

# New Zealand's Overseas Pensions Policy

## Enduring Anomalies and Inequities

### Introduction

As in most industrialised countries, demographic ageing in New Zealand is putting pressure on the public retirement pension scheme. The increasing mobility of citizens adds to the complexity of determining fair policies for pension eligibility and portability.

The global trends of population ageing and increasing labour mobility require suitable and equitable policies for public pension portability. An increasing number of New Zealanders spend some years working overseas; and an increasing number of overseas-born citizens immigrate to and retire in New Zealand. Both these groups may have contributed through taxation and/or through compulsory or voluntary payments, into superannuation or pension schemes, perhaps in more than one country. Both are affected by the pension policies of the countries where they have contributed, and to which they wish to retire. (Dale, St John and Littlewood, 2009, p.4)

The foundation of New Zealand's pension system is New Zealand Superannuation (NZS). Although NZS is 'generally acknowledged to be the simplest retirement set-up in the OECD' (Rashbrooke, 2009, p.98), retirement income policy is influenced by multiple and sometimes competing objectives, including financial affordability, political sustainability, income adequacy and intergenerational equity (Retirement Commission, 2010, p.52).

NZS is a universal, flat rate, taxable pension funded out of current taxation on a pay-as-you-go (PAYG) basis. Its design continues to 'ensure that old age is not a period of continuing poverty and hardship, regardless of the quality of life people have experienced before then' (Cook, 2006, p.14). The current adequacy of NZS is evidenced by the low levels of poverty among those aged 65 and over. In fact, overall 'poverty rates for those aged 65+ have been considerably lower than those for the rest of the population over the full period from 1982 to 2010' (Perry, 2011, p.130).

Access to NZS is remarkably open. An applicant who is a New Zealand resident is required to have lived for only 10 years in New Zealand, with five of those after the age of 50 (the 10(5) rule). A contributory record is not required, making New

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Zealand unusual in the OECD. The years-based residency qualification establishes an ‘all or nothing’ threshold: there is no pro-rata entitlement; however, those who do not meet the 10(5) rule may qualify under a reciprocal social security agreement.

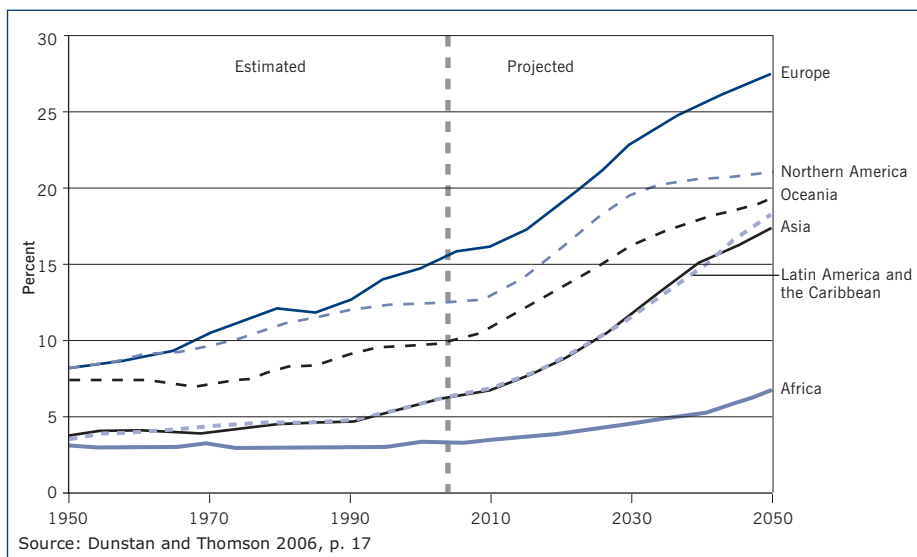
Accessing NZS is a matter of a straightforward interview at a Work and Income New Zealand office for most 65 year olds. It may take a matter of only a few minutes with the correct supporting documents. For some who have spent time abroad or who immigrated to New Zealand, however, it can be far less straightforward. Any entitlement to a state pension from another country may reduce their NZS, sometimes to zero under section 70 of the 1964 Social Security Act (the direct deduction policy, DDP)<sup>1</sup> even when residency requirements have been met.

At 31 July 2010, out of a total population of approximately 4.3 million, 561,053 New Zealand residents aged 65 and over were receiving either NZS or the veteran’s pension, and over 10% of these were also entitled to an overseas pension (Ministry of Social Development, 2011, pp.316-8).

Between 2007 and 2011, the Retirement Policy and Research Centre (RPRC) at the University of Auckland, in collaboration with the Human Rights Commission, and more recently with the Centre for Accounting, Governance and Taxation Research of Victoria University, produced numerous research publications and convened forums on the issues of overseas pensions in New Zealand and pension portability.<sup>2</sup> The findings were that while the DDP may appear to save the government money, there are important fiscal sustainability issues raised by New Zealand’s overseas pensions policies. More immediately, New Zealand’s overseas pensions policies are inequitable in many respects and prevent the possibility of concluding reciprocal social security agreements with some countries, for example Austria, Germany, Switzerland, Sweden and the United States (Ministry of Social Development, 2008a).

