The Treasury

New Zealand Superannuation Information Release

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Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[3] Deleted – not relevant to the announcements

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Regulatory Impact Statement:

New Zealand Superannuation policy options

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the New Zealand Treasury.

It provides an options analysis of how to make New Zealand Superannuation (NZS) more fiscally sustainable and the funding of it more equitable across generations.

The analysis draws upon work done by the Treasury, the Ministry of Social Development (MSD), and the *Review of Retirement Income Policies*, published in December 2016 by the Commission for Financial Capability.

The projections in this analysis use the most recently published demographic and labour market projections from Statistics New Zealand, the long-term fiscal projections based on Treasury's Half Year Economic and Fiscal Update 2016, and administrative-data modelling by MSD.

A caveat is that as the key changes analysed here will not occur for several decades, and the detailed costings are subject to some uncertainty over size and implementation. Hence it is important to review settings and social support programmes nearer the time of implementation to check life expectancy outturns, the need for job re-training and income support for older workers.

Another caveat is that while analysis along these lines has been done by many agencies inside and outside the government over a long period of time, this latest analysis using recent data has been done in a relatively short time frame.

Changes to NZS settings would affect the NZ Superannuation Fund, including future capital contributions and withdrawals, but we have not considered that in this RIS.

The constrained time also means the RIS contains limited options analysis.

Peter Gardiner, Manager, Modelling and Research, New Zealand Treasury

2 March 2017

Executive summary

The average age of New Zealand's growing population is rising as more people are living longer and fertility rates are declining. This means the numbers of people 65 and older are growing faster than the labour force. Our universal public pension scheme, NZS, funded out of current revenue, will require a growing share of tax dollars through the coming decades. This requires growing transfers of resources from younger taxpayers to older generations.

This will put other large spending areas, such as public health, long-term care, and education, under funding stress. These are outcomes outlined both in the Treasury's long-term fiscal statements and in the Retirement Commissioner's reviews of retirement income policy.

Without policy changes in revenue or spending settings, the resulting deficits will cause government debt to grow and rising borrowing costs will produce even faster growing debt. Possible changes to tax rates and bases may arrest debt growth for a while, but can have negative implications for economic growth and the taxpayer base. On the spending side, changes to healthcare, education and other welfare payments can moderate growth of debt, but may affect economic growth (education and health) and negatively affect those dependent on social security support. This leaves changes to NZS as an important option.

This RIS looks at options around changes to NZS settings that preserve many of the current desirable aspects of the universal pension on living standards, while shifting some of the cost onto people close to NZS age.

These options are designed to achieve the following objectives: Fiscal sustainability (lowering the rise in debt); fairness between generations and individuals (lowering the growth of current revenue contributions to pay for future NZS); and income adequacy for older New Zealanders (keeping poverty levels of older New Zealanders low). Trade-offs between these objectives may mean that an improvement in one may be accompanied by a reduction in another.

The RIS concludes that having a process that increases the age at which a person is eligible for NZS will reduce pressures on the fiscal position, allow more resources to flow to younger people, and provide a small boost to labour market participation and hence overall Gross Domestic Product.

Increasing fairness is the motivation behind options to extend the residency requirement for receiving NZS. Recipients should have contributed significantly to New Zealand.

Ruled out are mean-tests (on grounds they are administratively complex, invite avoidance behaviour and are seen as counter to many people's notions of fairness) and reducing the rate at which NZS payments grow (would produce a rise in poverty of older New Zealanders).

The Treasury supports a package of:

- raising the age of eligibility as a one-off step
- checking subsequently to see whether linking the NZS age to the growth of life expectancy changes is needed, and
- extending the residency requirement to 20 years on fairness grounds.

We would recommend these changes are brought in over shorter times for fiscal reasons (for example, one decade rather than two, for the age change), but acknowledge that a longer notice period may be required for community acceptance of the changes and for individuals to adjust their work and saving plans.

Status quo and problem definition

Summary

Population ageing is increasing the numbers of people receiving NZS. More older people are staying in the work force after the NZS eligibility age of 65, and these participation rates have been rising since the rise of the age to 65 early this century. This recipient growth is causing rising spending pressures from NZS and healthcare, so that future taxpayers will be supporting relatively more people receiving NZS than now. Without some policy changes, this will test our concept of fairness between generations.

The role of NZS

Retirement income policy is primarily a social welfare intervention, intended to minimise economic insecurity in retirement.

The long-standing design features of NZS – universal, flat-rate, tax-funded, age- and residency-tested – have the effect of providing a "citizenship dividend." NZS provides older New Zealanders with a dividend from their lifetime contributions to society and the economy – regardless of how much they earn. Its payments depend on a set of parameters – set out below – that have evolved in the past in response to demographic and fiscal changes. In contrast, the welfare system (e.g, jobseeker support [JSS], sole parent support [SPS] and supported living payment [SLP]) acts as a safety net to protect individuals against economic insecurity prior to retirement.

Currently, protection against income insecurity transitions at age 65 from being provided via needs-based welfare to universal NZS. A core policy issue is if, when, and how that transition should respond to a range of factors, including increasing life expectancy, an older demographic composition, changing views about ageing and the nature of retirement, and the overall long-term fiscal outlook.

NZS provides a basic income for people 65 and older and has been an important element in keeping old-age poverty low in New Zealand. Older New Zealanders have much lower rates of low-income hardship (after housing costs) and material hardship than all other age-groups, according to the *2016 Household Incomes Report* (MSD, 2016). The relatively good position of older New Zealanders reflects the mix of universal public provision (mainly NZS) and private provision built up by most of the current cohort over their lifetimes, especially from paying down mortgages on their houses. Under a European Union deprivation index (EU-13) for international comparisons of material hardship, New Zealand ranks well for people 65 and older.

NZS payments (for a couple) are set at 66% of the average weekly wage. Weekly payments have increased by 35 per cent (after tax) since 2008, compared with inflation of 14 per cent. This indexation has played a key role in keeping poverty levels among recipients low relative to other OECD countries.

NZS is paid to nearly all people from age 65. There are three rates depending on a person's living circumstances. All people with the same living arrangements receive the same NZS rate. The current after-tax rates are $295.97 per person a week for a married couple,

$355.16 for a single person in shared accommodation, and $384.76 for a single person living alone. NZS is paid whether the recipient is still working or not.

Payment is subject to residency criteria, where recipients must have lived in New Zealand for 10 years after age 20, of which five years are after age 50. NZS has no means-testing (except in the case of a non-qualified partner (NQP) – see below) and no direct contribution requirements. It is paid from general revenue.

