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New Zealand Retirement Income Policy as an 'Eco-system'

Abstract

The New Zealand retirement income system involves a range of policy areas and initiatives beyond New Zealand Superannuation and KiwiSaver. These interact with each other, and with wider social and economic trends. The potential for prolonging working lives, self-funding/decumulation and trends in homeownership need to be considered alongside the sustainability of current policy settings. A unified policy approach is required to ensure the adequacy of retirement incomes for older people and also intergenerational equity.

Keywords Superannuation, retirement income, fiscal costs, decumulation, policy change

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The retirement income framework in New Zealand can best be seen as an interdependent system, involving a range of policy areas and initiatives which interact with each other and with underlying economic trends, social trends and attitudes. This can be depicted diagrammatically as in Figure 1. The central objective of the system, as shown in the diagram, is to ensure that all older New Zealanders[1] have an adequate retirement income: that is, sufficient income to ensure that they are able to 'belong to and participate in the community' (Royal Commission on Social Security, 1972). Adequacy relates not just to the level of New Zealand Superannuation (NZS) and its ongoing fiscal sustainability, but also to supplementary payments, workforce participation, health services, housing support, and the ability to run down accumulated savings and assets. To achieve this objective requires policies which recognise the interdependence of the system as a whole.

In their 2016 review of retirement income policies, the Commission for Financial Capability recognised the wider implications of an ageing population, and suggested:

> the retirement income framework is an eco-system, meaning 'a complex network' or 'interdependent system'. The all-dominating subject of age of eligibility [for NZS] cannot be addressed without also acknowledging the interdependencies: the ageing workforce, the role of KiwiSaver, decumulation options, and more. (Commission for Financial Capability, 2016, p.4)

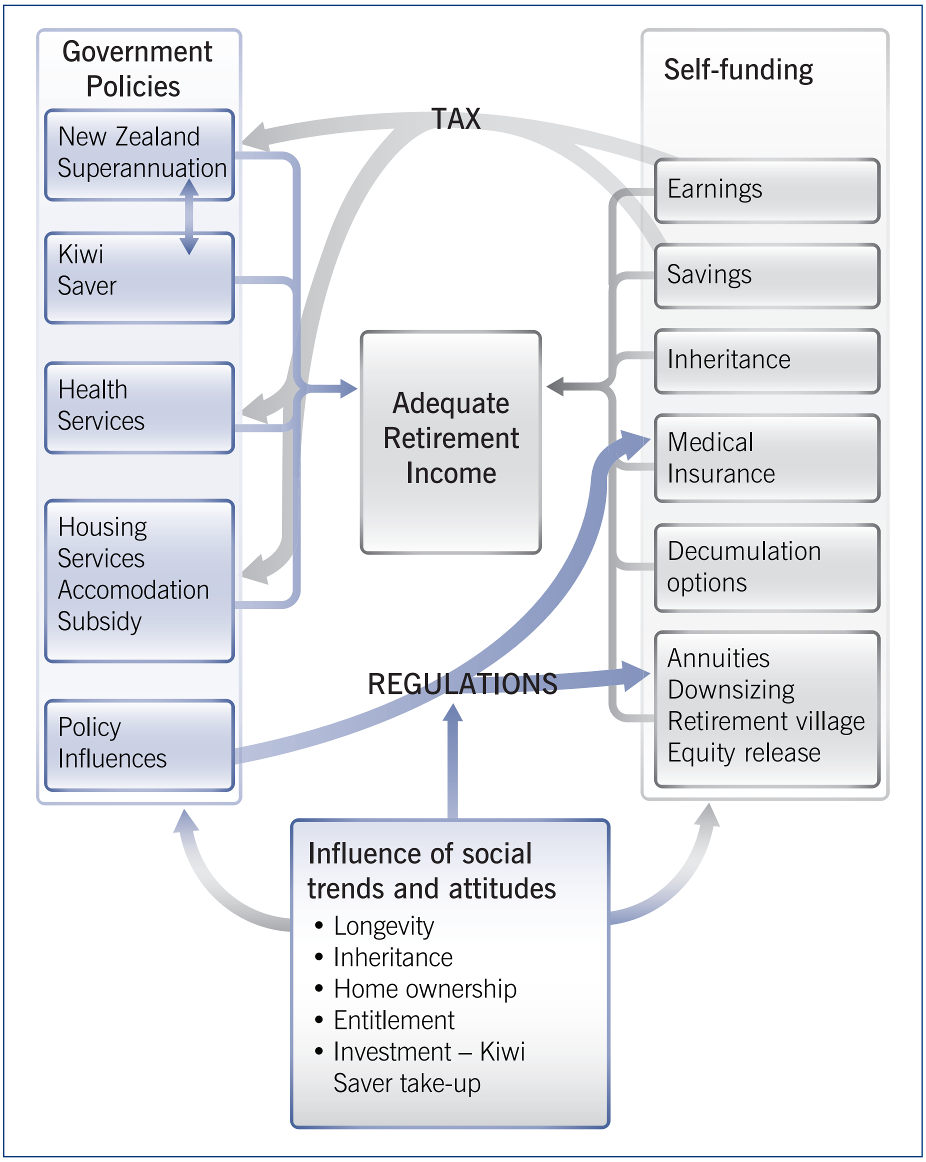
A round table discussion, under the auspices of the Institute for Governance and Policy Studies and the School of Government, held in June 2017 at Victoria University of Wellington, reached a similar conclusion. The discussion noted the relevance of the fall in homeownership; changes affecting the labour market; increasing longevity and associated health costs; and income and wealth inequalities.

