

# The taxation of retirement savings: a Trans-Tasman perspective

*Lisa Marriott*

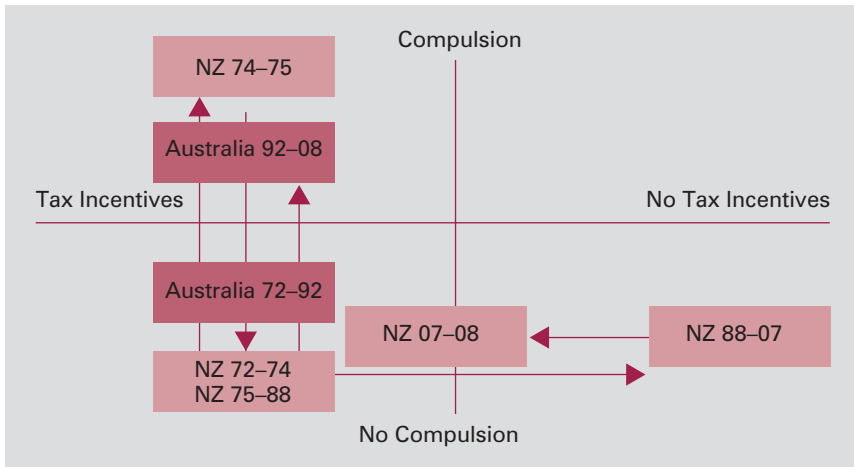


*The different approaches to retirement income policy taken by Australia and New Zealand have produced very different savings and superannuation outcomes. Australian retirees are likely to be advantaged relative to their Trans-Tasman peers, through there being some relationship between their pre-retirement and retirement incomes. This will also have implications for New Zealand through the effects of reduced consumption on economic growth, and greater reliance on the state in areas such as health and housing.*

New Zealand and Australia have adopted vastly different approaches to retirement saving and its associated taxation. Two fundamental differences exist: New Zealand offers little in the way of tax incentives for retirement savings and there is no compulsion;<sup>1</sup> and Australia provides highly concessionary tax incentives and has a mandatory occupational retirement savings scheme.

New Zealand and Australia have both introduced significant changes to retirement incomes policy since 1972. The changes in both countries

Figure 1: Key Changes to Retirement Savings Policy 1972–2008



Source: Adapted from Polak, P. 2008, *Out of Poverty*, San Francisco, Berrett-Koehler Publishers, p. 32.

in relation to the two key elements of compulsion and incentives are illustrated in Figure 1.

Following a long period of similar approaches to retirement savings, New Zealand and Australian policy diverged in the mid-1980s. New Zealand operates a two-tier system: a basic state pension paid from general revenue and voluntary private savings. There are no compulsory saving schemes and only a small, recently introduced, tax incentive. The Australian pension system has three tiers, with two tiers of state involvement. The first tier is a means-tested pension. The second tier is the Superannuation Guarantee Charge (hereafter referred to as the Superannuation Guarantee), which requires employers to provide superannuation cover for workers who have earnings above a specific threshold. Among OECD countries, Australia has the largest mandatory defined contribution scheme, where employers pay 9 per cent of their employees’ earnings into a pension account.

**Taxation of retirement savings**

The levels of taxation applied at various stages distinguish different taxation arrangements. Typically, the order in which these are referred to is contributions, investment earnings and withdrawals: *T* refers to fully taxed; *E* is tax exempt; and *t*

refers to concessionary taxation. The system of taxation in New Zealand for retirement income savings is known as *‘tTE’* referring to a small concession on contributions, taxed investment income and exempt benefits. This scheme, which operated as TTE from 1988 to 2007, provides minimal preferential tax treatment for retirement savings. No other OECD country has opted for this system. Historically, the focus of the New Zealand regime was tax neutrality, meaning that superannuation savings were treated from a tax perspective in the same manner as other forms of savings.

The Australian model is *‘ttE’* as contributions and investment earnings are taxed, but at preferential rates to other forms of savings. Withdrawals from taxed funds by individuals aged over 60 years are tax-exempt. These arrangements were implemented in July 2007. Table 1 outlines the

Table 1: Tax Treatment of Private Pensions in Selected OECD Countries<sup>2</sup>

EET		ETT		TTE
ETT	EET	ETT	tTE	ttE
Belgium	Austria	Denmark	New Zealand	Australia
France	Canada	Italy		
Germany	Finland	Sweden		
Ireland	Iceland			
Japan	Netherlands			
Korea	Norway			
Mexico	Poland			
Portugal	Switzerland			
Slovak Republic	United States			
Spain				
Turkey				
United Kingdom				

tax treatment of retirement savings among OECD countries. The table indicates that an EET approach is the most common system among OECD countries. New Zealand and Australia stand out as outliers in their approach to the taxation of retirement savings.

