Date: 31 May 2004

Report to : Minister of Finance
Minister for Social Development and Employment

REVIEW OF NEW ZEALAND SUPERANNUATION PORTABILITY

Executive Summary

Background

1 In 2000 the Minister of Finance requested a review of New Zealand Superannuation (NZS) portability. Joint Ministers agreed to the Terms of Reference (TORs) we submitted in 2001, which expanded the review to include New Zealand's international social security policies as a whole. In February 2003 we set out three Packages of options, which you agreed should be refined and costed. This paper presents the refined and costed Packages and an additional Package requested by Associate Ministers for Social Development and Employment.

Guide to reading the paper

Packages

2 The four Packages are described below (for a more detailed summary see Annexes I and III).

Package A: Proportional model (refer paragraphs 30-55)

3 NZS is portable (proportionalised*) at 1/40th for each year of New Zealand residence between the ages of 20 and 65, subject to a ten year residency requirement[1]. Overseas pensions do not affect a person's NZS payment (ie direct deduction is abolished). The amount of NZS payable does not change for people who have lived all their working lives in New Zealand, or have lived overseas for five years or less between the ages of 20 and 65. Each year, on average approximately 2,000 people who would have had an entitlement to NZS, in the absence of the proposed changes, would not be entitled due to the new residence provisions.

Package B: Proportional portability; direct deduction is abolished under social security agreements (refer paragraphs 56-64).

4 NZS is portable at 1/45th for each year of New Zealand residence between the ages of 20 and 65. Domestic clients covered by a social security agreement* have their NZS proportionalised, and are not subject to the direct deduction policy. Thus their overseas pension is paid on top of the NZS amount. Domestic clients not covered by an agreement continue to be subject to the direct deduction policy.

Package C: Full portability; moderated direct deduction (refer paragraphs 65-70)

5 The full rate of NZS is paid to domestic and portable clients who have 15 years' New Zealand residence after the age of 20 (partial NZS not payable). Domestic clients retain a small portion of overseas pension before the direct deduction policy takes effect.

Package D: Special portability provisions apply to everyone; moderated direct deduction (refer paragraphs 71-74)

6 The formula used for the special portability provisions (50% NZS after 10 years' New Zealand residence, rising to 100% after 20 years) applies to all portable clients. Domestic clients continue to receive full NZS after ten years residence in New Zealand. Domestic clients retain a small portion of overseas pension before the direct deduction policy takes effect.

Analysis of Packages

7 *Package A* most closely meets the criteria set out in the TORs (for a detailed summary analysis refer to Annex IV). It achieves equity between domestic and portable clients, enables more people to access a portable pension, and generates significant savings for Government. It also establishes genuine cost sharing between New Zealand and other countries in which a person has been resident and abolishes the problematic direct deduction policy. Officials recommend Package A.

8 *Package B* is the next best option, although it only addresses the unfair treatment of overseas pensions for people under a social security agreement. It also involves risks surrounding the social security agreement with the United Kingdom. *Packages C* and *D* involve costs and do not, we believe, sufficiently address current problems to be viable options.

[1] Refer to glossary for a definition of all terms followed by a *

Table 1: Analysis of Packages

	Equitable	Achieves genuine cost-sharing	Single portability system	Fiscally acceptable to Govt	Facilitates migration flows		Enhances negotiation of Agmts	Resolves obstacles to US Agmt	Resolves existing admin. difficulties	Easy to administer
					Inbound	Outbound				
Ideal	**Yes**	**Yes**	**Yes**	**Savings**	**Good**	**Good**	**Good**	**Good**	**Yes**	**Good**
Pkg. A	Yes	Yes	Yes~	Savings	Good	Good	Good	Good	Yes	Moderate
Pkg. B	No	Partial*	Yes~	Savings	Good	Good	Good	Partial	Partial	Poor
Pkg. C	Yes	No	Yes~	Cost	Poor	Moderate	Poor	Partial	No	Moderate
Pkg. D	No	No	No	Cost	Poor	Good	Poor	Poor	No	Moderate

*Only for people covered by a social security agreement ~only under special portability options (a) and (b)

Policy work undertaken

9 Our work on refining the Packages has included:

- developing a safety net for *Package A* to cover persons with limited New Zealand residence and a small or non-existent overseas pension (two options: one being means-tested, the other non-tested)
- developing a 'time-out' provision for *Package A* so that persons with small amounts of time overseas would not be affected by the proportional formula
- considering how overseas pensions should affect benefits other than NZS under *Package A*
- assessing the operational feasibility of *Package B*
- developing grand-parenting provisions for each Package
- developing a set of special portability options that are better aligned with the TORs objectives of equity and establishing a single portability system than the current system
- developing a mechanism to avoid double social security taxation for foreign companies and seconded workers
- considering appropriate levels for minimum residence requirements.

Advance notice of changes and grandparenting

10 Should Government wish to make any amendments to NZS, advance notice is required before the changes come into effect. This is because people close to the age of retirement have only a limited ability to make financial adjustments. Officials suggest a lead in period of 5-10 years (to be finalised during the next round of policy work). After that period has lapsed, we recommend that all existing clients be grandparented out under the current system, with domestic clients having the option of changing to the new system should they be better off.

11 The portable NZS changes proposed in this paper will not apply to people who are already overseas at the time the legislation comes into effect (apart from under special portability options (b) and (c)). Rather, it will apply to those people who leave New Zealand after that time.

Safety net payment

12 Under *Package A* the amount of social security pension income people receive from New Zealand and overseas sources would vary. In some instances people affected by *Package A* would have insufficient income to live on. Consequently we have developed two options for a safety net payment.

Costings

13 Table 2 outlines the benefit cost/(savings) of each Package, including administrative costs. It does not include costs for the special portability provisions, which will vary depending on the special portability option you choose; possible savings in health costs; and savings in supplementary benefits. As with all costings in this paper, figures are based on migration statistics since 1989. The costings should be considered as indicative only as actual numbers could vary considerably from our assumptions.

14 We suggested in paragraph 10 above that policy changes should be made after a lead in time of 5-10 years. The costings are for 2006/07 onwards and do not therefore include a lead in time. If a lead in time is adopted savings would not be achieved in the timeframes set out in the table. Figures are therefore presented to indicate orders of magnitude and relativities.

Table 2: Cost/(savings) of each Package

	Fiscal cost (savings) - $m				
	2006/07	2007/08	2008/09	2009/10	2010/11
Package A[2]	(46)	(99)	(143)	(187)	(233)
Package B	(82)	(124)	(161)	(197)	(235)
Package C	12	6	8	13	29
Package D	43	42	47	53	63

15 We estimate that *Packages A and B* will save Government in the region of $230 million per annum in 2010/11. *Package D* is the most expensive, costing Government $63 million per annum in 2010/11.

Additional policy issues

16 We have developed some policy options that can be applied to any Package.

Special portability options

17 We have developed two options for the special portability provisions for Pacific countries.

(a) *Create a single portability system for everyone:* under this option the special portability provisions are abolished and everyone is paid under the general portability provisions of whichever Package you choose.

(b) *Create a single portability system for everyone and allow applications from retirees in Pacific Islands:* the special portability provisions are abolished as for (a). In addition, we

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[2] These costs include the cost of offering a means-tested safety net (which costs $0.5 million in 2006/07 rising to $2.5 million in 2010/11). Should you not wish to income test the safety net, the cost would be an additional $4.5 million in 2006/07 rising to $22.3 million in 2010/11.

have established a concession under *Packages A* and *B,* to acknowledge that Pacific people will need more than the 20 years' New Zealand residence they currently require to obtain full NZS:

> those people aged 65 and over currently resident in the Pacific Islands who left New Zealand prior to age 65, but who have sufficient residence in New Zealand in the past to qualify for NZS should, once the legislation comes into effect, gain eligibility from the date of application for a general portability payment.

18 The Ministry of Foreign Affairs and Trade (MFAT), the Ministry of Pacific Island Affairs (MPIA) have developed a third option:

(c) retain the status quo (50% after 10 years, 100% after 20), with an amendment that applications from the Pacific Islands be allowed, but also pay the 'concession' offered in option (b) above.

Costings

19 The costings for the special portability options are detailed in the paper in paragraphs 78-101. If *Package A* is implemented option (c) is the most expensive ($28 million in 2006/07; $46 million in 2010/11); option (a) the most cost-effective ($8 million in 2006/07; $24 million in 2010/11).

Social security contribution relief for foreign companies and seconded workers

20 Some foreign companies and foreign seconded workers are subject to double social security taxation. MSD officials have been informed that some US firms view double social security taxation as a disincentive to establishing a presence in New Zealand. Therefore, although the magnitude is unknown, New Zealand could potentially be missing out on foreign investment and skilled seconded workers. Officials have done some preliminary analysis on whether there is a benefit for New Zealand to offer social security contribution relief. A practicable way of offering the relief is giving foreign secondees a rebate of 8% of their taxable income.