This article starts by examining the sustainability of NZS, the central element in the retirement income system at present. A second important element in the framework is KiwiSaver. This has the potential to deliver substantial funds to contributors at age 65. NZS and KiwiSaver may interact more closely in the future, possibly in a two-tier system, with NZS as a 'safety net'.

Health services and aged care – residential and home-based – also play their part in the retirement income eco-system, as do homeownership, housing support through the accommodation supplement, and government initiatives such as the Super Gold Card and the newly announced winter fuel allowance.

Decumulation of existing assets and self-funding from earnings, savings and investments have always been options for increasing the adequacy of retirement incomes. Decumulation could play a larger part in the system in future and some emerging options in the private sector are open to policy influences. Decumulation options are influenced by social trends and attitudes, listed in Figure 1, which are less open to government control. It must be acknowledged that these influences, which include electoral risk, pervade the whole retirement income system and may limit the potential for change.

Figure 1: Interdependence of Influences on adequacy of retirement income



The sustainability of government contribution to retirement incomes

With the ageing of the population, and no change in policy settings, the gross cost of NZS will rise from the current 4.8% of GDP to 7.2% in 2045 and to 7.9% by 2060 (Treasury, 2017). However, NZS is paid net of tax, and with no change in tax rates or thresholds, the resulting net cost will only rise from 4.2% of GDP in 2016 to 6.1% in 2040 and 6.7% by 2060. Adjusting tax thresholds for inflation would offset much of the difference between the gross and net costs. These rates are not high by international standards (the overall OECD contribution is 8.2%), but the increase in spending has given rise to concerns about the sustainability of spending on NZS as the population ages.

The New Zealand Superannuation Fund has a part to play in smoothing the fiscal cost of NZS and improving its future sustainability.[2] It will also contribute to intergenerational equity by reducing the future costs of NZS. The intention is to draw down the fund from 2035–36 to cover part of rising NZS costs. Offsetting that contribution is the tax paid to the government on returns from the fund. Rosenberg (2017) added in New Zealand Superannuation Fund expenditures/withdrawals, and concluded that the net fiscal costs of NZS only rise from 5.0% of GDP to 5.9% in 2060.

To assess total expenditure by the government on retirement incomes, its contribution to KiwiSaver needs to be added. In 2012 this was estimated to be about 12% of the current cost of NZS (Dwyer, 2013). Since then, the grant of $1,000 upon enrolment has been removed and the income-related tax relief capped at a maximum of $521 per annum. This will reduce the fiscal cost of KiwiSaver.

An estimated 42% of current health spending goes on the 65 plus age group and increased numbers of older people are likely to raise health expenditure in the future, provided there is no reduction in service provision or subsidies.

Since its inception, NZS policies have been subject to change. Especially significant was the rise in the age of eligibility from 60 to 65 between 1991 and 2001, which prompted higher rates of labour force participation in this age group; and the reduction in the percentage of average earnings used to calculate net superannuation. There are a variety of options and policy proposals for the future intended to increase the sustainability of NZS. These include:

