
FLEXI-SUPER

Discussion Document

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Contents

Joint foreword by Ministers	4
How to make a submission	5
Introduction	6
1 Context	7
2 Proposal	7
3 How Flexi-Super would work?	10
4 Advantages and Disadvantages	14
Appendix One: The structure of NZS rates	24
Bibliography	26

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Joint foreword by Ministers

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Introduction

In this discussion document, section one will look at the context for the Flexi-Super proposal, section two and three will outline the proposal, what it aims to achieve and how it could work. Sections four will outline some of the advantages and disadvantages of Flexi-Super, before section five presents a few examples on how this could work for different people.

The release of this document is a condition of the Confidence and Supply agreement between the National Party and United Future. This discussion document aims to test the public appetite for Flexi-Super. Following this consultation the Government will decide if it wishes to further explore the Flexi-Super proposal, at which stage detailed policy work and a further round of consultation would take place before any decisions are made.

1 Context

Demographic change and the provision of retirement income in New Zealand

Population ageing is a world-wide phenomenon. Increasing numbers of people will become eligible for New Zealand Superannuation (NZS) each year. Currently, around 14 percent of New Zealand residents are aged 65 and over (around 600,000 people). By 2031, this will be around 21 per cent, and the number of superannuitants will exceed 1 million.

14 percent of New Zealand residents are aged 65 and over

The proportion of the population aged over 65 in the labour force² is expected to increase also as the population ages. It is expected that around 8 percent of the total labour force will be aged 65 and over by 2021 (up from the current 4 per cent).³

Unlike many member countries of the OECD, New Zealand has policy settings that encourage older people to choose to remain active in the workforce after they qualify for NZS. As a result New Zealand's participation rates of older workers compare well with its OECD counterparts.

Current superannuation policy in New Zealand

New Zealand's first publicly provided pension was introduced over 100 years ago in 1898, since then there have been a number of iterations. The current form was introduced in 1977 and is centred on New Zealand Superannuation (NZS), a universal government-funded pension intended to assure a basic standard of living for older New Zealand residents.

To be eligible for NZS a person must:

- ▶ be aged 65 years or older
- ▶ be a New Zealand citizen or permanent resident
- ▶ have been resident and present in New Zealand for not less than ten years since the age of 20, of which five years or more must be since the age of 50
- ▶ be ordinarily resident in New Zealand on the date of application.

¹ (Statistics New Zealand, 2011)

² Labour force participation is defined as regularly working one or more hours per week or actively seeking work.

³ (Statistics New Zealand, 2006)

While receiving NZS it is possible to continue to working. NZS is counted as taxable income, and subject to income tax. People who don't meet the eligibility criteria but who are married to a qualified recipient of New Zealand Superannuation may receive this pension as a "non-qualified spouse".

The rates of NZS that superannuitants receive are linked to the average wage and inflation increases. For a full explanation of how these rates are calculated and what they currently are see appendix one.

NZS is funded out of general taxation⁴ and costs around 4.7 per cent of Gross Domestic Product (GDP) in 2010⁵. This is expected to almost double to around 8.0 per cent by 2050 due to demographic changes and indexation to average wage. This is due to both the population ageing but also an increase in life expectancy⁶. This proposal would not stop this expected cost increase.

NZS is qualitatively different from other, working-age benefits, which are more stringently targeted. NZS is also paid at a higher rate than social security benefits; as it is intended replace income over the medium to longer term. Social security benefits are indexed to price inflation whereas NZS is indexed to both prices and wages. This has resulted in low levels of poverty among older New Zealand residents, with only 1.5 per cent in poverty⁷. Bryan Perry's 2012 household income report showed that poverty rates for older New Zealand residents (65+) are lower than younger New Zealand residents.

⁴ However, the New Zealand Super Fund will help to fund the cost of NZS and is planned to be accessed from 2029.

⁵ (OECD, 2012)

⁶ (The New Zealand Treasury, 2013)

⁷ (OECD, 2012)

2 Proposal

What is Flexi-Super?

As outlined in the previous section, those that are entitled to NZS are able to access NZS from 65. It is possible to choose to take NZS later but there is no incentive to do so, nor is there an option to take NZS earlier, even at a reduced rate. Flexi-Super would give New Zealand residents the choice to take superannuation at reduced rates earlier than age 65, or at increasingly enhanced rates after the age of 65. This proposal looks into enabling early eligibility from 60 and deferral until 70.

This proposal looks into enabling early eligibility from 60 and deferral until 70

What Flexi-Super aims to achieve

Flexi-Super would enable New Zealand residents to manage their retirement income and lifestyle with more flexibility than they currently have by giving them greater choice in when to first take NZS. Flexi-Super would aim to achieve this while being fiscally neutral.

3 How Flexi-Super would work?

Flexi-Super would work in much the same way that NZS currently works. The difference is that there would be greater choice when to first access NZS.

Flexi-Super would work in much the same way that NZS currently works

Under Flexi-Super people would select when to first receive NZS, between the ages of 60 and 70. Once someone begins receiving NZS they will receive that rate, relative to someone that began receiving it at 65, for the rest of their lives. The earlier that someone decides to first take NZS, the lower the payment would be each year relative to the rate that would have received if they decided to first collect NZS at age 65. Conversely if they decide to take NZS after 65 they would receive a higher relative rate⁸.

There would be upper and lower ages that Flexi-Super would work from. Under this proposal the ages of first access to NZS are between 60 and 70. As is currently the case with the age of eligibility at 65, there would be no incentive to delay receipt of NZS beyond 70 (i.e. If someone decided to first receive NZS after 70 they would get the same rates as someone that first received NZS at 70).

This means that someone could decide to first take Flexi-Super at 61 and they would continue to get it at that relative rate for the rest of their life. Or if they chose to first take NZS at 68 they would not receive any NZS until they were 68 then they would collect NZS at that rate for the rest of their life.

Residency requirements

Flexi-Super does not plan to change the residency requirements for NZS. That someone would still have to have lived in New Zealand for 10 years since they were aged 20 years, of which five years must have been since they were aged 50 years.

Indexation of NZS

The mechanism for adjusting rates of NZS would not change. The absolute amount of NZS payments would increase over time through its indexation to CPI and wages, but relative to the rate of someone that first received NZS at the age of 65 it would not change.

