INTERNATIONAL SOCIAL SECURITY ASSOCIATION

Crisis country case study

New Zealand

This country case study is one of the studies produced under the *ISSA Crisis Monitor* Project

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The Crisis Country Case Studies are an integral part of the ISSA project to monitor and analyse the impact of the global financial and economic crisis on social security. These studies are based on data and research carried out between June 2009 and the first part of 2010. While every effort has been taken to ensure that the case studies are accurate, the situation in each country is constantly evolving.

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ISSA crisis case study: New Zealand

Summary

New Zealand was in an economic downturn prior to the crisis yet the global downturn clearly contributed to a recession which stretched over five successive quarters until June 2009. Levels of unemployment were closely correlated to the economic downturn, rising from 3.8 per cent in 2008 to 6 per cent in 2009. Moreover, pension funds were also hard hit, registering -26.2 per cent in nominal terms in 2008.

In response, the government opted for exemplary broad and deep initiatives including the acceleration of infrastructure projects, SME business relief programmes worth US-dollar (USD)352 million, expansion of job subsidies and work schemes both for the unemployed and employed. Close to half of general government expenditure remains earmarked for social protection and health expenditures.

Yet, there is ongoing concern that lacklustre growth in government revenue combined with high public expenditure expected in 2010–11 will jeopardize levels of generous social security programmes paid out of the Superfund – the country's sovereign wealth fund. Given that New Zealand's large non-contributory pension scheme is financed from government revenue, better planned management of the Superfund should help ensure that any attempt to mitigate the crisis does not risk using resources that would otherwise be assigned to social security.

Social security institutions covered

The Ministry of Social Development (Work and Income) administers pensions and benefits through its local offices. The Inland Revenue Department administers statutory paid parental leave benefits and tax credits for children.

Overview of the social security system

Along with its neighbour Australia, New Zealand is one of the few countries in the Asia and Pacific region where general taxation fully funds social security benefits and pensions. Apart from a PAYE Accident Compensation Corporation (ACC) scheme providing compensation in the event of an accident at work or elsewhere, social security is largely non-contributory – being funded from general taxation rather than direct employer and employee contributions.

Social security benefits such as unemployment, pension, sickness, maternity and disability are provided irrespective of employment history, though eligibility criteria and means-testing exists. For example, although unemployment benefits have no maximum period for which they can be paid, they are paid only after a minimum period of residence (two years) in New Zealand.

National superannuation (age 65+ state pensions) is paid out through a first tier, flat rate, universal system and requires a ten-year residence period from the age of 20, five years of which must be after age 50 (US Government, 2010). This makes entitlement to the old age pension relatively easy.

New Zealand's pre-funded superannuation investment fund (a sovereign wealth fund henceforth called the Superfund) is financed from taxation revenue and designed to smooth out (i.e. buffer) future increases in the cost of pensions by making prior contributions to an investment fund (International Social Security Association (ISSA, 2009)).

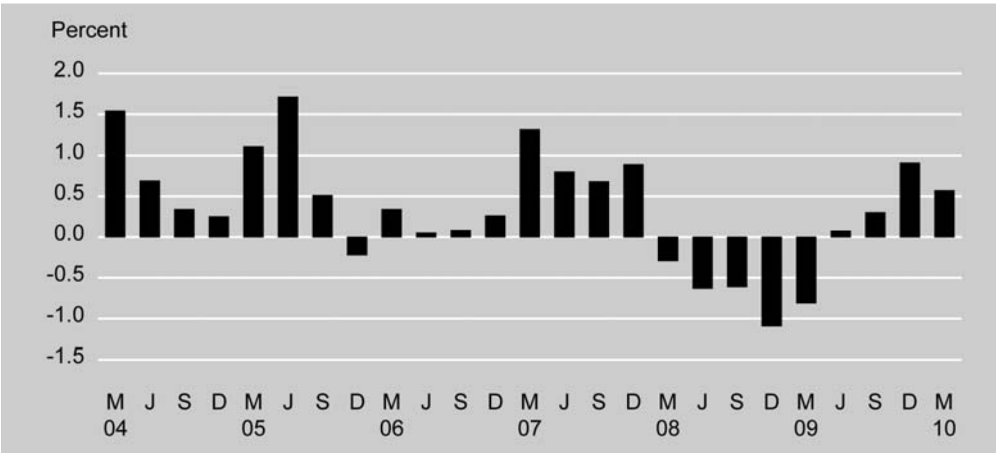
Impact of the crisis

The economy and labour force

According to Statistics New Zealand, the country was in an economic downturn prior to the international financial crisis. The economy contracted throughout 2008 and early 2009. Initial triggers of recession in 2008 were domestic factors, including drought and tight monetary policy to combat growing inflation pressures at the time.

