Dept. of Social Welfare
Library
Wellington, N.Z.

PRESERVATION

Old age, superannuation, and the finance system.

by Sir Frank Holmes.

DSW
368
.43

DEPT. OF SOCIAL WELFARE
LIBRARY, WELLINGTON, N.Z.

747
DEPT OF SOCIAL WELFARE, W'TON
A00346780B
PRESERVATION

Library (WSS)
Department of Social Welfare
Private Bag 21
Postal Centre
Wellington

OLD AGE, SUPERANNUATION AND THE FINANCIAL SYSTEM

By

Sir Frank Holmes,
Professor of Money and Finance,
Victoria University of Wellington.

DISCUSSION PAPER NO. 4 November 1975

OLD AGE, SUPERANNUATION AND THE FINANCIAL SYSTEM*

Sir Frank Holmes, Professor of Money and Finance, Victoria University of Wellington.

Providing for Retirement

Unless the Grim Reaper steps in ahead of schedule, we shall all grow old. Eventually, we shall have inflicted upon us, or gratefully accept, the opportunity of ceasing active work for financial reward. Those who no longer work must find means, other than pay for their services, to continue spending on the goods and services they feel they need or want. They are dependent on others to produce the goods and services they require, while they make no current contribution to adding to that flow of goods and services. However the spending of the retired is financed, the current producers in society have to carry the burden of providing goods and services for them, as for other dependent persons in society. In other words, a social problem of providing real resources for dependents, as and when they consume goods and services, exists, regardless of how the transfers of purchasing power to them are effected.

Different societies, or particular societies at different times, tackle the task of providing for the aged dependent in different ways, with the individual himself, his family, and the community assuming different degrees of responsibility for the provision. In less developed societies and in early periods of the history of the more developed societies, looking after the aged was seen as primarily a problem for the family or local community. With the rise of more urbanised and capitalistic economies, more weight was placed on private provision for retirement, especially by the more affluent, and on charitable provision. Since the late nineteenth century, the role of the central government in provision for the aged has been greatly expanded. What the right balance should be among the different possible methods of provision is a matter of considerable debate, involving political and social as well as economic considerations. The methods chosen have considerable implications for the level and pattern of saving and investment, and for the financial system.

Private Provision

Some methods of private provision for old age do not involve prior saving by the individual or others, and do not generate flows of money through financial institutions; for example, if the aging individual can and does rely on his family, relatives, or private charities to look after him when he ceases work. Other methods do involve savings by the individual and/or his employer prior to his retirement. Some of these do not directly generate flows of funds through financial institutions. For example, the individual may elect to make provision by developing a farm or a business, or invest in property or other real assets which will yield him a return or which he can sell on retirement. Alternatively, he may accumulate financial assets by direct purchase of the obligations of final borrowers (shares, debentures, local body or government stock), which he can sell or obtain income from, as required. The remaining methods, do generate business for financial institutions. They can take a variety

*Revised version of an address given to the Tenth National Credit Management Conference, 23 Sept., 1975.

VICTORIA UNIVERSITY OF WELLINGTON LIBRARY

of forms, such as the building up of deposits with savings banks and finance companies, the purchase of building society shares, the decision to pay premiums for endowment insurance, or contributions to a pension scheme at the employee's workplace, with the employer usually assisting by subsidy.

The Role of the State

The State's involvement in providing for the aged may take several forms. Taxation concessions and other incentives may be given to encourage private citizens to make provision for their retirements. Our Government, for example, allows deductions from income for contributions to insurance and approved pension schemes; gives some concessions in respect of interest receipts (especially from savings banks and special Government bonds); and helps people in lower income groups, in particular, to obtain their own homes- important assets in old age especially if owned without mortgage. The State can and does set up pension schemes of its own, not only a scheme for its own employees, but also schemes competing with those offered by private agencies. It can use its power of compulsion to make people join a private scheme or a State scheme. All of the foregoing involve inducing or compelling people to save in one form or another, and the saving is often directed through some kind of financial institution. This means that the individual foregoes some consumption during his working life, and builds up an entitlement to draw on the resources of the community for his sustenance, even if he is not working, in his old age.