- Raising the age of eligibility. Arguments for this are not based solely on fiscal savings but also on the increased longevity of the population and the potential for extending workforce participation. Some form of income support will still be needed for older people who cannot work or find work, which will reduce the fiscal gains.
- Adjustment of residence requirements. Many OECD countries have lengthened the residence requirement for pension receipt. The issue is also relevant for migration policy, although the number of inter-country social security agreements is growing.
- Targeting NZS. Income and/or asset testing is complicated, with detailed rules as to what constitutes income and assets, and can become intrusive, especially when eligibility is based on both partners' income and assets. The administration and compliance costs would be significant and avoidance schemes are likely to proliferate. Income testing would also discourage workforce participation beyond the age of eligibility for NZS.
- Changing the method of indexation of NZS. Options include using average earnings, median earnings or changes in consumer prices, each with different implications for the adequacy of NZS and levels of poverty among older people. Consumer price adjustments would probably lead to a two-tiered pension scheme, with means-tested supplements for those with limited income/assets.
- Raising taxes or cutting government expenditure[3] are traditional responses to tight fiscal situations, along with borrowing, and these options are part of the retirement income eco-system. Possible new tax options could include a capital gains tax, a wealth tax or a financial transactions tax. However, tax increases and spending cuts clearly bring electoral risks.
- Deferring receipt of NZS for a higher pension. This policy would be administratively complex and seems not to be actively under current consideration.

The contribution of KiwiSaver[4]

The 2016 review of retirement income policy had KiwiSaver as a primary focus, with numerous recommendations, covering: compulsion for workers to join, contribution rates, transparency of fees and extending coverage.[5]

Research done for the Commission for Financial Capability (2014) shows that most people found they needed something additional to NZS to have an adequate income in retirement. Compulsory enrolment in KiwiSaver would ensure additional retirement income for all workers. But there are arguments against compulsion (ibid.). For low-income earners, especially those with dependent children, KiwiSaver contributions could be a financial burden. An income floor before employee contributions are payable may be a solution, but, while providing current poverty relief, it would be at the expense of building up savings for retirement. Others may prefer to manage their own savings portfolio, or to adjust their savings to life-cycle flows of income and expenditure, taking into account repayment of student debt, house purchase, periods of work in other countries or offsetting the cost of dependants. In these cases income from savings will be a means of self-funding retirement income.

Other government spending on retirement incomes

In addition to direct spending on retirement incomes, other government programmes have the ability to contribute to the adequacy of retirement incomes.

An estimated 42% of current health spending goes on the 65-plus age group and increased numbers of older people are likely to raise health expenditure in the future, provided there is no reduction in service provision or subsidies. Increased health costs are also related to staff salaries and higher expectations of new medications, treatments and technology, not just ageing. Long waiting lists suggest that there may be scope for self-funding through decumulation, or medical insurance, which in the past has been encouraged through tax policies.

Already fewer people are in expensive rest home care, albeit at higher levels of dependency. But, if the policy of 'ageing in place' continues, then home care and services delivered in the community, including the provision of specialised housing for older people, become more important and are already under-resourced. Here again there is potential for self-funding, and policies, such as income-testing, could be developed to encourage this.

The accommodation supplement was designed to reduce the impact of housing costs on low incomes, so for older people it may be a useful addition to retirement income. Its adequacy has been questioned, given the rise in rents (particularly in Auckland and Wellington) – although accommodation supplement increases came into effect from 1 April 2018. The public housing stock is historically low and private landlords do not fill the gap. Poor housing has a negative effect on physical and mental health outcomes. Older renters may therefore generate higher health service costs. Unless there are increases in NZS or the accommodation supplement, greater poverty among older renters can be expected. In addition, the maturity of KiwiSaver accounts and their decumulation through annuities, or returns on occupational pensions, will affect eligibility for the accommodation supplement, which is means-tested.

In the 2008–09 financial year, 22,452 people receiving NZS also received the accommodation supplement, but this was only 9% of recipients. The percentage fell to about 8% in 2010–11 and then increased to about 10% in 2012–13. Of over 500,000 people receiving NZS in the 2008–09 financial year, only 4% received the accommodation supplement. This increased to about 5% in 2012. On this basis, around $100 million is distributed to older people in the housing subsidy. This type of assistance to retirement incomes could probably be expanded, along with the targeted rent and rates rebates.

Fuel poverty has become an increasing concern. The Labour-led administration claims that 'around 1600 Kiwis die each year due to cold housing in winter, and thousands more end up in hospital' (Woods and Sepuloni, 2017). The winter energy payment was introduced in 2018, payable to beneficiaries and superannuitants for 14 weeks from 1 July (in subsequent years to be for 22 weeks from 1 May), worth $450 for a single person and $700 for a couple, with a direct annual cost of $374 million in 2018 and $1.816 billion over four years (ibid.). This cash grant should add to the well-being of retirees and result in some savings in healthcare costs. However, it has been criticised as being poorly targeted, given its universal nature.