21 The estimated cost of offering the rebate is $2 million in 2006/07, rising to $4 million in 2010/11. However, there is a potential for New Zealand to gain some savings through a reduction in New Zealand Superannuation expenditure. If New Zealand offers a social contribution relief to US, US will release social security benefits to New Zealand citizens which can then be directly deducted from their New Zealand Superannuation. US will also release contact details of all US social security benefit recipients, which would ensure that recipients will not be able to evade the direct deduction of their New Zealand Superannuation. This is estimated to give savings of $8.2 million in 2006/07 and $10.2 million in 2010/11 to offset the rebate cost. These savings are only available for Package C and D; they are not available for Package A and B because direct deduction does not apply under these packages.

Analysis

22 Officials believe that social security tax relief should be granted only if the benefits justify the costs incurred. It is unclear that the removal of double social security taxation would attract many additional foreign companies or skilled foreign secondees to New Zealand. There is also a risk that the costs could be significantly higher than expected; the lack of data and the difficulty in predicting labour flows mean that in reality the estimated costs and savings may be significantly higher than expected. Given these reasons, Treasury considers the policy development in this area to have lower priority than the items with least priority in the current

tax policy work programme. Should ministers ask for further work in this area other items with higher priority may need to be discontinued.

Consultation with Treasury

23 Treasury have been fully consulted on this paper and agree with the recommendations.

Conclusion

24 Migration forecasts indicate that we can expect sustained high migration flows for some time to come, which will exacerbate problems with the international social security policies. New Zealand will therefore have to address these issues at some point in time. The longer we wait, the harder and possibly more expensive they may become to resolve.

25 We recommend that you select *Package A* for further work, with a means-tested safety net. This Package most closely meets the objectives set out in the TORs for this project and creates substantial savings. Should *Package A* not be acceptable, our next preferred option is *Package B*. In terms of the additional options that can sit alongside any Package, we recommend that you consider further work on social security tax relief for foreign companies and seconded workers. However, due to the relatively small impact of the proposal and the risk of costs being significantly higher than expected, Treasury advises that no further work be done on social security tax relief.

26 We have split recommendations on the special portability options. MFAT/MPIA/NZAID prefer option (c) (the status quo but also allowing applications from those already retired in Pacific countries). MSD and Treasury prefer option (a) (abolishing the special portability provisions and paying everyone the same rate), but if you wish to offer a concession on account of the longer residence requirement under most Packages, option (b). Should you prefer option (c), MSD and Treasury recommend reducing the number of countries from 22 to eight (para 100 refers).

Recommended actions

We recommend that you:

1 **note** that the Minister of Finance requested that the Ministry of Social Development (MSD) and the Treasury review the New Zealand Superannuation portability provisions before the introduction of the New Zealand Superannuation Bill in 2000. Because it involved substantive issues, a review was not possible before the introduction of the Bill

2 **note** that you agreed to the review, and the Terms of Reference (TORs) of 13 November 2001, which expanded the review to cover New Zealand's international social security policies as a whole

3 **note** that the TORs formed the basis for an options paper, *New Zealand Superannuation Portability*, which was submitted to Ministers on 14 February 2003. In this paper we set out three Packages of options. You agreed that these Packages should be refined and costed, and directed officials to report back by 31 May 2004 (a fourth Package was subsequently included, as requested by Associate Ministers for Social Development and Employment)

4 **note** that we have refined and costed all four Packages in this paper:

- *Package A:* all NZS payments are proportionalised, based on a person's New Zealand residence between 20-65. This package includes a safety net payment and a provision to allow people to leave New Zealand for up to five years without their NZS entitlement being affected
- *Package B:* a person's portable NZS payment is proportionalised; direct deduction abolished under social security agreements
- *Package C:* full NZS after 15 years' New Zealand residence; domestic clients retain a small portion of their overseas pension before direct deduction applies
- *Package D:* use special portability formula for all portable clients; domestic clients retain a small portion of their overseas pension before direct deduction applies.

5 **note** that:

- *Package A* best meets the criteria set out in the TORs and is officials' preferred Package
- *Package B* is officials' next preferred Package, but bringing the United Kingdom Social Security Agreement into alignment may not be feasible
- *Packages C* and *D* are expensive and not a great improvement over the status quo.

Recommended Package

6 **agree** that *Package A* is your preferred Package

AGREE / DISAGREE

7 **agree** that under *Package A*, a means-tested payment (safety net) be established for those with limited New Zealand residence and small/no overseas pensions

AGREE / DISAGREE

Additional options

8 **note** that these options have been designed to sit alongside any Package you choose

Special portability provisions

9 **agree** that:

EITHER (MSD and Treasury preferred approach)

(a) the special portability provisions should be abolished and a single portability system be created for everyone

AGREE / DISAGREE

OR (MSD and Treasury second preference)

(b) the special portability provisions should be abolished and a single portability system be created for everyone

AND should you agree to *Package A* (rec 6 above refers) or *B* then:

those people aged 65+ currently resident in the Pacific Islands who left New Zealand prior to age 65, but who have sufficient residence in New Zealand in the past to qualify for NZS should, once the legislation comes into effect, gain prospective eligibility (ie from the date of application rather than the date they turned 65) for a general portability payment

AGREE / DISAGREE

OR (MFAT, MPIA, NZAID preferred approach)

(c) the special portability provisions should be retained, with an amendment that applications from the Pacific Islands be permitted

AND

those people aged 65+ who left New Zealand to retire in the Pacific Islands prior to age 65, but who have sufficient residence in New Zealand in the past to qualify for NZS should, once the legislation comes into effect, gain prospective eligibility (ie from the date of application rather than the date they turned 65) for a general portability payment

AGREE / DISAGREE

EITHER (MSD and Treasury preferred approach)

should you choose to retain the special portability provisions under this option, they should apply to a smaller group of countries (Cook Islands, Fiji, Kiribati, Niue, Tokelau, Tonga, Samoa, Tuvalu) because the current group of 22 includes foreign territories and countries with whom New Zealand has minimal ties (eg American Samoa, Guam) (MS

AGREE / DISAGREE

OR (MFAT, MPIA, NZAID preferred approach)

retain the current 22 countries

AGREE / DISAGREE

Social security tax relief for foreign companies and seconded workers

10 **note** that given the risk and relatively small impact of the proposal, Treasury thinks that this would have lower priority than the items with least priority in the current tax policy work programme. Treasury advises that no work be done in this area as it implies discontinuing work on other higher priority items

11 **Dr Cullen**

indicate whether you would like further work to be done on social security tax relief

DO FURTHER WORK / DO NOT DO FURTHER WORK

Residence requirements

12 **agree** that the residence requirements should be relaxed so that clients who leave New Zealand after the legislation comes into effect will be able to apply for NZS from overseas (once they reach 65), and so that they do not have to have five years' New Zealand residence over the age of 50 in order to qualify

AGREE / DISAGREE

Next Steps

13 **refer** this paper on to the Ministers of Foreign Affairs and Trade and Pacific Island Affairs for their consultation, and the Ministers of Immigration and Senior Citizens, for their information

14 **direct** MSD and Treasury officials to prepare a paper on the basis of decisions you have made for the Cabinet Social Development Committee to consider by 30 June 2005.

AGREE / DISAGREE

Nicholas Pole
Deputy Chief Executive
Social Services Policy

Date

Hon Dr Michael Cullen
Minister of Finance

Date

Steve Maharey
Minister for Social Development and Employment

Date

PART ONE: BACKGROUND AND ISSUES

Background

1 In November 2000, Hon Dr Cullen planned to have officials review the provisions for portability of New Zealand Superannuation (NZS) before the introduction of the New Zealand Superannuation Bill [CAB (00) M32/3A refers]. Because it involved substantive issues, however, a review was not possible before the introduction of the Bill. Officials from the Ministry of Social Development (MSD) and Treasury formed a working group and submitted a scoping paper on 13 November 2001 (SDP/01/419 refers) to joint Ministers that recommended expanding the review to encompass New Zealand's international social security policies as a whole.

2 You accepted the Terms of Reference (TORs) attached to that paper and directed further policy work to commence. MSD has been leading a working group on this project since that time. Participants include the Ministries of Foreign Affairs and Trade (MFAT), the Ministry of Pacific Island Affairs (MPIA), the Treasury, the Inland Revenue Department (IRD) and the Retirement Commission. The working group's findings were the basis for an options paper, *New Zealand Superannuation Portability*, which was submitted to Ministers on 14 February 2003 (REP/03/2/44 refers).

3 In that paper we set out three Packages of options. Each would require change in legislation, but would not alter the 'at least 65% of the net average wage at age 65' formula for setting NZS rates or the age of eligibility. You agreed that these Packages be refined and costed, which has been undertaken in this paper. A further package was added at the request of Associate Minister for Social Development and Employment.

Issues

4 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 other countries overseas, which impacts negatively on other New Zealand Government priorities concerning positive aging and immigration. There are also considerable administrative problems with the current system.