In addition to encouraging, assisting or compelling individuals to provide for old age, the State may itself provide benefits to the aged. The benefits may be set at different levels, depending on the Government's concept of their purpose, i.e., whether it should be a small contribution as an adjunct to a private pension; whether it should be enough to guarantee all a basic minimum standard of living in old age; whether it should be enough to give recipients a sense of belonging to the community, in that through linkage with the average wage they can readily share in the community's life style; whether or not it should be related to the individual's past income. Conditons of eligibility for a benefit may vary - it may be subject to means test or made available regardless of income or wealth. It may be made available at different ages. It may require a short or a long period of residence in the country to be eligible. The more generous the benefits, the greater the extent to which they are made available as of right rather than subject to means test, and the earlier they are paid, the greater the finance required to pay them will be.

State provision of finance to beneficiaries does not involve direct expenditure by Government on goods and services, as say its provision of education, prison and defence services and of public works does. It is a transfer of income to them paid for from public revenues, largely by the use of the State's powers to levy tax. The benefits may be financed by contributions to an alleged fund, but a Government with powers to tax, borrow and print money does not need to build up funds to pay benefits. The Government does, of course, have to be concerned about whether the total spending of the community is too high or too low. Giving generous benefits does add to private spending, through beneficial outlays, which must usually be offset by tax restraint on others if inflationary over-spending is to be avoided. But if Government creates a "fund" to pay the benefits, it is usually a device to make the taxation involved

psychologically more acceptable, or to bring home to the community in some measure what the benefits (and other aspects of social security) are costing. The first Labour Government started with a fund concept, but with the proportional social security tax only covering about half of the outlays required for social security, it was finally abolished in 1964. Thus benefits are now financed from general revenues. If they are to be improved, the Government has a problem of deciding which taxes are to be increased, and how. Is it to be through personal income taxes, and if so to what extent do people at the lower, middle and upper ends of the graduated scale pay? Is it to be from company tax? Is it to be from taxes on commodities and services and if so, which? A wide range of choice is available to the Government on methods of financing benefits.

The Situation Prior to the New Zealand Superannuation Scheme

In New Zealand the State provides all who satisfy a residential qualification with tax-financed age or superannuation benefits, subject to an income test at 60, and as of right but taxable at 65. The benefits have not been formally linked to wage or price increases, but have usually been adjusted at frequent intervals to take account at least of cost of living increases. In recent years, the married age benefit has been the equivalent of about 45 to 50%, and the single benefit about 25 to 30%, of the average weekly wage for males. Special Christmas bonuses have often been given to income-tested beneficiaries, while emergency and supplementary benefits have been available to deal with special cases. The State has also ma e a generous superannuation scheme available to its own employees, and to others paid from the public purse, and offered various public schemes through the National Provident Fund and Government Life Office.

In addition, various taxation concessions have been made to encourage private provision for old age. These include deductions from income for tax purposes up to defined limits, by both employees and self-employed, for contributions to approved pension funds and life insurance premiums. Employers could also deduct from business income the subsidies they paid to approved pension schemes for their employees. Mention should also be made of the incidental advantage to those saving for old age of (i) the tax concessions made in respect of interest earnings from farm development, and (ii) the preferences given in the provision of credit for housing and farming.

Until this year, despite the taxation concessions given, only about a third of the labour force had become members of superannuation funds. Even in the field of Government employment, about a third of those eligible to join remained outside the Government Superannuation Scheme. Thus, the majority were relying on the State-provided benefits, on other forms of private saving, or on private assistance, to provide for full or partial retirement in old age. A survey of beneficiaries over the age of 65 completed in 1974 showed that while the majority of beneficiaries considered the assistance adequate to their requirements, a significant percentage were unable to attain what the Government regarded as a reasonable standard of living. The groups most disadvantaged seemed to be those with little or no capital or other means to supplement their benefit and who had regular commitments for housing and other needs. This year the Government has introduced a special "Additional Benefit", subject to tests of financial assets and income, to replace the supplementary assistance system and specially to cater for the needs of these groups. It has also provided for allowances towards their accommodation costs and other commitments.

The Financial Implications of the New Zealand Superannuation Scheme.