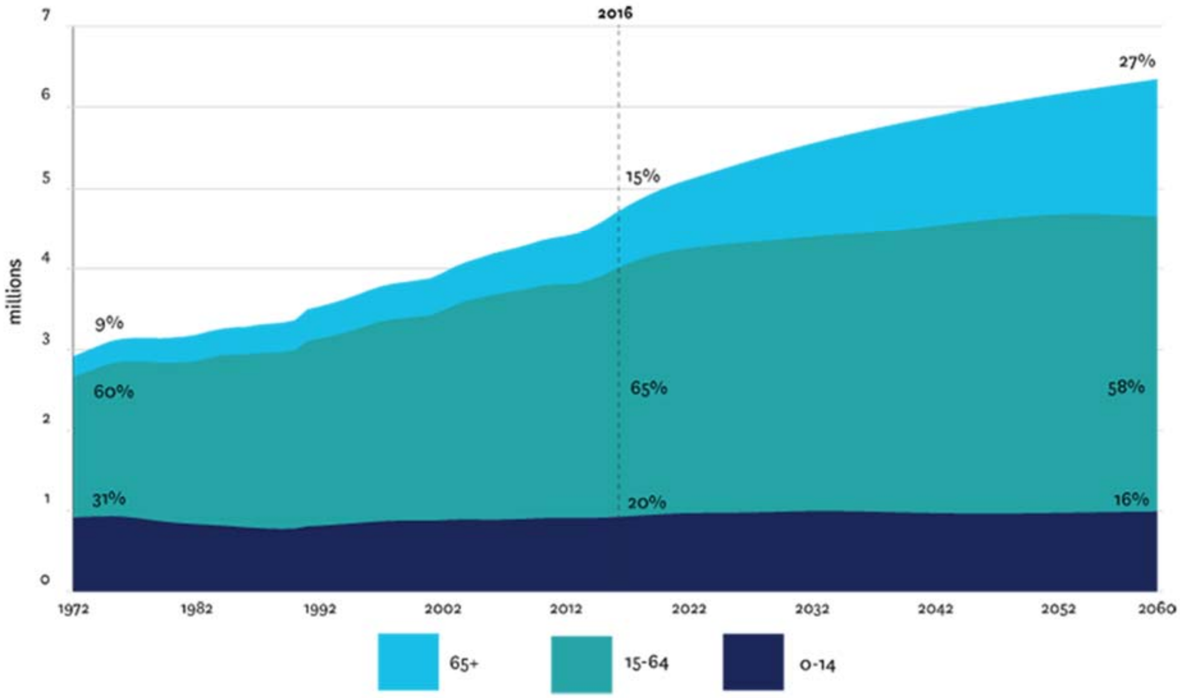
Current policy provides that a person who qualifies for NZS can choose to include an NQP. People who do not meet the eligibility criteria for NZS (either because they have not fulfilled the residency requirements or because they have not reached the age of 65), but who are partnered with a qualified recipient of NZS may receive a pension payment as an NQP, but the couple is subject to an income test. Where eligible, a couple with an NQP receive slightly less NZS than a couple who both qualify.

Demographic and fiscal context

New Zealand has experienced significant economic and social change over the past 60 years. Over this time, life expectancy at birth has risen 12 years. Starting in 1992, the age was raised by six months every year from 60. In the 15 years since 2001, the number of people 65 and older has grown by 50 percent, moving from 12 percent of the population to 15 percent. In the next 15 years, the median projection has the number of people 65 and over growing by 66 percent to reach 21 percent of the total population.

Since 2001, life expectancy at birth has risen by about four years. Statistics New Zealand projects life expectancy to increase at a rate of about two years per decade through the mid-2020s, with the increase declining to just over one year per decade in the 2060s. Life expectancy is expected to continue to rise on average by 1.3 years per decade until the end of the century – the equivalent of increasing by almost one day each week. At the same time, fertility rates are declining, pushing up the average age of the population.

Figure 1 - New Zealand population age structure: 1972 – 2060



Source: Statistics New Zealand

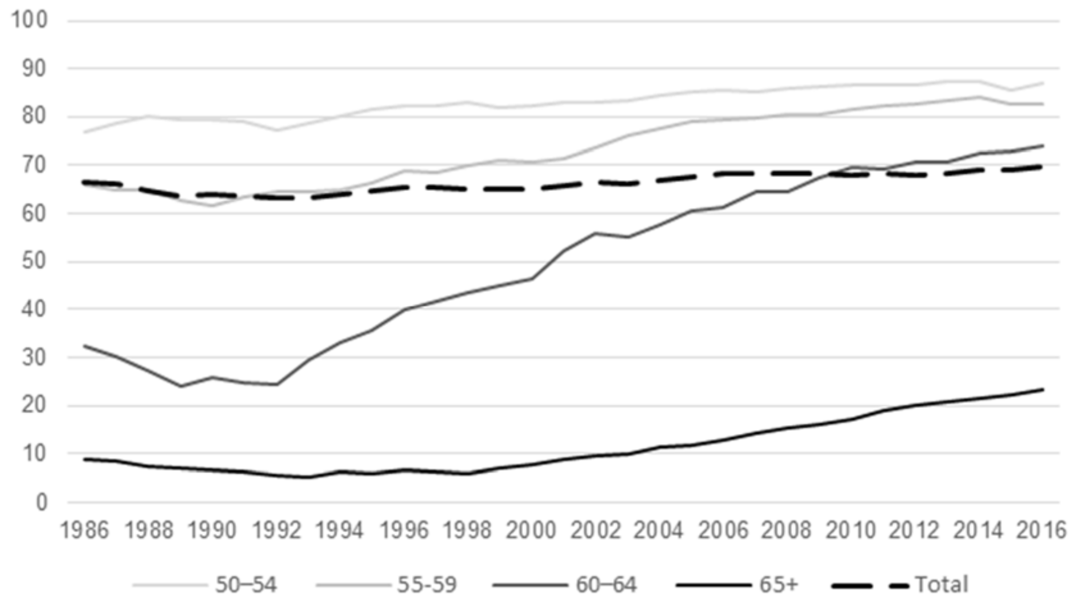
A feature of New Zealand's current demographic composition is the ageing of the baby boomers (people born between 1946 and 1965). The baby boomers represent a large cohort of the population, born at a time when births per female were historically high (around 3.5). Over the next 15 years this population cohort will continue to move past 65 years of age.

Immigration has been an important driver of our population growth and a source of work skills. For a while, it dampens the ageing of the population but then adds to ageing as immigrants age. The figures here contain the effects of recent high immigration, carrying through to projected population growth.

