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FILE NOTE – MEETING WITH MINISTER DUNNE ON THE FLEXI-SUPER DISCUSSION DOCUMENT

This file note is from a meeting with Minister Dunne on 1 May 2013 on the Flexible Superannuation discussion document in the confidence and supply agreement with the National Party. The purpose of the meeting was to hear Minister Dunne's objectives and timing for the discussion document.

Attendees:

- Minister Dunne and Minister Dunne's Office staff
- Treasury: Emily O'Connell and [s.9(2)(g)(i)]
- MSD: Alex McKenzie

Key point

- The Minister stated that the purpose of the discussion document is to set out the "high-level" concept of Flexi-Super and identify possible pros and cons. It should be an even handed discussion document to test the support of the public for Flexi-Super as a concept.
- This discussion document would not incorporate United Future's other retirement income policies, only Flexi-Super as per the confidence and supply agreement.
- The Ministers main objective for this policy is to give the public greater choice around their age of retirement.
- This discussion document is to be a National-United Future branded document, but written by Treasury.
- The Minister wishes for the document to be released in mid to late July. The results from this will then be presented to the Government who will then consider if they wish to move forward with the policy. If this is the case only then will more detailed work be required. However the Minister has some actuarial calculations (6% per annum discount when decreasing the age and 10% per annum premium when deferring the age) provided to him by Jonathan Eriksen.
- The Minister wishes to have a formal discussion document published as well as an online consultation forum where people can submit their comments and agree/disagree with ideas and statements.

Action points

- Officials to provide a draft framework for the discussion document and a proposed timeline for discussion with Hon Dunne in mid-late May 2013.

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THE TREASURY

Kaitohutohu Kaupapa Rawa

Treasury Report: Outline and Timetable for the Flexible-Superannuation Discussion Document

Date:	24 May 2013	Report No:	T2013/1298
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note the contents of the report.	None.
Minister of Revenue (Hon Peter Dunne)	Provide feedback on the content of this report when you meet with officials on May 27.	At the meeting with officials on May 27.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
[s.9(2)(g)(i)]	Graduate Analyst	[Withheld under s.9(2)(a)]	✓
Joanne Hughes	Manager, Financial Markets	04 917 6221 (wk)	

Actions for the Minister's Office Staff (if required)

None

Enclosure: Yes (attached)

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24 May 2013

SH-11-4-3-2-3-1

Treasury Report: Outline and Timetable for the Flexible-Superannuation Discussion Document

Purpose of Report

1. The purpose of this report is to provide Minister Dunne information regarding the outline and timetable for the Flexible-Superannuation (Flexi-Super) discussion document prior to meeting with officials on May 27.

Analysis

Discussion document release options

2. Minister Dunne's preference at his previous meeting with officials (1 May 2013) was that the Flexi-Super discussion document be released before the end of July. Officials explored a mid-July release date but do not think that it will be feasible once Cabinet committee processes are taken into account. In light of that, the two options we propose are:
 - i. submit the Cabinet paper to CBC instead of EGI and reduce some of the time that Minister English and Minister Dunne have to review the discussion document:

Date	Action
9 – 30 May	Drafting
30 May – 6 June	Departmental consultation
6 – 13 June	Revisions
13 – 20 June	Draft to Minister Dunne for review
20 – 27 June	Revisions in light of feedback from Minister Dunne
27 June	Submission to Officials Committee for EGI (OEGI)
1 – 8 July	Review by Minister English
	External proof read
1 July	OEGI
11 July	Submission to CBC
15 July	CBC
29 July	Cabinet

This would mean an end July release for the discussion document with departmental consultation and time for Ministers to review the document limited to one week each.

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ii. submit the Cabinet paper to EGI in early August:

Date	Action
21 May – 4 June	Drafting
4 – 17 June	Departmental consultation
17 – 24 June	Revisions
24 – 8 July	Draft to Minister Dunne for review
8 – 15 July	Revisions in light of feedback from Minister Dunne
15 – 29 July	Review by Minister English
	External proof read
18 July	Submit to OEGI
22 July	OEGI
1 August	Submit to EGI
7 August	EGI
12 August	Cabinet

This would mean a mid-August release with two weeks for departmental consultation and two weeks each, for Ministers English and Dunne, to review the discussion document.