The issues are complex, and likely to get more so as the population ages. This

**Figure 1. Proportion of population aged 65 and over by global region, 1950-2050**



article first argues that the DDP must be seen in the demographic context in New Zealand, and then outlines the current plight of retirees with entitlements to overseas pensions. Possible short-term reforms are proposed, with a change in residency suggested as one option for a longer-term solution which may also reduce future fiscal vulnerability of New Zealand’s retirement income policies.

**Demographic pressures**

New Zealand is not alone in the transition to lower mortality and fertility rates (see Figure 1). Globally, the proportion of the population aged 65 and over is expected to rise from the 8% of 1950 to at least 21% by 2050 (Department of Economic and Social Affairs, 2008). Currently the proportion of the New Zealand population that is over age 65 sits at just over 13%, and this is projected to increase to 15% within the next five years and to 21% by 2031 (Jackson, 2011, p.3). Jackson (2011, pp.9-10)<sup>3</sup> warns that Statistics New Zealand’s projections for average months life expectancy gained each year, even using the low mortality assumptions, may be too conservative. Regardless of whether pensions are contributory, funded or PAYG, there will be emerging tensions:

The steady increase of older age groups in national populations, both in absolute numbers and in relation to the working-age population, has a direct bearing on the inter-generational and intra-generational equity and solidarity that are the

foundations of society. (Department of Economic and Social Affairs, 2008)

While the rest of the OECD is acknowledging the costs directly related to their ageing populations (Chand and Jaeger, 1996; Bongaarts, 2004; McDonald, 2005), New Zealand appears to be focusing more attention on the ‘welfare crisis’ posed by the 13% of working-age residents currently on welfare benefits (Welfare Working Group, 2011; Ministry of Social Development, 2012).

New Zealand faces a rising burden of retirement pensions, even with high labour force participation rates for those aged over 65,<sup>4</sup> and even after the introduction in 2003 of the New Zealand Superannuation Fund, which partially pre-funds NZS and smoothes the tax burden of the cost of NZS between generations of New Zealanders.<sup>5</sup>

In contributory PAYG schemes, to keep annual budgets in equilibrium as the population ages contribution rates must be driven up, benefit levels reduced, qualification age increased and/or a means test introduced. In New Zealand’s case, where eligibility for the age pension is based not on contributions but on a minimal residency test, the same parameters affect fiscal sustainability and perceptions of equity. Cost pressures are also expected to increase in the health sector, including greater demand for long-term care.

Gross expenditure on NZS for 2011/12 is projected to be \$9.6 billion. Without allowing for longevity improvements, the

**Table 1: MSD clients receiving an overseas pension, by main countries of origin**

Country	2004	2010	% increase
Australia	914	7,248	693%
Canada	306	1,152	276%
China	166	494	198%
Fiji	45	115	156%
Germany	87	245	182%
Ireland	91	207	127%
Netherlands	2,400	3,539	47%
Switzerland	82	191	133%
UK	37,754	44,681	18%
USA	98	447	356%

(Source: Ministry of Social Development 2011, pp. 316 - 318)

net cost to the taxpayer, which excludes the long-term care and health costs of increasing numbers of superannuitants, is projected to double between 2005 and 2050 as a proportion of GDP (Bell et al., 2010). In this context, policies around the way in which immigrants and emigrants gain access to NZS are increasingly important in terms of both equity and fiscal sustainability.

As noted, a high proportion of retirees have access to some overseas pension, but the decision to settle and retire in New Zealand is usually made well before retirement age. Between 2002 and 2011, net permanent and long-term migration to New Zealand was positive. In the year ended February 2012, however, there were 83,900 permanent and long-term arrivals, but there was an overall net loss of 4,100 migrants, and the highest net loss ever of 39,100 people to Australia (Statistics New Zealand, 2011).

Factors affecting migrants' decisions include the institutional set-up of the country, the taxation and benefit regime, the physical environment and schooling system; and individuals take account of 'their access to the labour market, relevant net amounts of (household) income to be earned, local costs of living, and the existence of networks of co-nationals or members of their ethnic groups who moved to the host country at an earlier stage' (Munz and Werding, 2005, pp.204-5). Individuals also migrate from low-wage countries to high-wage countries, and although it may appear that wages (net of taxes) are the main driving force behind migration decisions, Wildasin (1999, p.16) notes that differentials in public pension provision

between countries are not an insignificant motive.

On the other hand, Munz and Werding (p.205) note that public pensions can entail an 'entrance fee' for potential migrants, and therefore can 'create a barrier for voluntary migration, even where it would be beneficial in terms of an optimal factor of re-allocation'. In the case of migration to New Zealand, the DDP may be considered by some as a fairly steep 'entrance fee' (Dale, St John and Littlewood, 2009, p.8).

The issues are complex, despite differences in pensions policies that on their own appear to make retiring in New Zealand relatively attractive.

#### **Pension portability and reciprocal social security agreements**

A social security agreement aims to coordinate the social security systems of two countries. It serves to eliminate residence and citizenship barriers to access to social security and ensure that individuals who have divided their working lives between two countries receive appropriate coverage when they retire in their country of choice. New Zealand has nine bilateral social security agreements: with Australia, Canada, Denmark, Greece, Ireland, Jersey and Guernsey, the Netherlands and the UK. The social security agreements vary but allow people to use their residency in New Zealand to qualify for a state pension in the agreement country or to receive up to 100% of NZS (Ministry of Social Development, 2008a). In the 1980s, after migration patterns globally increased and diversified, general portability provisions were introduced that allowed

superannuitants to take 50% of their gross NZS with them. The amendments to the New Zealand Superannuation and Retirement Income Act (NZSRI Act) 2010 then extended 100% (gross) NZS portability on a pro rata basis to non-agreement countries.

