TAXATION OF RETIREMENT SAVINGS:
NEW ZEALAND –
THE EXTREME SOCIAL EXPERIMENT

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Abstract

There are few areas of public policy that impact more directly on individual lifetime welfare than those related to retirement income. The topic of retirement income, and consequentially retirement savings, is complex and multi-faceted, and has been the topic of much debate throughout the Organisation for Economic Co-operation and Development (OECD). For some time, OECD governments have provided taxation incentives to encourage private retirement savings. New Zealand is the exception, as the only OECD country that does not offer any tax based incentives for retirement savings.

This research revisits the topic of taxation incentives for retirement savings. The paper adopts a case study approach, using New Zealand to investigate the policy, political and social explanations for the absence of tax incentives associated with retirement savings. The key question addressed is whether New Zealand has chosen to undertake an ‘extreme social experiment’ with the removal of all taxation concessions for retirement savings.

The research suggests that if this ‘social experiment’ results from a policy objective of poverty alleviation, then New Zealand may have adopted an appropriate approach, given the absence of evidence to show that tax incentives ‘work’. However, if New Zealanders are not choosing to save through other, less traditional, forms of retirement savings, as is indicated by recent statistics, then it is likely that current low- and middle-income earners will face a lower standard of living in retirement than those of their OECD counterparts.
1 Introduction
There are few areas of public policy that impact more directly on individual lifetime welfare than those related to retirement income. The topic of retirement income and, consequentially, retirement saving poses a challenge to governments throughout the Organisation for Economic Co-operation and Development (OECD). The issue is complex and multifaceted with countries facing ageing populations and concomitant societal pressures such as housing, health and financial support. The increasing elderly population demands attention, as they are a highly influential group with both political power and economic impact as consumers.

For a number of years governments throughout the OECD have provided taxation incentives to encourage private retirement savings. New Zealand is the exception, as the only OECD country that does not offer any tax based incentives for retirement savings. In addition, there are no compulsory retirement savings schemes in New Zealand.

This research revisits the widely researched topic of taxation incentives for retirement savings. The paper adopts a case study approach, using New Zealand to investigate the policy, political and social explanations for the absence of tax incentives to encourage retirement savings. New Zealand was accused of becoming the ‘social laboratory of the world’ with the introduction of the watershed Social Security Act 1938. It is suggested that New Zealand has again adopted this role and the key question addressed in this research is whether New Zealand has chosen to undertake an ‘extreme social experiment’ with the removal of all taxation concessions for retirement savings. A second area of interest in the research relates to the absence of any form of ‘second tier’ retirement schemes in New Zealand, which raises the question of whether New Zealand’s retirement savings objectives are significantly different from those of the rest of the OECD.

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1 While forecasts of ageing populations differ, it is generally predicted that the proportion of elderly persons within the population will exceed 20 per cent in most OECD countries by 2040 (OECD 1992:9). Australian research (e.g. Wills and Ross 2002:2) predicts that by 2051 the proportion of people aged over 65 in Australia will have doubled from 12% in 2002 to approximately 27%. In New Zealand this figure is projected to be around 26% (Stephenson and Scobie 2002:2).

2 While there are no deliberate tax incentives in the New Zealand system, an exception currently exists for a high-income occupational superannuation fund member. Employer contributions and fund earnings are taxed at 33%, but the highest marginal tax rate in New Zealand is 39% (for earnings over NZ$60,000); therefore an individual paying the 39% marginal tax rate will potentially benefit from a six per cent tax saving. This anomaly saw the introduction of tax avoidance schemes, such as ‘salary sacrifice’. Some attempt has been made to address this anomaly through the introduction of a five per cent withdrawal tax when funds are withdrawn, other than in specific circumstances, such as when an employee leaves the job or can demonstrate significant hardship. This situation is likely to correct itself with a change of legislation in April 2007.

3 The Social Security Act 1938 saw the introduction of a dual publicly provided pension system in New Zealand that was provided on the basis of equity and universalism.
The paper commences with an introduction to the various factors influencing retirement savings and the taxation of retirement savings. This is followed by a discussion on the literature pertaining to the taxation of retirement savings as well as a brief investigation of the literature associated with savings behaviour. Section four discusses retirement savings taxation in New Zealand and the events that resulted in the present day policy. Section five addresses the research question and undertakes analysis based on the previous sections. Conclusions are drawn in section six.

2 Background

From a taxation perspective most tax systems in OECD countries give preferential treatment to pensions. Such preferential treatment may take the form of tax relief on a portion or all pension income received, or the taxation system may privilege those receiving pensions in the form of additional allowances or zero-rate personal income tax bands.

The levels of taxation applied at various stages distinguish different taxation arrangements. Typically these are referred to in the order of contributions to funds, investment earnings and withdrawals from funds: T refers to fully taxed; E is tax exempt; and t refers to concessionary taxation. The current system of taxation in New Zealand for retirement income savings is known as ‘TTE’ referring to taxed contributions, taxed investment income and exempt benefits. This scheme, introduced in 1988, provides no preferential tax treatment or concessions for older people or those saving for their retirement. No other OECD country has opted for this system. The focus of the New Zealand TTE regime is tax neutrality, meaning that superannuation savings are treated from a taxation perspective in the same manner as all other forms of savings.

The key drivers of recent attention paid to retirement savings stem from forecast ageing populations and suggestions of inadequacy of savings. As with all OECD countries New Zealand is faced with an ageing population projected to peak around the middle of the 21st century. Recent years have seen a wave of pension reforms across OECD countries motivated by concerns about the financial sustainability of pension systems with forecast ageing populations (OECD 2005:16). However, the only precautionary measures adopted by New Zealand are the introduction of the New Zealand Superannuation Fund and the proposed KiwiSaver scheme. 4

Over the next 50 years, the New Zealand population aged over 65 is forecast to more than double to around 1.18 million by 2051, peaking at 1.23 million in the late 2060s (Statistics New Zealand 2000a). The most significant increases are expected to occur during the decades ending in 2021 and in 2031. The key implication of these figures is in the ratio between the traditional working age group (those aged between 15 and 64) and those in the traditional retired group (those aged over 65 years of age) - the

4 These two initiatives are explained in section four.
age dependency ratio. The age dependency ratio is forecast to decrease from 5.5 working age individuals for each retired individual in 2001, to 2.4 working age people to each retired individual over the next 50 year period. These figures indicate increasing pressure on the support systems for retired individuals over the decades ahead. The percentages resulting in the decreasing forecast age dependency ratio in New Zealand are outlined in Table 1.