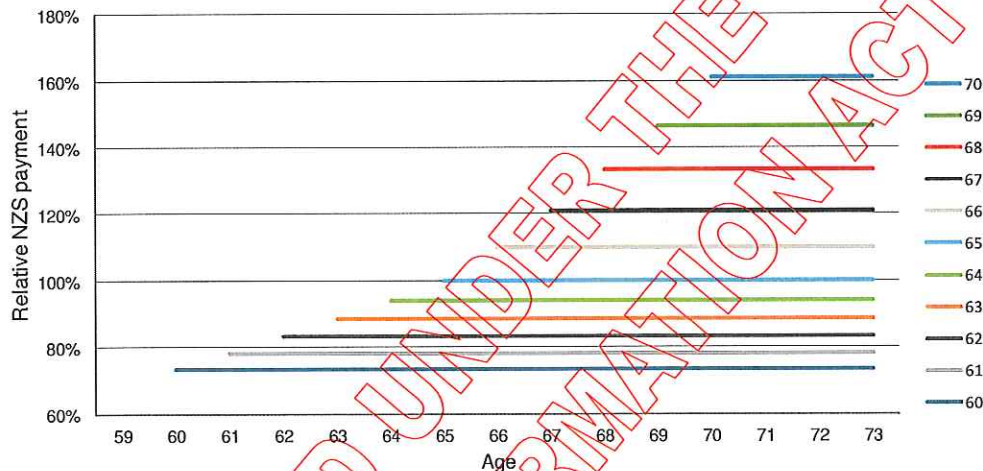
Flexi-Super payment structure

An illustrative example of how this could work is that the rates are adjusted yearly, by a 10 percent increase for each year after 65 and a 6 percent decrease for each year

⁸ The absolute amount would still increase overtime as it is adjusted for inflation and wage increases.

before 65. This means that if a person were to wait until 70 to first take NZS they could receive around 160 percent of the rate at 65. If instead, they were to take NZS from 60 they would receive 73 percent of the rate. The payment structure could then look like this:

Chart 1: Possible Flexi-Super payment structure



The lines in Chart 1 show the level of NZS someone could receive for the rest of their life depending on which age they first took NZS.

Currently a single person eligible for NZS is entitled to receive \$357.42 per week (see appendix one for further detail). Following through this illustrative example the amount someone would receive if they first took NZS at age 61 would be \$279.06 per week, or \$523.30 if they held off until age 69. The rate for couples that both qualify is currently \$549.88 between them. Under this example if they both first took NZS from 60 they would receive \$403.56 in total a week and if they both held off until age 70 they would receive \$885.59.

This is just an example and rate could be much different.

Other considerations

Working and receiving NZS

With flexi-super it would still be possible to continue working and receiving NZS. This means that someone could take NZS at 62 even if they didn't stop working until age 68 or they could take NZS at 70 and continue to work until they are 75 if they so chose to.

KiwiSaver treatment

Currently the date from which KiwiSaver members are eligible to freely withdraw their savings is linked to the age of eligibility for NZS, which currently is at the age of 65⁹. Flexi-Super would change this.

SuperGold card treatment

Currently, SuperGold card eligibility is at the age of 65¹⁰. Flexi-Super would not change this regardless of the age at which someone first received NZS.

International comparisons

A number of OECD countries have a similar policy to Flexi-Super. In some countries it is possible for people to choose to take their state pensions early at reduced rates. In others, pensions can be deferred and taken at increased rates. Some countries allow only a deferral while others allow both an early option and deferral. Some of these countries have rules around how many years someone has worked before they are eligible. A sample of other countries likeness to Flexi-Super is set out below:

Table 1: International comparisons to Flexi-Super

Country	Early option	Standard age	Deferral and increased rates	notes
Australia	No	65 (males) 63.5 (females) increasing	Yes, for five years	The financial incentive for deferral is a lump sum payment that depends on how long they have deferred.
Canada	Yes from 60	65	Yes, until 70	
France	56, subject to certain criteria	60	Yes	
Greece	Yes from 60	65 or after 37 years of work	Yes, until 68	
Germany	Yes, from 63	65 increasing to 67	Yes	
Ireland	No	65	No	
Japan	Yes, from 60	65	Yes	

⁹ Subject to the length of the contribution to the scheme.

¹⁰ However a non-qualified spouse is eligible for a SuperGold card.

Country	Early option	Standard age	Deferral and increased rates	notes
Netherlands	No	65	No	It used to be possible to access benefits early but was abolished in 2005 to stimulate labour market participation of older workers.
Sweden	Yes, from 61	65	Yes	
United Kingdom	No	65 but increasing	Yes	
USA	Yes, from 62	66 but increasing	Yes, until 70	

Sources: OECD (2011), and van Vuuren, (2011)

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4 Advantages and Disadvantages

Advantages:

Provides greater choice

Flexi-Super would give New Zealand residents greater choice when to first take NZS. Currently there is little choice when to first take NZS, it is possible to take it later but there is no financial incentive to do so. It is not possible to take NZS earlier, though people approaching the age of 65 who are facing financial hardship may access assistance through the social security system. Flexi-Super would allow New Zealand residents to take NZS earlier at decreased rates or later at increased rates. New Zealanders' lifestyles are very diverse and a single age of initial eligibility may not be practical for some people.

**Flexi-Super would give
New Zealanders greater choice
when to first take NZS**

Flexibility to adjust for unexpected changes in retirement wealth

Flexi-Super could give people greater flexibility in their retirement income. The flexibility acts as a hedge against shocks¹¹. It gives people the choice to continue working and defer NZS and get a higher rate or take NZS early if they suffer an unexpected life change, such as a partner's death or marriage separation. This is also an option if someone receives an unexpected financial windfall.

Fairness for people with shorter life expectancies

Life expectancy in New Zealand varies between different groups of the population. For example, average life expectancy is shorter on average for some groups such as Maori and Pasifika and longer on average for others such as women who are not Maori or Pasifika. NZS does not allow people to adjust for their own circumstances. Under Flexi-Super, those with low life expectancies would be able to retire earlier and live out a longer retirement than previously.

Flexi-Super will avoid a stigma associated with seeking benefits

Some people that have worked the majority of their life but can no longer work, due to sickness, injury or a disability may, feel a stigma towards receiving a social security benefit¹². People do not feel the same way about NZS which they see as an entitlement. Flexi-Super could enable these people that need financial aid to access it when they need it without the stigma attached to it.

¹¹ (van Vuuren, 2011)

¹² However, there are roughly 34,000 60-64 year olds receiving a social security benefit.

Ability to access NZS early would allow people to bring forward more of their NZS

Flexi-Super would give people the option to bring forward more of their NZS while working than previously. This could be done by taking NZS early and using the extra income while working to pay down housing debt or other assets that would offer support during retirement years.

Ability to defer NZS to 66-70 creates ability to “buy” an annuity

An annuity is a financial product used to purchase a future income stream. In some countries people can use their retirement savings to purchase annuities for their retirement. However, the market in New Zealand to purchase annuities is very small and for some people not an option due to the cost of these financial products.

If annuities markets were better functioning then the age of take up would not matter as it would be easy to purchase annuities for a later retirement or borrow against future retirement income to retire early¹³. Flexi-Super may help address this market failure as it acts like an annuity by enabling people to forgo a few years of NZS to access a higher level of NZS in the future.

Ability to defer NZS until 66-70 creates an incentive for people to participate in the labour force longer.

Giving people the option to defer their NZS to obtain a higher rate creates an incentive for people to work longer and thus stay in the labour force. With projected skill and labour shortages, older workers will play a vital role in contributing to New Zealand's future productivity and economic competitiveness. Having people stay in the labour force longer is beneficial as they contribute to economic output by passing on knowledge and skills and they also contribute more to tax revenue¹⁴. In 2012, people aged over 65 paid 8 percent of all income tax in New Zealand¹⁵. While some people might have chosen to keep working without this incentive, more people might be convinced to work longer.

However, people don't have to continue to work to contribute to economic output. Many older people who cease paid employment continue to make an economic contribution through participation in voluntary or unpaid work and care giving.

¹³ (van Vuuren, 2011)

¹⁴ (Samorodov, 1999)

¹⁵ Treasury analysis of the Statistics New Zealand Household Economic Survey 2009/10.

