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Pensions and Intergenerational Equity

Superannuation – a fiscal challenge or opportunity?

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PIE Commentary 2024-2[1]

On the 21st March, the Retirement Commissioner invited a range of participants to discuss the future of NZ Superannuation. The SUPER SUMMIT event comprised a set of four panels informed by a background document, Te Ara Ahunga Ora, New Zealand Super- Issues and Options.

This commentary relates primarily to the first panel on the fiscal sustainability of NZ Super, moderated by Pattrick Smellie. Panellists[2] were asked to dive into the fiscal realities and challenges of NZ Super, both now and in the future, including current policy settings, the social and economic case for maintaining the policy status quo or pursuing change. This commentary is based on Susan St John's contribution to the discussion.

Nga mihi o te ata. Greetings to all.

I would be among those first to applaud the genius of NZ Superannuation for all the well-known reasons:

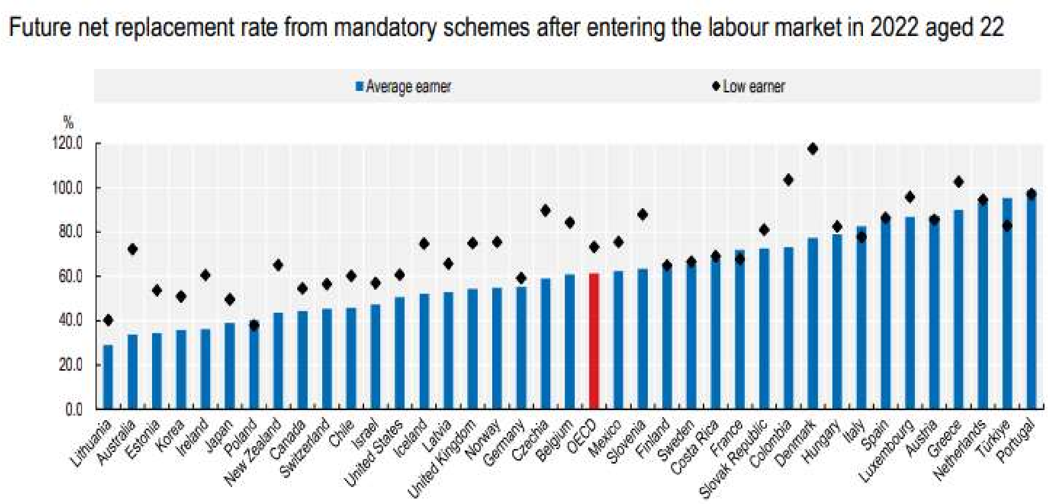
- Its ability to meet the poverty prevention objective
- Its non-contributory nature that makes it more inclusive of women
- its individual-basis like the tax system (but not the welfare system)
- It provides a basic income: a floor from which to do paid work without penalty
- Standard of living is protected by a wage floor.
- Can be accessed in full at age 65
- Low-cost administration

[1] PIE Commentaries are opinion pieces published as contributions to public debate, and do not necessarily reflect the view of the Pensions and Intergenerational Equity Hub.

[2] Panellists were Gail Pacheco, Professor of Economics and Director of the NZ Work Research Institute at AUT. Max Rashbrooke, Senior Associate, Institute for Governance and Policy Studies, Victoria University. Susan St John, Pensions and Intergenerational Equity (PIE) Hub, University of Auckland. Bryce Wilkinson, Senior Fellow, The New Zealand Initiative

We should not be too beguiled by our own cleverness. The claim is made that New Zealand's spending on age pensions is favourably low compared to other OECD countries (measured as pensions as a % GDP, see background [Issues and Options paper](#) p14). But one important reason that many other countries spend relatively much more on pensions than we do, is that they place a higher value on income replacement objectives for average income people. Figure 1 below shows that while we spend about the OECD average on basic pensions, we spend far less on earnings-related ones. We are not universally admired for this gap that will become more apparent over time as old-fashioned company and public sector pensions die out. In my view NZ Super does not provide sufficient longevity protection for the middle-income retirees but that is the topic for another day.

Figure 1 Net pension replacement rates for average and low earners (Pensions at a Glance 2023, p54)



And yes, our scheme is cheap to administer because it is so simple. But I am reminded of Einstein's observation that things should be as simple as possible but no simpler. The most important thing to ask is whether the scheme achieves desirable outcomes for society. The price of simplicity may be that we forgo other important spending. Here is an example: it is administratively very easy to pay all superannuitants an automatic Winter Energy Payment whether they need it or not, at an annual cost of about $300m. To make it an 'opt in' not an 'opt out' arrangement would introduce a little more complexity but deliver useful savings that might allow, for example, the rules for the Accommodation Supplement for older people to be greatly improved.