The 2010 amendments largely addressed the potential inequities for pensioners who leave New Zealand after qualifying for NZS. However, the amendments did not address the anomalies and inequities for those who retire in New Zealand with an entitlement to an overseas pension. They also introduced some further anomalies: for example, by allowing gross NZS to be taken to other countries regardless of whether tax is deducted in those countries as it is for superannuitants in New Zealand.<sup>6</sup>

#### **Section 70 and the direct deduction policy**

Even if the residency requirement is met, the chief executive of New Zealand's Ministry of Social Development (MSD) may apply section 70 of the Social Security Act 1964, the DDP, if a resident receives a 'state pension' from another country that is analogous to NZS. 'Analogous' is clarified as meaning:

the benefit, pension or periodical allowance, or any part of it, is in the nature of a payment which, in the opinion of the [chief executive], forms part of a programme providing benefits, pensions, or periodical allowances for any of the contingencies for which benefits, pensions or allowances may be paid under ... the New Zealand Superannuation and Retirement Income Act 2001 ... which is administered by or on behalf of the Government of the country from which the benefit, pension or periodical allowance is received ... . (Social Security Act, 1964, section 70)

Table 1 shows the growth in the numbers of recipients of NZS who also have an overseas pension by the major countries of origin, some of whom may be returning New Zealand citizens. While some of these overseas pensions may not be deductible and there may be some double counting, most of the total

of 59,300 pensioners are affected by the DDP (Ministry of Social Development, 2011).

The purpose of section 70 is to eliminate the possibility of a person receiving two state old age or other pensions, known colloquially as 'double-dipping'. This policy is based on the reasonable belief that an immigrant to New Zealand should not be advantaged over a New Zealand resident who has spent their entire life in New Zealand. An individual retiring in New Zealand with large retirement savings in a state fund in another country paid out as a pension may receive no NZS, despite having spent long periods of their working life in New Zealand. At the same time, a further consequence of the 2010 amendments to the NZSRI Act is that immigrants subject to section 70 who choose to stay in New Zealand can be treated less generously for NZS than if they decide to leave (Dale, St John and Littlewood, 2010; Dale and St John, 2011; Smith, 2011).<sup>7</sup>

Complexity and inequity arise with interpretation and application of section 70, and with definitions of 'state pension'. Many superannuitants argue that part or all of their overseas pension has arisen from their own and their employers' contributions and is akin to a supplementary pension scheme outside the basic state pension, analogous to KiwiSaver,<sup>8</sup> for example, rather than to NZS. If people feel they have not been treated fairly they can make a complaint to the chief executive of the MSD, who can order a hearing by the Social Security Appeal Authority. If not satisfied with the outcome, the complainant may then take their issue to the Human Rights Commission. If the Human Rights Commission agrees there may be valid grounds for a complaint, an opinion may be sought from Crown Law.<sup>9</sup>

Unfortunately, those difficulties and apparent injustices resulting in the many complaints brought to the Social Security Appeal Authority and the Human Rights Commission in recent years have produced little resolution for complainants. People have subsequently taken their complaints on to the retirement commissioner, the RPRC, members of Parliament and the media.

While the ministry's response has been that they apply the law correctly, it is noteworthy that their frequent reviews of New Zealand's pension system and its relationship to those of other countries (Ministry of Social Development, 2004, 2005, 2008a, 2008b) have produced many recommendations, including the following (2008a, pp.13-21):

- remove foreign state pensions built up by voluntary contributions from the scope of section 70 of the Social Security Act;
- discontinue the policy of deducting a person's overseas pension from their partner's NZS entitlement;
- clarify the wording of section 70 so it is in plain English, and set out each country's pension regulations.

In particular, deducting foreign state pensions built up by voluntary contributions, and deducting a person's overseas pension from their partner's NZS entitlement, could be considered to be human rights infringements.

#### **What overseas pensions should count for the DDP?**

Accurate presentation of pension systems of an economy and the comparison of systems across economies are crucial parts of policy analysis. Yet such presentations and comparisons are far from easy. They require a well-thought-out methodology, access to detailed information on national systems, verification of information and results by a network of pension experts to provide feedback to improve the quality and applicability of the research over time. (OECD, 2009, p.3)

Under the current legislation, behind closed doors and with no requirement that the basis of the decision be made public, the chief executive of the MSD determines which overseas pensions are analogous to NZS. Although the decisions are made with legal guidance, remarkably they appear to override any evidence that the particular pension comprises savings additional to the basic state pension. The MSD, in the 2008 review as quoted above, acknowledges that the DDP is applied

to foreign state pensions built up by voluntary contributions.

It appears that, in part, the DDP policy remains in place as a result of a lack of appreciation of the structure of overseas pensions. For example, the MSD review (2008) states: 'NZS has a simple period of residence and presence requirement and an "all or nothing" entitlement'. It then states that, by contrast, '[m]ost other countries have pension systems in which a retiree's level of entitlement is based on social security contributions made by that person over the period of their working life' (Ministry of Social Development, 2008a, p.3). This is an oversimplification. Most other countries have a more complex pensions system than NZS, and the boundaries between social insurance and private, occupational pensions are often blurred. Many countries have a basic pension which may be means-tested, and an additional mandatory, contributory employment-based pension, which may or may not be government administered, which will provide an income to the retiree based on their and their employer's contributions. Whether they are voluntary or mandatory, most overseas occupational retirement saving schemes also benefit from state subsidies, usually through the tax system (Rashbrooke, 2009). These two-tier systems are equivalent to NZS plus KiwiSaver, suggesting that that is how they need to be treated under section 70.