### Table 1: Percentage of the New Zealand Population in Three Age Groups (2001 – 2051)

<table>
<thead>
<tr>
<th>Year</th>
<th>0 – 14</th>
<th>15 – 64</th>
<th>65 +</th>
<th>Age Dependency Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>23</td>
<td>66</td>
<td>12</td>
<td>5.5</td>
</tr>
<tr>
<td>2011</td>
<td>19</td>
<td>67</td>
<td>14</td>
<td>4.8</td>
</tr>
<tr>
<td>2021</td>
<td>18</td>
<td>65</td>
<td>18</td>
<td>3.6</td>
</tr>
<tr>
<td>2031</td>
<td>17</td>
<td>61</td>
<td>22</td>
<td>2.8</td>
</tr>
<tr>
<td>2041</td>
<td>16</td>
<td>59</td>
<td>25</td>
<td>2.4</td>
</tr>
<tr>
<td>2051</td>
<td>16</td>
<td>59</td>
<td>25</td>
<td>2.4</td>
</tr>
</tbody>
</table>

In relation to saving, there is disagreement as to whether the New Zealand population is saving sufficient amounts to enjoy the standard of living they desire upon retirement. However, there is general agreement that the household saving rate in New Zealand is low, with a current declining tendency (e.g. Thorp and Ung 2000, International Monetary Fund 2003). The question of whether household savings in New Zealand are ‘too low’ is frequently debated.

What is known is that when considering retirement income savings as a proportion of overall wealth, New Zealanders lag behind their counterparts in Canada, the United States and Australia. Data from the Household Savings Survey (Statistics New Zealand 2001) shows that superannuation assets in New Zealand make up six per cent of the total value of all assets. In Canada the equivalent level is 15 per cent, in the United States of America it is 11 per cent, and in Australia 22 per cent of all assets are in the form of superannuation savings. In Australia superannuation assets are now the principal form of financial asset in the country, and the largest source of wealth for the lowest income earners (Statistics New Zealand 2001). The low proportion of

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5 It is noted that the age dependency ratio is a crude indicator, in that it does not take into account the relative costs of providing support for different categories of individuals. For example, the relative costs of the young and old differ considerably. Estimates indicate that the elderly require three times the amount of financial spending as that spent on the younger populations (Dixon 1982:20). Furthermore, with greater emphasis placed on education, many individuals do not commence working until their early 20s.

6 In addition, Statistics New Zealand reported in 1995 that almost 250,000 ‘baby boomers’ had emigrated by 1991. Their return to New Zealand in the future (or other changes in immigration policy) would result in increased pressure on welfare systems (Statistics New Zealand (2000b:8)).

7 Source: Statistics New Zealand (2000a).

8 This issue is considered in more detail in section five of this paper.
assets that New Zealanders have chosen to invest in retirement schemes is likely to reflect the approach adopted for retirement savings.\(^9\)

All OECD countries have some form of government provided pension for older people. Generally these are asset or income tested. The average minimum retirement benefit across OECD countries is around 29 percent of average earnings. In New Zealand it is 38 per cent and in Australia it is 23 per cent (OECD 2005:28). Only Luxembourg, Portugal and Greece in the OECD are higher than New Zealand.\(^10\) Research undertaken by the OECD (OECD 2005) shows that workers who derive the average level of earnings in the OECD can, on average, expect their post-tax pension to be worth just under 70 per cent of earnings after tax. New Zealand and Ireland have the lowest net replacement rates – both are less than 40 per cent.\(^11\)

In addition to state provided schemes, all OECD countries except Ireland and New Zealand have mandatory occupational pension schemes.\(^12\) Typically this ‘second tier’ is intended to ensure that retired people have an adequate standard of living in retirement, rather than to meet a sole policy objective of poverty prevention.

### 3 Literature Review

There are two key components of the literature that are relevant to this research. Both are covered in this section. The first section discusses issues relating to savings in general such as household savings behaviour, retirement savings in New Zealand, the role of the State in relation to retirement savings policy and reform approaches adopted by various countries. The second section provides a more in-depth perspective on the topic of taxation incentives for retirement savings.

#### 3.1 Household saving behaviour

It is difficult to address the topic of retirement savings without reference to overall savings. At a fundamental level retirement savings are no different from other forms of savings as they still require individuals to reduce their current consumption to allow for future consumption. From a micro-economic perspective the level of savings held by an individual will directly impact on that individual’s standard of living in retirement.

\(^{9}\) It is acknowledged that other forms of savings may act as substitutes for formal superannuation schemes.

\(^{10}\) The government provided pension, New Zealand Superannuation, is one of the most significant items of government expenditure, comprising approximately 14 per cent of total government expenditure (Budget 2002, Budget Speech, Dr Michael Cullen, Minister of Finance, Appendix to the Journal of the House of Representatives).

\(^{11}\) Net replacement rates are individual net pensions relative to individual net earnings, taking into account income taxes and security contributions paid by workers and retired individuals (OECD 2005:52).

\(^{12}\) While there is no legal obligation for employers in Ireland to provide occupational pension schemes, it is becoming more common and there is government encouragement for the practice. From 15 September 2003 employers must offer access to at least one Personal Retirement Savings Account to an employee who is not eligible to join an occupational pension scheme. Tax relief is available for contributions to approved pension schemes.
The reasons why individuals will decide to save or consume have been debated for some time. Keynes (1936:107) produced a list of reasons for consumption, which includes:

- precaution: to build up a reserve against unforeseen contingencies;
- foresight: to provide for an anticipated future relation between income and the needs of the individual or family that may be different from that which exists in the present;
- calculation: to enjoy interest and appreciation;
- improvement: to enjoy gradually increasing expenditure;
- independence: to enjoy a sense of independence and a power to do things;
- enterprise: to secure a sufficient amount to carry out speculative or business projects;
- pride: to bequeath a fortune; and
- avarice: to satisfy miserliness (i.e. aversion to expenditure).

Keynes (1936:108) also produced a list of reasons why individuals consume, which includes:

- enjoyment;
- shortsightedness;
- generosity;
- miscalculation;
- ostentation; and
- extravagance.

The reasons why individuals may choose to save or consume may change during their life-cycle and may be a combination of many or all of the above. Accordingly it is difficult to expect any one reason to explain saving behaviour, and this contributes to the difficulty associated with policy and planning for retirement savings.

The macro-economic impacts of insufficient national savings are well documented and include reliance on foreign capital, sensitivity of households to changes in interest rates and, perhaps the most obvious, an inability to meet the costs of health, housing or retirement without reliance on the state. As savings are a key source of funds for investment in capital, the rate of savings within a society can impact on the ability of the economy to grow.\textsuperscript{13} Household savings in general are seen as important as low saving can result in low investment flows, which may lower real wages and standards of living, or alternatively see greater overseas control of the country’s capital stock (Fitzgerald and Harper 1992:198).\textsuperscript{14}

A number of factors, other than tax incentives, have been suggested as having the potential to impact on levels of savings. For example, Scobie, Gibson and Le (2005) find evidence that enrolment in a workplace scheme is associated with higher levels of net worth. The ‘recognition effect’ is suggested as a potential explanation for this

\textsuperscript{13} It has also been argued that higher economic growth, in turn, promotes higher saving rates, as with individual wealth increases within a country due to economic growth, greater levels of saving are achievable (Savage 1999:13).