Disadvantages:

If NZS is taken too early there is potential for hardship

New Zealand has a low rate of old age poverty¹⁶ this is due to the level of NZS, which is effective at poverty prevention. A 2012 study by Dr Claire Matthews showed that over one quarter of retirees in New Zealand have concerns about the level of resources available to meet their retirement needs. The study goes on to show that the level of NZS is enough to sustain only a 'no frills' lifestyle. If people were getting a lower NZS payment than currently without additional income, the rate of old age poverty would likely increase.

Some people find it difficult and challenging when it comes to planning for their longer term interests, such as their retirement¹⁷. These people may take NZS too early under the Flexi-Super proposal winding up in financial hardship. Due to the nature of these individuals, they are usually the people who have inadequate private retirement savings also.¹⁸ This could mean that after a few years of receiving NZS, their NZS payments are not enough to live off after private savings has dried up and they could require additional financial assistance from the Government. The way that eligibility to means tested supplementary assistance is calculated; those with a lower income (those that stopped working and had taken NZS early) could be eligible for a higher level of supplementary assistance.

Potential negative fiscal impacts for the Crown

Achieving fiscal neutrality is difficult. The Flexi-Super policy would likely have the following impacts on the Crown:

i Increased uptake

Allowing people to access NZS to people aged between 60 and 65 who currently do not receive NZS would increase the number of people receiving NZS. As there would be more super annuitants the total cost of NZS would be higher. It is likely that many people aged between 60 and 64 who would otherwise rely on a social security benefit would access NZS early if the available rate of NZS exceeded the rate of social security benefit that was payable.

¹⁶ 1.5% (OECD, 2012)

¹⁷ (The New Zealand Treasury, 2013)

¹⁸ (Cutler, Liebman, & Smyth, 2006)

ii Higher level of additional financial assistance for the elderly

As outlined earlier, some people would decide to receive NZS early and then realise that the level of payment is not high enough to support their living costs. These people could seek further financial aid.

Adverse shocks may also have impact on people that seek additional assistance. Flexi-Super would enable couples of different ages to retire at the same time. However, if the couple was to separate or one of the members die, then they may not have enough to live on if they took NZS early at a reduced rate and also seek additional support

In addition to financial aid sought, if the rates were low enough for taking NZS early, people that took it at these rates would automatically qualify for certain additional benefits from Work and Income. However, this may be offset to some degree by people who will require less support after deciding to work a few more additional years to receive a higher NZS payment.

This additional support would come at greater cost to tax payers.

iii Information asymmetry

People have more information about how long they are likely to live than the Government¹⁹. Those people with life expectancies that deviate from the average could increase their total retirement income, by either first taking NZS early or late²⁰ under Flexi-Super. There is a risk that when these rates are calculated they cannot fully take into this information asymmetry which leads to a more expensive system.

iv Impact on tax revenue

As noted earlier NZS is treated as taxable income. Currently this means that if someone continues to work while receiving NZS they will most likely pay a larger share of their NZS back as tax than someone who has no additional income while receiving NZS. This is because additional income on top of NZS may push you into a higher marginal tax bracket.

Under Flexi-Super some of people could wait until they are 70 to receive their NZS then stop working and receive their NZS when they are in a lower tax bracket. With 8 percent of all income tax in New Zealand comes from those over 65²¹ this could see tax revenues decrease.

¹⁹ For example people know if they have been diagnosed health conditions or that their family tends to live longer than the average.

²⁰ (van Vuuren, 2011)

²¹ Treasury analysis of the Statistics New Zealand Household Economic Survey 2009/10.

This could be offset to some degree by those that take NZS earlier and then continue to work or those that continue to work much later than before for reasons outlined earlier in this document.

In order to compensate for these effects and achieve the principle of fiscal neutrality, the rates paid to those that choose to take NZS early or to defer could be further adjusted to account for these costs. This would mean that the rates for the 60 to 64 year olds would be further decreased. This would increase the risk that those opting to take NZS might experience hardship. Or this could be mitigated by having a higher first age of entitlement under Flexi-Super, for example Flexi-Super could be between 62 and 72. This would reduce the size of the adjustment that would need to be made.

Potential financial literacy concerns

Under Flexi-Super people's decisions when to first take NZS requires them to make an informed judgement on their future retirement income. There are some concerns about the level of financial literacy in New Zealand and introducing a more complex NZS system may mean that more people could make choices without fully understanding the long-term consequences. There would need to be good, clear information provided to the public by the CFLRI to help them understand the implications of this proposal, particularly the impact of taking NZS early.

Flexi-Super may reduce incentives to work for 60-64 year olds

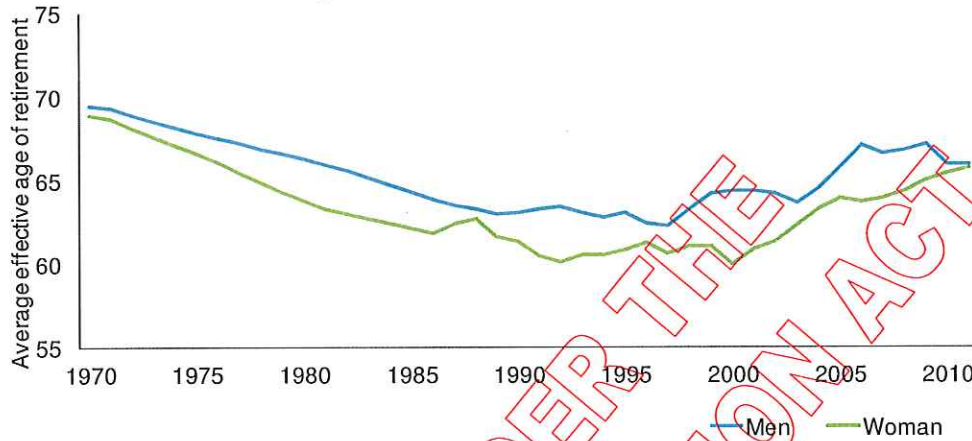
Even though there is no compulsory retirement age in New Zealand the age of eligibility for NZS can act as a signal which individuals use to inform their decision to retire.²²

The effective retirement age²³ in New Zealand is between 67 and 65 (Chart 2). This suggests that the NZS payment is enough of an incentive for a large proportion of the population to retire around 65 when they are first offered NZS.

²² (The New Zealand Treasury, 2013)

²³ OECD defines the "effective retirement age" as the average effective age at which older workers withdraw from the workforce. In many OECD countries this age is well below the official age for receiving a full old-age pension.