Along with population ageing, more people 65 and older are in the labour force. Their participation rate in the labour force has been rising since the late 1990s. At the end of 2016 almost a quarter of New Zealanders in this age group were in work. For the 65 to 69 age group, 48 per cent of males and 33 per cent of females were in the labour force. This change has been assisted by a number of factors, including healthy ageing, flexible labour market settings, and changes to NZS (e.g. increases in the age of eligibility).

NZS supports high rates of labour force participation by older people because NZS income is not subject to means-testing or contingent on retirement from employment. The labour force participation of people 65 and older is incorporated into the long-term fiscal projections set out below.

Figure 2 - Rising labour force participation rates for people aged 60 and over (per cent)



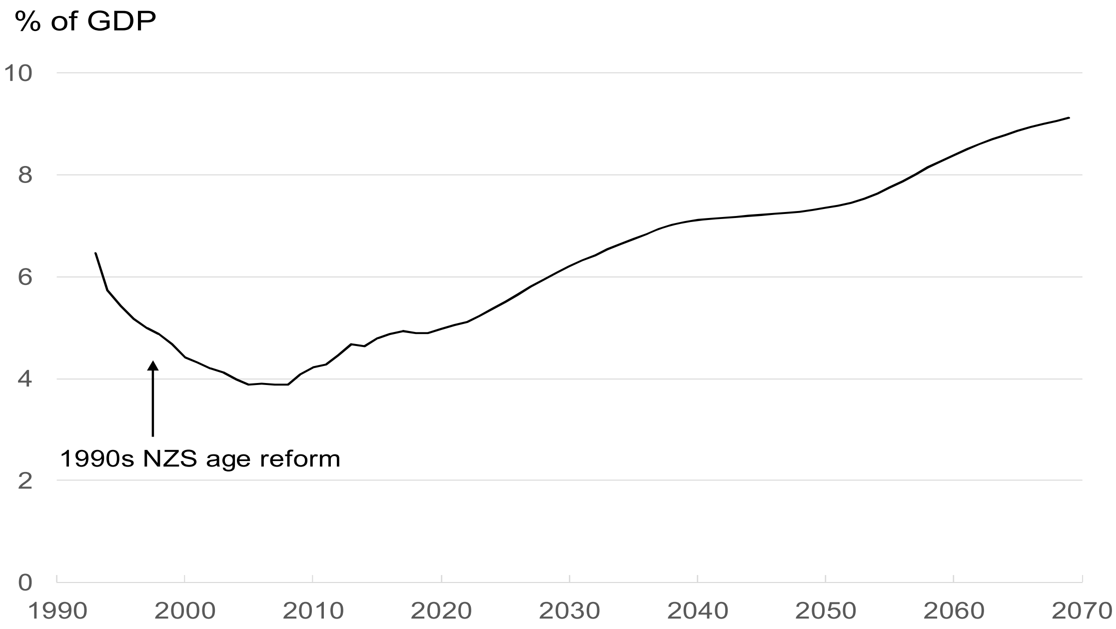
Source: HLFS, Statistics New Zealand

The Treasury's 2016 statement on the long-term fiscal position includes projections of NZS out to 2060, together with "what if" scenarios for the wider fiscal outlook (i.e. other expenses, revenues, fiscal balances, and net debt)[1]. The projections of NZS are based on the current legislative settings described above, together with projections of future demographics and future average wages (as NZS payments are linked to the average wage). NZS is projected to become more costly as more people move into older age groups. The gross cost of NZS

1 New Zealand Treasury (2016).

(before tax) is projected to rise from 5 per cent of GDP in 2017 to about 9 per cent 50 years later.

Figure 3 – Projected cost of NZS before tax



Source*: Half Year Economic and Fiscal Update 2016*, the Treasury

The sustainability of NZS needs to be assessed within the context of the wider fiscal outlook. For example, spending on public healthcare is projected to increase from around 6 per cent of GDP to almost 10 per cent in 2060. This is because of increasing demand for healthcare services from the ageing population and rising prices for those services. From 2025, around one-quarter of the annual growth in healthcare spending is the result of demographic change.

The long-term fiscal projections also include:

- Projections of capital expenditure (e.g. on schools, hospitals, and defence), with any borrowing for this spending increasing debt. Over the longer term, borrowing to fund long-lived assets spreads costs across the different generations that are expected to benefit from those investments.
- The New Zealand Superannuation Fund, which was created in 2001 to help smooth the increasing cost of NZS. Currently, the Government is not contributing to the Fund, given its priority to reduce net debt until prudent levels are achieved. Projections indicate that capital withdrawals from the Fund would cover about 4 per cent of NZS expenses by 2060.

Assuming tax-to-GDP remains constant, from the mid-2020s, projected revenues do not cover projected total expenses and governments would run operating deficits, with borrowing adding to net debt. Rising debt financing costs would in turn add to ever increasing operating deficits. By 2060, without any changes to any policy settings, the operating deficit is projected to be around 16 per cent of GDP with net debt at around 206 per cent of GDP.

This scenario is based on Statistics New Zealand's median population projections and the assumptions it contains about birth rates and life expectancy. Net migration is assumed to be 12,000 per year over the projection period. A higher net migration assumption of 25,000 per year would see projected net debt reach around 180 per cent of GDP in 2060. This is the net long-term effect of both higher GDP, and hence taxes, but also higher government spending on education, healthcare, and NZS.

Fiscal sustainability involves the maintenance of prudent and low average levels of debt over time. As demonstrated over the past decade, temporary fluctuations in the fiscal balance and net debt can be an appropriate government response to economic cycles and other shocks. They avoid the government having to make sharp adjustments to spending and/or taxes in order to balance the budget in a single year. This approach is more feasible when net debt is kept relatively low – at a level that facilitates responsible levels of temporary financing and temporary increases.

Governments have several options to address long-term fiscal challenges. For example:

- Managing spending and debt over the medium-term. The Government's long-term objective is to manage net debt within a range of 0 to 20 per cent of GDP. Achieving this debt objective involves spending control through annual allowances for both operating expenses and capital expenditure. Long-term cost pressures will still need to be addressed, but future governments would have a wider range of choices and more time to make adjustments.

- Specific actions to address long-term cost pressures, including changes to taxation, spending (including NZS), and investment to improve social outcomes.

- Economic growth provides revenue (e.g. through taxation) and, in turn, provides governments with choices on how to address expense pressures. Opportunities to lift economic growth by improving productivity, skills, and social outcomes further enhance these choices and can reduce some of the expense pressures (e.g. from welfare and justice expenses).