This brings me to the framing of the Retirement Commission's paper. We are invited to consider options for reform other than raising the age of eligibility but "only if fiscal savings are essential".

I would argue that we need to get away from this framing to one that asks "can we reorganise the money spent today on NZ Super to achieve better outcomes".

As things are today in Aotearoa New Zealand, it is hard not to come to the conclusion that society is falling apart. Everywhere we look there are social deficits of an incredibly serious nature. We can look narrowly within the generation aged over 65 where we see the re-emergence of elder poverty with unmet needs in housing and healthcare. The projections for future demand in aged care and dementia care are worrying, to say nothing of the healthcare demands, dental care, eye surgery, hearing aids, and hip and knee replacements.

But let's take a broader lens. The large physical infrastructure deficit is in our face along with the existential climate change crisis. But there is a huge ***social*** infrastructural deficit: foodbanks are running out of food and funding, children are in strife everywhere along with desperately hungry and homeless families. Many of the working age population and their children desperately need help.

But, critically, it is also in the interests of older people to care about this. Economic reality is that the standard of living of older people is closely tied to the health of the work force, i.e. whether we have enough well-trained doctors and nurses, plumbers and builders and caregivers.

In my view we must urgently review why we give a generous basic income to all whether millionaires/wealth owners or working in well paid work, when we can't ensure that all of the over 65s are protected from hardship, nor a modest degree of income security for low income families doing the vital work of raising the next generation.

It is going to be sweet comfort to have some money trickling out of the NZ Fund from mid-century when our children have left New Zealand for better conditions abroad. The contributions to this fund today also have an opportunity cost for today's working age population. They essentially pay twice- for today's retired and as contributions to their own pensions. Ironically, not one aspect of NZ Super for them is actually guaranteed by the fund. Nor does it make the cost any less. Come the end of this century we will have an enormous fund, but in the words of Ncholas Barr, a famous UK pensions expert "you can't eat pound note butties."

I agree for the multitudes of reasons listed in the Retirement Commission's background paper, that the age should stay at 65. The paper states that, if necessary, "income-testing is the fairest way to reduce expenditure on NZ Super". However we need to take care here as it does depend how we do this. New Zealanders would not like an Australian style means test.

The old surcharge is mentioned, but little time is spent considering the merits of a tax-based clawback. I was involved from the 1980s in discussions about the surcharge and have written about it extensively.[i] The surcharge was in place for 13 years until it was abandoned in 1998. The 1997 Todd taskforce on Retirement Income Provision of which I was deputy chair, were most unhappy at its demise. It had been at the heart of the Accord struck between Jim Bolger, National, Mike Moore, Labour, and Jim Anderton, the Alliance in 1993 (later joined by Peter Dunne, United). Yes, it was too complicated, as those of us doing our parents' tax returns discovered, but it saved a very useful 10% of NZ Super per annum.

In today's terms, saving 10% of NZ Super would generate $2.2 billion gross annually and over the past 25 years, had the surcharge not been abandoned, could have made quite a dent in today's various social and other infrastructural deficits.

This seminar invites us to look at the opportunities. We could build on the good features of NZS and make it a genuine basic non-taxable grant with a separate progressive tax on other income. It could be as effective at raising as much revenue as we want, but should, at minimum, generate as much as the old surcharge. The pressure would be off the need to raise the age and we could even consider extending the basic grant to groups such as Supported Living Payment recipients in their 60s. We should also act today to relieve hardship among the older group, to improve longevity and investment risk protection, and make the NZ Super fund actually work for us.

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[i] See for example:

St John, S., & Ashton, T. (1993). *Private Pensions in New Zealand, Can they avert the crisis?* Institute of Policy Studies, Victoria University of Wellington, 224pp.

St John, S. (1999). 'Superannuation. Where angels fear to tread', in P. Dalziel, J. Boston and S. St John (eds.) *Redesigning the Welfare State in New Zealand: Problems Policies Prospects.* Auckland, Oxford University Press, pp. 278-298.

St John, S. (1992). 'National Superannuation: How not to make policy.' In Boston, J. & Dalziel, P. (eds.), A Decent Society? A Critique of National's Economic and Social Policies, Oxford Press.

St John, S. (1991). 'Reform of the GRI surcharge', New Zealand Planning Council, Wellington.