The major features of the New Zealand Superannuation Scheme which came into operation on 1 April 1975 are set out in the discussion paper by Cameron and Nicholl (C & N) previously published in this series.*

(a) The Flow of Funds and Accumulation of Assets

The new scheme will result in a considerable accumulation of funds for investment each year for a prolonged period. Employees not previously covered by superannuation, and their employers, will be making their required contributions either to the New Zealand Superannuation Corporation or to an approved private scheme. In addition, the agencies will make an income from the investment of their contributions, while the outgoings for pensions in the early years will be relatively limited.

What the absolute values of the funds flowing into and accumulated by the Corporation and private schemes will be, will depend on several factors, notably the rates of wage increase and the rates of interest which the managers of the scheme can earn on investment. Economists are not much better at forecasting than meteorologists, geologists and doctors, and the problems of forecasting the likely rates of inflation of wages and prices and trends of interest rates over the next sixty years or so are rather formidable. However, these problems can be diminished, and a general impression of the probably relative importance of the New Zealand Fund and of the new private schemes developed through the introduction of the compulsory system can be obtained, by expressing the magnitudes involved as a proportion of the gross national product. (GNP).

The C & N study, making two different assumptions about the interest yields which can be derived from investments, estimates that the new inflow of finance each year into the New Zealand Superannuation Fund will grow from the equivalent of 0.5% of GNP in this year (about $50 million) to between 2.8% - 3.1% of GNP in year 11 of its operation, to 3.8% - 4.1% of GNP in year 21 and a peak of about 3.9% - 4.5% of GNP in year 51. If to this is added the net inflow of funds to private schemes, the combined total grows from 0.8% of GNP in year 1 to 4.2% - 4.6% of GNP in year 11. The combined net inflow reaches 5.2% - 5.7% of GNP in year 26 and peaks at between 5.2% and 6.1% of GNP in year 51. For comparison, * on average over the five years to March 1973, local authority loans raised were 1.9% of GNP, cash issues of ordinary shares by public companies were 0.7%, gross borrowing by Government was 5%, and total mortgage registrations were 12.3% of GNP.

With net inflows proceeding at this rate the New Zealand Superannuation Corporation and those running the private schemes will accumulate a substantial portfolio of investments. The New Zealand Fund is likely to have assets of a value equivalent to about 16-17% of GNP by year 11, 24-26% of GNP by year 16, and 50-55% of GNP when it has been running for half a

---

*R. Cameron and P. Nicholl :- Financial Implications of the N.Z. Superannuation Scheme. Discussion Papers in Money and Finance No. 1. Department of Economics V.U.W. 1975.

*K. Vautier, The NZ Superannuation Scheme. A report to the Life Offices Association of N.Z. N.Z. Institute of Economic Research 1974. p. 66.

century. Putting this together with the accumulations of the new private schemes, we get a total of assets equivalent to about 11% of GNP in year 6, 24-25% in year 11,52-57% of GNP in year 26, and 68-76% of GNP in year 51. As a basis for comparison, you might note that the total assets of the life insurance offices in New Zealand are at present about 20% of GNP, those of the trading banks slightly more than 20%. The accumulated assets of the New Zealand Fund will exceed this percentage after about 13 or 14 years of operation, and have funds of double this percentage towards the end of its third decade of operation. If it survives, the Corporation will thus become an institution of major significance in the New Zealand financial system, holding a much greater volume of assets than any other set of institutions in the system. Its operations will therefore have a substantial influence on the pattern of investment in the country.

(b) Effects of Saving and Investment

Determining what the effect of the scheme will be on total saving and investment is a complex problem, discussed in Section C of the C & N report. As indicated, the net inflows into the participant institutions will rise rapidly in the first decade or so to over 4% of GNP and then more slowly to between 5 and 6% of GNP in the second quarter century of its existence. However, we cannot assume that the total savings of the community will rise correspondingly. The increase in savings which employees and employers are compelled to make in this form may be offset to some extent by a reduction in their savings in other forms, e.g., individuals may take out less endowment insurance, have less to put into their savings banks, investment societies or building societies etc. than they would have had in the absence of this scheme. The forms of personal saving most likely to be affected are those directly connected with providing for retirement. Incentives to continue to save for other purposes, such as accumulating the deposit on a house, providing for that overseas trip etc. will remain. The extraction of compulsory superannuation contributions from the pay packet will means that the rate at which such savings can be built up will be slower than it otherwise could be, or spending on consumer goods and services will rise more slowly than would otherwise be the case. A combination of some reduction of other personal saving and some slowing up of the growth of consumption is the likely outcome.