A consistent theme of all four long-term fiscal statements is that no single option is likely to be sufficient to contain long-term fiscal pressures. In addition, the timing of action makes a significant difference to fiscal sustainability. The longer governments delay the return to stable debt, the larger debt-financing costs will be. As a consequence, the adjustment to spending and/or revenue would need to be larger. How quickly governments make the adjustment depends on a number of factors. For example, some government actions, such as social investment may involve upfront fiscal costs in order to generate both long-term fiscal savings and non-fiscal benefits to living standards. Other policy changes, such as those related to NZS settings, generally require a degree of clear signaling and phasing-in.

This RIS considers ways of reducing the future expected cost that future generations of taxpayers will have to pay in order to support future NZS recipients than current taxpayers are paying to support current recipients. At the same time, the RIS considers ways of minimising the impact on the positive outcomes being achieved under the present settings.

Objectives

The analysis above suggests the following objectives for NZS:

- **Fiscal sustainability** – this is an important underpinning of economic activity. It provides confidence that tax and spending policies will stay relatively constant or predictable over time. This enables better long-term investment planning and reduces the likelihood of unanticipated austerity.
- **Intergenerational fairness** – policy should not be significantly advantaging one demographic cohort at the expense of another.
- **Income adequacy** – to avoid poverty for those who have no means of financial support other than NZS. Any changes should provide an adequate basic income for older New Zealanders and not lead to rising poverty levels for that group.
- **Durability** – changes should attract a broad base of support so that future governments are likely to keep to the announced plans, thereby reducing uncertainty.
- **Adequate notice** – Because changes to NZS will affect people's future standard of living, they need time to adjust their income, savings and investment plans to accommodate the changes.

How can we tell whether changes to NZS meet the first three objectives? An indicator of success at meeting the fiscal sustainability objective could be a relatively stable debt-to-GDP ratio and that this is not achieved through large reductions in spending programmes or significant rises in taxes. The fairness objective requires some measure of the average taxes paid relative to lifetime income. Income adequacy for older New Zealanders is achieved if poverty rates remain low for this group.

Success measures for the other two objectives, durability and sufficient time for planning, will depend on whether enough people of all ages see the arguments for change as convincing and fair and whether the options gain general cross-party support. This is hard to second-guess and so we will not use them in our analysis.

Options and impact analysis

Over the years, the Treasury has analysed various options for addressing long-term fiscal challenges. For example, the 2013 statement on the long-term fiscal position[2] considered:

- Taxation – some increase in tax-to-GDP by not fully offsetting fiscal drag and a higher rate of GST.
- Spending – reducing growth in healthcare spending.
- NZS settings – the main options considered were raising the age of eligibility; pegging payments to inflation rather than wages.

These options were assessed using the five dimensions of the Treasury's living standards framework (i.e. economic growth, sustainability, equity, social cohesion, risk management). The 2013 statement emphasised a range of choices, that no one option was perfect, and that timing of adjustment matters.

The Treasury's 2014 assessment of retirement income policy examined the age of eligibility (one-off increase and on-going indexing to longevity), the rate of NZS, the amount of

2 New Zealand Treasury (2013a)

smoothing provided by the NZ Superannuation Fund, and interactions between compulsory private saving and NZS.[3] The assessment concluded that a fair, durable, and effective solution requires changes to the age of eligibility and modest public save-as-you-go (SAYGO), as fiscal conditions allow.

The 2014 assessment excluded residency on the grounds that fiscal savings were small and retirement income policy should aim to be a neutral factor in migration decisions (New Zealand Treasury, 2013b).

Other options have been advanced in the 2016 *Review of Retirement Income Policies* from the Commission for Financial Capability and earlier reviews.

Overall, this yields the following options around NZS. This is not a comprehensive list of possible pension reforms. Based on the previous Treasury analysis referred to above, we are ruling out several of these as going against the objectives previously outlined (the reasons for these choices are beside each option):

Table 1 – Potential change options for NZS

Option	Status
Raise the age of eligibility	Meets objectives
Link the age of eligibility to longevity	Meets objectives
Increase the residence requirement	Meets fairness objective
Reduce the indexation growth rate (from the growth of the average wage to something closer to CPI)	Changing the indexation of NZS payments would drive up poverty levels of the recipients of NZS relative to other groups in society
Lower the payment rate floor relative to the average wage	Depending on the decisions over the payment rate, lowering the floor could also push up poverty rate
Income- or asset-testing	While income- and asset-testing is used in some overseas jurisdictions, the Treasury has not recently supported means-testing for NZS as it is administratively complex, invites avoidance behaviours and is seen as violating many people's ideas of fairness. Means-testing creates strong disincentives to work and save and strong avoidance incentives
Change the partner-deduction regime for overseas pensions	Small fiscal consequences
Remove the non-qualified partner option	First time this was considered was in the Retirement Commission's 2016 review. Judged of lower priority than items at the top of this list
Simplify the payment rate structure	Small fiscal consequences
Abate compulsory private savings against NZS	The 1997 referendum rejected a compulsory private savings scheme
Increase the public save-as-you-go (SAYGO) component via the NZ Superannuation Fund	Public SAYGO will recommence in the early 2020s

The first and second options have been adopted by several countries as ways of mitigating the effects of population ageing. The third appeared in the Retirement Commissioner's 2016 review and, as noted above, should be included on equity grounds.

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3 A summary of this work was made public as part of the OIA release for 26 May-11 June 2015. See New Zealand Treasury (2014).

Changes to NZS settings would affect future capital contributions to, and withdrawals from, the NZ Superannuation Fund, but we have not considered that.

The rest of the section records the impact analysis carried out on these options.

Option 1: Raise the eligibility age above 65 at a certain date

Raising the age is a common policy suggestion to increase the fiscal sustainability of NZS and improve intergenerational equity. A move to an eligibility age of 67 is the policy for many OECD countries.

Table 2 - Planned rises in pension eligibility ages in selected OECD countries

Country	Current Pension Age	Proposed Pension Age	Date of Proposed Pension Age Change
Australia	65	65.5	1 July 2017
		66	1 July 2019
		66.5	1 July 2021
		67	1 July 2023
Canada	65[4]	n/a	n/a
United Kingdom	65	66	October 2020
		67	2028
		68	TBC
Denmark	65	67[5]	2022 for men, 2030 for women[6] [7]
Netherlands	65 years, 3 months	67	2024
Ireland	66	68	2028
Germany	65 years, 3 months	67	2030
Italy	66 years, 3 months for men, 63 years, 9 months for women.	67	2022
United States	66	67	2027
OECD average	64 for men, 63.1 for women	65.5 for men, 65.4 for women	n/a

Analysis by the OECD shows that the effective age of exit from the labour force in New Zealand has moved up to around 67 for men and women, giving the average expected years in retirement as 19 years for women and just under 17 years for men. So there is some indication that many New Zealanders have already moved towards a retirement age of 67.