Chart 2: Effective retirement ages in New Zealand and other countries



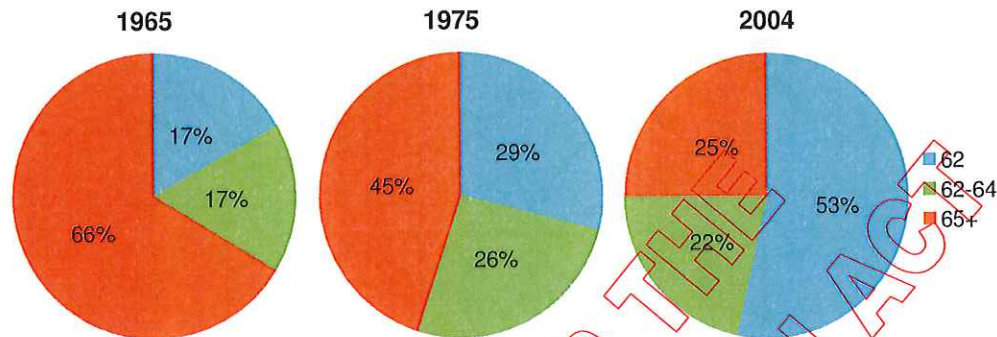
Source: OECD 2010

Allowing first access to NZS at 60 under Flexi-Super could reduce the incentive for people to continue to work later into their lives. From an earlier section we saw having people in the workforce longer is beneficial for the economy as a whole as they pass on knowledge and stop contributing to tax revenue²⁴. This is weighed against the welfare gains people get from retiring and it is not sensible to have everyone working until they are 70.

Chart 3 shows the United States has faced an issue with increased uptake of their social security from an early age. In 1962 17 percent of retired men first took social security at age 62 (the minimum age), over the years despite increased life expectancy this proportion jumped to 54 percent by 2004. If Flexi-Super was enacted a similar trend could develop. This could have a negative impact on New Zealand through higher taxes of future generations and lower productivity.

²⁴ (Samorodov, 1999)

Chart 3: Percentage break down of United States retired males retirement age²⁵



Source: Diamond and Orszag (2004)

Flexi-Super would add complexity to a simple system

Flexi-Super would bring complexity to what is currently a simple system:

i Interface with social security benefits

One of the principles of our social security legislation is that the provision of financial support provided takes into account the financial resources that are available to the person (ie their own resources) and resources from other publically funded sources. For example, if a person is aged 65 or over and has KiwiSaver funds, we would expect them to draw on those funds (as they are available to them). Similarly, if NZS was available to a person from age 60 to supplement their income, we would expect them to access it, before considering the provision of assistance under the social security legislation. This means that if someone was in between jobs they could have to take NZS instead of social security benefits.

ii Linkages with international pension systems

New Zealand has agreements with a number of countries to pay NZS to former NZ residents who are residing overseas and for payments of NZS to be made to people in New Zealand who have previously resided in another country. This link would become more complex under Flexi-Super.

²⁵ These numbers exclude people converting from disability benefits to retirement benefits at the full benefit age. There have been similar trends for females.

iii Linkages with ACC

Currently the link between ACC payments and NZS are complex. People cannot receive both ACC weekly compensation and NZS simultaneously. Subject to a transition period, people aged 65 or over must elect to receive either ACC compensation or NZS.

Under Flexi-Super people aged 60 to 64 years who were eligible for or receiving ACC weekly compensation would have reduced choice when to first receive NZS. This could be an issue as they might experience hardship in the long-term.

iv Future changes to NZS are more difficult

A change to Flexi-Super would also change NZS from an entitlement to a contractual arrangement. This is another element of complexity along with the different rates of payment and ages and rates of first access to NZS. These complexities would make it more difficult to make future legislative changes such as if a future government wanted to raise the age of entitlement to NZS to reduce the cost of the entitlement. If there are demographic or other changes that would require future changes to NZS this could be an issue.

v Different living arrangements

The current structure of NZS is very simple. There is one age of first entitlement there are standardised rates for different living arrangements. NZS payments differ for three living situations:

- Single, living alone
- Single, sharing, and
- Couple²⁶

Under the Flexi-Super proposal there would be multiple ages at which people could first receive NZS this would mean that there would be multiple rates for each of these living situations. For example, a couple, both eligible for NZS would have 66 different rates at which people could receive depending on their relative ages people first took NZS²⁷.

Other countries manage with a more complex state pension.

²⁶ It is possible to have a non-qualified spouse in a couple that receives NZS also.

²⁷ There are 11 different ages each could retire, following $t(n)=(n(n+1))/2$.

Questions

- ▶ Does the concept of more choice in the age of entitlement to receive NZS appeal to you?
- ▶ Are you comfortable with risk of higher levels of hardship among the elderly in order to gain flexibility in the age of first entitlement for NZS?
- ▶ Weighing up the pros and cons identified regarding Flexi-Super are you in favour of having Flexi-Super?

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Appendix One: The structure of NZS rates

The key legislative platform for retirement income policy is the New Zealand Superannuation and Retirement Income Act 2001.

NZS is governed by this Act, which set out the rates of payment and how these are annually adjusted. The net weekly rates of NZS must be adjusted on 1 April each year, in line with any annual percentage increase in the Consumers Price Index (CPI) for the year ending the previous 31 December.

After this adjustment, the after-tax²⁸ weekly amount of NZS payable to a married couple (where both qualify) must be at least 65 per cent of the average wage after tax, but cannot be greater than 72.5 per cent of the average wage after tax. It is current Government policy to ensure that the after-tax married couple rate is maintained at a minimum of 66 per cent of the average wage after tax.

If following the CPI adjustment the after-tax married couple rate is less than 66 per cent of the average wage after tax, a further adjustment is made to bring the rate up to this level. A further adjustment, above the CPI, was required on 1 April 2010, 1 April 2011, 1 April 2012 and 1 April 2013. Following the price and wage adjustment, the single sharing and living alone rates are set at:

- 60 per cent of the married couple rate for single people sharing accommodation
- 65 per cent of the married couple rate for single people who are living alone (and qualify for the Living Alone Payment).

Table 6 outlines the weekly after-tax payment rates of NZS from 1 April 2013, based on the tax code 'M'. This is the amount people will receive if NZS is their main source of income. Recipients have their NZS taxed at a higher rate if it is not their main source of income.

Rate type	Net rate based on M tax code	Gross rate
Married, civil union, de facto couple (both qualify)	\$549.88	\$620.68
Single sharing accommodation	\$329.93	\$377.05
Single living alone	\$357.42	\$410.32

²⁸ After tax at the standard 'M' rate.

Married, civil union, or de facto couple (maximum payable to a couple where a non-qualified partner is included)	\$522.62	\$ 587.46
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Source: Ministry of Social Development administrative data

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25 June 2013

Reference: T2013/1687
SH-11-4-3-2-3-1

Hon Peter Dunne
Freepost Parliament
Private Bag 18 888
Parliament Buildings
WELLINGTON 6160

Dear Hon Peter Dunne

LETTER TO HON DUNNE: DRAFT DISCUSSION DOCUMENT ON FLEXIBLE SUPERANNUATION FOR REVIEW

Please find attached a draft discussion document on flexible superannuation for your review. The document has been prepared consistent with the high-level structure indicated in the Treasury Report to you and our subsequent discussion with you on 29 May (T2013/1298 refers). Please note that it has been through departmental consultation, but has not yet undergone professional proofreading.

Feedback would be welcomed – ideally **by Friday 5 July**, to enable us to achieve the timeframes discussed with you on 29 May (see table below).

You indicated you would provide a draft Foreword for the document – if you could provide this **by Friday 5 July** as well that will enable us to insert it into the version that goes to the Minister of Finance.