Other related releases this year

3. The following table shows related documents that are planned to be released in this year:

Project	Organisation responsible	Date
Long-Term Fiscal Statement	The Treasury	Expected to be released 11 July 2013 ¹
2013 Review of Retirement Income	Commission for Financial Literacy and Retirement Income	September/October 2013
Statement on Older New Zealanders	Minister for Senior Citizens / Ministry for Social Development	September/October 2013
Government preparedness for the aging population	Office of the Auditor General	Later in 2013 (exact timing not known)

4. Minister Dunne indicated previously that he would like the discussion document to be released before the Commission for Financial Literacy and Retirement Income's (CFLRI) 2013 review of retirement income. This is due to be released in September/October both timeline options will see a release before this document.

5. The other document of interest, Treasury's Long Term Fiscal Statement is expected to be released 11 July. This document will have a section on retirement income policy. Both timeline options do not overlap with the release of the LTFS.

¹ The date is not currently public information.

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Discussion document outline

6. The proposed discussion document outline is attached in appendix A.

Consultation

7. The Ministry of Social Development was consulted on this report.

Next Steps

8. In addition to the timetable and outline we have identified some other issues we would like to discuss with Minister Dunne when officials meet with him at 1:30pm on Monday 27 May:
- a. the principle of fiscal neutrality and how it could be achieved
 - b. the optimal age of first entitlement (officials note that Minister Dunne does not want this to be addressed in the discussion document but would like to discuss it with him briefly), and
 - c. the online submission process.
9. We look forward to discussing these issues and any others that Minister Dunne wishes to raise when officials meet with him.

Recommended Action

We recommend that you:

Minister of Finance

- a **note** the contents of this report, and

Minister of Revenue

- b **provide** feedback on the content of this report when you meet with officials on May 27.

Joanne Hughes
Manager, Financial Markets

Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Revenue

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Appendix A: Discussion Document outline

FLEXI-SUPER DISCUSSION DOCUMENT OUTLINE

1. Joint foreword by Ministers
2. How to make a submission
3. Context:
 - The aging population and different rates of mortality in New Zealand.
4. Proposal:
 - What Flexi-Super is.
 - What Flexi-Super seeks to achieve.
5. How would Flexi-Super work?
 - Explanation of the mechanism:
 - This is not the age of retirement but the age of eligibility for NZS.
 - Treatment of KiwiSaver.
 - Requires informed decisions on by individuals about their retirement – financial literacy implications.
 - Governing principles:
 - Choice
 - including fiscal neutrality, and
 - administrative feasibility.
 - International comparisons
 - USA
 - UK
6. Pros and Cons
 - Pros:
 - Choice.
 - Fairness for people with shorter life expectancies or certain characteristics.
 - For 60-64s, can avoid stigma associated with seeking benefits.
 - Ability to access NZS early may help some people to pay down debt.
 - Ability to defer NZS until 66-70 creates an incentive for people to participate in the workforce longer.
 - Ability to defer NZS to 66-70 creates ability to “buy” an annuity (market failure).
 - Cons:
 - Myopic behaviour:
 - Potential for long-term hardship if NZS is taken early as NZS is just above the poverty line and needs may change through time.
 - Financial literacy concerns with a complex system.

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- For 60-64s, may reduce incentives to work.
 - Potential fiscal impacts for the Crown:
 - Impact on welfare system (higher costs) for those that access NZS early are automatically eligible for more financial assistance (eg, accommodation supplement) and more likely to experience hardship and seek additional support.
 - Information asymmetry and adverse selection mean that it is difficult to make this fiscal neutral (but there are options).
 - Impact on tax revenue.
 - Complexity:
 - Makes it harder to make future changes to NZS.
 - Complicates a simple system:
 - Different living arrangements
 - Linkages with international systems
 - Linkages with ACC
 - Other issues
 - Contractual arrangement on top of what is currently an entitlement which would make any future changes much harder.
7. Other
- A few examples of how this could work in practice.

From: [s.9(2)(g)(i)]
Sent: Thursday, 30 May 2013 9:00 a.m.
To: 'Gary White'
Subject: Flexi-Super - Update from meeting with Minsiter Dunne

Hi Gary

We met with Minister Dunne yesterday about the Flexi-Super TR we sent across last week. He is happy with what we are doing and the planned discussion document outline. On timing, Minister Dunne decided to go with the second option, this means the discussion document will be released in mid August.

If you have any questions feel free to give me a call.