Out-of-date polices

5 The general portability provisions* were originally developed to treat recipients of NZS "in the same way as residents in New Zealand" (1987 *Ministerial Taskforce*). The rate was set at 50%, to account for the fact that portable pensions were not subject to the surcharge or taxation prior to export. This became inconsistent with domestic policy when the surcharge was abolished in 1998.

6 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 benefit entitlement an inexact and often unfair method of sharing social security costs between countries.

Inequitable policies

7 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.

Portability

8 Four different formulas for calculation of NZS are currently offered, depending on the country in which a person chooses to retire. After 20 years' residence in New Zealand, for example, a person will receive:

- 100% NZS if resident in New Zealand
- 50% under the general portability provisions if they retire to a non-Pacific, non-Agreement country (eg the United States)
- 100% under the special portability provisions* if they retire to a Pacific Island country or
- either 20/40ths or 20/45ths NZS if they retire to an Agreement country*.

9 This makes for an ambiguous portability policy. It also means that there is no equity between those who retire overseas and those who remain in New Zealand.

Special portability provisions

10 The special portability provisions were introduced in 1993 to reflect New Zealand's special constitutional relationship with three Pacific countries: Niue, the Cook Islands and Tokelau. They were also established to recognise the contribution of these people to the New Zealand labour force and the inability of those countries to provide reciprocal social security.

11 At that time, the general portability provisions had just been established at the flat rate of 50% of full NZS for people who retired to countries with whom New Zealand did not have a social security agreement. The special portability provisions largely mirrored this rate.

12 In 1999 the formula was amended so that a person could receive full NZS after 20 years' New Zealand residence. This was, and remains, double what a person can receive under the general portability provisions, as they can only ever receive 50%, regardless of their New Zealand residence.

13 In addition, the number of Pacific countries covered by these provisions was increased to 22. This immediately obscured the original intent of the policy, as it now covers overseas territories of the United States (US) and France.

Direct deduction

14 Under the direct deduction policy, a person generally loses their entire overseas pension, as it is deducted dollar-for-dollar from their New Zealand benefit entitlement. This means that many people do not inform MSD about their overseas pensions, or do not apply for their overseas pensions (we estimate the cost to Government could be approximately $100 million per annum).

15 Another problematic aspect of the direct deduction policy is its lack of genuine cost-sharing. It is customary overseas for each country in which a person has been resident to share a proportionate 'burden' of that person's social security costs. The direct deduction policy means that the New Zealand Government often avoids doing so, as can be seen below:

Mr A lives in Sweden for 30 years, and in New Zealand for 15. His Swedish pension is **$280 per week.** After his overseas pension is deducted from his NZS entitlement of $300, New Zealand's contribution is only $20 NZS. This does not reflect an adequate sharing of the burden for Mr A's social security costs for 15 years.

30 yrs of Swedish pension	$ 280
Direct deduction ($300-$280)	$ 20 (NZS)
TOTAL income (gross)	$ 300

16 As a result, a number of countries (eg Germany, Switzerland, Austria) do not wish to negotiate a social security agreement with the New Zealand Government. In the case of Germany, the lack of any agreement means some German pensions are not paid to people resident in New Zealand. As a result, we pay these people full NZS (which does not achieve genuine cost-sharing either).

Failure to provide 'seamless' social security provision

17 Our current policy settings are out of step with Members of the European Union (EU) and many other countries, where emphasis is placed on 'seamless social security provision' for migrant and seconded workers. Such seamless provision is generally afforded by:

- ensuring that each country in which a migrant works proportionately shares the social security costs of that migrant (our direct deduction policy negates this for migrants who retire here, and our general portability policy negates this for those who wish to retire overseas)
- exempting foreign companies (and hence the seconded workers they employ) from 'double social security taxation' (New Zealand offers no such exemption).

18 The impact of these factors are not known but they may potentially be important to foreign companies and migrants when they are considering potential destination countries in which to work.

Failure to support the Positive Ageing Principles

19 The extremely low take up of the portability provisions outside of social security Agreements (currently 172 people under general portability and 401 for special portability, with a combined take-up rate of less than 10 people per annum) is, we suggest, due to the fact that the residence restrictions prevent a person from applying from overseas and, in the case of general portability, the low rate of entitlement. Therefore, the portability provisions do not adequately support the Government's *Positive Ageing Principles* relating to empowering older people to make choices about where they live.

Administrative difficulties

20 There is currently confusion about how the temporary absence provisions relate to the special portability provisions. Many people move to the Pacific Islands but return to New Zealand for short stays every 26 weeks. In doing so they wrongfully expect that they can rely on the temporary absence provisions (which allow retirees to go overseas for less than 26 weeks without affecting their entitlement) for payment of NZS.

21 In addition, it is often complicated to determine whether or not an overseas pension is direct deductible as it is not always clear what type of pension is being paid. For example, many

countries have compulsory pension systems that require contributors to contribute to private pension accounts. Some other countries pose their own unique problems. The UK, for example, allows contributors to 'contract out' of its second tier pension into private occupational pensions. These problems will bring the sustainability of the direct deduction policy into question in the medium-term.

Problems going forward

22 We believe that New Zealand's international social security policies are unsustainable in the medium-term for the following reasons. First, those who are potentially affected by these policies represent a sizeable proportion of the population.

- Of the domestic population aged 65+, 26% (and growing) are foreign born. Many of these are unsatisfied,[3] and are putting pressure on Government for change because:
    - they are inhibited from returning to their home country before 65, as they will receive no NZS, or only 50% if they wait until 65 (unless they are under an Agreement or retiring in the Pacific)
    - many of those who retire in New Zealand will lose the value of their entire overseas pension through the direct deduction policy.
- Of the New Zealanders who are retired overseas only 573 are receiving a portable NZS payment outside an Agreement. We expect the main reason for this is because they departed New Zealand before they turned 65.

23 The second reason we believe New Zealand's international social security policies are unsustainable is because the current system involves significant costs to the Crown, as follows:

- while the direct deduction policy saves Government $178 million per annum, evasion of the policy is costing Government more than $100 million per annum. Despite MSD's efforts to reduce this figure, lack of data about specific clients who are receiving overseas pensions will always mean a high degree of evasion.
- the 10 years' New Zealand residence required for NZS is not limited to working age residence (i.e. that between 20-65 years of age). Older people therefore arrive under, say, the Family Parent immigration policy and wait 10 years until they qualify for full NZS, despite making a limited contribution to New Zealand society (which applied to more than 1300 people in 2002/03).
- Government pays full NZS to people who would normally have entitlement to an overseas pension because our current policy settings mean these countries will not negotiate a social security agreement with us (eg the US, Germany, Austria and Switzerland; unpaid overseas pensions totalling approximately $21 million per annum).

24 Migration forecasts indicate that we can expect sustained high migration flows for some time to come, which will exacerbate the problem. New Zealand will therefore have to address these issues at some point in time. The longer we wait, the harder and possibly more expensive they may become to resolve.

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[3] The degree to which these people find the policies unfair can be illustrated by the fact that their complaints constitute a significant proportion of all correspondence to the Minister for Social Development and Employment (and his Associates), and complaints are frequently received by the Minister of Finance. Also of the public submissions made to the *Periodic Report Group* in 2003, over half were concerning the nature of the direct deduction policy.

PART TWO: OBJECTIVES AND WORK TO DATE

Objectives

25 The objective of this paper is to propose a cohesive international social security framework that meets the following criteria:

- is equitable
- ensures genuine cost-sharing mechanisms are in place for overseas pensions
- better facilitates the free flow of migrants and labour
- improves the interface between the social security system of New Zealand and those of other countries
- provides a single, easy to understand portability system
- assists New Zealand to negotiate social security agreements with other countries
- resolves obstacles to a US social security agreement and portability of US benefits
- is fiscally acceptable to the Government
- is simple to administer
- links to on-going policy work in Social Assistance area, such as simplification and retirement policy, which may impact on rationale and logic of options.

Refinement of the Packages: Work to Date

26 Three Packages were presented in the *New Zealand Superannuation Portability* (14 February 2003) paper. Since the submission of that paper, Associate Ministers requested that we develop a Package whereby the special portability provisions apply to everyone (Package D below). There are now four Packages for your consideration which have been refined and costed. They can be summarised as follows (for a fuller description refer to Annex I or Annex III, at page 35 or 37):

- *Package A: Proportional model* NZS payment to domestic and portable clients is proportionalised at 1/40th for each year of New Zealand residence, subject to a minimum of ten years residence (based on the years a person has lived in New Zealand between the ages of 20 and 65). Overseas pensions do not affect a person's NZS payment.
- *Package B: Proportional portability; direct deduction is abolished under social security agreements* NZS is portable at 1/45th for each year of New Zealand residence between the ages of 20 and 65. Domestic clients covered by a social security agreement* have their NZS proportionalised and are not subject to direct deduction. Thus their overseas pension is paid on top of the NZS amount.
- *Package C: Full portability; moderated direct deduction* The full rate of NZS is paid to domestic and portable clients who have 15 years' New Zealand residence after the age of 20 (partial NZS not payable). Domestic clients retain a small portion of overseas pension before the direct deduction policy takes effect.
- *Package D: Special portability provisions apply to everyone; moderated direct deduction* The formula used for the special portability provisions (50% NZS after 10 years' New Zealand residence, rising to 100% after 20 years) applies to all portable clients. Domestic clients retain a small portion of overseas pension before the direct deduction policy takes effect.