The remaining stages for the discussion document are as per the timeline below:

Date	Action
24 June – 8 July	Draft to you for review
8 – 15 July	Revisions in light of your feedback
15 – 29 July	Review by Minister English External proof read
18 July	Submit to Officials' committee for Economic Growth and Infrastructure Cabinet Committee (OEGI)
22 July	OEGI
1 August	Submit to Economic Growth and Infrastructure Cabinet Committee (EGI)
7 August	EGI
12 August	Cabinet

We look forward to receiving your feedback.

Yours sincerely

Katherine Meerman
Acting Manager, Financial Markets Team

cc: Minister of Finance

[Draft not released - final version publicly
available]

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FLEXIBLE SUPERANNUATION

Discussion Document

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New Zealand Government

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The PURL for this document is <see the Team leader, Websites and Intranet>

Contents

Joint foreword by Ministers	5
How to make a submission	6
Introduction	7
1 Context	8
2 Proposal	8
3 How Flexi-Super would work?	11
4 Advantages and Disadvantages	15
Appendix One: The structure of NZS rates	24
Bibliography	26

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Joint foreword by Ministers

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How to make a submission

[insert section on how to submit]

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If you would like us to withhold any commercially sensitive, confidential or proprietary information included in your submission, please clearly state this in your submission and identify the relevant sections. We will consider any request to have information withheld in accordance with our obligations under the Official Information Act.

Introduction

In this discussion document, section one looks at the context for the flexible superannuation proposal (Flexi-Super), sections two and three outline the proposal, what it aims to achieve and how it could work. Section four outlines some of the advantages and disadvantages of flexi-super and section five presents a few examples on how this could work for different people.

The release of this document is a condition of the Confidence and Supply agreement between the National Party and United Future. This discussion document aims to test the public interest in having more choice regarding when New Zealand Superannuation can be accessed. Following this consultation the Government will consider whether to further explore the Flexi-Super proposal, at which stage more detailed policy work and a further round of consultation would take place before any decisions are made.

1 Context

Demographic change and the provision of retirement income in New Zealand

Population ageing is a world-wide phenomenon. Increasing numbers of people will become eligible for New Zealand Superannuation (NZS) each year. Currently, around 14 percent of New Zealand residents are aged 65 and over (around 600,000 people). By 2031, this will be around 21 per cent, and the number of super annuitants will exceed 1 million.¹

The proportion of the population aged over 65 in the labour force² is expected to increase also as the population ages. It is expected that around 8 percent of the total labour force will be aged 65 and over by 2021 (up from the current 4 per cent).³

Unlike many member countries of the OECD, New Zealand has policy settings that encourage older people to choose to remain active in the workforce after they qualify for NZS. As a result New Zealand's participation rates of older workers compare well with its OECD counterparts.

Current superannuation policy in New Zealand

New Zealand's first publicly provided pension was introduced over 100 years ago in 1898, since then there have been a number of iterations. The current form was introduced in 1977 and is centred on New Zealand Superannuation (NZS), a universal government-funded pension intended to assure a basic standard of living for older New Zealand residents.

To be eligible for NZS a person must:

- ▶ be aged 65 years or older
- ▶ be a New Zealand citizen or permanent resident
- ▶ have been resident and present in New Zealand for not less than ten years since the age of 20, of which five years or more must be since the age of 50
- ▶ be ordinarily resident in New Zealand on the date of application.

¹ (Statistics New Zealand, 2011)

² Labour force participation is defined as regularly working one or more hours per week or actively seeking work.

³ (Statistics New Zealand, 2006)

While receiving NZS it is possible to continue to working. NZS is counted as taxable income, and subject to income tax. People who don't meet the eligibility criteria but who are married to a qualified recipient of New Zealand Superannuation may receive this pension as a "non-qualified spouse".

The rates of NZS that super annuitants receive are linked to the average wage and inflation increases. For a full explanation of how these rates are calculated and what they currently are see appendix one.

NZS is funded out of general taxation⁴ and costs around 4.7 per cent of Gross Domestic Product (GDP) in 2010⁵. This is expected to almost double to around 8.0 per cent by 2050 due to forecast demographic changes. This is due to both the population ageing but also an increase in life expectancy⁶. This proposal would not stop this expected cost increase.

NZS is qualitatively different from other working-age benefits, which are more stringently targeted. NZS is also paid at a higher rate than social security benefits as it is intended to replace income over the medium to longer term. Social security benefits are indexed to price inflation whereas NZS is indexed to both prices and wages. This has resulted in low levels of poverty among older New Zealand residents, with only 1.5 per cent in poverty⁷. Bryan Perry's 2012 household income report showed that poverty rates for older New Zealand residents (65+) are lower than for younger New Zealand residents.

⁴ However, the New Zealand Super Fund will help to fund the cost of NZS and is planned to be accessed from 2029.

⁵ (OECD, 2012)

⁶ (The New Zealand Treasury, 2013)

⁷ (OECD, 2012)

2 Proposal

What is Flexi-Super?

As outlined in the previous section, those that are entitled to NZS are able to access NZS from 65. It is possible to choose to take NZS later but there is no incentive to do so, nor is there an option to take NZS earlier, even at a reduced rate. Flexi-Super would give New Zealand residents the choice to take superannuation at reduced rates earlier than age 65, or at increasingly enhanced rates after the age of 65. This proposal looks into enabling early eligibility from 60 and deferral until 70.

This proposal looks into enabling early eligibility from 60 and deferral until 70

What Flexi-Super aims to achieve

Flexi-Super would enable New Zealand residents to manage their retirement income and lifestyle with more flexibility than they currently have by giving them greater choice in when to first take NZS. Flexi-Super would aim to achieve this while being fiscally neutral.

3 How Flexi-Super would work?

Flexi-Super would work in much the same way that NZS currently works. The difference is that there would be greater choice when to first access NZS.

Flexi-Super would work in much the same way that NZS currently works

Under Flexi-Super people would select when to first receive NZS, between the ages of 60 and 70. Once someone begins receiving NZS they will receive that rate, relative to someone that began receiving it at 65, for the rest of their lives. The earlier that someone decides to first take NZS, the lower the payment would be each year relative to the rate that they would have received if they decided to first collect NZS at age 65. Conversely if they decide to take NZS after 65 they would receive a higher relative rate⁸.

There would be upper and lower ages that Flexi-Super would work from. Under this proposal the ages of first access to NZS are between 60 and 70. As is currently the case with the age of eligibility at 65, there would be no incentive to delay receipt of NZS beyond 70 (i.e. If someone decided to first receive NZS after 70 they would get the same rates as someone who first received NZS at 70).

This means that someone could decide to first take Flexi-Super at 61 and they would continue to get it at that relative rate for the rest of their life. Or if they chose to first take NZS at 68 they would not receive any NZS until they were 68 then they would collect NZS at that rate for the rest of their life.

Residency requirements

This Flexi-Super proposal would not affect residency requirements for NZS. To be entitled to NZS, a person would still have to have lived in New Zealand for 10 years since they were aged 20 years, of which five years must have been since they were aged 50 years.

