Social Security Abroad

New Contributory Pension Program in New Zealand*

A compulsory, earnings-related pension was added to New Zealand's old-age, survivors, and invalidity program in August 1974. The new pension, effective April 1975, is designed to increase the level of retirement income. Financed by employee and employer contributions, the earnings-related benefit will be added to the existing Government-financed guaranteed minimum benefit payable to all residents at age 65. The law, known as the New Zealand Superannuation Act of 1974, requires all workers to be covered by either the new Government-administered pension program or a private plan that offers at least equivalent contributions and benefits.

Before enactment of the 1974 law, a dual system had been in effect that provided for an income-tested benefit (age pension) payable from age 60, or a universal pension (superannuation benefit) payable at age 65 to all residents regardless of income. The income test applied to the age pension was also used to determine the amount of the invalidity and survivor pensions. The new law continues the dual system with a different combination of components. The age pension is replaced by a contributory earnings-related pension, and the universal pension is retained. There is no income test under the 1974 act. Retirement, incapacity, and death benefits are related to each person's accumulated amount of contributions plus interest.

BACKGROUND

New Zealand has had national social security legislation since 1898. The total system did not assume its comprehensive welfare nature, however, until passage of the 1938 Social Security Act. The essential feature of the 1938 act was the extension of cash benefit payments, funded from general national taxes, to all needy persons regardless of the cause of need.

With subsequent revisions, the primary function of the program became the provision of a guaranteed minimum monthly income for persons who qualified on the basis of need. The program was aimed, not at attempting to replace a portion of a retired or disabled employee's previous earnings, but at raising the individual's level of income sufficiently to maintain a "sense of belonging to, and participating in, the community." Toward this end, entitlement to benefits was based on need at age 60 under the age pension and made universally available at age 65 by the superannuation pension.

As indicated above, the 1974 act abolishes the age pension and adds an earnings-related supplement to the existing flat-rate superannuation pension. Consequently, the new old-age pension program calls for a universal pension based on residence and a supplementary pension tied to the recipients' former earnings. Since 1960 the benefit rate under the universal pension has consistently been about a third of the average wage in manufacturing for a single person and about 60 percent for a married couple. Discussions by planners of the new law had indicated as a possible aim that the addition of the earnings-related pension could lift the benefit-wage ratio another 25–30 percent. No additional amount has been provided for dependent spouses.

PROVISIONS OF NEW LEGISLATION

Coverage

Although the income-tested pension is abolished, all regular residents continue to be covered under the superannuation pension. Under the new earnings-related program, all wage and salary workers aged 18–65 must be covered by the new Government program or by a comparable private plan. Self-employed persons may elect coverage on a voluntary basis, but it is not compulsory. As a transitional measure, persons aged 55 with 10 years of residence at the time the law becomes effective in April 1975 have the option of exemption from coverage under the earnings-related program.

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Retirement Age

Both the universal flat-rate and the earnings-related pensions are payable at age 65 for persons with at least 10 years' residence. There is no retirement test. Beneficiaries who wish to continue working will receive, after application, both pensions without penalty or reduction. In this instance, contributions continue to be made from earnings.

Early retirement may be elected at age 60 or, for workers in certain arduous occupations, before age 60. Only the earnings-related pension is payable to early retirees unless there is need for supplementary assistance. The benefit amount payable to early retirees is not reduced, but the pension is based only on contributions made up to the time of retirement. This provision is designed to prevent workers from receiving benefits and then returning to work in order to raise the benefit rate through additional contributions. The restriction is lifted at age 65, however, and contributions based on earnings made after age 65 are used to increase the monthly benefit amount.

Benefit Rates

The 1974 legislation does not provide for changes in the annually adjusted flat-rate universal benefit. The amount of the universal benefit will continue to be about a third of the average wage in manufacturing.