\textsuperscript{14} It is noted that the most important measure is national savings (public and private savings), and therefore the savings rate can be significantly influenced by government savings patterns.
finding. Seminal research by Cagen (1965) and Katona (1965) found a ‘recognition effect’, where retirement savings increase as an individual’s awareness of the need to save is raised. A further explanation offered is that of self-selection bias. As with the recognition effect, this has been documented widely and suggests that individuals who enrol into one form of retirement savings are more likely to save than the population as a whole. For example, in the United States, households that are contributing to Individual Retirement Accounts (IRAs) tend to be older, wealthier and have higher incomes than those who do not (Hubbard and Skinner 1996:76).

Government policy has also been raised as having the potential to influence private savings rates. Research undertaken by Carroll and Summers (1987) investigates whether government policy can affect private savings rates, and if so, to what extent and via what mechanisms. The research is undertaken using the ‘exceptionally good natural experiment that has been provided by Canada and the United States of America’ over the 35 year period to 1985 (Carroll and Summers 1987:249). Rates of savings in America and Canada were similar for a 25-year period, after which time they diverged dramatically with savings in America reducing and savings in Canada increasing. The research shows that the divergence of the savings rates occurred at a similar time to the introduction of major savings incentives in Canada in the early 1970s. Caroll and Summers conclude that tax policies can have a significant impact on savings behaviour and the differences in tax structures between the two countries are important factors in explaining the patterns of savings in the two countries. In addition, Caroll and Summers found that macroeconomic variables did not explain the majority of the movements in the savings rates.

Bernheim (2002:1233) also investigates the issue of whether, and to what extent, specific public policies influence the levels of savings. Referring to the life cycle model Bernheim notes that conventional life-cycle models imply that changes in the pre-tax rate of return and the income tax rate both impact on savings as they alter the after-tax rate of return achieved on savings. The exact level to which savings are influenced is determined by the interest elasticity of saving. Some researchers (e.g. Savage 1999) argue that as the decision to save depends on the marginal return to saving, relative to the cost of saving (in the form of foregone consumption), saving rates of return should be a key determinant of saving trends.

3.1.1 Retirement income savings in New Zealand

When compared to other countries, there is a scarcity of research in some areas relating to retirement income savings in New Zealand. While this situation has improved over the past ten years, there are still significant gaps in the literature. Noticeable gaps exist in relation to areas of policy development, the role of the state

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15 The life cycle model of household savings behaviour is that most frequently used in the analysis of household savings behaviour. Life cycle models examine the effect of an individual’s decisions over their lifetime based on present and expected future income. The model suggests that households have high levels of savings at times of high earnings, which are then ‘dissaved’ during periods of lower income, such as retirement.
in retirement provision and the determinants of saving in New Zealand.\textsuperscript{16} There has also been little robust academic discussion on taxation incentives in New Zealand.\textsuperscript{17} As noted by Savage (1999:15), the evidence that is available in New Zealand ‘presents a mixed and incomplete explanation of New Zealand household saving patterns’.

Research does exist on the composition and levels of savings in New Zealand. There has been a general decline in superannuation scheme membership in New Zealand since the late 1980s, although this has stabilised in recent years. Registered superannuation schemes have reduced by more than half over the past decade, from 1451 schemes in 1995 to 625 in 2004. Meanwhile participation in occupational schemes has continued to decline from 23% in 1993 to 15% in 2001 (Statistics New Zealand 2004).

When looking at the overall asset composition of New Zealanders in 2004, 21% had some form of superannuation scheme in which an average of NZ$13,844 was saved. The total asset value held within superannuation funds was NZ$24.7 billion. This compares to the Australian total asset value of superannuation of AU$472.9 billion.\textsuperscript{18}

3.1.2 State intervention

Throughout the OECD there are numerous forms of state intervention in relation to retirement savings, including the regulation of private retirement savings arrangements, compulsory occupational schemes and government pension provision incentives. The World Bank (1994:6) argues that the key question of the role of the state is not whether the public sector should be involved instead it is how the public sector should be involved. However, the World Bank approach is not universally accepted, with a number of commentators questioning the reasonableness of state intervention in retirement income participation. Nonetheless, typically the model promoted for retirement savings is that of the World Bank. The World Bank model is a three-pillar model recommending firstly a state provided pension, secondly some form of mandatory work-based retirement savings scheme and thirdly voluntary savings through private financial markets. Typically most OECD countries do have these three components within their retirement savings models, although New Zealand does not have the second pillar. In addition, there is wide variation in the forms adopted in the second pillar among countries.\textsuperscript{19}

\textsuperscript{16} Typically the quality and availability of data on saving, and the degree of structural change in New Zealand, are the reasons provided for the absence of research in this area of savings determinants in New Zealand.

\textsuperscript{17} The extent of the ‘gaps’ can be seen when looking at the most recent bibliographic reference of research on New Zealand Ageing (New Zealand Institute for Research on Ageing 2005). Of this 50-page document, two and a half pages are devoted to retirement income, with the primary focus being health, education and care.


\textsuperscript{19} It is noted that an extension of the three-pillar structure has been developed by the World Bank to include two additional pillars – a basic (zero) pillar to deal more explicitly with the poverty alleviation objective and a non-financial (fourth) pillar to include the broader social context, such as access to health care and housing (Holzmann and Hinz 2005:2).
The key arguments typically raised in the defence of state involvement in retirement saving include:

- the myopia argument, as few individuals save sufficient funds to continue their lifestyle during employment into retirement (Knox 1992:65);\(^{20}\)
- the belief that compulsory work based savings encourages the development of capital markets and facilitates economic growth (St John and Willmore 2000:15);
- insurance market failures, which can be the result of moral hazard behaviour (where individuals have an incentive to consume at the present time in order to be eligible for a means-tested benefit in retirement), adverse selection or correlations among individuals making insurance against many risks unavailable (World Bank 1994:5);
- inadequate savings instruments, where capital markets are undeveloped and economic conditions unstable;
- the paternalistic argument, where changes in policy may leave an individual with retirement income that is insufficient with earlier plans (Carmichael and Plowman 1985:131);\(^{21}\)
- income redistribution, where income earners may have insufficient earnings during their working lives to save sufficient amounts for retirement;
- a reduction in government spending on public pensions, and a higher level of private provision for those most in need (Task Force on Private Provision for Retirement 1992:50); and
- access to information, where individuals may be unable to assess their requirements in retirement with a sufficient degree of accuracy, and at the point when sufficient information is available to make informed decisions, it is too late to make the necessary changes to savings levels.

Many of these points are disputed in the literature. For example, the first of these points is disputed by Carmichael and Plowman (1985:130), who argue that in the absence of government intervention an individual’s desire to avoid poverty in their retirement will provide sufficient incentive to save for retirement. Other researchers (e.g. Savage 1999) argue that actuarially fair publicly provided pensions\(^ {22}\) will have no net effect on individual saving or consumption behaviour, as any premium payments will be offset against expected lifetime income. Although, equally it is argued that the presence of a ‘safety net’ may discourage individuals from saving further for their own retirement provision. However, the level of savings, or

\(^{20}\) Feldstein (1996) argues that most households accumulate little or no financial assets, which is rational decision-making based on the assumption that state-provided benefits will substitute for private wealth accumulation, as an alternative to the argument that individuals are myopic. Borsch-Supan (2004:112) suggests that there is considerable empirical evidence corroborating the potential for myopia. A study by Kotlikoff et. al. (1982) (cited in Schulz 1992) conclude that without some form of social welfare support a substantial percentage of the population would be inadequately prepared for retirement. Mitchell (1998) also finds that a study of American savings patterns undertaken in 1992 indicates that most Americans save too little to preserve their current consumption standards in retirement.