Business saving will also be affected by the requirements for employers to contribute. As with individuals, the contributions are deductible from income for tax purposes, so that the net cost to business is less than the gross sums involved. Nevertheless, either other compensation of employees will grow more slowly, or net profits will rise somewhat less than they would otherwise have done, so that the growth of dividends and/or retained profits will be restrained. No doubt both business and employees will wish to pass on as much as possible of the extra cost in which they are involved; and their efforts to do so will complicate the task of Government in curbing inflation. The facts that the scheme is being phased in gradually, and that payment is made by prior deduction from income, are important in diminishing pressure for compensation. They avoid the sharp effect on disposable income which immediate application of the final rates of contribution would have had.

The eventual outcome so far as total saving is concerned will depend heavily on the Government's fiscal, credit and incomes policies, especially how far these accord importance to restraining the growth of consumption and encouraging saving. The existence of the scheme, with its contractual commitments to save, should help Government to raise the ratio of national

savings to GNP as the funds build up, if it regards this as an important objective. Kerrin Vautier's opinion was that, at maturity, when the net inflow of finance into the schemes would be between 5 and 6% of GNP annually, the ratio of net additional savings to GNP would be only about 2% per annum when the reductions of other forms of saving were taken into account. C & N (p.27) feel that this understates the likely impact of the scheme on savings, but admit that the overall outcome is uncertain.

(c) Effects on the Pattern of Investment

The foregoing statistics of the net inflows into and accumulation of funds by the New Zealand Superannuation Corporation indicate that it will have an increasingly substantial influence on the pattern of investment, as it decides where to place new funds and whether it should rearrange its existing portfolio in the light of changing relative yields on different assets. It has power to invest in property as well as in financial assets, and to invest overseas as well as in New Zealand. However, this power would be subject, like that of other financial institutions, to both formal and informal influence by the Government and the Reserve Bank. The legislation, regulations and moral suasion available to control credit and overseas exchange transactions would certainly be used by any Government to ensure that the Corporation's activities conformed with elements of Government policy deemed important.

There has naturally been some concern at the extent of the financial power which will be at the disposal of the Corporation, and at the possibilities of "nationalization by stealth" or undue diversion of funds to Government's own activities. So far as financial power is concerned, the Government and Reserve Bank already control the disposition of funds by major financial institutions, through the variation of requirements to hold reserve assets or public securities, and by a variety of formal or informal arrangements designed to influence the flow of funds of some institutions to the private sector. At this stage, it appears that the New Zealand Superannuation Corporation will have to conform with requirements similar to those imposed on life offices and private superannuation funds. There is presently a limit, of 15% of the voting stock, on the investment which the Corporation may make in any particular company. Looking at the present Government and Board, I would not expect either to wish to use the Fund as a device to extend public ownership or exert control over industrial and commercial enterprises. Future governments could, of course, if they wished, change the nature of the Board and place fewer limitations on its power to invest in companies, but I see the dangers as potential rather than of any great interest in the foreseeable future.

The Corporation could, as indicated, be required to divert a higher proportion of its funds to Government activities, if Government felt it desirable to raise Government security requirements. At present, the requirements are to invest 30% of assets in public securities (of which 9% may be on the slightly higher yielding local body sector), with another 10% in either housing mortgages or public securities. In estimating the net flow of funds to Government, however, it is necessary to remember that contributions to the Fund (and to the private schemes generated by the legislation), by both employers and employees, are deductible from income for tax purposes, and the net reduction so caused in tax receipts must be offset against the large volume of loan funds flowing to Government.

Given the present Government security requirements and tax rates, there is no doubt that, to the extent that net savings are increased by the compulsion to join a superannuation scheme, they will flow mainly into private investment, unless there is some change in policy which makes public securities a good deal more attractive than they have been in the past.

This proviso introduces an important question, the answer to which will greatly influence the future pattern of investment of the Corporation. What will Governments' policies be towards the yields which they will offer on their own securities and permit local bodies to offer? One of the most important criticisms of the present compulsory scheme is that if rapid inflation persists, and if the present policies on security requirements and interest rates are maintained, the Corporation will find it difficult to earn yields on the investment of its funds which will keep pace with the rise of wages and prices. If it cannot earn a positive real rate of return on its funds, the Corporation will not be able to fulfil the basic purpose of the scheme of providing "a reasonable continuing income on retirement." The further the yield on contributions falls below the rate of inflation, the lower will final pensions be in relation to the incomes of contributors in their last few years of service.