The chief executive of the MSD may decide that a particular overseas pension should be taken into account in the calculation of NZS, and that the DDP should apply, if, as stated in section 70 of the Social Security Act, the pension is 'administered by or on behalf of the Government of the country from which the benefit, pension or periodical allowance is received'. Importantly, as Smith (2009, p.16) emphasises:

under the [DDP], the total amount of a pension paid to a claimant will be determined by New Zealand only. An individual retiring in New Zealand with a generous public pension entitlement from another country could possibly receive no [NZS] thus relieving New Zealand totally from the cost of paying pensions to such individuals despite them having spent



part of their working lives in New Zealand. On the other hand there is a case for the [DDP] on grounds of preventing a 'windfall' where a person receives two public pensions because they split their working life between two countries and qualified for a public pension in both of them without invoking the totalisation provisions of a [social security agreement].

Inconsistencies in what pensions are considered to be of like nature to NZS have been identified during the RPRC's research. The MSD appears to make its decisions based on which entity is 'providing benefits, pensions, or periodical allowances' (Social Security Act, section 70). However, the 'nature of [the] payment' (another key expression in section 70), or the underlying philosophy of the benefit concerned, should be more material than the identity of the provider or administrator.

The test of the 'state as the pension provider' has led to a number of inconsistencies in the application of section 70. For example, the Tier 2 Canada Pension Plan is included in the DDP, while the equivalent compulsory Chilean arrangement, delivered by private providers, is not. Another example: the UK's state-provided 'state second pension' (S2P)<sup>10</sup> is included in the DPP, while the alternative, equivalent, 'contracted-out' entitlement is not. Yet the alternative scheme is required by UK law to cover the same contingencies that the S2P covers; and the sponsoring employer and employees receive reductions in their National Insurance contributions to pay for the contracted-out benefits.

Another acknowledged difficulty is that some countries' public pensions perform the dual functions of providing retirees with an acceptable standard of living, and providing benefits directly related to the person's period of employment and remuneration (in New Zealand, 'workplace-related provision'). Such a 'hybrid' scheme operates, for example, in Greece. Clearly, a single rule cannot be devised to cover all situations.

#### Is the DDP justified?

In many cases where the DDP is applied its use is appropriate, although the affected

retirees may disagree. The provision of two full basic state pensions where each is designed to protect a basic standard of living would be iniquitous. However, it often comes as a significant shock to a retiree to find that their voluntary retirement savings, set aside out of earned income to improve their quality of life in old age, is deducted by the MSD against their NZS entitlement.<sup>11</sup> Such retirement savings, if set aside from New Zealand-based earnings equivalent to, for example, KiwiSaver or some other occupational superannuation scheme, would not result in a reduction of NZS.

**If one partner's NZS is fully reduced to zero because the overseas public pension amount is greater than the rate of NZS, the excess amount is then applied to directly reducing the other partner's NZS.**

Importantly, as stated in a 2004 MSD report to the Minister of Finance:

New Zealand's policies on payment of NZS overseas and of overseas pensions into New Zealand are out of date and inequitable. We are significantly out of step with the 'seamless' provision of social security adopted in Europe and many countries overseas, which impacts negatively on other New Zealand Government priorities concerning positive aging and immigration ... The direct deduction policy has remained largely unchanged since its inception in 1938. New Zealand's migration patterns have increased and diversified significantly since then, making the dollar-for-dollar deduction of an overseas pension from a person's New Zealand pension entitlement an

inexact and often unfair method of sharing social security costs between countries. Because these policies have been developed in a largely ad hoc manner, they have become inequitable with one another and, in some cases, have diverged from their original policy intent. (Ministry of Social Development, 2004, p.10)

A 2005 report to the Minister of Finance was even more critical:

There are approximately 51,000 New Zealanders who receive overseas pensions that are directly deducted from NZS. The majority of these people have been in New Zealand for more than 30 years and are living on modest incomes. Seven percent of these people were born in New Zealand. Currently the direct deduction policy produces annual savings for the government of \$174 million ... The direct deduction and payment overseas rules are an increasing source of dissatisfaction amongst superannuitants. This is partly because of increasing international mobility, which means more people are affected by these rules ... Lastly, the policy is difficult to administer because it is not always clear which pensions should be deducted. (Ministry of Social Development, 2005, pp.1-2)

It is cause for concern that some cases reveal a lack of clarity, consistency and accuracy in the way the DDP is applied to overseas contributory pensions. It may be perceived that not only is there an absence of fairness and transparency, there is a violation of the human right to be treated in a non-discriminatory way.