Decumulation/self-funding

Self-funding or decumulation, both terms meaning the running down of savings and investments to increase current income, are ways of increasing retirement incomes, assuming that such assets are available. This depends on individual working and housing careers, as well as life experiences. In 2016 the Commission for Financial Capability report called for more work on decumulation tools and information on mechanisms for decumulation. A New Zealand Society of Actuaries report (2017) has guidelines about the use of such mechanisms, with the benefits and impacts of each approach.

Many people die with money in the bank. This may be because of intentional bequest motives, 'rainy day' contingency plans, conservatism, insufficient knowledge of decumulation options, premature death or inertia. Attitudes towards bequeathing are important. But with increased longevity, those receiving bequests may well be into their 60s – a way of funding the next generation's retirement lump sums? The fall in homeownership will, of course, reduce the availability of funds to be passed on. Potential inheritances may be diverted into later life health and residential care costs as a means of self-funding, linked to the availability of health services.

Although KiwiSaver accumulations are as yet not high, the Commission for Financial Capability (2014) reported that about a third of members reaching 65 are withdrawing all their funds, a third are leaving them as investments, and a third make some drawings, often shifting money into term deposits in banks. More information is needed about the attitudes and expectations of KiwiSaver members and others, to assess the potential of this method of self-funding retirement incomes.

There are several options for decumulation, with the possibility that people will use more than one.

- Invest KiwiSaver lump sums and other savings, using the returns for current income needs, and leaving the capital for a 'rainy day' or bequest.
- Draw down capital and accumulated interest regularly, based on a target income, which can be altered if circumstances change. Capital access is maintained, but financial capability is required for this to operate successfully.
- Trade down to smaller/less expensive dwellings, which often have the added advantage of being more suitable for later life; or move into a retirement village where greater certainty about housing costs is offset by a significant charge on home equity and very limited options to move on to other housing (Stock, 2017).
- Commercial equity release schemes, mainly in the form of reverse mortgages with compounding interest on released capital loans, are further options and are widely used overseas (Davey and Wilton, 2006; Davey, 2010). This option also brings a much reduced ability to move to other accommodation as loans must be repaid on the client's death or move into residential care.

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- Commercial annuities. The presence of NZS as a universal and inflation-indexed quasi-annuity has impeded the development of a private sector life annuity market in New Zealand (St John, 2009). Among the barriers are uncertainties about longevity and the difficulty of obtaining adequate margins, alongside the need to set aside solvency capital. Regular annuity payments may also affect benefit eligibility (for the accommodation supplement and the residential care subsidy). New products, such as drawdowns associated with deferred and variable annuities, could be more acceptable, but are as yet relatively undeveloped.[6] There could be a role for government in the annuities sector, although this may mainly benefit those who are already financially secure.

Given the need to achieve an adequate income in retirement by supplementing NZS, decumulation appears to be an accessible avenue for self-funding. It is worth pursuing as part of the policy mix and deserves more attention from policymakers.

Prolonging working lives

Extending working lives has resulted from better health, requirements for extra income, interest in work, and need for social contact and stimulation. It is serving a wider economic purpose by helping to ease labour and skills shortages. Between the censuses of 2001 and 2013, the percentage of men aged 65-plus who were employed rose from 17 to 28% and of women from 7 to 16% (Cameron, 2014). Earning income after the age of 65 will help to supplement NZS and increase overall retirement income.

Higher labour force participation will raise the tax base and thus the affordability of NZS. There is no work test for NZS and no compulsory retirement, so current settings encourage working longer (Davey, 2014). The Commission for Financial Capability included workforce ageing in its 2016 review of retirement income policies and recommended a national conversation and attitude change regarding older workers. To gain the potential economic and social benefits from extending workforce participation, investment in retraining and career transition support for older people (over 50) is a priority (this might usefully include support for entrepreneurship), along with improved capability on the part of employers to manage an ageing workforce. Increased flexibility of employment, both part-time and part-week, would also make it easier to 'work longer'.

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Adequacy of retirement incomes

The interaction of the policies examined above should ensure an adequate retirement income, as defined. NZS could be seen as the income floor below which superannuitants should not fall. At present, the level of NZS is just below the commonly used New Zealand poverty threshold of 60% of household median disposable income, suitably adjusted for family size and composition. In 2015, just over 30% of those aged 65 plus had incomes below this threshold, but they required relatively little income in addition to NZS to rise above it (Perry, 2017); hence the importance of ways to achieve this additional income, including earnings, self-employment and self-funding.