This problem already exists for most private superannuation schemes, and a similar problem confronts a number of financial institutions who are essentially "taxed" by Government by being compelled to lodge part of their funds in low-yielding investments which they would not voluntarily choose. The introduction of compulsion on people to be in a superannuation scheme emphasizes the injustice of continuing to levy this "tax" on the institutions compelled to invest in public securities, and indirectly on those who put funds with them. It will also make it more obvious that a policy of holding certain interest rates artificially low can often hurt the less wealthy sectors of the community most.

The choices facing Government will be (1) to force the Corporation (and private schemes) into a position where they will pay disappointing pensions to contributors; (2) to subsidize pensions; (3) to keep the required ratios of investment by the Corporation and others in public securities and low-interest housing low, so that a high proportion of funds can go to property, equities and higher-yielding fixed interest investments; (4) to issue to superannuation institutions special bonds, indexed to the rate of inflation, so that a positive yield is virtually guaranteed on funds which they invest in public securities, or (5) to pay more competitive rates on public securities and help people on low incomes with housing, not by "taxing" financial institutions but by more general subsidies paid from public revenue. If the scheme surives, I am optimistic that course 5 will increasingly commend itself to Government (and incidentally make Government's control of money and credit more effective than it has been in the past). Even if the present compulsory scheme is abolished, it may have helped to illuminate the injustices and distortions which past policies have caused in our financial system, and thus paved the way for more sensible approaches in future.

More effective control of money and credit would, of course, help to curb inflation, and thus make the potential conflicts of objectives for Governments in relation to superannuation less serious than they will be if rapid inflation persists. Within this context, the existence of the Fund should help to ease the problems of business in raising funds by the issue of shares and debentures, and of potential home-owners and farmers in raising mortgage finance, so that those in such groups should be better able to avoid the high rates of interest which many have had to pay in the past through uncontrolled channels, especially during periods of tight liquidity.

Whether overseas investment by the Corporation will assume any importance is an interesting question. When the possible introduction of the Scheme was first being debated, overseas conditions were good and overseas reserves high. Some had visions of New Zealand as an increasing, if modest, overseas lender. Recent events have somewhat blurred the vision, and Government is unlikely to welcome initiatives in this direction by the Corporation in the next few years. However, some overseas investment by the Corporation, as an adjunct to our foreign trade and aid policy, is a possibility in due course.

The Debate About the Future of the New Zealand Scheme

Whether the New Zealand Scheme should continue in force is now an object of public debate and has become one of the important matters dividing the parties in this election campaign. The full dimensions of the debate are not yet clear, but as the outcome will have important implications for the financial system, I feel that we should consider some of the issues and possibilities involved.

The problem of finding the means of financing national development, given the resistances which exist to increasing rates of taxation, was probably one of the reasons why the Labour Party chose to place so much emphasis in their policy on a funded superannuation scheme. It appears that they were trying to kill three birds with one stone:-

(a) They wished to bring all wage and salary earners into employer-subsidised schemes to provide for their retirement. Indeed at first they wished to go further than this and bring in self-employed as well. However, they eventually exempted the latter from compulsion to join, and left them, along with non-earners, to make other provisions for supplementing the growing benefits available under social security for the aged.

(b) They wanted to make it possible for all workers to carry pensions with them if they changed their jobs.

(c) They believed that they could raise the rate of national savings, through the growing fund of surplus contributions which would accumulate over many years, both in the New Zealand Superannuation Scheme and in approved alternatives. This in turn would make it possible to sustain a higher level of investment, and therefore faster growth of national real income. Labour saw this as the essential basis for real improvement in both social services and private living standards.

In putting forward their alternative approach, the National Party picked upon the unpopular features and weaknesses of the Labour scheme:-

(a) The compulsion on unwilling employees and employers to contribute.

(b) The long period which will elapse before new contributors will be eligible for a full pension.