\(^{21}\) Carmichael and Plowman (1985:131) also argue that paternalism can arise from a divergence between an individuals marginal rate of time preference and society’s marginal rate of inter-generational preference, whereby an individual with a strong preference for current consumption may save a level of retirement income that is below that desired by society.

\(^{22}\) That is, those that are funded from taxes and go to individual accounts.
conversely the level of support required, will depend on personal preferences such as the willingness to save, together with other sources of income (such as charitable sources or assistance from families). Similarly, the size of the ‘safety net’ and the extent to which it is targeted will influence saving behaviour.

3.1.3 Challenges to state intervention

There are a number of reasons proposed for sole reliance on voluntary provision, including that it:

- provides flexibility and choice for individuals;
- allows individuals to save what is affordable to them;
- promotes competitive financial markets and better savings products;
- may lead to higher rates of economic growth; and

Despite the support for compulsory work-based retirement savings schemes the rationality of the approach has been questioned. A frequent commentator on retirement savings in New Zealand is St John (e.g. Ashton and St John 1988; St John 1992; St John 1999; St John 2001). St John and Willmore (2000:14), among others (e.g. Agulnik 2000; Willmore 1998) raise the question of why a society should care whether a worker has the means to consume above a certain subsistence level during retirement. As noted by the World Bank (1994:5):

> when traditional, informal arrangements for subsistence break down in other spheres, they are replaced by formal market arrangements. Why doesn’t that happen for old age subsistence? Why do governments everywhere in the industrial world and increasingly in developing countries intervene so extensively in this area?

When considering the issue of what would be ‘sufficient’ funds for retirement and why it is thought that the state is better placed to decide this than the individual, Agulnik (2000:49) writes:

> if our future selves really do need to be protected from our current selves, then this has far wider implications; for instance, smoking would be illegal and obesity would be a punishable offence. In a liberal, democratic society, such authoritarian behaviour is rarely countenanced; faith in individuals’ ability to decide for themselves (and their future selves) usually prevails.

While not entirely discounting this paternalistic argument Agulnik (2000:46) finds that only the willingness to pay argument may be reasonable – and this is primarily because it provides a political explanation as to why work-based retirement schemes were implemented. None of the arguments raised are found by Agulnik to constitute a sound basis for support of state involvement in retirement savings.

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23 This issue is also supported by Fitzgerald (1996:3) who raises the issue that influence of the level of savings by government presupposes that there is a ‘right’ level of saving.
3.1.4 Reform approaches

A frequently researched topic relating to retirement savings is the many potential options for reform. Since the 1980s most OECD countries have witnessed a variety of both retirement savings and taxation reforms. Typically tax reforms have had efficiency based objectives, leading to simplification of taxation policy, elimination of tax loopholes, reduction of higher marginal tax rates and creation of a wider revenue base (Radaelli 1999:138). Retirement savings reforms have been focused on the three components of efficiency, equity and simplicity, as well as concerns about financial pressures on extant systems with forecast ageing populations.

Generally, recent reforms have taken the form of mandatory private savings, supplemented by a state provided pension and voluntary savings – as prescribed by the World Bank. Chile was one of the first countries to adopt this approach in 1981, and was followed soon after by Switzerland and Australia (Bateman 2005:4). A number of Latin American countries adopted the Chilean model during the 1990s, and a number of OECD countries have adopted the World Bank model or a variation thereof. Other reforms adopted include the ‘contracting out’ of the State Earnings Related Pension Scheme in the United Kingdom, with concessions for then joining private schemes and the introduction of individual financial accounts in conjunction with a new pay-as-you-go notional account system in Sweden (Fox and Palmer 2000).

Several OECD countries have had long-established work-based retirement savings schemes that have become the foundation for a mandatory system. Denmark is one of these countries, where both employer and employee are required to contribute, with the contribution based on hours worked, rather than earnings. France has a compulsory work-based retirement scheme that is funded by employer and employee contributions and Switzerland has had compulsory work-based retirement savings since 1985 (Gillion, Turner, Bailey and Latulippe 2000). In the United States of America IRAs have been in place since 1974. A further targeted savings program, the 401(k) plan has been established since the early 1980s.

In countries where superannuation investment income is subject to tax, it tends to be taxed more leniently than ordinary income (Dilnot and Johnson 1993:6). Furthermore, the treatment of lump sum payments from pension funds differs widely. Some countries, such as France, do not allow lump sum payments out of tax-advantaged schemes; other countries, such as Ireland treat lump-sum payments more generously for tax purposes than other payments, while yet other countries tax lump sums in much the same way as other payments. Hong Kong has taken the most extreme measures with tax exemptions for retirement savings at all three possible options, in addition to mandatory contributions of 5 per cent for employees and 5 per cent for employers.

\[401(k)\] plans and IRAs are voluntary, narrowly targeted, personal savings incentives. They feature preferential tax treatment of contributions and investment earnings, annual contribution limits and penalties for early withdrawals.
3.2 The taxation of retirement savings

In theory, any form of taxation introduces distortions into savings behaviour. The principal argument raised in favour of taxation-based support for retirement savings is that retirement savings are more important than other forms of savings. Explanations given for this are that individuals may fail to predict their needs in old age, individuals are likely to have difficulty in saving further once retirement age has been reached and increased savings by individuals will reduce reliance on the state in retirement. Countries that provide income- or asset-tested retirement pensions can reduce their liability where individuals have sufficient funds to support themselves in retirement.

Bateman, Kingston and Piggott (2001:135) argue that the two most important policy questions in retirement income savings taxation are how preferential the taxation of retirement savings is, and at what point retirement savings is taxed. Table 2 outlines these two elements relating to the taxation treatment of retirement savings in a number of countries. The scheme most commonly used is EET where employers and employees may claim a tax deduction for their contributions to retirement savings funds, and contributions and earnings on the contributions are exempt from taxation until the funds are paid out on retirement. The key advantage of this approach is that of tax deferral and the potential for a lower level of income tax on fund withdrawals (assuming a progressive income tax structure) as typically earnings are lower in retirement than during employment.