Indexation of NZS

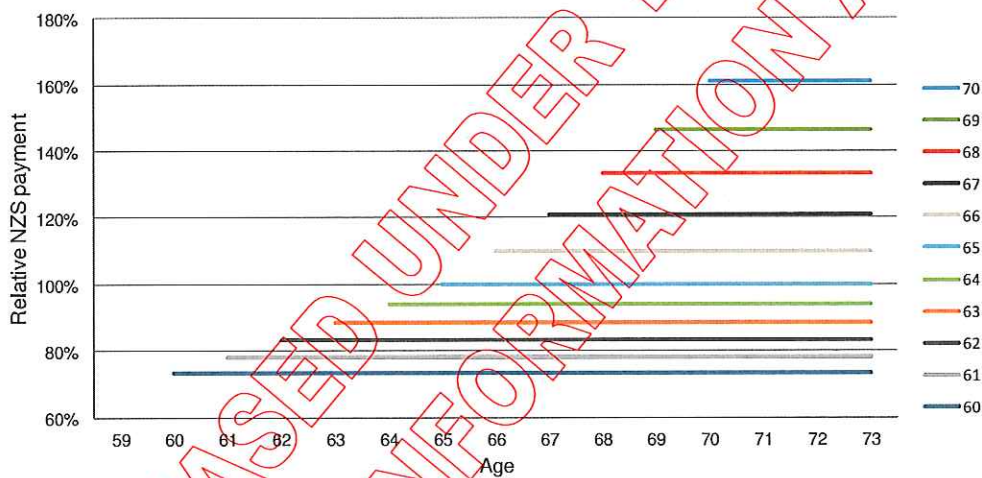
The mechanism for adjusting rates of NZS would not change. The absolute amount of NZS payments would increase over time through its indexation to CPI and wages, but relative to the rate of someone that first received NZS at the age of 65 it would not change.

⁸ The absolute amount would still increase overtime as it is adjusted for inflation and wage increases.

Flexi-Super payment structure

An illustrative example of how this could work is that the rates are adjusted yearly, by a 10 percent increase for each year after 65 and a 6 percent decrease for each year before 65. This means that if a person were to wait until 70 to first take NZS they could receive around 160 percent of the rate at 65. If, instead, they were to take NZS from 60 they would receive 73 percent of the rate. The payment structure could then look like this:

Chart 1: Possible Flexi-Super payment structure



The lines in Chart 1 show the level of NZS someone could receive for the rest of their life depending on which age they first took NZS.⁹

Currently a single person eligible for NZS is entitled to receive \$357.42 per week (see appendix one for further detail). Flowing through this illustrative example the amount someone would receive if they first took NZS at age 61 would be \$279.06 per week, or \$523.30 if they held off until age 69. The rate for couples that both qualify is currently \$549.88 between them. Under this example if they both first took NZS from 60 they would receive \$408.56 in total a week and if they both held off until age 70 they would receive \$885.59.

This is just an example and actual rates could be much different, depending on the detailed policy work that would be required before implementing this proposal.

⁹ The chart just extends to age 73 for illustrative purposes.

Other considerations

Working and receiving NZS

With flexi-super it would still be possible to continue working and receiving NZS. This means that someone could take NZS at 62 even if they didn't stop working until age 68 or they could take NZS at 70 and continue to work until they are 75 if they so chose to.

KiwiSaver treatment

Currently the date from which KiwiSaver members are eligible to freely withdraw their savings is linked to the age of eligibility for NZS, which currently is at the age of 65¹⁰. Whether this would need to be changed would have to be considered in the detailed policy work if this proposal were to be pursued.

SuperGold card treatment

Currently, SuperGold card eligibility is at the age of 65¹¹. Flexi-Super would not change this regardless of the age at which someone first received NZS.

International comparisons

A number of OECD countries have a similar policy to Flexi-Super. In some countries it is possible for people to choose to take their state pensions early at reduced rates. In others, pensions can be deferred and taken at increased rates. Some countries allow only a deferral while others allow both an early option and deferral. Some of these countries have rules around how many years someone has worked before they are eligible. A sample of other countries likeness to Flexi-Super is set out below:

Table 1: International comparisons to Flexi-Super

Country	Early option	Standard age	Deferral and increased rates	notes
Australia	No	65 (males) 63.5 (females) increasing	Yes, for five years	The financial incentive for deferral is a lump sum payment that depends on how long they have deferred.

¹⁰ The general age at which members can start making retirement withdrawals from KiwiSaver is currently 65; however, there is also a 5-year minimum lock-in period, so at present members who join KiwiSaver after their 60th birthday must have 5 years of KiwiSaver membership before they can make retirement withdrawals.

¹¹ However a non-qualified spouse is eligible for a SuperGold card.

Country	Early option	Standard age	Deferral and increased rates	notes
Canada	Yes from 60	65	Yes, until 70	
France	56, subject to certain criteria	60	Yes	
Greece	Yes from 60	65 or after 37 years of work	Yes, until 68	
Germany	Yes, from 63	65 increasing to 67	Yes	
Ireland	No	65	No	
Japan	Yes, from 60	65	Yes	
Netherlands	No	65	No	It used to be possible to access benefits early but was abolished in 2005 to stimulate labour market participation of older workers.
Sweden	Yes, from 61	65	Yes	
United Kingdom	No	65 but increasing	Yes	
USA	Yes, from 62	66 but increasing	Yes, until 70	

Sources: OECD (2011), and van Vuuren, (2011)

4 Advantages and Disadvantages

Advantages:

Provides greater choice

Flexi-Super would give New Zealand residents greater choice when to first take NZS. Currently there is little choice when to first take NZS, it is possible to take it later but there is no financial incentive to do so. It is not possible to take NZS earlier, though people approaching the age of 65 who are facing financial hardship may access assistance through the social security system. Flexi-Super would allow New Zealand residents to take NZS earlier at decreased rates or later at increased rates.

Flexi-Super would give New Zealanders greater choice when to first take NZS

Flexibility to adjust for unexpected changes in retirement wealth

The flexibility regarding when NZS could be accessed under Flexi-Super could act as a hedge against shocks¹². It gives people the choice to continue working and defer NZS and get a higher rate or take NZS early if they suffer an unexpected life change, such as a partner's death or a relationship separation. The flexibility may also be advantageous in the event that a person experienced a positive shock such as an unexpected financial windfall.

Fairness for people with shorter life expectancies

Life expectancy in New Zealand varies between different groups of the population. For example, life expectancy is shorter on average for some groups such as Maori and Pasifika, and longer on average for others, such as women who are not Maori or Pasifika. Under Flexi-Super, people that might have shorter life expectancies would be able to access NZS earlier and receive more of the benefits than they would under current policy settings.

Flexi-Super avoids possible stigma associated with seeking benefits

Some people that have worked the majority of their life but can no longer work, due to sickness, injury or a disability, may perceive a stigma associated with needing to seek a social security benefit¹³. NZS does not have this association as it is perceived as an entitlement. Flexi-Super may enable people that need financial aid to access it when they need it without the stigma some attach to other social security benefits.

¹² (van Vuuren, 2011)

¹³ However, there are roughly 34,000 60-64 year olds receiving a social security benefit.

Flexi-Super may enable some people to pay down debt or build assets

Under the Flexi-Super proposal, some people with debt may opt to take NZS early, possibly while still working, to enable them to pay down or pay off their debt. This may reduce the accumulation of interest compounding on their debt and enable them to sustain themselves on a lower income in the long-term if they are no longer having to make payments on the debt. Alternatively, some people might choose to take NZS early, while still working, and use the extra income to build other assets that would offer financial support during retirement.