#### Family status discrimination

One particularly egregious aspect of the current DDP practice is abatement of a person's NZS by reason of their partner's overseas pension. A spouse may lose some or all of their NZS if the partner's overseas pension income exceeds their NZS entitlement. For each of a married couple living in New Zealand with no overseas pension deemed analogous to NZS, the entitlement to NZS is fixed and paid without regard to the other spouse's

NZS entitlements or income.<sup>12</sup> However, if either spouse is entitled to an overseas pension that is deemed to be subject to the DDP, NZS changes from an individual pension to one that is calculated for the couple. As the Retirement Commission's 2010 review stated:

If one partner's NZS is fully reduced to zero because the overseas public pension amount is greater than the rate of NZS, the excess amount is then applied to directly reducing the other partner's NZS. In some cases it can mean that a New Zealand citizen who has lived and worked all their lives in this country receives no NZS because their partner receives a public pension from overseas. This is an inconsistent piece of policy that goes against the principle of universal individual entitlement and needs to be changed. (Retirement Commission, 2010, p.79)

The official support for section 70 is sometimes stated as a concern that if there is a concession for the current position with regard to those who are entitled to NZS, other 'beneficiaries' may also claim similar treatment in respect of other (non-age pension) benefits. This concern seems unjustified because NZS for those aged over 65, although it is described as a *benefit* in section 3 of the Social Security Act, is not a welfare benefit (Ministry of Social Development, 2011); it is a universal pension, granted as an *individual* entitlement under separate legislation and without regard to the pensioner's own 'other income' or the spouse's income. There is no logic in denying NZS to someone who happens to marry the 'wrong' person when, if they were not married, or were married to someone else, they would receive the full amount. Yet, '[i]n some situations a person can lose complete entitlement to NZS in their own right as a result of their partner's personal overseas state pension offsetting the entitlement of both of them' (Retirement Commission, 2010, p.130).

This practice would appear to meet the stringent tests applied to establish discrimination under the Human Rights Act,<sup>13</sup> and is therefore an indefensible inequity. Fixing this inequity would require an amendment to section 70 of

the Social Security Act, and there would be some cost involved; however, MSD's 2009 data showed only 124 pensioners affected, and retrospective payments need not be incurred. While the numbers are likely to rise, the annual cost of fixing this anomaly may be of the order of \$2-3 million a year,<sup>14</sup> a small price to pay for fairness, given that the total budgeted cost of NZS in 2011/12 is \$9.6 billion (Treasury, 2011).

#### Improved information

Personal stories related by superannuitants about the treatment of their overseas

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pensions suggest that the ministry applies the current rules inconsistently. Also, unfortunately, it seems the local MSD offices provide inconsistent and misleading advice on entitlements. The inconsistency is explained in part by the complexity of pensions and social security policy and legislation. However, the emotional and financial cost for all parties of many unsatisfactory reviews and appeals could have been avoided, and the interests of equity, transparency and consistency could be served, if the rules and review decisions were published in an accessible format and by country of pension origin. Also, the reasons behind the classification decisions for each case could be published, and be subject to review and appeal by interested individuals, not necessarily just affected pensioners, as is presently the case. At the end of that process, the review

and appeal decision should apply to all affected individuals, even-handedly and openly.

It would also be helpful if individuals could apply for a decision, with the appropriate review/appeal processes, before reaching the entitlement age for NZS. This would allow them to make appropriate financial planning decisions for retirement.<sup>15</sup>

The detailed application of the DDP to pensions from countries covered by a social security agreement needs to be easily accessible. Once the features of what constitutes a pension analogous to NZS have been identified, such pensions where the DDP would apply, and their country of origin, could be published by the MSD in all relevant brochures and websites. Until very recently, inaccurate or misleading written material was available to immigrants. For example, the ministry's *Departures and Arrivals* brochures suggested that an immigrant 'may be entitled to two pensions'. The erroneous impression was that the overseas pension did not affect the immigrant's future NZS entitlements. Legally there may be two pensions, but, as the MSD's website explains, 'Generally, you will get paid the same amount as those who have lived all their lives in New Zealand. This amount may be made up of a combination of your New Zealand and overseas benefit or pension payments.'<sup>16</sup>

The MSD is in the process of updating the brochure for each country, and as far as possible is attempting to specifically address each pension to which an immigrant might be entitled, and how that pension might affect the calculation of NZS under the DDP, with illustrative examples. These improved brochures are now available, before immigrants select New Zealand as their destination.

The main countries currently affected by New Zealand's overseas pensions policy (shown in Table 1) are the UK, Australia, the Netherlands, Canada, the United States and China. The ministry could proceed with the suggested reforms on a country-by-country basis, prioritised by the numbers of affected people. As the OECD (2009) notes, descriptions and comparisons within and between pensions systems are not easy,

and are regularly subject to major and minor change. Regular updating of such information is necessary.

The issues noted above were also raised in the *Review of Retirement Income Policy* (Retirement Commission, 2010). These issues affect pensions from all countries, not just from those nine countries with which New Zealand has social security agreements. Unambiguous information needs to be available in all countries from which New Zealand expects to attract migrants.

#### The special case of Australia

The relationship with Australia requires special attention for both the short and the long term. For example, Australians who emigrate to New Zealand at or approaching the state pension age are potentially more favourably treated than New Zealanders who emigrate to Australia in similar circumstances.<sup>17</sup> As Table 1 shows, the numbers of beneficiaries from Australia affected by section 70 have grown faster than any other group.<sup>18</sup> Australian retirees in New Zealand may enjoy a clear advantage, given that, unlike the universal NZS, the Australian age pension is means-tested, and the Australian employment-based pension can be cashed up and brought to New Zealand without being affected by the DDP. The richest Australian may immigrate to New Zealand, bringing their employment-based savings, and get the full NZS.