Table 2: The Taxation Treatment of Retirement Savings

<table>
<thead>
<tr>
<th>Country</th>
<th>Contributions</th>
<th>Investment Income</th>
<th>Benefits</th>
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<tbody>
<tr>
<td>Australia</td>
<td>t²⁵</td>
<td>t</td>
<td>t²⁶</td>
</tr>
<tr>
<td>Canada</td>
<td>E</td>
<td>E</td>
<td>T</td>
</tr>
<tr>
<td>Chile</td>
<td>E</td>
<td>E</td>
<td>T</td>
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<tr>
<td>France</td>
<td>E</td>
<td>E</td>
<td>T</td>
</tr>
<tr>
<td>Italy</td>
<td>t</td>
<td>E</td>
<td>t</td>
</tr>
<tr>
<td>Japan</td>
<td>E</td>
<td>E</td>
<td>T</td>
</tr>
<tr>
<td>New Zealand</td>
<td>T</td>
<td>T</td>
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<tr>
<td>Sweden</td>
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<td>T</td>
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<td>United Kingdom</td>
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<tr>
<td>United States</td>
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<td>E</td>
<td>T</td>
</tr>
</tbody>
</table>

The usual tax treatment of non-retirement savings vehicles is the TTE approach, which is used in New Zealand for all forms of savings, including retirement savings. New Zealand’s TTE scheme is focused on tax neutrality of investment decisions. Typically tax concessions exist in most countries to encourage saving for retirement and to provide a benefit for restricting access to these funds until retirement age. In addition, generally retirement savings are taxed at preferential rates to other forms of savings. Furthermore, most tax systems give preferential treatment to pension payments themselves.

²⁵ The lower case ‘t’ in reference to Australia and Italy denotes concessionary taxation.
²⁶ Current proposals, suggested for implementation from 1 July 2007, would see superannuation benefits paid from a taxed fund becoming tax free when paid out to individuals aged 60 and over.
3.2.1 The impact of tax incentives

There has been considerable debate on the issue of taxation incentives and retirement savings, particularly over the past two decades as tax incentives have become accepted in almost every developed country. Bernheim (2002) argues that how taxation impacts on saving decisions is one of the most studied issues in empirical public finance. As well as the desire to understand the effect that taxation has on behaviour, the level of interest is partially driven from the suggested link between savings, the cost of capital and productive investment in an economy.

While most countries continue to offer incentives to encourage or to support retirement savings, there is an absence of evidence to verify their effectiveness as a mechanism to increase levels of savings. There is general agreement that high tax rates on savings may act to deter savings, as current consumption is encouraged at the expense of saving and investment (Freebairn, Porter and Walsh 1989:93). However, while lower tax rates may reduce such behavioural distortions inherent within the system, it is unlikely to remove them altogether.

Typically there are a number of arguments that are raised to support the existence of taxation incentives in relation to savings. These arguments include:

- increased national savings;
- decreased dependency on state-provided pensions;
- to change behaviour;
- to signal the importance the government places on having people accept responsibility for their own retirement provision;
- provision of a reward for the ‘locking-in’ of savings until retirement;
- improved capital market efficiency;
- encouraging taxpayers that can provide for their own retirement to do so; and
- in the case of New Zealand, to bring New Zealand in line with the rest of the OECD.  

The key arguments against the provision of taxation incentives include:

- the privileging of some individuals that would have saved in the absence of the tax incentive;
- the generally accepted argument that the greatest advantage from tax incentives is provided to higher-income earners;
- the ‘locking-in’ of retirement savings means that some forms of savings will be favoured above others;
- the fiscal cost associated with incentives;
- weakened signals, whereby savers in tax-preferred products are less sensitive to poor returns or high administrative costs, thereby tax incentives can reduce efficiency in the financial services industry; and
- compliance and administration costs.

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3.2.2 Tax incentives and savings

Much of the research undertaken in the area of retirement savings relates to the association between tax advantaged saving and new savings. In other words, the extent to which tax incentives create new savings, rather than transfers from non-tax-preferred investments. For example, Attanasio, Banks and Wakefield (2004) consider empirical evidence from the United Kingdom and the United States of America to examine the extent to which funds in tax advantaged accounts represent new savings. Generally, it is considered that a tax advantage for a savings vehicle is equivalent to a small increase in the rate of return of that asset. This can potentially have two impacts on the decision-making of the saver: it might either change the total amount that an individual will save, or it will change the composition of the savings portfolio. Tax incentives are intended to result in the first of these points, but research has established that the second point is also highly relevant. Attanasio, Banks and Wakefield (2004:5) find that only small fractions of the funds should be considered to be ‘new’ saving, and that the policies have been an expensive form of encouraging saving.

Seminal research undertaken by Engen, Gale and Scholz (1996) examines the impact of tax incentives on private and national savings. The authors write of the inherent difficulties in undertaking such research including:

- the tendency for households that participate in savings plans to have stronger tastes for saving than other households;
- households that have utilised savings incentives have taken on more debt than other households;
- comparison is restricted by balances in saving incentive accounts being pre-tax, whereas more conventional savings accounts represent post-tax balances; and
- a lack of consideration that employer contributions to saving incentive plans are part of a total employee compensation package.

Engen, Gale and Scholz (1996) find that where savings incentives indicate increased savings, the results can be traced to the various biases outlined above that overstate the effects of saving incentives. When these biases are removed the positive effect of the incentives on savings is removed.

Along with Carroll and Summers (1987), Jump (1982) investigates the divergence in savings patterns between Canada and the United States of America since the mid 1970s. In contrast to the findings of Carroll and Summers, when Jump (1982) examines the effect of tax incentives on the rate of savings in Canada it is concluded that the incentive would effectively be a lump-sum transfer to middle and higher income taxpayers that would not encourage savings for lower income taxpayers. Jump observed that such incentives required the government to set higher tax rates, and accordingly may actually have perverse effects insofar as the incentives have been financed by increased taxes, which are paid by all taxpayers. Moreover, Jump concludes that tax incentives may have contributed more towards a decline in personal saving in Canada, while acknowledging that personal savings did increase over the time period considered. Jump suggests personal savings rates appear to have

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28 Discussed in section 3.1
increased because of distortions of price inflation, rather than the result of any behavioural change on the part of consumers.

Blundell (1996) investigates whether tax-advantaged savings accounts introduced in the United Kingdom in the late 1980s and early 1990s resulted in new savings. Along with other researchers in this area Blundell finds a significant degree of portfolio substitution across savings accounts, with no more than 15 per cent of Tax Exempt Special Savings Accounts representing new savings. Blundell, as with Engen, Gale and Scholz (1996), also finds that individuals who save in tax-preferred savings vehicles are likely to have a stronger taste for saving through other mechanisms.

Earlier research by Munnell (1982) found that people reduce their own saving by approximately 65 cents for each dollar of private pension saving (resulting in a net savings increase of 35 cents). However, Munnell writes that it is impossible to determine whether this net increase is due to the favourable tax provisions or to other features of private plans such as uncertainty about future benefits, forced saving and induced retirement. Munnell finds that the most useful hypothesis for policy purposes appears to be that consumers reduce saving in other forms to compensate for expected future pension provision. While Munnell’s study investigates private pension provision, it would appear reasonable to extend the conclusion to state provided pension arrangements, to the extent that they can be relied upon to exist at the time of retirement.

Gale (1999) reviews the theoretical and empirical research on the impact of pensions on savings. He finds there is a wide range of outcomes from much of the research, but generally most research finds little impact of pensions on other wealth accumulation. Gale (1999:1) encapsulates the issue when writing that ‘taken as a whole, the theoretical literature yields ambiguous predictions concerning the magnitude and even the direction of the effects of pensions on other wealth’. While it is generally accepted that there is uncertainty about the effectiveness of tax concessions in creating new savings, tax incentives can significantly impact on the form that savings take. Accordingly tax incentives may be utilised as a policy tool to influence behaviour.