Benefit rates under the new earnings-related pension program are to be based on a set percentage of the total cash accumulation from an individual's contributions. The accumulated amount draws a statutory minimum of 5 percent interest per annum under both Government and private programs. At the time of withdrawal from the labor force for retirement, ill health, or disability, the total contribution plus interest is used to purchase an annuity. A Board of Management determines the monthly annuity amount based on four factors: mortality rates, administrative expenses, investment yields from the contributions, and cost-of-living increases. The initial benefit rate, yet to be determined, will be reviewed annually in light of inflationary trends. An adjustment will be made in any year in which the consumer price index advances by 0.5 percent or more.

Beneficiaries of the earnings-related pension may also elect to receive a partial lump-sum payment in addition to a monthly annuity. A single payment of up to 25 percent of a beneficiary's total contribution plus interest is payable on request. The balance of the cash accumulation is then used to calculate a monthly annuity. Certain low-income contributors may elect to receive their total contribution plus interest in one lump-sum payment providing that the capital value of the annuity is less than NZ$2,000.[1]

Benefits are payable to a contributor and to the spouse, if any. There are no provisions for payments to survivors other than the spouse. Payments to a surviving spouse are based on a graduated scale determined by the age of the deceased. If a contributor has not attained age 51 at the time of death the widow or widower is entitled to full annuity. This amount is reduced by 5 percent for each year over age 51 up to age 60 and reduced by one-half if death occurs at age 60 or after.

Financing

Under the new legislation the universal pension continues to be financed by funds from general revenues, but the new earnings-related pension is funded by compulsory contributions through payroll deductions (and by employer contributions). Each worker's contributions are put into a trust fund under an individual account where they accumulate and draw interest. The contributions to the earnings-related pension program are made in equal proportions by employees and employers. In order to ease the burden imposed by the initiation of a payroll tax, contribution rates will be phased in over a 5-year period. Beginning April 1975 the initial tax rate is 1 percent of wages for both the employee and employer. In April of subsequent years the rate will increase—to 2 percent in 1976, 2.5 percent in 1977, 3 percent in 1978, 3.5 percent in 1979, and 4 percent in 1980 and the following years. Individuals may voluntarily increase their contribution rate in order to receive a higher pension

[1] One New Zealand dollar equaled $1.31 in U.S. dollars, as of September 30, 1974.

amount. Contributions from the self-employed—whose coverage is voluntary—must at least equal the combined rate paid by employees and employers.

Administration

To administer the program the 1974 legislation established a nine-member Board of Management under a newly created New Zealand Superannuation Corporation. The Board's members represent Government, employers, and labor. The Board is primarily responsible for investing the contributions collected from employees and employers, determining the credit value of individual contributions, and disbursing the benefits.

Private Pension Programs

Private pension plans are encouraged by the 1974 act as an alternative to the Government program. To ensure that the beneficiaries of either system receive the same minimal protection, the private plans must meet Government standards. In particular, the provisions for benefit levels, contribution rates, monthly payments, lump-sum provisions, and persons eligible for benefits must be at least equivalent to those of the Government program. In addition, the full cash value of the contribution credits must be retained for persons who transfer to another private program or to the Government plan.

EXPENDITURE CONSIDERATIONS

A basic intent in changing the country's program was to increase the level of benefits, while keeping costs down. In attempting to determine how this could best be done, a study was made of foreign experience. Particular attention was paid to countries that had started with flat-rate or universal systems like those in New Zealand and had found ways to improve the adequacy of benefits, especially for the low-income earner. A number of European countries had originally provided some form of guaranteed income for residents through a universal benefit, usually like New Zealand, through general revenues. These countries found, however, that the cost of attempting to keep this benefit at any adequate level became prohibitive. The solution that most of them (Canada, the United Kingdom, Sweden, Norway, and Finland, for example) chose was to add an earnings-related layer to the universal system. The new layer was financed through the payroll tax. New Zealand has followed their example.

Expenditures under the former system had been rising disproportionately. In the period 1964–72, expenditures doubled, more than keeping pace with wage increases. During the same period, the number of beneficiaries under the age pension program increased only 11 percent. Under the universal pension program the increase was 29 percent. The 1974 reform aimed at adding a new pension (based on payroll contributions) that would not place additional pressure on general taxes.