Thanks

[s.9(2)(g)(i)]

[s.9(2)(g)(i)] | Graduate Analyst | Financial Markets | The Treasury
[Withheld under s.9(2)(a)]

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FLEXI-SUPER DISCUSSION DOCUMENT OUTLINE

Joint foreword by Ministers

How to make a submission

[insert section on how to submit]

We will not treat any part of your submission as confidential unless you specifically request we do so. Submissions will be subject to the Official Information Act 1982. We may make submissions available on our website, may compile a summary of the submissions or draw attention to individual submissions in internal or external reports.

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 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 benefits and costs 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 a further round of consultation would take place before any legislative changes would be made.

1. Context:

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 the elderly.

The requirements of NZS are minimal with all residents, subject to residency requirements, eligible to first draw on NZS from age 65. While receiving NZS it is possible to continue to working, during this time NZS is treated as taxable income.

NZS is funded out of general taxation and costs around 4.7% of Gross Domestic Product (GDP) in 2010¹. This is expected to almost double over the next 40 years due

¹ (OECD, 2012)

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to demographic changes. This is due to both the population aging but also an increase in life expectancy².

NZS is qualitatively different from other, working-age benefits, which are more stringently targeted. NZS is also significantly higher than other benefits, due to the fact that NZS is a long-term benefit and not just temporary and that other benefits are indexed to price inflation rather than wages and inflation as NZS is. This has resulted in low levels of poverty among the elderly in New Zealand with only 1.5% of elderly in poverty³.

2. Proposal:

What is Flexi-Super?

As outlined in the previous section, currently New Zealanders are first entitled 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 Zealanders the choice to take superannuation at reduced rates earlier than age 65, or at increasingly enhanced rates if they hold off. This proposal looks into enabling early eligibility from 60 and deferral until 70.

What Flexi-Super aims to achieve

Flexi-Super would enable New Zealanders 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.

Under Flexi-Super people would select when to first receive NZS, between the ages of 60 and 70. When people decide when to begin receiving NZS they would continue to receive it at that relative rate 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 been 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 rate⁴.

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. If someone decided to first receive NZS after 70 they would get the same rates as someone that first received NZS at 70.

² (The New Zealand Treasury, 2013)

³ (OECD, 2012)

⁴ The absolute amount would still increase overtime as it is adjusted for inflation and wage increases.

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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.

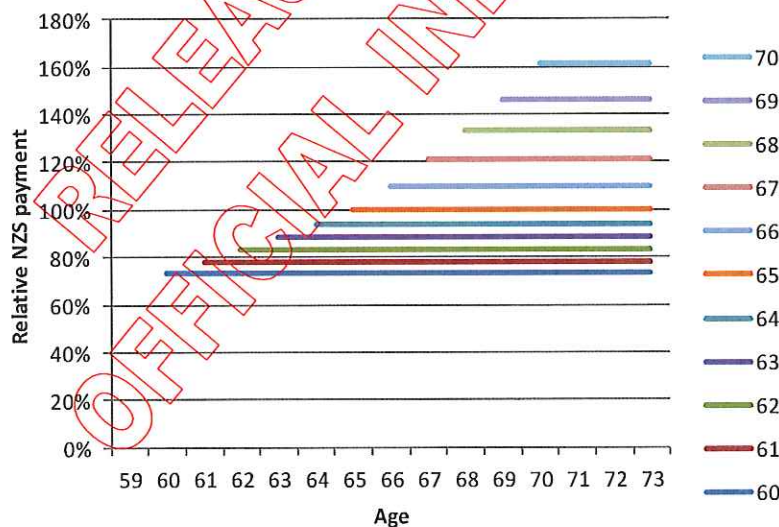
Indexation of NZS

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

Other considerations

Working and receiving NZS

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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 access to KiwiSaver is linked to eligibility for NZS, which currently is at the age of 65. Whether this would remain linked is an issue that would need to be considered further.

SuperGold card treatment

Currently, SuperGold card eligibility is at the age of 65. Flexi-Super would not change this regardless of the age at which someone first received NZS.

International comparisons

A wide range of OECD countries have a similar policy to Flexi-Super. In these countries it is possible for people to choose to take their pensions early at reduced rates and defer at increased rates. Below lists a sample of other countries likeness to Flexi-Super:

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	58, 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

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				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. Pros and Cons

Pros:

Provides greater choice

Flexi-Super would give New Zealanders 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. Flexi-Super would allow New Zealanders to take NZS earlier at decreased rates or later at increased rates. New Zealander's lifestyles are very diverse and a single age of initial eligibility may not be practical for some people.