NZS settings were developed on the assumption that a high proportion of New Zealanders in retirement would be homeowners. Housing costs affect the level of income available for current expenditures, and thus material standards of living. Figures from the 2013 census show that almost 80% of those aged 65 plus owned their own homes, usually mortgage free, resulting in relatively low housing-related expenditures and a consequential fall in income poverty after adjusting for housing costs. When all asset ownership is added, people aged 65 plus have a material deprivation level of 3%, compared to 18% for families with dependent children (Perry, 2017).

Homeownership is thus a way of pre-funding some retirement accommodation costs, although this is offset by the payment of rates, insurance, repairs and maintenance expenditures. But homeownership rates have been declining for all age groups, falling from a peak of 73.5% in 1986 to 65% in 2013, with projections of further decreases. A Department of Building and Housing report predicted that, by 2051, 21% of households where the reference person is 65 years old or older will be living in rented accommodation (Nana et al., 2008). The impact of this trend on the adequacy of NZS will need to be carefully monitored to ensure that poverty rates for older people in the future do not increase substantially.

The contribution of the accommodation supplement has already been mentioned. This potentially raises retirement income adequacy for older people who qualify, whether renters or owners. The impact of the winter energy payment has yet to be seen.

Conclusion

This analysis concludes that NZS is sufficient to provide a minimum standard of living, but any reduction of support in other areas (health, housing subsidies) will result in increases in income poverty. The decline in home ownership and higher rents are also likely to lead to an increase in material deprivation among older renters. To avoid these outcomes, consideration needs to be given to how NZS can be supplemented. As discussed in this article, government policies can bring improvements in this area, but there will be a fiscal cost, driven by population ageing.

The maturing of KiwiSaver accounts and other savings, and income flows from decumulation, have the potential to contribute significantly to an adequate standard of living in retirement. However, for people on low incomes, with few assets or savings, there may be insufficient avenues for decumulation, so NZS will remain the basis for their retirement income. And for people already close to retirement there may be insufficient time for principal and accumulated interest to provide an adequate KiwiSaver fund to draw on.

By OECD standards, New Zealand spends a low proportion of its GDP on pensions, mainly because of flat-rate NZS compared to earnings-related pensions overseas. In 2015 this was 5.1% of GDP as opposed to 8.2% for the OECD overall. There are many other legitimate claims on government spending, ranging from poverty relief for working-age families, to education, affordable housing, mental health services, tax cuts, etc. Easing of the 'burden' of NZS, perhaps with the maturity of KiwiSaver accounts, may open up resources for reallocation.

As well as fiscal considerations, an examination of retirement income policies, their trends and interrelationships, highlights the importance of social and behavioural issues. These include intergenerational equity and fairness between age groups in terms of contribution and receipt of benefits (which the New Zealand Superannuation Fund was designed to address in part). Rising expectations of lifestyles and access to services are often attributed to the baby boom generation. This supports the need for savings and decumulation and probably for a higher degree of private provision. Deeply ingrained in New Zealand society is the historic preference for homeownership over renting, and feelings of entitlement to government support as against the requirement to self-fund. All these have political implications and resonate with politicians.

The debate about retirement income policies at the public level needs to be widened, with better understanding of interconnecting policies and political trade-offs. Movement towards this goal can be seen in the 2016 review of retirement income policies. As well as developing policy instruments for addressing the sustainability and adequacy of retirement incomes, it is crucial for government to recognise the interdependencies outlined in this article and work towards a unified policy approach to ensure adequacy of retirement incomes and intergenerational equity.

1 For convenience this is means all people aged 65 plus (the current age of eligibility for NZS). This age group is the generally accepted definition of 'older people', although there is no official or compulsory retirement age in New Zealand.
2 The Labour-led government elected in 2017 intends to resume contributions to the New Zealand Superannuation Fund after the National-led government ceased to add to the fund during its term of office.
3 Cutting government expenditure can also include stopping New Zealand Superannuation Fund contributions, as done by successive National-led administrations between 2008 and 2017. While this reduced the then government deficit, it came at the expense of the size of the fund, and thus intergenerational equity.
4 The purpose of the KiwiSaver Act 2006 is 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 previous standards. The act aims to increase individuals' well-being and financial independence, particularly in retirement. Both employees and employers contribute to individual accounts, held by registered KiwiSaver providers. Funds mature at age 65, but can be withdrawn as a deposit for a first home and there is a provision for financial hardship withdrawals or 'holidays' from contribution.
5 The Labour-led government has not yet indicated what action it will take on these recommendations.
6 A recently launched product – Lifetime Retirement Income – offers a tax-paid fortnightly income for all of the investor's life, based on returns from an initial invested sum.

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