PART THREE: PACKAGES

27 This Part discusses the four Packages. It does not discuss the special portability provisions or the additional options officials have developed (eg social security tax relief for foreign companies/seconded workers). These are discussed in Part Four. You should note that your choice of Package from Part Three links into your choice from the additional options in Part Four.

28 The costings for each Package include administrative costs but do not include costs for the special portability provisions, as these will vary depending on which special portability option you choose; possible savings in health costs; and savings in supplementary benefits. Figures for each Package are based on migration statistics since 1989. This is subject to change as the population ages, and in the event that migration patterns change significantly.

29 Further policy development and analysis will be required to cover other related policy areas affected by the four packages. It is proposed that this work be undertaken in respect of whichever package is chosen for further work. These policy areas include:

- Veterans Pension
- administrative impact on IRD if *Package A* is implemented
- payment for non qualified spouses of NZS recipients
- definitions around what is acceptable residence under the proportional models
- temporary absence from New Zealand provisions
- hospital rate of NZS
- implications of in-work payment announced in Budget 2004
- Residential Care Subsidy.

Package A

30 *Package A* maintains the provision of a universal age pension, but changes the residence requirements. The current 'all or nothing' approach is replaced with a 'proportionalised'* rate that depends on the number of years a person has spent in New Zealand between the ages of 20-65. To obtain full NZS a person needs to be resident in New Zealand for 40 years during this time.

31 People who have spent the majority of their lives in New Zealand will not be affected in terms of the amount of NZS they will be paid, (allowance will be made for 'time out', provision for people who have spent up to five years overseas). The two groups of retirees who will notice a change under *Package A* are:

(a) New Zealand residents who wish to retire to a non-Agreement country

(b) those who have lived overseas, but are now resident in New Zealand.

32 For people in group (a), they will receive 1/40th the full rate of NZS for every year of New Zealand residence between the ages of 20-65. A person will need at least 10 years' New Zealand residence to receive an NZS payment (which, after 10 years would be 10/40ths).[4]

[4] While we initially suggested a five year minimum residence requirement between the ages of 20-65, we now believe 10 years (ie 10/40ths) is preferable because it would significantly reduce administration costs (ie those associated with

33 Some people in group (b) who have lived overseas but who retire in New Zealand will not be eligible for NZS. Each year, on average, approximately 2,000 people who would have had entitlement to NZS in the absence of the proposed changes would not be entitled due to the new residence provisions that require them to have 10 years residence in New Zealand between the ages of 20 and 65. If these people have financial hardship they will be eligible for Emergency Benefit.

34 The direct deduction policy will be abolished for people in group (b). Instead, these people will be able to keep their overseas pensions, but their NZS will be based on their working life years in New Zealand (rather than on current residency requirements). An example of this is as follows:

Ms Z has spent 25 years in Germany and 20 years in New Zealand between the ages of 20-65. She is entitled to a German pension of $192 per week. The tables below illustrate how Package A would differ from the current direct deduction policy:

Current system		Package A	
25 yrs of German pension	$ 192	20/40ths NZS	$ 150
Direct deduction ($300-$192)	$ 108 (NZS)	25 yrs of German pension	$ 192
TOTAL income (gross)	**$ 300**	**TOTAL income (gross)**	**$ 342**

Time out

35 Allowance will be made for 'time-out' (relatively short periods of residence overseas) to ensure that people are still free to travel overseas for a period of time without having their NZS payment reduced. We suggest a time-out period can be provided by allowing applicants a 45 year period from the ages of 20 to 65 to qualify, but only requiring 40 years of residence in that period to qualify for a full pension. In practice this means that NZS would be assessed using a formula with a 40 year denominator, rather than a 45 year denominator as was suggested in the *New Zealand Superannuation Portability* paper.

36 The time out provision would marginally increase Crown costs. For example, a superannuitant with 10 years' residence in New Zealand would receive $300 a year more under this provision than under the 45 year denominator. The overall additional expenditure for Government would be approximately $4 million per annum. Administration would be simplified as front line staff would not have to account for an applicant's short periods overseas.

Safety net payment

37 Under *Package A* the rate of social security pension income people receive from New Zealand and overseas sources would vary. In some instances, persons with limited New Zealand residence and/or a small or non-existent overseas pension may have a very restricted level of income which, together with the proportionalised NZS, would be insufficient to live on. Therefore a safety net would be required. For example:

processing overseas claims and paying small benefits overseas) without overly compromising the facilitation of migration flows.

Mr X has 15 years' residence in New Zealand. He also spent time in Bulgaria, where he made contributions to the Bulgarian pension system for 15 years. He has cash assets of $3700 and other income of $100 a week. On retirement, Mr X would be entitled to the level of social security pension income per week illustrated in the table to the right:	15/40ths of NZS (gross)	$ 113
	15 yrs of Bulgarian pension	$ 20
	TOTAL pension income	$ 133
	c.f. under current system (NZS)	$ 300

38 For the purposes of costing the safety net, we have set the rate at the rate of Invalids Benefit (IB). The rate of IB has been chosen because, apart from NZS, it is the highest benefit rate payable. The level of the IB rate recognises that clients are likely to be long-term recipients and may have limited ability to supplement their income through paid employment. However, Ministers may wish to consider a different rate, for example aligning the rate with unemployment benefit. Officials can provide costings for a range of rates.

39 The rate of NZS has not been selected, as this would no longer equate to a safety-net payment. Rather, it would maintain the current system of paying full NZS to everyone who qualifies. This contravenes the underlying tenet of *Package A*, which is that a person's NZS payment should be in proportion to their New Zealand residence.

40 There are two options to operate the safety net: it can be treated as a targeted 'hardship' payment or a universal 'top-up' payment.

Option 1: Means tested payment

41 The safety net will be payable under this option if a person's total social security pension income is less than the rate of IB. However, payment of the safety net would be subject to a means test.

- The income test will be that used for the income-tested rate of NZS (for a non-qualified spouse). With this test, the safety net (gross) is reduced by 70 cents for each $1 of private income over $80 (gross) a week.
- The asset test will be that currently applied to the Emergency Benefit (ie if you have cash assets over a certain threshold you do not receive any hardship payment). Any other supplementary assistance (eg Accommodation Supplement; Disability Allowance) will be paid on top. So taking the example of Mr X:

STEP ONE: CHECK ELIGIBILITY FOR SAFETY NET (total pension income)

Add NZS entitlement + overseas pension: must be < (for these purposes) full IB: $246 (gross)

So for Mr X: $113 + $20 = $133 → YES he is eligible

STEP TWO: CHECK ELIGIBILITY FOR SAFETY NET (asset test)

Does person have cash assets more than $4300 (single) or $7464 (married/dependants)?

Mr X: $3700 → YES he is eligible

STEP THREE: DETERMINE LEVEL OF SAFETY NET (before income test)

Subtract total (NZS + overseas) pension income from full IB: Mr X $246 – ($93 + $20) = <u>$133</u>

STEP FOUR: DETERMINE AMOUNT OF TESTABLE INCOME

Take the total 'other income', deduct $80 ('safe zone'): So for Mr X: $100 - $80 = **$20** testable income

STEP FIVE: APPLY INCOME TEST

Apply the 70c for every $1 over that amount: $20 x 70c = **$14** deduction from safety net

Subtract deduction from safety net to get final safety net payment: $133 - $14 = **$119** safety net payment

42 As we have set the level of the safety net to IB, this hardship payment will cover all people whose NZS entitlement and overseas pension (total pension income) is lower than IB (only persons eligible for NZS will be eligible for a safety net payment).

43 Crown expenditure will be $0.5 million in 2006/07, increasing to $2.5 million in 2010/11 (note: all existing clients will be grandparented, as discussed in paragraph 75).

44 The main advantage of this option is that it ensures an adequate minimum level of income for older people in need, while maintaining the underlying tenet of this Package that people with limited New Zealand residence should not be entitled to full NZS. The main drawback of this option is that the income and asset testing would be relatively intrusive for clients and would provide a disincentive to apply for an overseas pension. Nevertheless, this will be no more so than if a person applied for the Emergency Benefit or supplementary assistance currently.

Option 2: Non means-tested 'top-up' payment

45 Under this option, persons with pension income of less than the level of IB would receive an untested 'top-up' payment that would bring them up to that level. This will cost Government $4.5 million in 2006/07, increasing to $22.3 million per year in 2010/11.

46 The main advantage of this option is that it minimises the number of 'losers'. It is also more administratively simple and avoids an invasive income and asset test. While this won't directly increase Crown revenues under this Package (as there is no direct deduction), it will generate small savings because clients are receiving their overseas pensions in their entirety, and are therefore not requiring as much supplementary assistance.