Currently there are 17,895 people entitled to an NZS payment in Australia, including 550 clients who get a nil NZS payment because the agreement requires that they are paid the lesser of their entitlement to NZS or their entitlement to the Australian means-tested age pension (Ministry of Social Development, 2011, p.315). While there are presently only 7,240 New Zealand superannuitants with an Australian pension in New Zealand, there are more than 500,000 former New Zealand residents under retirement age now living in Australia (ibid., p.309). In the future, with an increasing state pension age in Australia (rising from 65 to 67 between 2017 and 2023),<sup>19</sup> a harsher income test, and because 'totalisation' can be applied under the social security agreement, New Zealand may become a

relatively attractive place for Australians to retire to. The wealthier they are, the less the Australian government pays to offset NZS. This may prove costly and inequitable for the working-age population of New Zealand.<sup>20</sup>

#### Other costly unanticipated consequences of current policy

An emotional cost, rather than a monetary cost, is implicit in the review and appeal rights expressed in sections 10 and 12 of the Social Security Act. Tracing the relevant case law, and reading the records provided

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by appellants, shows that reviews and appeals have seldom if ever resulted in the chief executive's decision being overturned to the benefit of the pensioner.

While the modest qualification requirements make NZS an easy pension to understand and administer, there are significant difficulties when co-ordinating it with entitlements arising from overseas pension arrangements. Issues already noted are: determining which overseas pensions are 'analogous' and should therefore be offset under the DDP; requested changes create the potential problem of a fiscal 'black hole' as a consequence of adverse selection; the absence of any requirement for contribution to the tax base; and the modest residency-based qualification requirements for a basic universal NZS,

may attract retirees from countries overseas where there is not such an accessible and generous recognition of the non-financial contributions and future needs of the aged.

The potentially large fiscal cost in pensions and health care created by this attractive and accessible option for immigrants is exacerbated by the 2010 NZSRI Act amendments, increasing the ease with which emigrants can leave, taking NZS, on a *pro rata* basis, with them to their overseas retirement destination.

#### Possible solutions

New Zealand's current policy settings and the absence of clear principles have resulted in insufficient weight being given to the right to achieve a degree of income replacement through voluntary supplementation via state-administered (or mandated) arrangements in other countries (Smith, 2009). As already noted, many of the inequities in the treatment of overseas pensions can be resolved by administrative changes.

Section 70 applies to all benefits administered by the MSD, including NZS. Having a single legislative provision that covers all benefits provided by the MSD, and co-ordinating retirement income arrangements of two or more countries, multiplies that complexity. It requires that the MSD has a wide discretion. The 2001 NZSRI Act could be amended to include an equivalent to section 70 designed specifically for NZS.<sup>21</sup> With a separate decision-making power with respect to NZS, the MSD could make decisions on retirement income benefits without needing to be concerned with potential precedents that might affect other welfare benefits. With that separate power, the human rights issues regarding spousal pensions could be resolved.

In contrast to New Zealand's 'all-or-nothing' test, nearly all other countries calculate pensions based on periods of residence and/or periods of employment and/or contributions (or those of a spouse) in that country.<sup>22</sup> Shorter residence or contribution periods mean a smaller state pension. This system obviates the need for a DDP or an equivalent 'harmonisation' provision. To the extent that overseas pensions are portable, each country bears

the pension costs for periods of residence/employment in that country.

For those who emigrate from New Zealand to a non-social security agreement country, the 2010 amendment apportions gross NZS based on the 1/540 rule.<sup>23</sup> The RPRC considered such a reform principle for those who immigrate to New Zealand (Littlewood and Dale, 2010). Under this reform, if the applicant for NZS has a pension from overseas that is analogous to NZS, their entitlement would be 1/540th of NZS for each month of residence in New Zealand between the ages of 20 and 65. Any entitlement to an overseas pension would not be affected; the MSD would not need to know the amount or other terms of the overseas pension, but usual income tax rules would apply to the total income received. For immigrants, this formula would replace the current ten-year residency requirement, and would apportion entitlement to NZS based on the 540-month system that now applies to emigrants from New Zealand after age 65 under the 2010 amendment.

Each country would pay the age pension accrued during the period the person lived/worked in that country. Combining those entitlements would give a full, 'blended' pension without any country subsidising another. Such blending would require changes to current policy and legislation applying to NZS. It also requires every country's pension scheme to be understood and assessed by MSD, with transparent decisions as to what basic pensions would trigger this assessment.

Such changes to NZS would, however, remove the simple, clear, universal basis of NZS and add to the complexity and uncertainty of entitlements, and ensure that at least some immigrants would have insufficient to live on without other welfare assistance. Women are potentially adversely affected if they have only a small or no overseas pension, reflecting limited work experience.

#### **A possible way forward**

Rather than tinker with administrative rules in a complex reform to apportion NZS as outlined above, a possible solution may lie in reform of the residency requirement for NZS, and abandoning of the DDP.