Ability to defer NZS to 66-70 creates ability to “buy” an annuity

An annuity is a financial product used to purchase a future income stream. In some countries people can use their retirement savings to purchase annuities for their retirement. However, the market in New Zealand to purchase annuities is very small and for some people not an option due to the cost of these financial products.

If annuities markets were better functioning then the age of take up would not matter as it would be easy to purchase annuities for a later retirement or borrow against future retirement income to retire early¹⁴. Flexi-Super may help address this market failure as it acts like an annuity by enabling people to forgo a few years of NZS to access a higher level of NZS in the future.

Ability to defer NZS until 66-70 creates an incentive for people to participate in the labour force longer.

Giving people the option to defer their NZS to obtain a higher rate creates an incentive for people to work longer and thus stay in the labour force. With projected skill and labour shortages, older workers will play a vital role in contributing to New Zealand's future productivity and economic competitiveness. Having people stay in the labour force longer is beneficial to the economy as they contribute to economic output by passing on knowledge and skills and they also contribute more to tax revenue¹⁵. In 2012, people aged over 65 paid 8 percent of all income tax in New Zealand¹⁶. While some people might have chosen to keep working without this incentive, more people might be convinced to work longer.

It should be noted that working in paid employment is not the only way that people make an economic contribution. Many older people who cease paid employment continue to make an economic contribution through participation in voluntary or unpaid work and care giving.

¹⁴ (van Vuuren, 2011)

¹⁵ (Samorodov, 1999)

¹⁶ Treasury analysis of the Statistics New Zealand Household Economic Survey 2009/10.

Disadvantages:

If NZS is taken too early there is potential for hardship

New Zealand has a low rate of old age poverty¹⁷ due to the level of NZS, which is effective at poverty prevention. A 2012 study by Dr Claire Matthews showed that over one quarter of retirees in New Zealand have concerns about the level of resources available to meet their retirement needs. The study goes on to show that the level of NZS is enough to sustain only a 'no frills' lifestyle. If people were getting a lower NZS payment than currently without additional income, the rate of old age poverty would likely increase.

Some people find it difficult to plan for their long-term interests, such as retirement¹⁸. There is a risk that under Flexi-Super some people may take NZS early at a lower rate and later end up in financial hardship. Research suggests that people at risk of making such decisions are also more likely to have inadequate private retirement savings.¹⁹ This could mean that in the long-term, the lower NZS payments are not enough to live off after their private savings have been used up and they could require additional financial assistance from the Government. The way that eligibility to means tested supplementary assistance is calculated, those with a lower income (those that took NZS early) could be eligible for a higher level of supplementary assistance.

Potential negative fiscal impacts for the Crown

The Flexi-Super policy could have the following impacts on the Crown:

i Increased uptake

Allowing people to access NZS who are aged between 60 and 64 and currently do not receive NZS would increase the number of people receiving NZS. As there would be more super annuitants the total cost of NZS would likely be higher. It is likely that many people aged between 60 and 64 who would otherwise rely on a social security benefit would access NZS early if the available rate of NZS exceeded the rate of social security benefit that was payable.

ii Higher level of additional financial assistance for the elderly

As outlined earlier, there is a possible risk that some people might access NZS early and then find that the level of payment is not high enough to support their living costs in the long-term. These people may then need to seek further financial assistance from the welfare system at additional cost to the Government.

¹⁷ 1.5% (OECD, 2012)

¹⁸ (The New Zealand Treasury, 2013)

¹⁹ (Cutler, Liebman, & Smyth, 2006)

Unexpected life changes may also lead people that accessed NZS early to seek additional financial assistance. For example, if a couple that accessed NZS early were to separate or one of the members die, then they may not have enough to live on without experiencing hardship and may seek additional support

iii Information asymmetry

People generally have more information about how long they are likely to live than the Government. For example, they may have diagnosed health conditions or may know that people in their family tend to live longer than the average. Those people with life expectancies that deviate from the average could increase their total retirement income, by either first taking NZS early or late²⁰ under Flexi-Super. There is a risk that calculating rates for accessing NZS early or later that they cannot fully take into this information asymmetry into account, resulting in a higher overall cost to the Government.

iv Impact on tax revenue

As noted earlier NZS is treated as taxable income. Currently this means that if someone continues to work while receiving NZS they will most likely pay a larger share of their NZS back as tax than someone who has no additional income while receiving NZS. This is because additional income on top of NZS may push you into a higher marginal tax bracket.

Under Flexi-Super some of people could wait until they are 70 to receive their NZS then stop working and receive their NZS when they are in a lower tax bracket. As 8 percent of all income tax in New Zealand comes from those over 65 this could see tax revenues decrease.²¹

This could be offset to some degree by those that take NZS earlier and then continue to work or those that continue to work much later than before for reasons outlined earlier in this document.

In order to compensate for these effects and achieve the principle of fiscal neutrality, the rates paid to those that choose to take NZS early or to defer could be further adjusted to account for these costs. This would mean that the rates for the 60 to 64 year olds would be further decreased. This would increase the risk that those opting to take NZS might experience hardship. Or this could be mitigated by having a higher age of first entitlement under Flexi-Super. This could reduce the size of the adjustment that would need to be made.

Potential financial literacy concerns

Under Flexi-Super, people's decisions about when to first take NZS requires them to make an informed judgement about their future retirement income. There is a risk that

²⁰ (van Vuuren, 2011)

²¹ Treasury analysis of the Statistics New Zealand Household Economic Survey 2009/10.

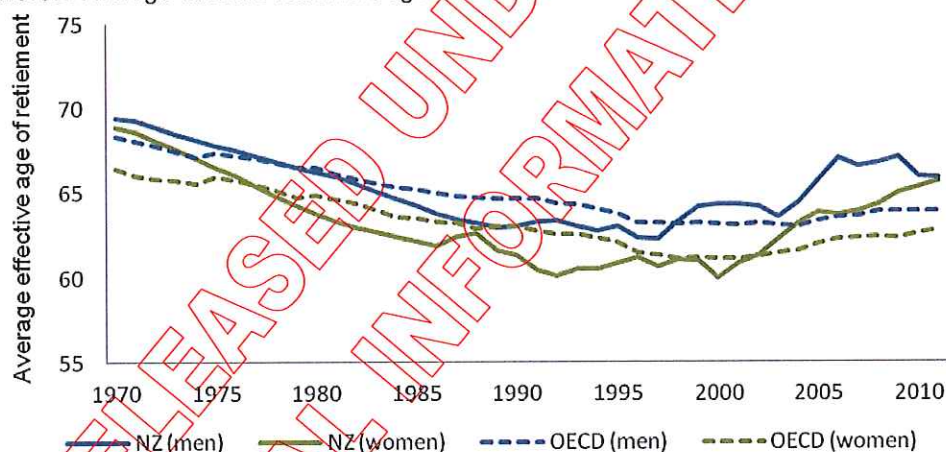
introducing a more complex NZS system may mean that people may make choices without fully understanding the long-term consequences. There would need to be good, clear information provided to the public to help them understand the implications of this proposal, particularly the impact of taking NZS early at a lower rate.