47 The main disadvantage of this option is that people with substantial other income and/or assets will nevertheless receive a top-up payment. Creating a universal rate, even at the lower rate of IB, therefore negates the rationale for establishing a safety net, which is to provide income assistance to people with very limited income.

Treatment of other benefits if direct deduction policy is abolished for NZS

48 Implementation of *Package A* would require amendment of section 70 of the Social Security Act 1964 so that the direct deduction policy no longer applies to New Zealand Superannuation. The direct deduction also applies to benefits paid under the Social Security Act. It may not be appropriate to continue to directly deduct the overseas pensions of beneficiaries (1107 beneficiaries currently receive overseas pensions).

49 We recommend that the direct deduction should no longer apply to benefits. This would mean that overseas pensions would be treated as income. Failure to apply for and declare an overseas pension could result in the termination of a person's New Zealand benefit (because

in so doing they are depriving themselves of income that would reduce the amount of New Zealand benefit they would otherwise receive.

50 The advantages of abolishing the direct deduction policy are: an increased incentive for people to apply for their overseas pension; treating overseas pensions as income is administratively simple; and it provides more equitable cost-sharing with other countries and a basis to negotiate new social security agreements. As mentioned previously, it also generates savings as Government does not have to pay as much supplementary assistance.

Costings

51 Tables 2 and 3 show the cost/(savings) of *Package A* with a means-tested safety net, and with a non means-tested safety net. You will note that overall this Package generates significant savings for Government.

Table 2: Costings for Package A with Means Tested Safety Net

	Fiscal year cost (savings) - $m				
PACKAGE A with means tested safety net	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Benefits and Other Unrequited Expenses: NZS Option 1: Hardship-tested safety net	(63)	(103)	(147)	(192)	(238)
Departmental Output Classes: Services to Seniors	17	4	4	5	5
Total operating	(46)	(99)	(143)	(187)	(233)

Table 3: Costings for Package A with Non Means Tested Safety net

	Fiscal year cost (savings) - $m				
PACKAGE A with non means tested safety net	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Benefits and Other Unrequited Expenses: NZS Option 2: Non means tested safety net	(59)	(94)	(134)	(176)	(218)
Departmental Output Classes: Services to Seniors (Option 2)	17	4	4	4	5
Total operating	(42)	(90)	(130)	(171)	(213)

Administrative Impact

52 *Package A* involves positive and negative administrative impacts, as outlined in Table 4 below:

Table 4: Administrative Impacts for Package A with Non Means Tested Safety net

Positive Administrative Impact	Negative Administrative Impact
• Overseas pensions disregarded and not deducted from NZS payment • relatively easy for clients to understand	• assessing a client's residence is more complex and decisions are more contestable • higher burden of proof on clients regarding residence in NZ • risk in authenticating applications from non-Agreement countries • changes to SWIFTT are complex and substantial

Analysis

53 Of all the Packages presented in this paper, *Package A* most closely meets the objectives set out in the 2001 TORs. In particular, it achieves equity between those who live overseas and those who have remained in New Zealand all their lives while generating significant savings for Government. It also establishes genuine cost-sharing between countries, thereby providing an incentive for people to claim their overseas pension and enabling us to negotiate more social security agreements with other countries. In addition, it facilitates the Government's objective of greater migration and labour market flows into and out of New Zealand. By awarding the same rate of portable NZS as domestic NZS, it removes the main obstacle we currently face in negotiating a social security agreement with the United States.

54 Officials believe that *Option 1: Means tested payment* is the most appropriate safety net mechanism, as it ensures that everyone receives an adequate level of income, and yet does not award people with limited New Zealand residence the same rate of NZS as those with extensive New Zealand residence.

55 Officials acknowledge that this Package will involve significant administrative (particularly Information Technology (IT)) costs for MSD. It also requires clients to present additional evidence of New Zealand residence. We nevertheless believe that these drawbacks are more than offset by the benefits and fiscal gain to Government outlined above.

Package B

Operational feasibility

56 In the February 2003 paper *Package B* restricted the application of the proportional model in *Package A* to those with overseas pensions (who will be required to declare them); or those who are living in, or wish to retire to, a non Agreement country.

57 We have since determined that *Package B* is not operationally feasible, as it relies heavily on information from other countries in order to determine the period of time a client has contributed to an overseas pension. Our experience in testing overseas pensions (whereby information is sought in a similar manner) demonstrates that such information is frequently difficult to obtain from countries with whom we have an Agreement, where there are often delays of between six months and six years. Gaining this information from many non-Agreement countries would be impossible. The only way to avoid these difficulties is to rely solely on a client's word, which we do not find acceptable.

Revised Package B

58 Officials have therefore revised *Package B*. Under this option, portable NZS would be proportionalised. In keeping with the objective of this Package, which is to be more limited in nature than *Package A*, the main group of people this Package affects are those who are going overseas.

59 The other group of people affected by *Package B* are those who retire in New Zealand that are covered by a social security agreement. *Package B* removes the direct deduction for these people and proportionalises their NZS (along the lines of *Package A*, but with no time out provisions so using 45 years as a denominator instead of 40). We suggest the best way to do this is to follow the relevant EU regulations[5]. Under these provisions, when a person

[5] Article 46 of Regulation (EEC) No. 1408/71

receives an overseas pension a pension calculation is made under domestic legislation, then a proportional amount is calculated, and the pension amount paid is the higher of the two.

Ms Y has spent 30 years in New Zealand. She is entitled to a Swedish pension of $120 per week after having lived in Sweden for 15 years.

First calculation		Second calculation	
15 yrs of Swedish pension	$ 120	15 yrs of Swedish pension	$ 120
Direct deduction ($300-$120)	$ 180 (NZS)	30/45ths NZS	$ 200
TOTAL income (gross)	$ 300	TOTAL income (gross)	$ 320

The rate of NZS payable is higher under the right-hand calculation (without the direct deduction), so that is the rate Ms Y would be paid.

Administrative impact

60 *Package B* involves positive and negative administrative impacts, as outlined in Table 5 below:

Table 5: Administrative Impact for Package B

Positive Administrative Impact	Negative Administrative Impact
• Overseas pensions disregarded for agreement countries	• running two sets of rules for agreement and non-agreement countries • for Agreement clients, assessing residence is more complex and decisions are more contestable • higher burden of proof on clients regarding residence in NZ • direct deduction problems remain for many clients ie non agreement countries • changes to SWIFTT are complex and substantial

Costings

61 Table 6 shows the cost/(savings) of *Package B.*

Table 6: Costings for Package B

	Fiscal year cost (savings) - $m				
PACKAGE B	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Benefits and Other Unrequited Expenses:					
NZS	(93)	(125)	(162)	(198)	(236)
Departmental Output Classes:					
Services to Seniors	11	1	1	1	1
Total operating	(82)	(124)	(161)	(197)	(235)

Analysis

62 The main advantage of this Package is that other countries will view our treatment of overseas pensions to be fairer than the current system, so we will be able to conclude more social security agreements. People will also have a greater incentive to claim and declare their overseas pensions, as they will be receiving a net gain from doing so. Therefore, even though we will lose many direct deductions, this will be offset by the proportionalisation of NZS payments.

63 A drawback of *Package B* is that it does not achieve equality between those who go overseas and those who remain in New Zealand (hence it does not solve the main obstacle we have in negotiating an agreement with the United States). There will also be a number of people whose overseas pensions will still be subject to the direct deduction policy, because there are certain countries with whom we cannot negotiate due to the nature of their system (e.g. Singapore which has a Provident fund). Even for those people whose NZS is proportionalised, the administrative problem Work and Income staff currently face in determining the nature of a person's overseas pension (and whether or not it is able to be direct deducted) remains. In addition, there will be significant administrative costs (especially related to IT) for MSD, although these costs are less than for *Package A*.

64 Under this option, the agreement with the United Kingdom (UK) presents some risks. As the dollar amount of UK pensions paid into New Zealand is large we would need to carefully consider the outcome if the direct deduction were modified for UK pensioners. We would only want to offer modified direct deduction to the UK if they offered indexation of pensions in return. This would be difficult for the UK to agree to as other non-indexed countries would seek the same treatment. To leave UK pensioners out of any policy change would be contentious.

Package C

65 With this Package the full rate of NZS would be portable upon fulfilment of the minimum residence requirements. In order to minimise fiscal ramifications, these need to be raised from 10 to 15 years (raising them to 20 would be more preferable from a fiscal point of view, but this would create other problems such as barriers to migration flows).

66 For purposes of equity, the amended residence requirements need to apply to both those who retire in New Zealand and those who retire overseas. Re-negotiations of current social security agreements would also be required for the purposes of consistency. This Package is incompatible with the totalisation provisions in agreements, which would require New Zealand to pay a full pension to persons with as little as one year of residence in New Zealand (under the current system they receive a proportional payment based on years of residence in New Zealand).

67 This Package retains the direct deduction policy, but with a degree of moderation. A 'safe zone' would be implemented, so a pensioner can keep an amount of overseas pension equivalent to 5% of the single sharing rate of NZS and the remainder is direct deducted.