4 The pension age was set to increase to 67 (proposed implementation in 2023) as stated in the Old Age Security Act, but this policy was reversed in 2016.

5 This is planned to increase further to 72.

6 The pension age is planned to rise again beyond this date, according to life expectancy.

7 This gender difference is based on differences in life expectancy.

This change can be attributed to the rise in NZS eligibility age through the 1990s, which produced a rise in labour force participation. Other drivers of the participation rise were the removal of a compulsory retirement age in most occupations in 1999, the move towards more knowledge-based and skill intensive rather than physically intensive work, and a greater proportion of older people renting rather than owning their house.

Table 3 - Effective retirement age and expected years in retirement

Country	Gender	Effective age at labour force exit	Years in retirement	Life expectancy at effective age of labour force exit
NZ	Women	67.0	19.4	86.3
NZ	Men	67.2	16.7	83.9
AU	Women	63.0	23.7	86.7
AU	Men	65.3	18.8	84.2
UK	Women	62.4	22.7	85.1
UK	Men	64.1	18.5	82.6
OECD	Women	63.1	22.3	85.4
OECD	Men	64.6	17.6	82.2

Source: OECD (2014).

Impact analysis

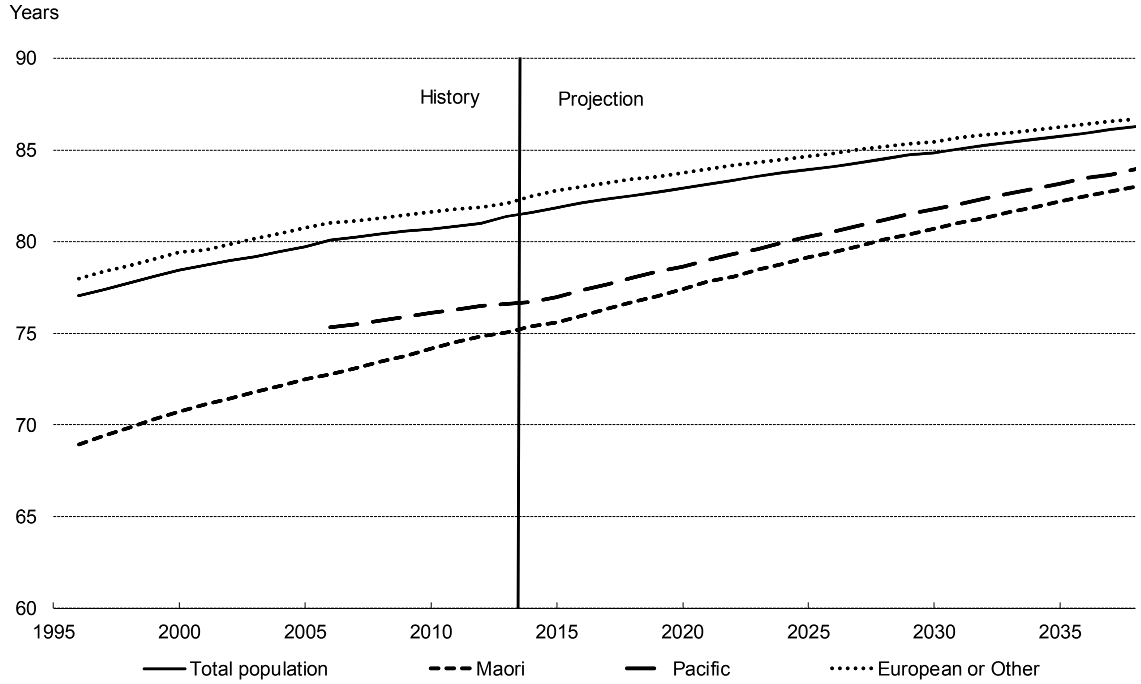
The Treasury, in its work on retirement income policy in 2014 (see New Zealand Treasury, 2015), compared the status quo with the option of raising the age of eligibility up to a target and then linking further increases to rises in life expectancy. The rise would lift labour force participation, improve private and national saving, and distribute costs more fairly across generations than the status quo.

Law, *et al.* (2013) find that raising the age to 67 will initially increase private savings by 0.5 per cent of GDP, but the effects reduce over time as life expectancy increases.

Because the change reduces the number of recipients, it lowers the cost of NZS, dampens the rise of debt to GDP and adds to fiscal sustainability. Intergenerational fairness is increased because most of the living costs until the age of eligibility is reached will come from income or from savings, rather than from the tax revenue of the younger generation.

The Treasury's 2014 analysis also pointed out that a lift in the age would discriminate against some people. While the life expectancies of Māori and Pasifika are converging to those of the rest of the population, the gap is not expected to close in the next few decades. So some of these people will be worse off if the NZS eligibility age rises.

Figure 4 - Life expectancy at birth for ethnic groups in New Zealand



Source: Statistics New Zealand

Similar considerations also apply to people whose health prevents them from working after 65. In several of the NZS policy options analysed here, where people are disadvantaged by the change, targeted help by the social welfare system is available. This happens now for people unable to work to age 65.

Currently on turning 65 in New Zealand, people are eligible for receiving NZS payments, but not if they are younger (NQP status aside). Once the policy change option has been fully implemented, if a person is unable to work, the social welfare system will be available to support them through to their 67th birthday (although the size of those transitional benefits will be smaller than, and not grow as much as, the NZS payments).

The other variable in these proposals is the amount of time between the announcement and the implementation of the change. It is difficult to evaluate what constitutes sufficient notice of the policy change. Our history has two examples of NZS age change following quickly after the announcement (1977 and 1992). The practice around the world is to give a longer notice period to allow people the time to adjust their work, savings and investment plans. The Retirement Commissioner in her December 2016 review recommended a decade-long notice period.