3.2.3 The effectiveness of incentives
There is uncertainty about why savings incentives have not been more effective. Engen, Gale and Scholz (1996) suggest that existing incentives are poorly designed, that households have low intertemporal elasticities of substitutions or that people may be uninformed about the need and opportunities for saving.

The absence of certainty in relation to benefits of taxation incentives has raised the issue of why taxation support for retirement savings is provided at all. One view, raised by Edey and Gower (2000:290) and Ingles (2001:21) is that providing tax concessions when mandatory occupational schemes exist is somewhat wasted, as there is no need to provide an incentive to do what is already compulsory. Knox (1992:54) writes:
throughout this century governments within the developed world have expressed strong support for occupational pension and superannuation schemes through the provision of significant taxation incentives and concessions ... it is so common that one may be considered a heretic for asking why such support exists.

Criticism of taxation incentives comes from the often significant cost attached to their provision. Research by Yoo and de Serres (2004) undertakes a cross-country comparison of the ex-ante tax cost of tax incentives and concludes that most OECD governments incur a significant positive net tax cost that amounts to at least 10 cents per unit of pre-tax contribution. Yoo and de Serres (2004:101) argue that this highlights the importance placed by governments on promoting private savings.

3.2.4 Behavioural and equity issues of tax incentives

Considerable research has been undertaken that emphasises the inequity created by tax incentives, including seminal research undertaken by Sinfield (2003) in the United Kingdom. Sinfield found that at least half of the taxation subsidy on contributions goes to the richest ten per cent of taxpayers, with a quarter of the tax subsidy going to the top 2.5 per cent of taxpayers. The distribution leaves the lowest ten per cent of taxpayers (measured by wealth) with one per cent of the taxation benefit. Sinfield (2003) puts forward an argument for the potential of a ‘dangerous social schism’ in the United Kingdom, with the potential for a number of undesirable outcomes in retirement, such as greater inequalities in living standards after work than in work.

Similar results have been found in the United States of America and in Australia. Edey and Britten-Jones (1990) find that contributions to superannuation funds in Australia (and therefore utilisation of taxation incentives) were disproportionately provided by high income earners. The highest income quintile provided 45 per cent of fund contributions, while the top two quintiles combined provided 75 per cent (Edey and Britten Jones 1990:125). More recent research in Australia has found similar results, where approximately one-third of the value of tax concessions for superannuation accrues to the top ten per cent of income-earners.29 In the United States of America Burman, Gale, Hall and Orszag (2004) find that as a share of income, tax preferred saving incentives provide the most significant benefits to households with an income between US$75,000 and US$500,000 - approximately the 80th to 99th percentile of income distribution. In addition, Burman et. al. find that in 2004 the top 20 percent of tax filing units by income received 70 per cent of the tax benefits from new contributions to defined contribution plans and almost 60 percent of tax benefits to IRAs.

Burman et. al. find evidence to suggest that high income and wealth households are more likely to participate in substitution of savings to take advantage of tax-preferred

29 Submission to the Senate Select Committee on Superannuation’s Inquiry into Superannuation and Standards of Living in Retirement by the Australian Council of Social Service, Fairness and Flexibility: making superannuation work for low and middle income-earners. ACOSS Paper No 123.
accounts, whereas lower income households are more likely to finance their retirement savings through a reduction in consumption. Accordingly Burman et al. conclude that high-income and high-wealth households are more likely to be accumulating sufficient private savings to maintain their living standards in retirement, while low and middle income households are more likely to face difficulty in achieving the same result.

4 Retirement Savings Taxation in New Zealand

Among other terminology, New Zealand’s retirement income policy has been labelled a ‘political football’ (Grimes and Smith 1999) and a ‘bold experiment’ (OECD 1994). The suitability of this language can be seen when reviewing just a small proportion of the changes in retirement income savings policy in New Zealand since 1970. These changes include introduction of a compulsory savings scheme; removal of the compulsory savings scheme; increases in the levels of superannuation payments; reductions in the levels of superannuation payments; removal of all taxation incentives attached to retirement savings; introduction of a surcharge; removal of the surcharge; and introduction of a pre-funding scheme. Indeed, superannuation has historically been called ‘the most contentious political issue in the history of New Zealand welfare’ (Palmer 1977:9) and it could be argued that nearly 30 years after this claim it still remains valid.

With the election of the fourth Labour government in 1984, significant changes were made to retirement policy. The most noteworthy change occurred in 1988 and remains in place today. This change was the removal of tax concessions on contributions to private and occupational pension or superannuation schemes, along with removal of tax concessions to the superannuation funds themselves. In addition, from 1988 onwards superannuation funds were required to pay standard company tax rates. Prior to the reforms contributions and fund earnings were exempt from taxation, and withdrawals from the fund were taxed. The new regime required contributions to funds to be made from after-tax income, taxes fund earnings, and makes withdrawals from the funds tax-exempt. The objective of these reforms was to improve the fairness of the taxation system and introduce consistent treatment of income from investment, irrespective of the form of investment and the institution through which the investment was made.

Other changes implemented during the 1980s included the introduction of a tax surcharge on income above a specified limit in 1985. The age of eligibility was increased (on a gradual basis) to 65 years, also in 1985. In 1989 state provided superannuation was reduced to move between a band of 65 and 72.5 per cent of the net average wage level, from the existing level of 80 per cent. The surcharge was abolished in 1998, while at the same time the state provided superannuation of 65 per cent of the minimum average wage level was reduced to 60 per cent. This was restored to 65 per cent in 2000. Further details of key events in New Zealand’s retirement savings history can be found in Appendix 1.
Prior to 2001 the universal state-provided pension, New Zealand Superannuation, functioned as a ‘pay-as-you-go’ scheme. Although this remains, a ‘smoothed pay-as-you-go’ arrangement was introduced in October 2001 when the New Zealand Superannuation Fund was created. The fund is intended to finance part of the future cost of New Zealand Superannuation, by drawing resources from budget surpluses over the next 20 – 30 years, and then progressively drawing on these funds over the following 20 – 30 years as the annual cost increases.

A more recent initiative is the proposed introduction of KiwiSaver accounts in 2007. KiwiSaver is a voluntary occupational savings scheme with automatic enrolment, and voluntary ‘opt-out’ provisions. Contributions are privately funded, although the government will make an initial $1000 contribution and fee subsidy to each new account. While savings are locked-in until retirement, there are a number of exceptions that allow withdrawal of funds, such as permanent emigration.

5 Analysis
The well-established arguments supporting and opposing the provision of tax incentives for retirement savings have been considered over the previous sections. The key question this research addresses is why New Zealand has adopted a position that contrasts that of the rest of the OECD. This section suggests some possible outcomes from New Zealand’s approach, together with some possible answers. In addition it questions whether the ‘extreme social experiment' may even be appropriate.