Administrative impact

68 *Package C* involves positive and negative administrative impacts, as outlined in Table 7 below:

Table 7: Administrative impact of Package C

Positive Administrative Impact	Negative Administrative Impact
• relatively easy to administer • minimal changes to SWIFTT	• direct deduction problems will remain • risk in authenticating applications from non agreement countries

Costings

69 Table 8 shows the cost/(savings) of *Package C*. You will note that overall this Package involves costs for Government.

Table 8: Costings for Package C

	Fiscal year cost (savings) - $m				
PACKAGE C	2006/07	2007/08	2008/09	2009/10	2010/11
Benefits and Other Unrequited Expenses:					
NZS	4	5	7	13	29
Departmental Output Classes:					
Services to Seniors	8	1	1	0	0
Total operating	12	6	8	13	29

Analysis

70 *Package C* improves equity between those who go overseas and those who remain in New Zealand. However, it does not adequately address problems with the direct deduction policy and is incompatible with the totalisation provisions in social security agreements

Package D

71 This Package has been developed in response to a request from Associate Ministers for Social Development and Employment. Fifty percent of NZS would be portable after 10 years' residence in New Zealand rising to 100% after 20 years (this is the same formula currently used under the special portability provisions). Domestic clients would be assessed in the same way as they are now except for the implementation of a safe zone. The rate formula in this Package would be incompatible with social security agreements because it does not provide a way of paying people who can gain a pension through the totalisation provisions of an agreement (ie those with less than 10 years residence in New Zealand).

Administrative impact

72 *Package D* involves positive and negative administrative impacts, as outlined in Table 9:

Table 9: Administrative impact of Package D

Positive Administrative Impact	Negative Administrative Impact
• relatively easy to administer • minimal changes to SWIFTT	• direct deduction problems will remain • risk in verifying and authenticating applications from non-Agreement countries

Costings

73 Tables 10 shows the cost/(savings) of *Package D*. You will note that overall this Package involves costs for Government.

Table 10: Costings for Package D

	Fiscal year cost (savings) - $m				
PACKAGE D	2006/07	2007/08	2008/09	2009/10	2010/11
Benefits and Other Unrequited Expenses:					
NZS	38	42	47	53	63
Departmental Output Classes:					
Services to Seniors	5	0	0	0	0
Total operating	43	42	47	53	63

Analysis

74 *Package D* improves the rate of general portability, creating a single portability system, but does not achieve equity between those who go overseas and those who remain in New Zealand. It does not overly improve the incentive for people to claim/declare their overseas pensions and has moderate fiscal implications for Government. It is not compatible with the totalisation provisions in social security agreements.

ADDITIONAL OPTIONS

75 This section outlines the further work we have undertaken on the options in the February 2003 paper, which can sit alongside any Package.

Advance notice of changes and grandparenting provisions

76 Should Government wish to make any amendments to NZS, advance notice is required before the changes come into effect. This is because people close to the age of retirement have only a limited ability to make financial adjustments. Officials suggest a lead in period of 5-10 years (to be finalised during the next round of policy work). After that period has lapsed, we recommend that all existing clients be grandparented out under the current system, with domestic clients having the option of changing into the new system should they be better off.

77 The portable NZS changes proposed in this paper will not apply to people who are already overseas at the time the legislation comes into effect (apart from under special portability options (b) and (c)). Rather, it will apply to those people who leave New Zealand after that time.

Special portability provisions

78 In the TORs you agreed to in 2001, one of the key objectives we were directed to meet was a single portability system. Another was to establish equity between domestic and portable clients. The special portability provisions as they currently stand do not support either of these goals. Officials have therefore developed options that, to varying degrees, address these concerns.

Option (a): single portability system for everyone

79 Under this option the special portability provisions are abolished and the general portability provisions of your chosen Package apply to everyone. So in the case of *Package C*, for example, everyone receives full NZS after 15 years' New Zealand residence, regardless of where they retire.

80 Across all Packages this creates a single portability system. In the case of *Packages A* and *C*, it removes the last barrier to establishing a single rate of payment for all clients – whether they are domestic or portable.

81 The drawback with this option is that there are some 'losers':

- under *Packages A and B:* clients retiring to a Pacific country will need 40 years' New Zealand residence (as opposed to 20 currently) to receive full NZS;
- under *Package C:* people will need 15 years' New Zealand residence instead of 10 to qualify for a portable payment (although when they do qualify, the payment will be the more generous rate of 100% NZS)

Costings

82 As illustrated by Table 11, option (a) will cost Government approximately an additional $8 million for all Packages in the first year, increasing to $20-30 million in 2010/11, depending on

the Package. The costs arise because people will be able to apply for a portable pension while resident in a Pacific country.

Table 11: Costings for special portability option (a)

	fiscal cost (savings) - $m				
NZS costs	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Package A	8	10	14	18	24
Package B	8	9	12	15	20
Package C	8	11	16	22	30
Package D	8	10	14	19	25

Analysis

MSD and Treasury view

83 MSD and Treasury prefer this option. We acknowledge the special relationship that New Zealand has with some Pacific countries. Nevertheless we consider that the need for an equitable system is paramount, and that this option would provide equitable and fair pensions to Pacific people who decide to retire in a Pacific country.

84 The special portability provisions were developed within an overall policy framework of restricted portability for other New Zealand residents who wished to retire overseas. There is nothing intrinsic to the provisions that dictate that they should give more generous provisions to persons retiring to a Pacific country in comparison to New Zealanders who retire to other countries. The original policy rationale for the special portability provisions was to recognise the contribution of Pacific people to New Zealand, and it was implicit in the rationale that the general portability provisions provided insufficient portability to recognise that contribution. We consider that our proposed amendments to the general portability provisions would recognise a person's contribution to New Zealand, regardless of the country they chose to retire in, and therefore there is no longer a requirement for more generous provisions for persons retiring to a Pacific country.

85 The TORs have charged us with developing policy that meets the following criterion: "with respect to portability of New Zealand Superannuation, consistent rights that are fair and equitable for all people who move out of the country". To achieve this, we believe that the basis for determining a person's level of portable NZS should be based on one factor only: their length of New Zealand residence. Their chosen country of retirement should be irrelevant. We therefore do not support the use of Vote: Social Development to provide preferential treatment to people retiring to Pacific countries, and thus support the incorporation of the special portability provisions into the general portability provisions.

MFAT/MPIA/NZAID view

86 MFAT/MPIA/NZAID do not support any measures that cause Pacific people to need more than 20 years' residence to receive full NZS. If the special portability provisions were to be abolished, as under this option, Pacific people would require 40 years under *Package A* and 45 under *B*. MFAT/MPIA/NZAID believe this could cause tensions within Pacific communities in New Zealand because of a reduction in benefits and the view that the 'special' status of Pacific Island countries was being eroded.

Risks

87 There is a risk that some Pacific Island countries could view this option as a signal that New Zealand holds lesser value in its relationship with these countries. We believe that this can be mitigated by careful relationship management. In particular, our recommendation to relax current residence requirements (recommendation 12 refers) is likely to mitigate any concerns, as Pacific people would be able to leave New Zealand before they turn 65 and apply for their NZS from the Islands once they retire.

Option (b): single portability system for everyone and allow applications from retirees in Pacific countries

88 Under this option, as with option (a), the special portability provisions are abolished and the general portability provisions that apply under your chosen Package will apply to everyone. Under *Packages A* and *B,* this will mean that Pacific people will need a lot more New Zealand residence to attain full NZS.

89 Should you feel it appropriate to offer Pacific Island countries a concession in return for the longer residence required under these Packages, we suggest you enable those people who left New Zealand for the Islands prior to age 65, but who have sufficient residence in New Zealand to qualify for NZS, to be eligible for a general portability payment once the legislation comes into effect. Their eligibility would be prospective, rather than retrospective (i.e. they would be able to claim general portability from their date of application, not from the date they turned 65). We estimate that 1600 people will be able to receive such payment in the first year.

Costings

90 As illustrated by Table 12, option (b) is significantly more expensive than (a) described above. While it cannot be established from the figures, the 'additional' component of paying those currently retired in the Islands will reduce over time.

Table 12: Costings for special portability option (b)

	fiscal cost (savings) - $m				
NZS costs	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Package A	19	23	28	35	42
Package B	17	20	25	30	36
Package C	29	35	44	53	65
Package D	29	35	43	51	61

Analysis

MSD and Treasury view

91 While MSD and Treasury's first preference is for option (a), we acknowledge that option (b) may prove a useful foreign policy ally. Given the finite and reducing nature of the group of people who will receive concession, we find this an acceptable 'second best' option.