Options analysis

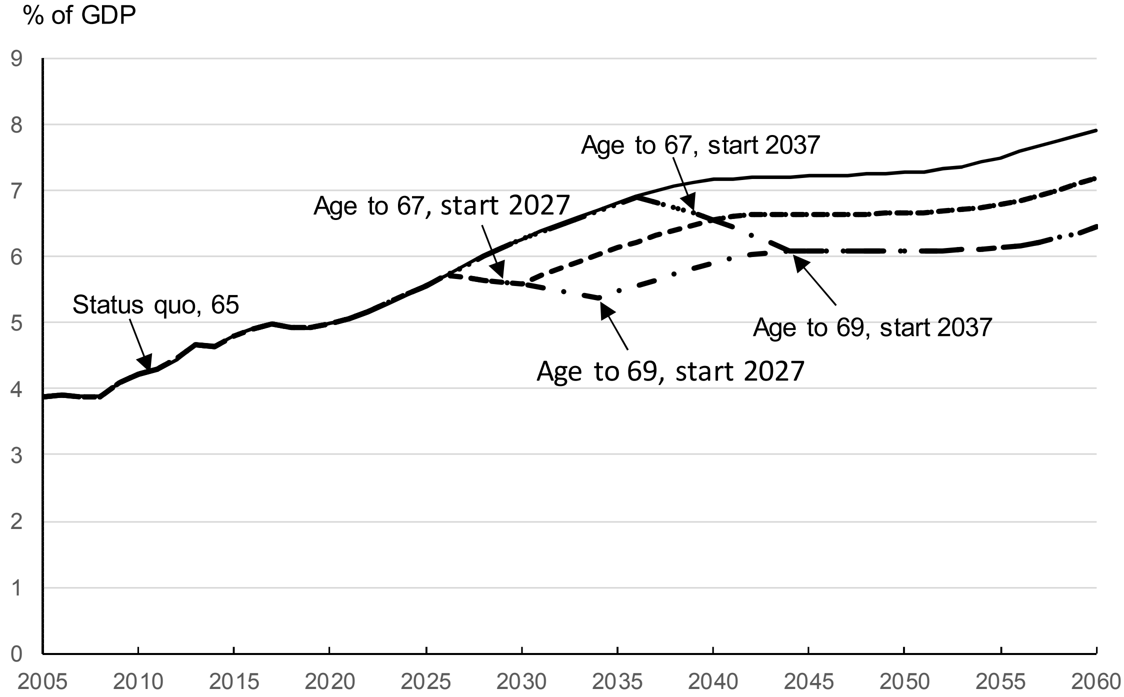
We analyse here the effects of notice periods of one and two decades as well as one-off increases in the age to 67 and to 69 (in each case the age is assumed to rise at the rate of six months per year).

MSD has assumed that a proportion of the 65 and 66 year olds no longer eligible for NZS take up a benefit (JSS or SLP). For the two-decade notice case, the benefits paid amount to around $520 million after the two-year change is bedded in. This offsets the savings made by the change of age.

Once the transition to the new NZS age is complete, the ratio of NZS spending to the GDP track roughly parallels the status quo track. The proposed change to the age of eligibility delivers a significant reduction in the gross cost of NZS of approximately $4.3 billion per year by 2040/41 – a saving of around 0.6 per cent of GDP (or a reduction of about 8-10% from the status quo level of NZS spending).

For a rise to 69, the reduction is about 1.2 percentage points of GDP (or a reduction of 16-19% of the NZS status quo spending). For the rise to 67, the earlier start in 2027 produces a fiscal saving of $29 billion compared with the 2037 start. After the 2027 start of the rise to 67, the reduction in superannuitants is 120,000 in 2031, and for the 2037 start, 113,000 fewer in 2041.

Figure 5 - NZS spending with a range of ages of eligibility and starting dates



Source: Treasury, based on the December 2016 Half-Year Economic and Fiscal Update projection. Note: All options have the age rising by 6 months for every year.

Delaying the take-up of NZS does not affect the amount a recipient receives from that point onwards. Before that, the change provides an incentive for working after 65 for a little longer. Some help in keeping older workers' skills sharp, as recommended by the Retirement Commissioner, would be a good supportive policy.

Conclusion

The Treasury supports the option of raising the age of NZS eligibility. Age 67 is a good first target. Many are still working at age 67 already. The change will further boost labour force participation, and ease some of the fiscal pressure, while helping somewhat to rebalance the costs of NZS between the old and the young. A later start gives people more time to adjust their saving and investments, but means the spending on NZS remains higher for a decade longer. The earlier the proposed change the greater the cumulative fiscal savings and the earlier the benefits to the economy.

As for lifting the age to 69 in one step, this would produce much more hardship among population groups, and it can be dismissed on the basis of fairness and income adequacy.

Option 2: Link eligibility age to life expectancy

An alternative to one-off rises in the age is to set up a rule that links the age with longevity. These could also be introduced sequentially: one-off to start the process and then linking to rising life expectancy.

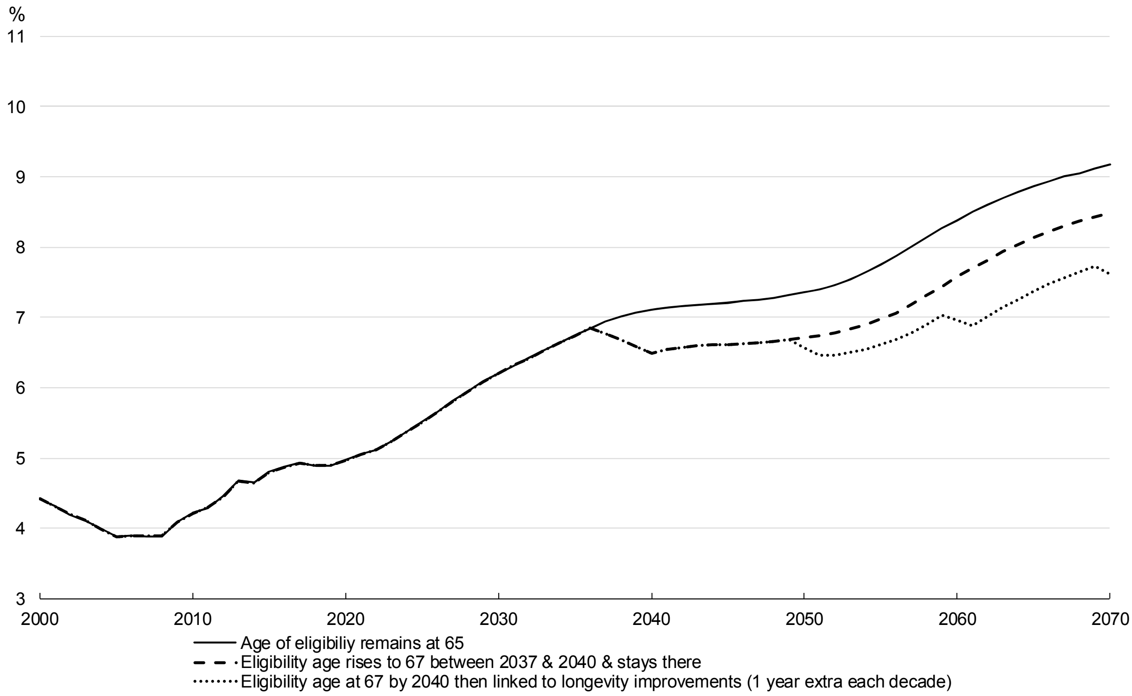
The Treasury (2014) analysis indicated that this produced stronger outcomes than the one-off rise in the eligibility: more participation, a stronger impact on private saving from the continuous rises in the eligibility age.