One potential outcome from New Zealand’s approach to the taxation of retirement savings is the low savings rate in New Zealand. Household saving rates in New Zealand were relatively stable over the 1970s and 1980s, but have been declining over the 1990s (Claus and Scobie 2002). In addition, New Zealand has a household savings rate that is consistently one of the lowest among OECD countries and financial asset holdings that are also low compared to OECD countries (Goh, 2005).

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30 The KiwiSaver Act received Royal assent on 6 September 2006 and is proposed to commence on 1 July 2007.
31 Evidence from both the United Kingdom and the United States of America finds that auto-enrolment in occupational schemes may be effective, as only around 10 – 20 per cent of employees take up the opt-out option (PricewaterhouseCoopers 2005:3).
32 When the KiwiSaver Scheme was originally proposed withdrawal of funds was permitted for use as a deposit on a first home. At the current time this concession appears likely to be removed before the scheme is implemented.
33 This is debated by some researchers. For example Clements (1984) argues that the real savings ratio has been declining since the mid-1970s, in contrast to the impression provided by the data. Clements argues that under alternative inflation adjusted data services, the level of saving in New Zealand did not rise in the 1970s.
34 It is acknowledged that there are a number of difficulties with cross country comparisons of savings due to measurement differences, financial market developments, institutional arrangements and societal preferences.
35 For example, IMF country report No. 03/122 finds that New Zealand’s average national savings rate is 15.5 per cent, compared to the OECD average of 21 per cent.
Furthermore, New Zealand’s frequent current account deficits indicate that national savings are inadequate to fund new investment.\textsuperscript{36}

Net national savings have varied across OECD countries, ranging from Finland with an average rate of one per cent of GDP to Korea with 21 per cent of GDP (Claus and Scobie 2002:16). Norway has also seen a relatively high rate at around 12 per cent of GDP. New Zealand is positioned at the lower end with savings of four per cent of GDP. However, the overall trend for decline witnessed in New Zealand has been similar for most OECD countries. The net national saving rate in New Zealand, as measured by the conventional flow approach in the national accounts, has been trending downward for the last 30 years (Claus and Scobie 2002:32).\textsuperscript{37}

A number of reasons have been suggested for the relatively low level of financial asset holdings in New Zealand. Goh (2005) suggests factors such as the absence of a compulsory retirement savings scheme, the absence of tax incentives to promote savings, a preference for investment in property, risk aversion after the 1987 sharemarket crash, a lack of access to diversified financial investment products and a relatively generous minimum retirement income may be factors contributing to New Zealand’s lower financial asset holdings when compared to other OECD countries. Similarly the IMF (2003:21) claim that empirical evidence points to the significant influence on savings stemming from government pension and other income support transfers in New Zealand.

It should also be mentioned that the question of whether New Zealanders are saving sufficiently is far from clear. Commentators such as Claus and Scobie (2002) and the IMF (2003) find little support for the claim that there is a savings problem in New Zealand. Research by Scobie, Gibson and Le (2004) examines the issue of savings in New Zealand, with a focus on determining whether New Zealanders are preparing adequately for their retirement. Their research suggests that there is not widespread undersaving for retirement in New Zealand. However, findings of this nature reflect the definition of ‘adequacy’ that is adopted in the research. More recent research by Scobie, Gibson and Le (2005) takes the measure of adequacy of retirement savings as the ability to maintain the level of pre-retirement consumption, working on the assumption that New Zealand Superannuation will be provided.\textsuperscript{38}

The economic rationale supporting the absence of tax incentives for a particular form of savings is clear: in the absence of market distortion, efficient decision-making should result. It is clear that savings through traditional superannuation vehicles have

\textsuperscript{36} It is noted that current account deficits are not uncommon in other OECD countries such as Australia, Canada, the United Kingdom and the United States.

\textsuperscript{37} National savings and individual savings are different concepts. When discussing the topic of savings in the economy, this incorporates household saving as well as business and government savings. A number of reviews have pointed to a key problem in New Zealand resulting from low government savings.

\textsuperscript{38} Conversely, Australian research (e.g. Wills and Ross 2002:12) has found that people in Australia are not saving enough to have the standard of living that they expect in retirement, and savings for retirement need to be increased beyond the mandated nine per cent work-based levels currently in place.
reduced in New Zealand. However, it is not clear whether there have been corresponding increases in less traditional forms of savings. This is supported by research undertaken by Hiebert (2006), who investigates possible explanations for why a decline in household savings rates has been seen in some OECD countries, but not in others. Hiebert finds that while the countries have similarities insofar as institutional or cultural features, factors such as capital gains or rapid financial innovation have played some part in the differences in household savings rates. For example, gains in the value of assets such as housing have been important as a substitute for traditional household saving.

Hiebert (2006) finds that a reduction in the overall level of savings in a number of OECD countries has corresponded with a rise in wealth and improved access to capital gains in financial and residential markets. Hiebert concludes that gains in wealth in these other forms have been used increasingly as a substitute for traditional forms of savings, thus ‘active’ saving has been replaced by ‘passive’ saving. This research demonstrates that the changing nature of saving may be an important factor to take into account when considering levels of national savings.

Housing assets account for around 70 per cent of New Zealand households’ total assets (Goh 2005). This compares with around 65 per cent in Australia, between 50 and 55 per cent in the United Kingdom, Germany and France, and around 37 per cent in the United States (Goh 2005). If a degree of rational behaviour is assumed, it is possible that individuals in New Zealand may prefer to invest in property as a form of retirement savings, in favour of more traditional savings methods. As property is one of the few tax-preferred items remaining in New Zealand, it would not be surprising to find that property investment has, to some extent, replaced other savings vehicles since the removal of superannuation taxation concessions in the late 1980s. However, research undertaken by Statistics New Zealand (2001) shows that this is not necessarily the case. The report *The Net Worth of New Zealanders: A Report on Their Assets and Debts* shows that 36% of total asset values held by individuals in New Zealand is invested in the owner-occupied home, followed by investment in farms (9%), businesses (9%), bank deposits (6%), superannuation (6%) and trusts (6%). Rental property accounts for just 4% of asset values – the same percentage as motor vehicles.

A second suggestion is that the policy objectives of New Zealand and other OECD countries have diverged over the past two decades. While most welfare systems have developed on the basis of need, and it is generally accepted that it is socially desirable that retired individuals should not face undue hardship in their old age, most countries have elaborated more specific goals for retirement income policy. For example, in Australia retirement income policy is focused more on facilitating maintenance of

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39 In New Zealand less than 15 per cent of the labour force are members of work-based superannuation schemes and a significant number who have access to superannuation schemes are not members (Davey 2004:10).

40 It is noted that a propensity to invest in property is not unique to New Zealand. A 2005 Reserve Bank discussion paper on property ownership in Australia found that residential property represented more than 60 per cent of all household assets (Sydney Morning Herald 28-29 October 2006:45).
employment standards of living into retirement. The policy objective for retirement savings in New Zealand has been articulated as encouraging increased private sector provision for retirement and assisting workers to have a better standard of living in retirement. However, the policy enacted to achieve this objective has adopted a significantly more ‘hands-off’ approach to that seen throughout the rest of the OECD. If policy objectives were attempting to achieve aims beyond poverty alleviation, it would be expected that a greater degree of state involvement in retirement income savings would be seen.