### Propensity to save

New Zealanders are lagging behind their Australian counterparts in a number of measures of saving statistics, including superannuation.

This has created the opportunity for Australia to be a significant player in the global investment fund industry.

In 2007 over 90 per cent of the Australian workforce was covered by occupational superannuation schemes. In New Zealand the equivalent was 13.4 per cent of private and public sector employees with employer-supported occupational superannuation schemes.<sup>6</sup> The New Zealand figures are likely to reflect, among other

for the changes to the tax treatment of retirement savings over the past 30 years. Typically, these include the economic conditions in both countries, ageing populations, declining levels of private savings and concern about the sustainability of existing schemes. It is also common to see individuals such as Paul Keating or Roger Douglas, or institutions such as the trade union movement in Australia or the New Zealand Treasury credited (or blamed) for policy choices. At a certain level, all of these factors have some relevance. However, a number of broader variables also contribute a contestable explanation to the policy directions adopted in each country.

An examination of primary and secondary data and discussions with many influential individuals involved in the reforms to retirement savings policy over the 1982 to 1992 period reveal the effects of four key variables: the environment;

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Moreover, the difference in levels of savings through traditional superannuation funds is becoming more pronounced with time. Savings in managed superannuation funds in Australia were A\$1.3 trillion in 2007 while such savings in New Zealand were A\$22 billion (NZ\$25 billion).<sup>3</sup> Taking into account that the Australian economy is approximately five times larger than that of New Zealand, the figures still indicate that total savings in Australian superannuation funds is over 10 times the level in New Zealand. Contributions to superannuation funds show a similar picture, with contributions of over A\$100 billion in Australia and A\$2 billion in New Zealand in 2006–07.<sup>4</sup> Australia now has the fourth largest investment fund asset pool in the world, and the largest in Asia.<sup>5</sup>

factors, the generous state provision of superannuation, the absence of tax incentives to save for retirement and the lack of compulsion for retirement savings.

### The differences

In the decade between 1982 and 1992, New Zealand and Australia moved from similar policy approaches for retirement savings and taxation to fundamentally different approaches. The key events which triggered this shift were the removal of all tax incentives for retirement savings in 1988 in New Zealand, and the introduction of compulsory occupational retirement savings in Australia in 1992.

### Why the different approaches?

Historically, a number of explanations have been provided



institutions; power dynamics; and the influence of ideas. The strongest ideas were found in New Zealand, where reform was the most radical.

### The environment

In the early 1980s, both New Zealand and Australia had forecast ageing of their populations. In Australia, demographic issues had been widely discussed from the late 1970s and were used to justify the need for incentives and compulsion for retirement saving. In New Zealand, the projected demographic changes were given little attention in the period from 1982 to 1992. Furthermore, Australia and New Zealand both faced serious adverse economic conditions during the 1980s, but there appears to be general agreement that New Zealand faced weaker economic conditions than Australia, at that time. Another



important environmental difference in the two countries was the existence of the universally provided New Zealand Superannuation. By providing a generous universal pension, much of the argument raised in Australia around concepts of equity was diluted in New Zealand; there was little likelihood of a cohort of elderly individuals living in poverty. This created very different debates in the two countries.

One area of significant divergence between the two countries was their respective attitudes towards national saving. One of the primary arguments in Australia in relation to retirement savings policy was the perceived need to increase levels of national saving. Conversely, in New Zealand, three contrasting arguments dominated in relation to saving: first, that New Zealand did not need higher levels of saving; second, that the introduction of a neutral scheme of taxation may increase saving (as the trade-off for tax incentive removal was lower personal income tax rates); and, third, that the presence of international capital markets removed any imperative to improve national saving.

In Australia, these environmental factors were used to support the implementation of the Superannuation Guarantee Charge and the continuation of generous tax incentives. Conversely, in New Zealand, environmental conditions were used to justify the removal of state support for retirement savings.

### Institutions

The institutions with the strongest influence on the policy process were those that, through historical



events or historical opportunity, had preferences that were aligned with the state. Arguably, influential institutions, in particular the New Zealand Treasury and the trade union movement in Australia, were also afforded greater authority in the policy-making process than at any other time in the 20th century.

The importance of the mutual agreement of the Australian Council of Trade Unions (ACTU) and the Government on this policy issue in Australia in the mid-1980s cannot be overstated. The ACTU was reliant on government support to pursue the policy through the appropriate channels, while the Government was reliant on the ACTU to sell the policy to its members. The alignment of the trade unions in Australia and the Government, together with the existence of established relationships and powerful individuals in influential positions, resulted in an arrangement in which dissenting voices were infrequently heard. Similarly, there was little dissension in New Zealand between the Government and the New Zealand Treasury; in keeping with the 'level playing field' approach, no interest groups, employer groups or industry groups were privileged.