A rule that periodically raises the eligibility age in step with rising life expectancy would broadly maintain the same average span of years on NZS. Alternative principles for establishing this process include changing the age so that people receive NZS for a fixed proportion of their expected life, or a fixed proportion of the average working life.

Growth in Statistics New Zealand's projections of life expectancy at birth starts at about 2 years per decade declining to just over 1 year per decade in the late 2060s. Life expectancy at 65 is perhaps a better measure for NZS considerations (as it deals with death rates later in life). Growth of the projection of this measure in the 2020s is 1.4 years per decade, falling to 0.9 years a decade in the late 2060s.

The following chart projects that the ratio of NZS spending to GDP may well have flattened out at just over 7 per cent with the NZS age indexed to life expectancy, compared with 9 per cent if the age remained at 65. This illustrates the principle that monitoring life expectancy growth and other social and fiscal indicators ahead of the NZS age change would allow adjustments to the process.

Figure 6 - Effects of longevity indexation of eligibility age on NZS spending



Source: The Treasury

Conclusion

The Treasury's analysis in 2014 concluded that linking the age of eligibility to life expectancy, compared with the effects of a one-time shift, would boost intergenerational equity even further, be better at achieving higher labour force participation and private saving, and be better at boosting resilience against external imbalances and economic risk. On the other hand, it was judged to be more difficult to maintain policy durability, and make coping with the change more difficult for some groups in the population.

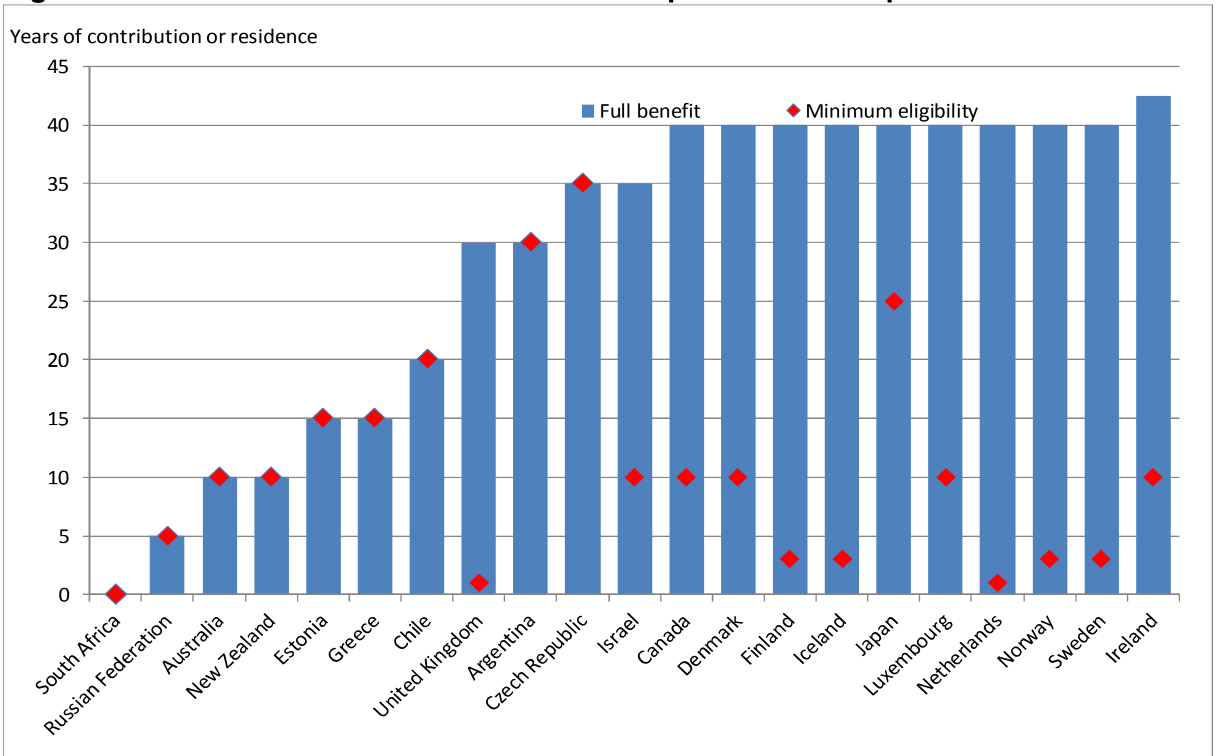
Future NZS age changes could proceed along two paths. Every decade or two, assess longevity and announce a change in the age starting at a later date. Or make the process more automated by linking the age to a measure of life expectancy change. The advantage of the first is that the process could draw on a wider range of demographic, social, labour, and fiscal indicators. The advantage of the second is that it would happen automatically and not be subject to interpretation of various indicators.

Option 3: Increase the length of residency required before qualifying for NZS

Current settings

To meet the residency requirements for NZS, people must be ordinarily resident in New Zealand and have lived here for 10 years since the age of 20. Since 1990, New Zealand has also required that five years of the qualifying period of residency should be after age 50.

Figure 7 - Years of contribution or residence required for basic pensions



Source: *Pensions at a Glance 2015*, OECD. Note: For the United Kingdom, the new state pension will require 35 years for the full benefit and 10 years for the minimum. Basic pensions refer to the benefit paid based on either the length of residency or the duration of contributions, irrespective of earnings.

New Zealand and Australia have nearly the lowest residency requirement in the OECD. However, very few counties have a public universal scheme quite like NZS. For countries where longer residency results in a higher contributory pension, the incentives on migrants are different from those involved around NZS. Other countries with residence-based systems (e.g. Canada, Iceland, Finland and Denmark) require 40 years of residency to qualify for a maximum pension.

New Zealand's approach attempts to strike a balance between supporting the ageing population and allowing retirees to live wherever they choose, and ensuring that people who were born here, but have limited subsequent connection to New Zealand, do not access NZS by returning to New Zealand near the age of eligibility.

The Retirement Commissioner recommended an extension to 25 years. We think that this is much longer than the residency qualification ages for universal public pension systems like NZS around the world, and it penalises the increasing mobility of people during their working lives. We have therefore excluded this option.