The issue of inequity with the provision of tax incentives was one of the key arguments raised by the New Zealand Government to support the removal of tax incentives for retirement saving. As well as the potential for greater utilisation of incentives by higher income earners it was also suggested that it was this same group that were more likely to take advantage of tax planning opportunities that existed at the time. This argument gained currency despite the presence of a not overly generous maximum limit of tax concession that could be claimed. While the issue of equity, or, more appropriately, inequity, is frequently raised in the international debate surrounding tax concessions, it would appear to have not found sufficient political or social support to remove, or reduce, incentives throughout OECD countries. Furthermore, it could be argued that recent reforms in some countries (such as Australia) are likely to increase any inequities in the current arrangements.

Given the absence of tax incentives it is perhaps not surprising to find that private coverage for superannuation is rising in all countries with the exception of New Zealand (Disney and Johnson 2001:42). It is suggested the decrease in private superannuation savings was at least likely, if not predictable, from the policy changes in the 1980s. From this position, the policy objectives can only be assumed to exclude encouragement of private provision, although the rhetoric would tend to dispute this.

A final suggestion for the continued New Zealand approach to retirement savings is the political sensitivity of the topic. With the changes that have occurred over the past two decades, superannuation and its taxation has become an area that is now politically difficult to change. There was little in the way of public support for removal of the incentives in the 1980s, but once the arrangements were in place they became difficult to undo. Reasons for the entrenchment of the policy included the trade-off associated with the removal of the tax incentives, that is, the reduction of personal income tax rates. This was effectively treated as ‘compensation’ for removal of the tax incentives and it is generally accepted that in the absence of this trade-off implementation of the policy would not have been possible. In addition, the


42 Of the 225 submissions received on the proposal, none were entirely in favour of the removal of tax incentives.

43 It is interesting to contrast the New Zealand and Australian experiences with the trading off of tax concessions and personal income tax rates in 1988. The 1988 May Economic Statement in
absence of strong interest groups in New Zealand to contest the changes was apparent. While employer groups, trade unions and other lobby organisations attempted to challenge the changes, none were successful.

6 Conclusion
The numerous policy changes witnessed in New Zealand have led to criticism of the historical and current schemes. A particularly harsh indictment came from the (United Kingdom) Institute of Chartered Accountants (1999:20) who describe the retirement income reform process in New Zealand as ‘especially unhappy, protracted and frankly absurd. A full description of all the reforms, proposed reforms, counter-reforms and about turns reads like a rather implausible script for a farce’. While most commentators are not generally so harsh, the New Zealand system is generally included in studies more for its originality than as any ideal model that can be recommended.44

It is widely accepted that concerns about population ageing have played a significant role in the reforms adopted throughout the OECD. This can be seen in the international trend towards increased support of retirement savings. A recent example is the Australian proposal to allow superannuation benefits paid from a taxed fund to be provided tax free to individuals aged 60 years and over, thus making an already highly concessionary scheme even more generous. New Zealand faces the same concerns and despite reviews, reports, consultative committees and task forces on the topic of retirement savings and its concomitant taxation, there has yet to be any serious consideration of a move towards reinstating tax incentives for retirement savings. If this ‘social experiment’ results from a policy objective of poverty alleviation then perhaps New Zealand has adopted the correct approach, given the absence of evidence to show that tax incentives ‘work’.

If New Zealanders are saving for retirement through less traditional mechanisms, such as property, then the apparent low savings rate compared to other OECD countries should not be problematic. However, if New Zealanders are not selecting to save through other vehicles, and data would indicate that this is the case, then it is likely that current low- and middle-income earners will face a lower standard of living in retirement compared to those of their OECD counterparts. It would appear that there is a need for research to investigate the ‘real’ levels of savings in New Zealand, including those held in less traditional savings vehicles. If the results of this research indicate that New Zealanders are choosing to consume in the present rather than in the future, then it may be necessary to have greater intervention into the ‘neutral’ New Zealand savings market.

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44 Australia outlined new arrangements that effectively reduced the deferral benefit of tax, with the increased revenue gained being used to cut income tax rates applying to other personal income. Whereas in New Zealand the trade off was the complete loss of tax incentives in return for reduced personal income tax rates.

Although it has found favour with some commentators (e.g. Willmore 2000).
References


Appendix 1: Chronology of Primary Events in New Zealand Retirement Savings

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>1898</td>
<td>Old Age Pension 1898 introduced.</td>
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<td>1910</td>
<td>National Provident Fund established.</td>
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<td>1915</td>
<td>Tax concessions for private superannuation provided for in the Finance Act 1915.</td>
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<td>1916</td>
<td>Concessions introduced for investment earnings of superannuation funds.</td>
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<td>1921</td>
<td>Employer contributions to superannuation funds qualified for tax concessions.</td>
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<tr>
<td>1938</td>
<td>Social Security Act 1938 introduced the dual publicly provided pension system. Superannuation funded through compulsory social security tax to the Social Security Fund.</td>
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<tr>
<td>1975</td>
<td>Introduction of a compulsory contributory retirement savings scheme. Pensions taxed as EET, lump sum withdrawals taxed as EEE.</td>
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<tr>
<td>1977</td>
<td>Withdrawal of compulsory contributory retirement savings scheme. Universal superannuation scheme known as National Superannuation introduced. Superannuation now financed from ordinary government revenue.</td>
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<tr>
<td>1979</td>
<td>Basis for determining rates revised to reflect a net rather than gross relationship with average wages.</td>
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<td>1982</td>
<td>Lump sum investment income taxable as ETE.</td>
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<td>1984</td>
<td>Tax review announced</td>
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<tr>
<td>1985</td>
<td>National Superannuation surcharge introduced (announced in 1984). Age of eligibility increased to 65 (on a gradual basis).</td>
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<tr>
<td>1988</td>
<td>Removal of all tax concessions associated with retirement savings. Superannuation funds required to pay standard company tax rate.</td>
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<tr>
<td>1989</td>
<td>National Superannuation no longer linked to 80 per cent of average wage levels – rates changed to increase by the lower of price and wage movements within a band of 65 – 72.5 per cent of net wages.</td>
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<td>1990</td>
<td>National Superannuation renamed Guaranteed Retirement Income.</td>
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<td>1994</td>
<td>Transitional Retirement Benefit introduced for those affected by the increase in qualifying age.</td>
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<td>1997</td>
<td>Referendum held on the introduction of a compulsory retirement savings scheme – 92 per cent voted against the initiative.</td>
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<td>1998</td>
<td>Surcharge abolished and minimum level of superannuation payment reduced to 60 per cent.</td>
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<td>2000</td>
<td>Minimum level of superannuation payment restored to 65 per cent.</td>
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<td>2001</td>
<td>New Zealand Superannuation Act 2001 passed, which established the New Zealand Superannuation Fund.</td>
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<tr>
<td>2004</td>
<td>State Sector Retirement Savings Scheme introduced: a scheme for public sector employees, which benefits from employer contributions of up to six per cent of earnings.</td>
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