(c) The fact that those who do not contribute (e.g. many women) will not benefit, and that those who contribute for only part of their lives between 15 and 60 will get relatively small benefits from the Fund (though they will of course be eligible for social security benefits).

(d) The threat that continued inflation poses to the real value of money accumulated in a fund for retirement.

(e) The danger that a government so minded could use a large accumulation of funds for "nationalisation by stealth."

It is for these reasons that National has proposed to remove the compulsion to contribute to a funded scheme and promised a striking early increase in benefits for all those over 60, to be financed from general tax revenues. This promise has provoked a response by Labour in the form of an undertaking to provide an even larger increase in the benefits available to those over 60 who meet certain income tests.

In discussing the two parties' approaches, there was a tendency at first for commentators to compare Labour's compulsory, funded scheme, on its own, with National's improved, tax-financed benefits, on their own./In fact, both parties have a "two-tier" approach to providing for old age. With National, the tax-financed benefit is uncompromisingly said to be the first tier, with people left free to supplement this if they wish with private arrangements for superannuation (and other methods of providing for retirement) without conditions as to capitalisation of benefits, etc. They promise to continue to give generous tax concessions to contributors to approved second-tier schemes. Labour makes provision for retirement through membership of their New Zealand Scheme,,or an approved alternative, compulsory for wage and salary earners, and sees this as an increasingly important element in most people's provision for old age. They too continue to offer tax concessions to contributors to approved schemes (whether they are wage and salary earners or not) and now promise significant improvements in social security benefits for the aged. The differences between the parties therefore lie in (1) whether or not it should be compulsory for wage and salary earners and their employers to contribute to funded superannuation schemes and (2) the level and conditions of social security age benefits.

Implications of Abolition of the New Zealand Scheme

National says that, if elected, it would abolish the present funded superannuation scheme and return both employer and employee contributions to employee account holders, without interest but free of tax. If this statement is accepted at face value, it means that about $50 million would have to be found for replayment to people in the New Zealand Scheme. What would be done by Government about those who wished to contract out of the approved alternative schemes is not clear. In both cases, the contributions made up to the date of abolition would have been invested in some form or other - probably at least up to 40 percent in public securities and housing loans with the rest in other forms of investment, like debentures, shares and

property. These investments could not, without damage, be unloaded quickly on private markets. It is more likely that the Government would find the money for repayment of contributors out of public revenues, take over most of the assets in which the funds had been invested and sell them gradually over time to private buyers. The public deserves a fuller discussion than it has been offered so far of the implications of this proposal for fiscal and monetary policy in the period following the abolition of the compulsory scheme.

To the extent that people and companies opted out of superannuation, the inflow of funds that would have been available for investment in shares, debentures, mortgages, public securities, housing and other channels from this source, would be diminished. Unless it were intended that investment should also be correspondingly diminished, alternative sources of finance would need to be developed. In practice, given the financial situation likely to confront them, it would be surprising if a National administration did not actively try to induce those now contributing compulsorily to superannuation, to continue to do so voluntarily or to increase their voluntary savings is some other way. Unfortunately the manner in which the proposals have been presented in the election pamphlet has left the impression that self-provision, and therefore saving for old age, would hardly be necessary under the National Scheme. I think it is unlikely however that National in government would wish to load the dice so strongly in favour of consumption and against saving as their proposals seem to imply.

One hopes too that if National did abandon the compulsory scheme, the Government would wish to preserve the portability of pensions as far as possible, perhaps by making provision for portability in the Government's own schemes, and requiring it as a condition for tax concessions in private schemes.

Both National and Labour are offering significant increases in the benefits to the aged. National offers to phase in over three years a gross benefit to a married couple equivalent to 80% of the average ordinary time weekly wage, with single people receiving 60% of the married benefit. These benefits are to be available at age 60 to all with ten years' residence, without means test but subject to income tax. The gross cost of paying the new higher benefits, when fully phased in, is estimated to be about $275 million, equivalent to about 15% of the total incomes of salary and wage earners. It should be noted that the benefits are linked to wages, so that their real value will not be eroded by inflation unless prices rise more rapidly than wages. Usually, wages outpace prices by a margin approximately representing the growth of productivity, adjusted for changes in the terms of trade, but when the country needs to reduce excessive borrowing overseas, as at present, some fall in real wages may be required. Nevertheless, if the National Scheme were introduced the bill to government and the taxpayer for age benefits would grow proportionately to the growth of money wages, and this must be taken into account when assessing the longer-run costs of the scheme.