Flexi-Super may reduce incentives to work for 60-64 year olds

Even though there is no compulsory retirement age in New Zealand, the age of eligibility for NZS can act as a signal which individuals use to inform their decision to retire.²²

The effective retirement age²³ in New Zealand is 65.9 for men and 65.7 for women (Chart 2). This suggests that the NZS payment is enough of an incentive for a large proportion of the population to retire around 65 when they are first offered NZS.

Chart 2: Average effective retirement ages in the OECD and New Zealand



Source: OECD 2010

Allowing first access to NZS at 60 under Flexi-Super could reduce the incentive for people to continue to work later into their lives. As discussed earlier, having people participating in the workforce for longer is beneficial for the economy as a whole as they pass on knowledge and continue contributing to tax revenue²⁴. It is important to consider in this context, however, the welfare gains people get from retiring, people's ability to keep working and their lifestyle preferences.

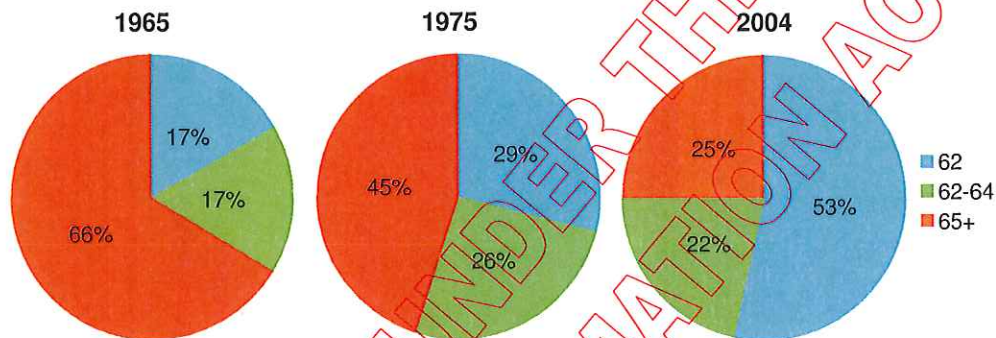
²² (The New Zealand Treasury, 2013)

²³ OECD defines the "effective retirement age" as the average effective age at which older workers withdraw from the workforce. In many OECD countries this age is well below the official age for receiving a full old-age pension.

²⁴ (Samorodov, 1999)

Chart 3 shows the United States has faced an issue with increased uptake of their social security from an early age. In 1962, 17 percent of retired men first took social security at age 62 (the minimum age), but over the years despite increased life expectancy this proportion jumped to 54 percent by 2004. If the Flexi-Super policy was implemented a similar trend could develop. This could have a negative impact on New Zealand through higher taxes on future generations and lower productivity.

Chart 3: Percentage break down of United States retired males retirement age²⁵



Source: Diamond and Orszag (2004)

Flexi-Super would add complexity to a simple system

Flexi-Super would bring complexity to what is currently a simple system:

i Interface with social security benefits

One of the principles of New Zealand's social security legislation is that the provision of financial support provided takes into account the financial resources that are available to the person (ie their own resources) and resources from other publicly funded sources. For example, if a person is aged 65 or over and has KiwiSaver funds, we would expect them to draw on those funds (as they are available to them). Similarly, if NZS was available to a person from age 60 to supplement their income, we would expect them to access it, before considering the provision of assistance under the social security legislation. This means that if someone was in between jobs they could have to take NZS instead of social security benefits.

²⁵ These numbers exclude people converting from disability benefits to retirement benefits at the full benefit age. There have been similar trends for females.

ii Linkages with international pension systems

New Zealand has agreements with a number of countries to pay NZS to former New Zealand residents who are residing overseas and for payments of NZS to be made to people in New Zealand who have previously resided in another country. Also, some super annuitants' overseas pensions are offset against NZS entitlements. These links would become more complex under Flexi-Super.

iii Linkages with ACC

Currently the links between ACC payments and NZS are complex. People cannot receive both ACC weekly compensation and NZS simultaneously. Subject to a transition period, people aged 65 or over must elect to receive either ACC compensation or NZS.

Under Flexi-Super people aged 60 to 64 years who were eligible for or receiving ACC weekly compensation would have reduced choice when to first receive NZS. This could be an issue as they might experience hardship in the long-term.

iv Future changes to NZS may be more difficult

The range of ages of first access to NZS and different rates of payment would make administering NZS more complex. These complexities may make it more difficult to change NZS, for example, if a future government wanted to raise the age of entitlement or change the way the rate of the entitlement is indexed.

v Different living arrangements

The current structure of NZS is very simple. There is one age of first entitlement and there are standardised rates for different living arrangements. NZS payments differ for three living situations:

- Single, living alone
- Single, sharing, and
- Couple²⁶

Under the Flexi-Super proposal there would be multiple ages at which people could first receive NZS. This would mean that there would be multiple rates for each of these living situations. For example, a couple, both eligible for NZS would have 66 different rates at which people could receive depending on their relative ages people first took NZS²⁷. This may create complexity if a couples' living arrangements change.

²⁶ It is possible to have a non-qualified spouse in a couple that receives NZS also.

²⁷ There are 11 different ages each could retire, following $t(n)=(n(n+1))/2$.

Questions

- ▶ Does the concept of more choice in the age of entitlement to receive NZS appeal to you?
- ▶ Are you comfortable with risk of higher levels of hardship among the elderly in order to gain flexibility in the age of first entitlement for NZS?
- ▶ Weighing up the pros and cons identified regarding Flexi-Super are you in favour of having Flexi-Super?

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Appendix One: The structure of NZS rates

The key legislative platform for retirement income policy is the New Zealand Superannuation and Retirement Income Act 2001.

NZS is governed by this Act, which set out the rates of payment and how these are annually adjusted. The net weekly rates of NZS must be adjusted on 1 April each year, in line with any annual percentage increase in the Consumers Price Index (CPI) for the year ending the previous 31 December.

After this adjustment, the after-tax²⁸ weekly amount of NZS payable to a married couple (where both qualify) must be at least 65 per cent of the average wage after tax, but cannot be greater than 72.5 per cent of the average wage after tax. It is current Government policy to ensure that the after-tax married couple rate is maintained at a minimum of 66 per cent of the average wage after tax.

If following the CPI adjustment the after-tax married couple rate is less than 66 per cent of the average wage after tax, a further adjustment is made to bring the rate up to this level. A further adjustment, above the CPI, was required on 1 April 2010, 1 April 2011, 1 April 2012 and 1 April 2013. Following the price and wage adjustment, the single sharing and living alone rates are set at:

- 60 per cent of the married couple rate for single people sharing accommodation
- 65 per cent of the married couple rate for single people who are living alone (and qualify for the Living Alone Payment).

Table 6 outlines the weekly after-tax payment rates of NZS from 1 April 2013, based on the tax code 'M'. This is the amount people will receive if NZS is their main source of income. Recipients have their NZS taxed at a higher rate if it is not their main source of income.

Rate type	Net rate based on M tax code	Gross rate
Married, civil union, de facto couple (both qualify)	\$549.88	\$620.68
Single sharing accommodation	\$329.93	\$377.05
Single living alone	\$357.42	\$410.32

²⁸ After tax at the standard 'M' rate.

Married, civil union, or de facto couple (maximum payable to a couple where a non-qualified partner is included)	\$522.62	\$ 587.46
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Source: Ministry of Social Development administrative data

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