed. "We need better information before far-reaching decisions are made about changes to the tax system" says Littlewood.

If the true number is between, say $60-$100 billion, New Zealand can start a discussion about that level of investment. If it is 'inappropriate' then perhaps we need to consider changes to the income tax system that apparently encouraged that over-investment. If the true number is in fact 'appropriate' then changes to the income tax framework might not be needed on that account alone."

RPRC PensionBriefing 2010-1 is available here.

Contact: Michael Littlewood at michael.littlewood@auckland.ac.nz

Mark your diaries: RPRC Breakfast Briefing 13 April:

Bernard Hickey asks "KiwiSaver and the economy: Are there design issues?"

13 April 2010, 7.15am to 8.45am,
Decima Glenn,
Level 3, Owen G. Glenn Building,
The University of Auckland,
12 Grafton Rd, Auckland.

Bernard Hickey is a leading financial journalist and editor with over 18 years' experience including roles with Reuters, the Financial Times Group and Fairfax Media in Wellington, Canberra, Sydney, London and Singapore. He was involved in the formation of www.reuters.co.uk, msn and Stuff, and is currently editor of Interest.co.nz.

Bernard is a regular commentator on local and international financial, economic and investment issues, as well as matters to do with house prices, interest rates, finance companies, banks, and on-line media.

He raised questions recently on the Tax Working Group's exercise and conclusions, and whether raising GST is justifiable.

Bernard will discuss the impact and importance of KiwiSaver in the economy with a critical analysis of what works and what doesn't.

Michael Chamberlain, BSc, FNZSA, FIA will take the role of discussant, offering commentary on the presentation, and chairing questions from the floor. Michael is an actuary, an adviser to large investors on strategy, and part-owner of Aventine, the managers of SuperLife (a master trust) and SuperLife KiwiSaver.

A Registration Form is available here, or
Contact Tressy Menezes at t.menezes@auckland.ac.nz.