The foregoing comment is relevant to an examination of assertions of National that "the money required can be found from the increased volume of taxation which naturally accrues year by year with the growth of incomes." The growth that has taken place in the last three years of rapid inflation cannot be regarded by anyone as "natural" or "normal". One hopes that all parties will regard it as one of their highest priorities to bring the rates of increase of prices and money incomes back closer to those which prevailed in the first twenty years after the war.

Even if more rapid inflation persists, we must query the assumption that it will be easy to provide for a big increase in age benefits plus the repayment to those who wish to withdraw from Labour's compulsory scheme both their own and their employers' contributions. This is not the only increase in public expenditure to be provided for. Even if we concentrate on the problems of the aged, there are glaring deficiencies in the medical and hospital geriatric services crying out for attention. And more generally, we have yet to hear the full range of improvements which each party wishes to make to our health and education services, housing programmes, aid to a depressed farming industry and other important government activities.

It is not only tax revenue that increases with inflation. So too does government expenditure. The impact of inflation on government costs, especially the pay of those serving the government or other public agencies, together with new policies, produced estimates in the Budget for government finances for 1975/76 which showed a deficit before borrowing of $767 million. To this must be added at least $130m, representing the supplementary expenditure since approved over and above that provided for in the original estimates. This is an abnormally high deficit and if, as we hope, the economy is recovering by next year, whichever government is elected will have to reduce it substantially, by restraining the growth of expenditure below that of taxes and charges for public services.

It is not made clear in the National Party's proposals what its policies on taxes and charges for public services will be. Is it the "natural" growth of taxation with existing tax scales that will provide the finance for the higher benefits and other government expenditure? We can take it for granted, especially if rapid inflation persists, that there will be considerable pressure for review of tax scales. What wage earners and others are interested in is their real take-home pay and they have become increasingly conscious of the effects on their real incomes of a graduated scale of taxes as inflation carries their money incomes upwards into higher tax brackets. One reason for the incomes apparently unreasonable level at which pay demands are pitched when inflation gathers momentum is the desire to ensure that protection is obtained against both higher prices and the higher tax that higher money incomes will attract. Any party which wishes to keep the growth of money incomes under control must heed this important cause of cost inflation.

This year both parties agreed that it was wise to make concessions in tax rates to secure moderation in wage claims from the unions. In formulating their policies for 1976/78, they should certainly ask themselves whether similar action will be desirable again, whether by formal "indexation" of the structure of tax and allowances or by regular reviews.

Likewise there is a strong case for reviewing the accounting practices presently used for calculating business profits. These are overstated in inflation, especially because of under-valuation of the costs involved in maintaining the assets of the business. Therefore, any such

review would be likely to reduce the inflow of revenues at existing rates. I am not saying that reducing taxes of individuals and business should take priority over increases in benefits and other government expenditures. That is a matter for political decision. What I am suggesting is that it will become harder for governments in the future to finance growing expenditure through the surreptitious growth of tax revenues via the impact of inflation on pay and profits in money terms. If the parties are concerned about inflation, and if they believe a larger slice of the national cake should be taken for government-provided services or government transfers to selected groups, they will have to persuade the public to accept the restraints that will be necessary on other private incomes and spending to make this possible.

National spokesmen have claimed that their proposals bring better and earlier benefits to the aged at similar cost to the compulsory contributions which will have to be made to Labour's New Zealand Superannuation Scheme. (The likely total of these contributions, at 1975 income levels, when the scheme is fully phased in, has been estimated at from $200 to $250 million to the Corporation and $280 to $340 million to the Corporation and new private schemes combined.) However, three important differences must be noted :-

(i) The net cost to contributors to the compulsory super scheme is a good deal less than the gross cost, because contributions are deductible from income for taxation of both employees and employers.

(ii) The pattern of inflows and outflows would differ. The compulsory contributions to the New Zealand Superannuation Scheme are made by employees not previously belonging to a pension fund and by their employers. The benefits eventually paid are related to their contributions. The benefits proposed by National will come from general revenue, including taxes levied on those already providing for old age by contributing to a pension or in other ways. What share different taxpayers will pay will depend on how National levies the additional taxes, and we have not been told this. All who survive to age 60 and beyond will benefit, at a standard rate, regardless of contribution.