Flexibility to adjust for unexpected changes in retirement wealth

Flexi-Super could give people greater confidence in their retirement wealth. The flexibility acts as a hedge against shocks⁵. It gives people the choice to continue working and defer NZS and get a higher rate if they suffer an unexpected life change, such as a partners death or marriage separation. The opposite is also possible 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 Pacific Islanders and longer on average for others such as women. 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 injury or old age, feel a stigma towards receiving non-NZS financial aid. 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.

⁵ (van Vuuren, 2011)

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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 debt if they have any, so when they finally retire, they would have less debt.

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. Having people stay in the labour force longer is beneficial as they pass on knowledge and they contribute more to tax revenue⁶. In 2012, people aged over 65 paid 8% of all income tax in New Zealand⁷. While some people might have chosen to keep working without this incentive more people might be convinced to work longer.

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 capital 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 early⁸. Flexi-Super may help address this market failure by enabling people to forgo a few years of NZS to access a higher level of NZS in the future.

Cons:

If NZS is taken too early there is potential for hardship

New Zealand has a low rate of old age poverty⁹. This is due to the level of NZS, which is deliberately set at a rate to try to avoid poverty. If people were getting a lower NZS payment than currently without additional income, the rate of old age poverty would likely increase.

⁶ (Samorodov, 1999)

⁷ (Rodway, 2012)

⁸ (van Vuuren, 2011)

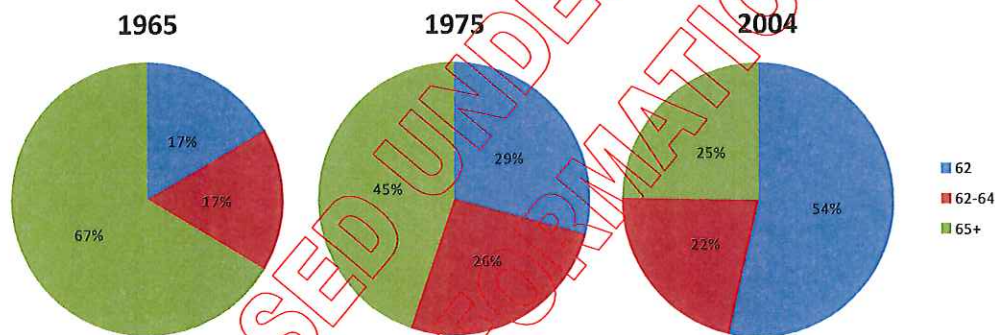
⁹ 1.5% (OECD, 2012)

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Some people may not be rational when it comes to retirement planning¹⁰ and 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.¹¹ This could mean that after a few years of receiving NZS, their NZS payments are not enough to live off and they could require further financial assistance from the Government.

The United States has faced an issue with increased uptake of their social security from an early age. In 1962 17% of men retired first took social security at age 62 (the minimum age), over the years despite increased life expectancy this proportion jumped to 54% by 2004.

Chart 2: Percentage break down of United States retired males retirement age¹².



Source: Diamond and Orszag (2004)

This shows that this could be a significant issue if Flexi-Super was to be enacted.

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 early would increase the number of people receiving NZS. As there would be more super annuitants at any one time the total cost of NZS would be higher.
- ii. Higher level of additional financial assistance for the elderly**

¹⁰ (The New Zealand Treasury, 2013)

¹¹ (Cutler, Liebman, & Smyth, 2006)

¹² These numbers exclude people converting from disability benefits to retirement benefits at the full benefit age. There have been similar trends for females.

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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 were low enough, people that took it at these rates would automatically qualify for certain additional benefits from Work and Income.

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 Government¹³. Those people with life expectancies deviate from the average could increase their total retirement income, by either first taking NZS early or late¹⁴ under Flexi-Super. This is a form of information asymmetry which would make the system more expensive.

iv. Impact on tax revenue

When someone continues to work and receive NZS their NZS payments are treated as taxable income. This means, that if people work until 70 they are paying a portion of their NZS back in tax. Under Flexi-Super some of people could wait until they are 70 to receive their NZS. With 8% of all income tax in New Zealand comes from those over 65¹⁵ this could see tax revenues decrease.

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 the document.

In order to 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. This

¹³ For example people know if they have been diagnosed health conditions or that their family tends to live longer than the average.

¹⁴ (van Vuuren, 2011)

¹⁵ (Rodway, 2012)

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could be mitigated by raising the age of first entitlement, for example, to 62 rather than 60. This would reduce the size of the adjustment that would need to be made.