The residency requirement for eligibility for NZS, for example, could be increased from the current 10(5) rule<sup>24</sup> to a single test of, say, 25 years' residence between ages 20 and 65. Unlike the current arrangement, there would be no possibility of meeting the requirement using residency after age 65. Where there is a social security agreement, totalisation of years of residence would be possible, but only one pension would then be payable. For example, any entitlement to the United Kingdom's basic state pension may be forgone if those years of residence in the UK were used to qualify

**If NZS required at least 25 years' residence between the ages of 20 and 65, it may then be far less important to identify the kinds of overseas pensions that are brought into New Zealand.**

for NZS. Where there is no social security agreement, or the 25 years of residence is satisfied without totalisation, any overseas pension would not be taken into account in the calculation of NZS (except as taxable income).

If NZS required at least 25 years' residence between the ages of 20 and 65,<sup>25</sup> it may then be far less important to identify the kinds of overseas pensions that are brought into New Zealand. Since 85% of the 51,618 NZS recipients caught by the DDP have lived in New Zealand for more than 30 years (Ministry of Social Development, 2005), a 25-year residency record could largely eliminate the perceived inequities related to the DDP. This policy change would help these retirees, the bulk of whom have modest resources only.

To prevent hardship, and retain the human rights standards for people who

do not meet residency of 25 years for NZS, an emergency or other welfare benefit would continue to be available,<sup>26</sup> and any overseas pension would be taken into account in the household income test. That would reduce the income-tested benefit, but not by as much as the existing dollar-for-dollar DDP arrangement. The existing married rate and single rate for NZS would be retained, but every person's entitlement would be individual. This would prevent the current situation where a spouse has their pension reduced when their partner's overseas pension exceeds the NZS married-person rate.

With regard to the trans-Tasman issues, the existing social security agreement with Australia would need to be renegotiated. For example, if a New Zealander retiring to Australia had fulfilled the 25 years in New Zealand, they might get the full *pro rata* NZS with a top-up Australian age pension if they qualify. An Australian retiring to New Zealand would also need to meet the 25-year requirement to receive the full NZS (without totalisation). If totalisation is used to meet the 25 years they should not receive NZS at a greater rate than their entitlement to the Australian means-tested age pension. Under the stricter residency requirement, those qualifying would be able to supplement their NZS with additional retirement income derived domestically, like KiwiSaver, or from state and private sources from overseas.

There are some issues that would need to be resolved that are not addressed in this article, and in any new policy or policy change there are issues at the margin that need to be addressed to ensure new inequities are not created. Some principles would need to be clearly stated to determine what would happen: for example, if someone had resided in New Zealand for 24 years and three months prior to reaching age 65.

The transition from the pension policies that prevail now to the proposed system would require careful consideration. Backdating would not be possible: the new system would need to begin with a 'clean slate'.

In general, this option for reform improves equity and transparency and acknowledges the complexity



of state involvement. Vertical equity considerations may require reform of the taxation of other income and NZS, so that local and overseas retirees with higher incomes, including incomes from lump sum superannuation benefits, pay appropriate taxation. There would be issues, too, around whether the NZS for emigrants would be gross or net in non-agreement countries.

### Conclusion

In 2012 section 70 remains in place and intact. Despite the possible human rights implications, the reforms proposed by MSD itself, the Human Rights Commission, the Retirement Commission and the RPRC have not been adopted. Yet few of the immediate recommendations require legislative amendments, or entail significant costs.

This article proposes a particular approach to perceived problems with direct deduction and residency policies. More development of the proposed policy changes would reveal the impact these changes would have on migration, poverty rates, who would gain and who would lose, and how much the new policies would cost.

The recommended administrative changes could be implemented promptly, as they involve modest cost while providing great improvements in human rights and in the equity of New Zealand's overseas pensions policy. This includes, as a priority, removing the marital discrimination. The proposals for changes to the arrangements with Australia and the longer-view options require a research-informed and open discussion with all affected parties, including potentially affected pensioners. Once decisions have been made on the

short-term changes and the longer-term reforms contemplated, social security agreements would need to be reviewed, and perhaps renegotiated.

The starting point for the necessary debate is a discussion about the residency requirement. Raising this to a meaningful level, from 10 years currently to 25 years, will help address the fiscal risk posed and the intergenerational burden imposed by an age pension that, in international comparisons, is both generous and accessible.

- 1 The DDP was originally established by the 1938 Social Security Act.
- 2 See the appendix for a list of RPRC publications and forums.
- 3 'We might also ask whether the projected numbers of those aged 65+ years is likely to be accurate. The data ... are based on the medium case projections, which assume an increase in life expectancy at birth by 2061 of 7.6 years for males and 6.5 years for females. Several sets of 10 projections in fact exist, three based on higher life expectancy assumptions (Series 7, 8, and 9). However it would appear that all might be a little conservative' (Jackson, 2011, pp.9-10).
- 4 The labour force participation rate for those aged 65+ rose to 19.5% between December 2010 and December 2011 (Statistics New Zealand, 2012, p.6), although it is likely that at least some of that significant increase was a response to the global financial crisis, and the diminishing of their assets.
- 5 See <http://www.nzsuperfund.co.nz/>.
- 6 Some American states, and some countries, including Chile, do not impose income tax on foreign pensions (<http://www.spencerglobal.com/chile-tax-law/35-chile-taxes/115-income-tax-in-chile.html>).
- 7 It is also noted that social security agreements that enable immigrants without sufficient residence for NZS to use residence in the country from which they have emigrated to qualify ('totalisation') may entail other anomalies.
- 8 KiwiSaver, launched in 2007, is a privately-provided, auto-enrolment, opt-out retirement saving scheme, with modest minimum employer and employee contributions. If an employee becomes a member, the employer's contribution up to 2% (3% from 1 April 2013) is compulsory.
- 9 Since 2002 the government can also be challenged under part 1a of the Human Rights Act when people feel they have been discriminated against in public policy.
- 10 Previously called the 'state earnings related pension scheme' or SERPS.
- 11 It is noted that in January 2012 the Ministry of Social Development deferred the deduction of pension amounts derived from voluntary contributions (personal communication from older people's and international policy unit, MSD).
- 12 The exception is where a 'young' spouse of a superannuitant applies for NZS before reaching age 65.
- 13 See <http://www.hrc.co.nz/home/hrc/resources/resources.php#case> for Human Rights Commission complaints information, and fact sheets covering discriminatory laws: discrimination by the public sector and the private sector.
- 14 This probable overestimate, based on 2009 data, assumes that full entitlement to NZS for the non-pension spouse is to