Impact analysis

Residency in countries with which New Zealand has Social Security Agreements counts towards the NZS residency requirement (this includes the UK, Australia and seven other countries). Therefore, people moving to New Zealand from those countries will be largely unaffected by this change (about 95% of immigrants are from these countries).

MSD notes that around 75 per cent of overseas recipients first granted NZS since October 2011 have more than 25 years' residence in New Zealand. Migrants to New Zealand may decide to come here earlier than they would have before the change.

Options analysis

The alternatives we consider involve raising the residency requirement from the status quo 10 years to 15, or 20 years after age 20 (and keeping the existing five years from age 50 the same for both alternatives). These are more common residency requirements for the type of basic universal pension that NZS is. A longer residency implies more time living in New Zealand and contributing to NZS via taxes paid.

We assume that existing recipients of NZS will be grandparented so that the residency criteria continue to apply for people who are New Zealand citizens or residents at the time the legislation is enacted.

The increased residency requirement will apply to all new applicants from the proposed date of introduction. We have assumed approximately half of the people who do not qualify for NZS because of the increased residency period would receive social security benefits, JSS or SLP, and these benefits are netted off the savings from fewer people being able to take up NZS.

Table 4 – Two scenarios of residency requirements of 15 and 20 years

Option: Increase residency from 10y	Scenario 1	Scenario 2
Residency to qualify for NZS	15 years after age 20 (of which 5 years after age 50)	20 years after age 20 (of which 5 years after age 50)
Estimated gross savings (net of JSS/SLP increase)	$34.0m in 2041	$195.1m in 2041
Number of people affected	1,251	3,556

Source: MSD modelling

The lengthening of the residency requirement could be seen as increasing fairness for those whose tax dollars have paid for NZS throughout their working lives, perhaps for more than 40 years, compared with people who have arrived here at, say, age 50. This policy change affects recent migrants who may well contribute much to our economy and society. This makes it difficult to make a case for the 15-year option against the 20-year option.

Conclusion

The savings from the 15-year scenario are small in 2041. The 20-year scenario produces savings six times larger in that year, but these are not substantial when compared with the projected amount spent on NZS in 2041 of $50 billion. The signal of increasing fairness would appeal to some sectors of the population. In the recent past, many migrants have been in New Zealand for more than 25 years. A rise to 20 years should improve the perception of fairness.

Consequential changes from implementing these options

All these changes to NZS policy settings have consequences for other programmes and for other legislation. For example, all these changes reduce the numbers of recipients and so will lower the NZS spending track as a ratio of GDP. This therefore will change the contribution rate for the New Zealand Superannuation Fund.

Changes will affect the age of access of KiwiSaver funds, the Independent Earner Tax Credit, the special portability arrangement with Pacific countries, Veteran's Pension, SuperGold Card and the Accident Compensation Corporation.

Consultation

The current process began just before the end of 2016 and was taken up again from the middle of January 2017. The timeframe has meant that no external consultation over the content of the RIS has been carried out.

However, the idea of raising the eligibility age for NZS has been discussed in published documents on many occasions, for example, by the Treasury in its long-term fiscal statements and its accompanying public engagement programmes, by successive Retirement Commissioners, and in many academic policy publications and conferences.

In doing this work, the Treasury has worked closely with analysts in the Ministry of Social Development.

Conclusions and recommendations

Living longer and in good health is an outcome we should all welcome, but it does put stress on the government's fiscal position. The Treasury in its work on fiscal sustainability and living standards over the past two decades has often analysed changes to NZS settings to counter some of these fiscal consequences. We are seeing a rise in the ratio of people older than 65 to those who are younger and this rise is projected to continue. For the current analysis, we have applied results from an assessment undertaken by the Treasury in 2014.

The current NZS scheme has many desirable aspects – it has little effect on people's labour force attachment, it is not means-tested, its size is independent of a person's income before 65.

The options analysed in this paper suggest that the unfairness between generations can be reduced by moving up the age at which NZS becomes available to older people at first from 65 to 67 (or to 69). Many have “voted with their feet” and continue to work into their later 60s. That should have benefits to GDP growth from more people continuing to work.

Any change to current settings will disadvantage those who are unable to work or don’t have the resources to support themselves over the time between when they turn 65 and the new age of eligibility. They could turn to the social support system in that case.

We would prefer that the change were to happen in the next decade rather than in the 2030s, as an earlier start would address the fiscal pressures sooner and have more people in the lead-up to the new NZS age supporting themselves through working or from savings. On the other hand, the 2016 long-term fiscal statement indicated we have a window of time thanks to the reduction in the debt level to near 20 per cent.

On equity grounds, the Treasury supports an extension of the residency requirement from 10 years up to 20 years (of which 5 years are after the age of 50). We are not sure whether the availability of NZS is a major incentive for migrants (after all, three quarters of migrants who began receiving NZS in the last six years have lived in New Zealand for more than 25 years). A higher age, however, will put us closer to other countries’ residency requirements, and be fairer to New Zealanders who have spent most of their working lives here contributing to NZS through their taxes.

Implementation plan

A proposal for legislative change will be presented to Cabinet in 2018 and a Bill brought forward for the 2018 legislative programme. The proposals in this paper will require amendment of the New Zealand Superannuation and Retirement Income Act 2001 and the Veterans’ Support Act 2014. There may also be consequential amendments required to the Social Security Act 1964, for example, if any new transitional provisions are required for those who cannot work past the age of 65.

A legislation paper will also consider any other consequential amendments resulting from changes to NZS settings or follow-up changes that may be required.

The proposed Act would bind the Crown, on the basis that it would make amendments to the New Zealand Superannuation and Retirement Income Act 2001 and the Veterans’ Support Act 2014, both of which bind the Crown.

Any changes would require extensive communication so that people will be able to adjust their work and saving plans in plenty of time. Much of this could be achieved by the media, but other communications strategies could be needed, especially given different impacts on different groups, such as recent immigrants and Māori.

Monitoring, evaluation and review

A lift in the age of eligibility has impacts on the participation of older workers and on the health and safety programmes of employers. Some groups have lower life expectancy (although converging towards other groups’) and the changes could disadvantage them. Changes in the longevity and labour market conditions of different groups and whether any temporary additional support is needed for people unable to work past 65 will be considered in a proposed review in 2030, seven years before the change to the age of eligibility in the late 2030s.

A similar review could be conducted in the early 2040s to assess how the changes are bedding in. Consideration could also be given at the time to further changes in the age of eligibility to reflect actual and future changes in longevity.

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