Potential financial literacy concerns

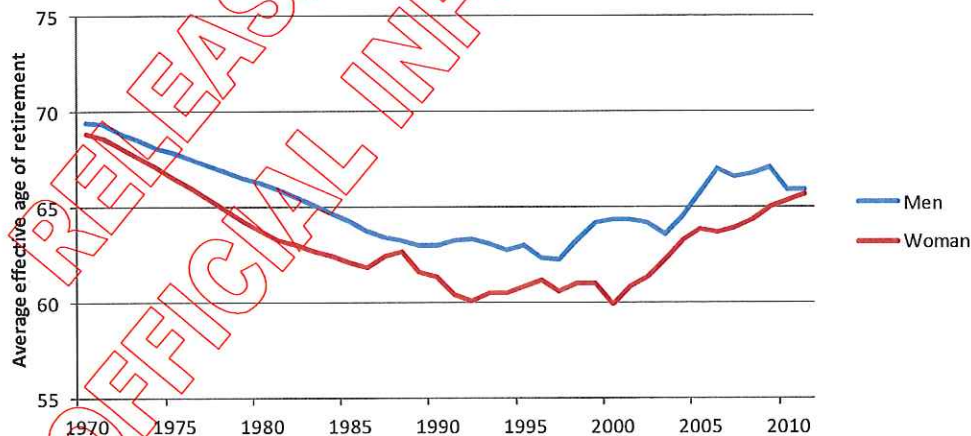
Under Flexi-Super people's decisions when to first take NZS requires them to make an informed judgement on their future retirement income. There are some concerns about the level of financial literacy in New Zealand and introducing a more complex NZS system may mean that more people could make choices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

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

Even though there is not an official 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.¹⁶

The effective retirement age in New Zealand is between 67 and 65 (Chart 3). 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 3: Effective retirement ages¹⁷ 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. As chart 2 shows the USA have suffered a similar issue with a great proportion of those retired retiring early following the introduction of a flexible pension age. From an earlier section we saw that having

¹⁶(The New Zealand Treasury, 2013)

¹⁷ 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.

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people in the workforce longer is beneficial for the economy as a whole as they pass on knowledge and stop contributing to tax revenue¹⁸. This could have a negative impact on New Zealand through higher taxes of future generations and lower productivity.

Flexi-Super would add complexity to a simple system

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

i. 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
- Couple (both qualify)

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, the couple living situation would have 66 different rates at which people could receive depending on their relative ages people first took NZS¹⁹.

ii. Linkages with international 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 linkage would become more complex under Flexi-Super.

iii. Linkages with ACC

Currently the linkages 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 this could require people take Flexi-Super early, reducing their 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

¹⁸ (Samorodov, 1999)

¹⁹ There are 11 different ages each could retire, following $t(n)=(n(n+1))/2$.

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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.

Question one: Does the concept of more choice in the age of entitlement to receive NZS appeal to you?

Question two: 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?

Question three: Weighing up the pros and cons identified regarding Flexi-Super are you in favour of having Flexi-Super?

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FLEXI-SUPER DISCUSSION DOCUMENT OUTLINE

Joint foreword by Ministers

How to make a submission

[insert section on how to submit]

We will not treat any part of your submission as confidential unless you specifically request we do so. Submissions will be subject to the Official Information Act 1982. We may make submissions available on our website, may compile a summary of the submissions or draw attention to individual submissions in internal or external reports.

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 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.¹

¹ (Statistics New Zealand, 2011)

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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.

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

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

³ (Statistics New Zealand, 2006)

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)

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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.

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.

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.

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 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).

⁷ (OECD, 2012)

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

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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.

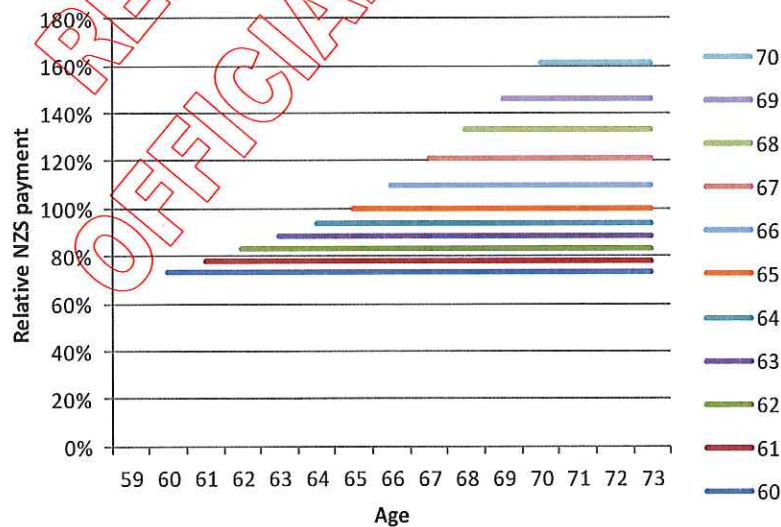
Indexation of NZS

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 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.