- be restored (<http://www.treasury.govt.nz/budget/2010/ise/v10/105.htm>).
- 15 Access to detailed information on overseas pensions is now available in the OECD's Pensions at a Glance series.
- 16 See <http://www.workandincome.govt.nz/individuals/travelling-or-migrating/getting-an-overseas-benefit-or-pension-in-nz.html#Howmuchcanyouget2>.
- 17 See <http://www.fahcsia.gov.au/sa/international/ssa/currentagreements/Pages/nz-nz.aspx>.
- 18 In part this fast growth reflects changes made in 2002 to the way the governments of the two countries share the pension costs.
- 19 The state pension age for the majority of OECD member countries is 65 years, with the exception of France and Turkey with a pension age of 60. Iceland, Norway and the US are phasing in an age of 67, and in 2009 the UK and Australia announced their intention to increase the age of state pension entitlement to 67. See [http://www.centrelink.gov.au/internet/internet.nsf/individuals/ssp\\_age\\_pension.htm](http://www.centrelink.gov.au/internet/internet.nsf/individuals/ssp_age_pension.htm).
- 20 These issues are outlined in Smith (2011), St John and Dale (2010) and Littlewood and Dale (2010).
- 21 In some of the benefit 'machinery' provisions, the NZSRI Act is already cross-referenced (e.g. section 71); in other cases where NZS itself may be at issue (e.g. section 71A, section 76), the reference is to the NZS benefit; finally, in other cases there is no specific reference to NZS at all (e.g. section 70A and 72), suggesting that there are no insurmountable barriers to drafting a modernised replacement in the NZSRI Act.
- 22 Note that Australia, Mauritius, Samoa, Nepal, Lesotho, Namibia, Botswana, Bolivia, Brunei, Kosovo and Mexico City all provide equivalents to NZS, and similar entitlement provisions.
- 23 Payment will be based on the number of months of residence in New Zealand between the ages of 20 and 65. See: <http://www.workandincome.govt.nz/individuals/travelling-or-migrating/pension-going-overseas/residing-in-any-other-country.html#Howmuchcanyouget2>.
- 24 Under the Old Age Pensions Act 1898 the residency requirement was 25 years. By 1937 this had been reduced to 10 years, probably to encourage immigration (Ashton and St John, 1988). Under the 1938 Social Security Act the residency requirement was increased to 20 years, until in 1977, with the introduction of National Superannuation, it was reduced again 10 years (Dale, St John and Littlewood, 2009, p. 11).
- 25 Perhaps the requirement would include 10 years from the age of 50 years, meaning New Zealand would be likely to benefit from some mature and skilled contribution from immigrants.
- 26 In 2010, for example, 4,832 people aged 65+ were receiving an emergency benefit. When they have resided in New Zealand for the required ten years, the majority of these people would transfer to NZS (Ministry of Social Development, 2011, p.117).

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## Appendix: Publications and forums toward addressing New Zealand's overseas pensions policy inequities and anomalies

The following publications from the Retirement Policy and Research Centre, University of Auckland, are available on its website, [www.rprc.auckland.ac.nz](http://www.rprc.auckland.ac.nz):

- Lazonby, A. (2007) *Passing the Buck: the impact of the direct deduction policy on recipients of overseas pensions in New Zealand*
- Dale, M.C., A. Lazonby, S. St John and M. Littlewood (2009) *Literature Review: New Zealand Superannuation and overseas pensions*, working paper 2009-1, prepared for the Human Rights Commission

- Dale, M.C., S. St John and M. Littlewood (2009) *New Zealand Superannuation and Overseas Pensions: issues and principles for reform*, working paper 2009-2

- Dale, M.C., S. St John and M. Littlewood (2010) *New Zealand Superannuation and overseas pensions: reform options 1 and 2*
- St John, S. and M.C. Dale (2010) *Option 1: reforming New Zealand Superannuation for a mobile trans-Tasman population*, working paper 2010-2

Littlewood, M. and M.C. Dale (2010) *New Zealand Superannuation and Overseas Pensions: reform option 2*, Working Paper 2010-3

Dale, M.C., S. St John, M. Littlewood and A. Smith (2011) *Overseas Pensions Policy: the next steps*, Working Paper 2011-1

In 2010 two Overseas Pensions Forums were held at the University of Auckland, in conjunction with the Human Rights Commission and the Centre for Accounting, Governance and Taxation Research, Victoria

University of Wellington: on 1 February and 25 August. The proceedings of these forums are available on the RPRC website.

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