## Power

That the New Zealand Treasury had significant power and influence on this element of policy is clear. Similarly, that the trade union movement in Australia had considerable influence with government is also evident. In the New Zealand and Australian contexts, there was little effective opposition to the policy changes during the decade 1982 to 1992. It is not intended to imply that opposition did not exist; rather the power structures in place left those with dissenting opinions with little opportunity to influence policy direction. Potential conflict was neutralised by the dilution of interest group power.

It is important also to acknowledge structural factors in both countries that affected power arrangements. Power within the New Zealand environment was, at least in part, facilitated by its unitary state and unicameral parliamentary structure. However, in Australia, the federal state and bicameral parliamentary structure may have limited potential options. In addition, New Zealand had a first-past-the-post voting system until 1996, which facilitated rapid changes in policy direction and the introduction of radical policy.

## Ideas

The prevailing ideas in each country permitted a cohesive approach to the policy changes, both in the manner in which it was communicated and in the language used. Two key ideas drove the policy direction: equity and efficiency. Phrases such as 'level playing field', 'neutrality' and 'efficiency' became commonplace in

New Zealand. Meanwhile, Australia's debate regularly referred to 'equity' and the 'social wage'.

The role played by powerful individuals in both countries (Paul Keating in Australia and Roger Douglas in New Zealand) can be clearly seen. They provided either ideas, or support for ideas, which were made acceptable to the majority through trade-offs or their willingness to negotiate. Furthermore, institutions such as the New Zealand Treasury and the trade union movement in Australia, communicated a cohesive and well-defined world-view to

placed on the economic crisis, the myriad of distorting practices in the tax environment (and thus the need to create a more neutral playing field) and that New Zealand had no need for increased levels of private saving. In Australia, emphasis was placed on demographic issues and the need to increase saving. These two different emphases provided, in their respective contexts, coherent arguments to support the different reforms to retirement savings policy.

At the present time, New Zealand's retirement savings figures and participation in occupational superannuation are among the lowest

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support their policy preferences. The ideas in both countries enjoyed a strong fit with the prevailing environment. In New Zealand, this was to ameliorate, to the extent possible, the economic crisis. In Australia, it was to provide reward for labour without fuelling inflation, while simultaneously addressing forecast demographic issues.

## Summary

Legitimacy for these reforms was achieved in both countries through a high degree of public acceptance of the need for change or the anticipated benefits from the change. In New Zealand, emphasis was

in the OECD. Australian retirees can expect to have an income of 70–80 per cent of their final retirement income, after 40 years of Superannuation Guarantee participation. New Zealand retirees will, assuming National Superannuation continues unchanged, receive a minimum of 60–65 per cent of the average wage. The difference in the standard of living that these amounts will support is significant. Australian retirees will be advantaged, with some relationship between their pre-retirement and retirement incomes, a benefit which retirees in New Zealand will not enjoy. What also cannot be ignored are the economic impacts likely to



result from these outcomes, such as the impact of reduced consumption on economic growth, and greater reliance on the state in areas such as health and housing. ■

## ENDNOTES

- <sup>1</sup> A small tax incentive was introduced in July 2007 with the introduction of KiwiSaver accounts. While the KiwiSaver scheme is optional, individuals must 'opt-out' when changing employment if they do not wish to participate.
- <sup>2</sup> Adapted from K. Yoo and A. de Serres 2004, *Tax Treatment of Private Pension Saving in OECD Countries*. OECD Economic Studies No. 39, 2004/02 and OECD 2007, *Pensions at a Glance: Public Policies Across OECD Countries*.
- <sup>3</sup> Report of the New Zealand Government Actuary for the Year ended 30 June 2007, www.isu.govt.nz, and Rice

Warner Actuaries Media Release, November 2007, www.ricewarner.com.

- <sup>4</sup> *ibid.*
- <sup>5</sup> Australian Government: Invest Australia, www.investaustralia.gov.au. Australia is behind the United States, Luxembourg and France.
- <sup>6</sup> Report of the New Zealand Government Actuary for the Year ended 30 June 2007, www.isu.govt.nz. It is acknowledged that this figure has significantly increased with the introduction of KiwiSaver accounts in 2007.

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### Lisa Marriott

Lisa Marriott is a Lecturer in Accounting and Taxation at Victoria University of Wellington, New Zealand.  
Email: lisa.marriott@vuw.ac.nz