MFAT/MPIA/NZAID view

92 While MFAT/MPIA/NZAID believe the concession offered in this option is useful, they do not support the abolishment of the special portability provisions, as Pacific people would then need more than 20 years' residence to receive full NZS if you were to select *Packages A* or *B.*

Risks

93 There is the possibility that pressure for the same treatment may come from people resident in other countries, who have past New Zealand residence but similarly do not qualify due to the residence restrictions. We expect this is likely to be mitigated in respect of certain Pacific Island countries due to their special relationship with New Zealand (but less likely should this apply to all 22 countries covered under the current provisions).[6]

Option (c): retain special portability provisions and allow applications from retirees in Pacific countries

94 This option has been developed by MFAT and MPIA in response to their concerns that Pacific peoples' entitlement would be eroded under options (a) and (b). Option (c) therefore retains the special portability provisions as they are but, as with option (b), enables those people who left New Zealand for the Islands prior to age 65, but who have sufficient residence in New Zealand to qualify for NZS, to be eligible for a general portability payment once the legislation comes into effect (their eligibility would be prospective). In addition option (c) proposed an amendment that applications from the Pacific Islands be allowed.

95 The benefit of option (c) is that there is no risk that Pacific people will perceive a reduction in their entitlements by tampering with the special portability provisions. As with option (b), NZS payments will be able to be made to retirees in the Islands who are currently ineligible. The drawback is that this continues an inequitable system and it is expensive.

Costings

96 As illustrated by Table 13, option (c) is the most expensive ($28 million in 2006/07 rising to $46 million in 2010/11 for all Packages). The concession awarded to retirees in Pacific countries would, however, reduce over time (as discussed in option (b) above).

Table 13: Costings for special portability option (c)

	fiscal cost (savings) - $m				
NZS costs	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Package A	28	33	37	42	46
Package B	28	33	37	42	46
Package C	28	33	37	42	46
Package D	28	33	37	42	46

Analysis

<u>MSD and Treasury view</u>

97 MSD and Treasury do not support the retention of the special portability provisions, as discussed under option (a) above. Moreover, the concession that we developed under option (b) was intended to be in exchange for the longer residence required for full NZS. It was not intended to be an additional 'add-on' to the existing provisions. To award this concession in addition to retaining the special portability provisions would, in our view, be to act in direct contradiction to the goals of equity and a single portability system you agreed to in the TORs.

98 In addition, this option does not achieve the goal MFAT/MPIA favour (i.e. continuation of a 'special status' for Pacific people) under *Packages C* and *D:*

[6] A list of the 22 countries is in Annex II

- *Package C*: 15 years' New Zealand residence is required to receive NZS (there is no partial payment before this time). Pacific people only need 10 years currently to receive 50% full NZS

- *Package D*: everyone will be paid at the special portability rate. There will be no exceptions for Pacific people.

<u>MFAT/MPIA/NZAID view</u>

99 This is the preferred option of MFAT/MPIA/NZAID. It amends the status quo (by allowing applications from the Pacific Islands), and releases payment to people who have to date been ineligible because they left New Zealand before turning 65. As the government set out in its 2001 Pacific Policy, New Zealand has a close interest in the well-being and economic development of our regional partners. For this reason a considerable part of our ODA is directed there. MFAT/MPIA/NZAID continue to see particular merit in providing SPP for Pacific Islanders who want to return to their home Islands. This offers the potential to contribute both skills and investment capital. In addition the original reasons for introducing SPP remain valid (recognized the Pacific as the focus of many of New Zealand's political, security and economic interests (in particular our ODA investment) and our obligations as a good neighbour and regional leader).

Coverage of special portability provisions

<u>MSD and Treasury view</u>

100 As discussed previously, the special portability provisions currently cover 22 Pacific Island countries, including some territories of foreign countries (e.g. American Samoa). It is the view of MSD and Treasury that, if you choose to retain the special portability provisions under option (c), then Government should reduce coverage to a smaller group of eight countries (Cook Islands, Fiji, Kiribati, Niue, Tokelau, Tonga, Samoa and Tuvalu) which more accurately reflect the original policy rationale to recognise the close constitutional and relational ties New Zealand has with certain Pacific countries.

<u>MFAT/MPIA/NZAID view</u>

101 On the question of the coverage of the provisions, the preference of MFAT/MPIA/NZAID is to retain the current list 22 countries. In their opinion there seems to be only marginal cost savings to be had by reducing the number of Pacific countries to 8, weighed against the benefits of maintaining the current list of 22 countries.

Double social security taxation

102 As presented in the February 2003 paper, some foreign companies (and therefore foreign seconded workers) are subject to double social security taxation. This is because they must make contributions in their country of origin as well as in New Zealand (through paying full taxes).

103 MSD officials have been informed by the New Zealand Embassy in Washington DC that US firms view double taxation as a disincentive from establishing a presence in New Zealand, particularly when other countries such as Australia offer social security tax exemptions. Although the magnitude of the impact is unknown, New Zealand could potentially be missing out on foreign investment and the skilled labour flows that come (via seconded workers) from

the presence of foreign companies. Officials have investigated whether there is a benefit to New Zealand offering relief from double social security taxation.

104 One way of offering social security tax relief is to calculate a proxy contribution for New Zealand that can then be rebated to foreign secondees and companies affected by double social security taxation. The proxy is derived by calculating NZS expenditure as a proportion of total taxable income. Using data from the 2002/03 financial year, this is found to be equivalent to a rebate of 8% of the secondee's taxable income (this rate can be adjusted over time)[7]. At this rate, the cost of offering such a rebate is expected to be $780,000 per 100 people per annum.[8] The rebate could be divided equally between the company and the employee, ie each could receive a rebate of 4%.

Costings

105 Social security tax relief will result in foregone tax revenue to New Zealand. No data is available on the number of foreign secondees in New Zealand so we roughly estimate the figure to be 250 people in 2006/07 and 500 in 2010/11. This results in foregone tax revenue of approximately $2 million in 2006/07, rising to $4 million in 2010/11.

106 However, there is a potential for New Zealand to gain some savings through a reduction in expenditure for NZS. United States is currently unable to pay Social Security benefits into New Zealand due to their domestic legislation but will be able to do so if New Zealand offers a social security tax relief to it US secondees. Under a social security agreement, the US would also release the details of all social security payment recipients, which would ensure that recipients would not be able to evade the direct deduction from their New Zealand Superannuation. Under Package C and D, foreign pension received by New Zealand residents is directly deducted from NZS, thus lowering NZS expenditure. This does not apply to Package A, and Package B where there is a social security agreement. We roughly estimate savings to NZS under Package C and D to be $8.2 million in 2006/07, rising to approximately $10.2 million in 2010/11.[9]

107 Table 14 shows the difference between the cost in terms of foregone tax revenue and savings on NZS. Note that due to the lack of data and the difficulty in predicting labour flows, the result in reality could be savings or tax revenue foregone that are significantly higher than expected.

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[7] New Zealand does not have compulsory superannuation contribution. To calculate a social security contribution relief rate, NZS expenditure is used here as a rough proxy for compulsory contribution. Assuming that each income taxpayer pays an equal percentage from their taxable income, each income taxpayer needs to pay 8% of their taxable income to fully cover NZS expenditure for the 2002/03 financial year.

[8] The cost of offering a rebate at 8 cents in the dollar of taxable income is $784,496 (average wage), based on average wages for the year ended 31 March 2002. The assumptions are that: per 100 people, 70 are males and 30 are females; they are aged 35-55 inclusive; they are the top 20% of income earners in this age band; and that at no time during the year did they receive any of the following: a social security benefit, NZS, a student allowance, earnings-related ACC.

[9] The average Social Security payment is estimated to be $8282. We estimate that the number of New Zealanders receiving social security payment is 467 people in 2006/07 and 836 in 2010/11. With the current arrangement, about 75% of social security recipients (people who have citizenship in other countries who are residents in New Zealand) are not reporting their foreign pension for direct deduction. Therefore, the release of social security recipients' details would also result in savings. There is an estimated 753 people in 2006/07 and 976 in 2010/11 who fit under such a category. We adjust these numbers down by 60% because we assume that only 40% of these people receive New Zealand Superannuation.

Table 14: Cost/(savings) for social security contribution relief for foreign companies/seconded workers

	Fiscal year cost (savings) - $m	
	2006/07	2010/11
Package A	2	3.9
Package B	2	3.9
Package C	(6.2)	6.2
Package D	(6.2)	6.2

Analysis

108 Other than the net fiscal loss/gain of offering social security tax relief, there are other factors to be considered. The main benefit of offering social security contribution relief to foreign companies (and therefore seconded workers) is that New Zealand removes a potential impediment to becoming more competitive with other countries in the drive to attract foreign skilled labour and investment. In addition, New Zealand seconded companies and workers would be able to obtain similar relief overseas. Note however the tax relief may not have a large effect on encouraging foreign secondees as most secondees receiving the tax relief may have come anyway since they are likely to have the bargaining power in wage negotiation. Also, double social security taxation is one of a myriad of factors that foreign companies would consider before setting up in New Zealand eg business profitability, employment law and corporate tax rates. The cost of double social security taxation is likely to be a negligible proportion in a foreign firm's total expenses and thus have little impact on their decision.