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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 \$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

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

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

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				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	
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. Pros and Cons

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 Zealander's lifestyles are very diverse and a single age of initial eligibility may not be practical for some people.

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 partners death or marriage separation. This is also an option if someone receives an unexpected financial windfall.

¹¹ (van Vuuren, 2011)

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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.

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

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

¹³ (van Vuuren, 2011)

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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.

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

¹⁴ (Samorodov, 1999)

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

¹⁶ 1.5% (OECD, 2012)

¹⁷ (The New Zealand Treasury, 2013)

¹⁸ (Cutler, Liebman, & Smyth, 2006)

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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, 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.

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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

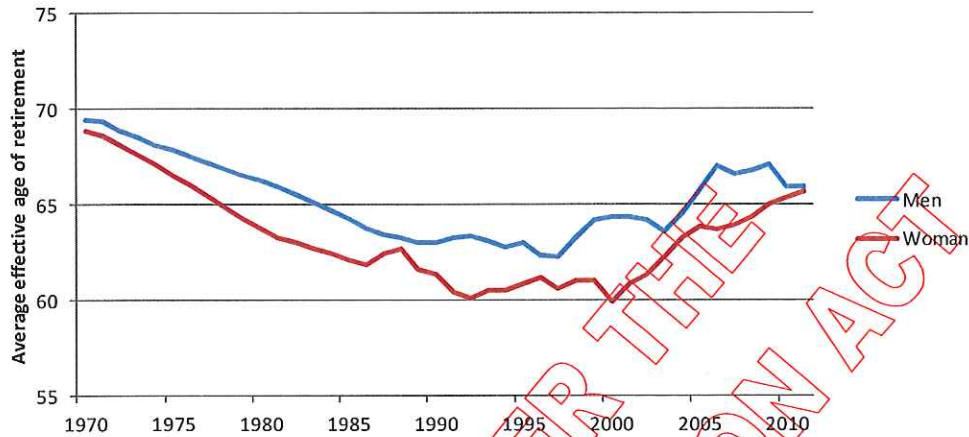
The effective retirement age²³ in New Zealand is between 67 and 65 (Chart 2). This suggests that the NZS payment is enough of an incentive for a large proportion of the population to retire around 65 when they are first offered NZS.

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

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.

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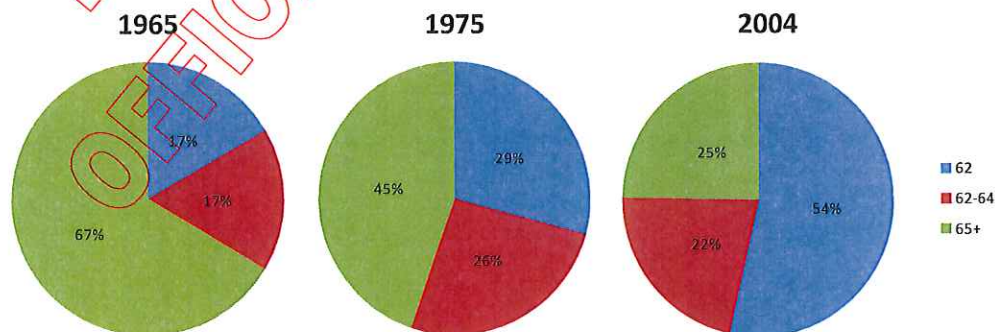


Source OECD 2010

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.

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



Source: Diamond and Orszag (2004)

²⁴ (Samorodov, 1999)

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

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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.

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. 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

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

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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.

v. 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.

Question one: Does the concept of more choice in the age of entitlement to receive NZS appeal to you?

Question two: 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?

Question three: Weighing up the pros and cons identified regarding Flexi-Super are you in favour of having Flexi-Super?

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

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Appendix 1: 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
Married, civil union, or de facto couple (maximum payable to a couple where a non-qualified partner is included)	\$522.62	\$ 587.46

Source: Ministry of Social Development administrative data

²⁸ After tax at the standard 'M' rate.

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