(iii) Especially in the earlier phases of the New Zealand Superannuation Scheme, the majority of the contributions flow into saving and investment. In the National scheme, the funds are transferred directly to beneficiaries and will be spent predominantly on consumption.

While retaining the New Zealand Superannuation Scheme, Labour has reacted to the National proposals by also proposing to phase in, over the next three years, a significant improvement of social security age benefits. Politicians readily criticize private enterprises for misleading advertising, but they are less ready to apply similar standards of quality of consumer information to their own electoral proposals. Thus Labour offers a benefit to a married couple of at least 90% of the average net ordinary-time wage, tax free, while National offers a taxable benefit of 80% of the gross average ordinary-time wage. But included in the Labour benefits, for purposes of this calculation, are Christmas bonuses, concessions on telephone rentals and TV licences, rate rebates and a contribution of $1 per week towards power costs. Moreover, the Labour benefits are to be subject to a test of income (although allowable income limits are to be liberalized), but the National

benefits are not. While the Labour proposal sounds more generous for the means-tested beneficiary, it may not be if National continues or expands the concessions to pensioners on TV, telephones and rates. The important distinction is that the means test applied by Labour would bring the additional benefits to a smaller proportion of the population between 60 and 65 years of age. Thus, the total net additional cost of Labour's proposals to the taxpayer would be much less than National's, probably about $50 million compared with about $275 million. So far as future adjustments are concerned, Labour's scheme would be more expensive than National's, in any period of falling real wages, because it links the increase in benefits to either the rise in wages or the rise in prices, whichever is the higher.

It is evident that comparisons are difficult, but whichever party is elected a considerable competitive escalation of age benefits will have ensued from the intense party debate over Labour's superannuation proposals. Indeed, this cannot be the end of the chain of consequences. It is difficult to see how either side could deny for long similar treatment to that proposed for the aged to other, younger people who qualify for benefits, e.g. because they are widowed, sick or unemployed. Such extensions would raise total benefit costs considerably.

If the community wants a substantial escalation of the whole benefit structure, well and good. But it would be quite misleading to leave the impression that generous, inflation-proofed increases in transfers to beneficiaries can be made, in the circumstances likely to confront us in the next few years, without considerable sacrifice by the tax-paying section of the community.

Both the Government and, with greater vehemence, the Opposition, have correctly been pointing out that the country has been living considerably beyond its external means. The deficit between current overseas expenditure and current overseas income in the year ending March 1975 was the equivalent of about 15 percent of our gross national product. It is not inappropriate for a country like New Zealand, with considerable potential for continued growth of export income, to seek external assistance in its development through overseas borrowing and investment, probably to the extent of about 1½ percent or 2 persent of GNP per annum on average. We have been overshooting this figure by a wide margin. Whatever Government is in power will have to see that better balance is achieved between imports and exports. The more export receipts grow, the less the restraint on imports will have to be. However, the need to release resources to the export industries and to curb imports to the extent that is required makes it inappropriate for any party to suggest at this stage that the average New Zealander can enjoy rising material living standards for the next year or two. Real transfers to one section of the community will therefore involve sacrifices by others, and this should be borne fully in mind by all those who are attempting to assess the promises which are made by political parties in this election year.

This year, more than usual, we should beware of politicians bearing gifts, and ask those who do to tell us clearly who is going to pay for their apparent generosity.

VICTORIA UNIV... OF
WELLINGTON LIBRARY

WELFARE
No. 5951
CLASS Q368.43
HOL

Q368.43 5951
HOLMES, Frank W.
Old age, superannuation and the financial system. 1975.

Name	Date Due	Name	Date Due
J Cimmins	28/8/78		
Ken Tonks Valuation Dept 847-849 x45	24.4.78		
Muriel Carruthers	14. DEC. 1988		
Keith Bode Policy	17/7 -9. APR. 1989		

S.W.253

Date Due

14. DEC. 1988		
-9. APR. 1989		
-8 APR 1993		
21 AUG 1993		

DEPT. OF SOCIAL WELFARE
LIBRARY, WELLINGTON, N.Z.