109 Officials believe that social security tax relief should be granted only if the benefits justify the costs incurred. It is unclear that the removal of double social security taxation would attract many *additional* foreign companies or foreign secondees to New Zealand. There is also a risk that the costs could be significantly higher than expected. Given these reasons, Treasury considers the policy development in this area to have a lower priority than the items with least priority in the current tax policy work programme.

Risks

Human rights risks

110 There is a degree of risk that all the options could be held to be prima facie inconsistent with the right in section 19 of the New Zealand Bill of Rights Act 1990 (BORA) to be free from discrimination on the grounds in the Human Rights Act 1993. This risk arises from the degree to which the effects of each Package are seen to disadvantage predominantly those not born in New Zealand (and hence could be argued to be indirectly discriminatory on the ground of ethnic or national origin).

111 This risk arises particularly in regard to *Packages A, B,* and *D* where payment of full NZS, or full portable NZS, is dependent on an extensive period of residence unlikely to be attained by many immigrants. The risks could be mitigated by any safety net or safe zone provisions applying to them.

112 The direct deduction policy applying to *Packages B* to *D* has already attracted complaints of discrimination on the ground of national origin under the Human Rights Act 1993[10]. The Bill to give effect to the package chosen will be subject to BORA vetting by the Ministry of Justice, and any discrimination found will need to be justified to avoid a section 7 report (which must be tabled by the Attorney-General in Parliament in accordance with the BORA and the Standing Orders).

113 The special portability options, and particularly options (b) and (c), have the same risks as it could indirectly confer advantage based on ethnic or national origin, and therefore discriminate on that basis against persons resident in other countries not given the same advantage. However, any discrimination may be justified under section 5 of the BORA on the basis of the contribution of Pacific Island residents to New Zealand and the constitutional relationship with the Cook Islands, Niue and Tokelau.

Other risks

114 There is a risk the public might perceive that Government is reneging on their commitment not to alter superannuitants' '65 at 65' entitlement under *Package A*. This is not the case, as full NZS will still be payable under the '65 at 65' scenario, but the residence that is required to be eligible for and receive full NZS will change. To mitigate this risk a careful communications strategy will be necessary. This will be considered as part of the development of the Cabinet paper, should you agree.

Summary Analysis

Findings

115 Table 15 illustrates that *Package A* is the option that most successfully meets the criteria set out in the TORs (for a more detailed summary analysis refer to Summary Table 2 on page 39). *Package B* is the next best option, although there are risks surrounding the UK Agreement. *Packages C* and *D* are costly and do not, we believe, adequately address current problems.

Table 15: Analysis of Packages

	Equitable	*Achieves genuine cost-sharing*	*Single portability system*	*Fiscally acceptable to Govt*	*Facilitates migration flows*		*Enhances negotiation of Agmts*	*Resolves obstacles to US Agmt*	*Resolves existing admin. difficulties*	*Easy to administer*
					Inbound	*Outbound*				
Ideal	**Yes**	**Yes**	**Yes**	**Savings**	**Good**	**Good**	**Good**	**Good**	**Yes**	**Good**
Pkg. A	Yes	Yes	Yes~	Savings	Good	Good	Good	Good	Yes	Moderate
Pkg. B	No	Partial*	Yes~	Savings	Good	Good	Good	Partial	Partial	Poor
Pkg. C	Yes	No	Yes~	Cost	Poor	Moderate	Poor	Partial	No	Moderate
Pkg. D	No	No	No	Cost	Poor	Good	Poor	Poor	No	Moderate

*Only for people covered by a social security agreement ~only under special portability options (a) and (b)

[10] Although the Crown Law Office has defended such complaints by arguing there is no discrimination as the policy applies to anyone entitled to or receiving an overseas pension regardless of their national origin, there remains a risk that the Human Rights Tribunal could find otherwise if any of the complaints goes to adjudication.

Consultation

116 MSD has been leading a Working Group on this project since 2002. Participants include: MFAT, MPIA, the Treasury, the IRD and the Retirement Commission. NZAID has also been consulted.

117 All Government departments support *Package A* with the means-tested safety net as the preferred Package, as well as relaxing the residence requirements and offering social security contribution relief to foreign companies and seconded workers. However, Treasury does not think that further work on social security contribution relief should be done due to its relatively small impact and the risk of costs being significantly higher than expected. Officials are divided over the special portability provisions.

Next Steps

118 Should you agree, we will prepare a Cabinet paper on your preferred Package, which would also include your preferred special portability option and the removal of double social security taxation, should you so choose. The paper would be considered by the Cabinet Social Development Committee in June 2005.

Conclusion

119 New Zealand's international social security policies are inequitable and do not support the Government's policies relating to attracting skilled migrants and *Positive Ageing*. We believe that they are not sustainable in the medium to long term, as they affect a sizeable portion of the population that is continuing to grow.

120 We recommend that you select *Package A* for further work, with a hardship-tested safety net. This Package most closely meets the objectives set out in the TORs for this project and creates substantial savings. Should *Package A* not be acceptable, our next preferred option is *Package B*. In terms of the additional options that can sit alongside any Package, we ask you to indicate whether you would like officials to do further work on social security contribution relief for foreign companies and seconded workers. Treasury considers that the impact of such relief would be small and there is a risk of foregone tax revenue being significantly higher than expected. Therefore, Treasury does not view policy development in this area as a priority.

121 We have split recommendations on the special portability options. MFAT/MPIA/NZAID prefer option (c), whereas MSD and Treasury prefer option (a) or, if you wish to offer a concession on account of the longer residence requirement under most Packages, option (b). Should you agree to option (c), MSD recommends reducing the number of countries from 22 to eight.

Glossary

Agreement	Refer 'Social Security Agreement'
Direct deduction policy	A person's overseas pension is deducted dollar-for-dollar from their New Zealand benefit entitlement
Domestic client	A person who receives their NZS while resident in New Zealand
General portability provisions	Payment of NZS overseas at a rate of 50% full rate
Portable client	A person who receives their NZS payment while resident overseas
Proportionalised	Where the rate of NZS is paid in proportion to a person's residence in New Zealand (1/40th for each year under *Package A* and 1/45th for each year under *Package B*)
Special portability provisions	People retiring to one of 22 Pacific Island countries can receive 50% NZS after 10 years' residence and 100% after 20 years (provided they meet all other eligibility criteria)
Social Security Agreement	A bilateral agreement that helps maintain seamless social security coverage for persons covered. One of the ways of doing this is to count the periods of residence or contributions a person has had/made in one agreement country as periods of residence or contributions in the other (known as totalisation, which helps a person to qualify for benefits where there is a minimum contribution or residence requirement)
Seconded worker	A person who is temporarily transferred to work for the same employer in another country

Annex I: Summary of Packages

Package A: Proportional Model

- 10 years' residence in New Zealand between ages 20 and 65 required for NZS eligibility
- level of payment depends on number of years' residence in NZ between ages 20 and 65 over a denominator of 40 years
- portable payment is the same as domestic payment
- applications from overseas allowable for persons who leave after the date of the legislative change
- special portability provisions subsumed within general portability provisions (grandparent existing clients)
- safety net is an income-tested supplement to the level of IB
- voluntary grandparenting for domestic NZS recipients
- direct deduction policy is repealed – overseas pensions treated as income to assess level of payment of social assistance benefits

Package B: Revised

(c) 10 years' residence in New Zealand between ages 20 and 65 required for NZS eligibility

(d) portable payment depends on number of years' residence in NZ between ages 20 and 65 (grandparent existing clients)

(e) applications from overseas allowable for persons who leave after the date of the legislative change

(f) special portability provisions subsumed within general portability provisions (grandparent existing clients)

(g) social security agreements override direct deduction policy

Package C: Full Portability and Moderated Direct Deduction

- fifteen years' residence in New Zealand after the age of 20 required for eligibility
- full NZS paid after 15 years' residence to both New Zealand and overseas residents
- overseas pension direct deducted after a safe zone of 5% of the single sharing rate of NZS
- applications from overseas allowable for persons who leave after the date of the legislative change
- safety net requirements covered by Emergency Benefit
- grandparenting for domestic NZS recipients with less than 15 years residence in New Zealand and for portable clients

Package D: Special Portability Formula and Moderated Direct Deduction

- 10 years' residence in New Zealand after the age of 20 required for eligibility
- domestic NZS payable at 100% after 10 years residence
- portable pensions payable at 50% after 10 years residence rising to 100% after 20 years residence
- overseas pensions direct deducted after a safe zone of 5% of the single sharing rate of NZS

- applications allowable from overseas for persons who leave after the date of the legislative change
- safety net requirements covered by Emergency Benefit
- no grandparenting for domestic NZS clients
- grandparenting for portable NZS clients

Annex II: Schedule of Pacific Countries covered by Special Portability Provisions

American Samoa
Federated States of Micronesia
French Polynesia
Kiribati
Nauru
Niue
Palau
Pitcairn Island
Solomon Islands
Tonga
Vanuatu
Cook Islands
Fiji
Guam
Marshall Islands
New Caledonia
Northern Mariana Islands
Papua New Guinea
Samoa
Tokelau
Tuvalu
Wallis and Futuna