The impact of the global downturn, however, while significant, was smaller than for most developed nations. In the Organisation for Economic Co-operation and Development (OECD), only Australia and Poland had smaller falls in real output from when the crisis began. New Zealand's performance was supported by a sound financial system, growth in key trading partners China and Australia, strong commodity exports and falling emigration. These factors helped pull New Zealand out of recession in the June 2009 quarter. Although the beginning of recovery in mid-2009 was subdued, it gathered strength in the December quarter with growth of 0.8 per cent (New Zealand Treasury, 2010). This is illustrated in Figure 1.

Figure 1. ***Gross domestic product, 2004–2010 (quarterly change)***



Source: US Government (2010).

According to Statistics New Zealand (2010a), economic activity was up 0.6 per cent in the March 2010 quarter. However, gross domestic product contracted 0.4 per cent in the year ending March 2010 compared with the year ending March 2009. This highlights the fact that the economy has not yet returned to the level of activity that existed before the recession.

Levels of unemployment have been closely correlated to the economic downturn. Unemployment rose from 3.8 per cent in March 2008, when the economy first contracted, to a peak of 7.2 per cent in December 2009. In the March 2010 quarter, the unemployment rate fell to 6.0 per cent. This was the first fall in both the number of people unemployed and the unemployment rate since the December 2007 quarter, and the largest fall in the unemployment rate recorded since the Household Survey began in March 1986 (Statistics New Zealand, 2010b). However, the June quarter saw seasonally adjusted unemployment rise to 6.8 per cent, reflecting volatility in the labour market (Statistics New Zealand, 2010c).

Investment performance

The Superfund smoothes the tax burden between generations by investing contributions received during the early period of the Fund and, through returns generated over decades of investing, by growing the size of the Fund. At a certain point – currently from 2031 – the government then begins making withdrawals from the Fund to help meet the cost of superannuation at that time.

"Pre-funding" the future cost of superannuation in this way means that future governments do not have to seek as much from future taxpayers (or from other sources, such as through raising debt) to meet the cost of superannuation when it is increasing most sharply.

The global recession had a significant impact on the Superfund's portfolio. The return for the year to 30 June 2009 was -22.1 per cent (see Table 1). Included in this period were the two worst quarters in the history of the Fund's performance, as well as the single best quarter. This performance was not out of line with indexes for global large-capitalization equities in the same year, which fell 24 per cent – one of the worst performances on record (New Zealand Superannuation Fund, 2010).

Table 1. ***Superfund investment performance, 2009***

30/06/2009	Market Value			Fiscal Year-to-date			Annualised return since inception		
	USD (Million)	%	Benchmark	Return	Benchmark	Diff	Return	Benchmark	Diff
NZ equities	538	6.2%	7.5%	-9.7%	-10.6%	0.8%	7.2%	5.1%	2.1%
Intl Equities Large Caps	2,596	30.1%	32.0%	-31.0%	-23.8%	-7.2%	1.7%	3.4%	-1.7%
Intl Equities Small Caps	600	7.0%	5.5%	-32.6%	-22.2%	-10.4%	2.4%	3.4%	-0.9%
Intl Equities Emerging Markets	340	3.9%	3.0%	-33.4%	-30.9%	-2.5%	13.4%	14.7%	-1.3%
NZ Bonds	43	0.5%	17.0%	10.2%	10.3%	-0.2%	6.6%	6.6%	0.0%
Overseas Bonds	1,372	15.9%		8.7%	9.1%	-0.4%	7.3%	8.3%	-0.9%
Cash	570	6.6%	0.0%	5.8%	5.5%	0.3%	6.8%	6.6%	0.2%
Property	807	9.4%	10.0%	-32.4%	-34.6%	2.1%	-1.5	-2.1%	0.6%
Infrastructure	540	20.4%	25.0%	-26.7%			0.2%		
Private Equity	98			-14.1%			5.7%		
Commodities [1,2]	361			-47.7%	-49.3%	1.6%	-5.0%	-6.0%	1.0%
Timber [1,3,4]	788			15.2%			11.8%		
Total Fund	8,625	100%	100%						
Return v weighted average assets class benchmarks				-22.1%	-17.5%	-4.6%	3.9%	4.6%	-0.8%
Return v Fund objective of cash plus 2.5%				-22.1%	8.0%	-30.1%	3.9%	9.1%	-5.3%

(1) Other growth assets, commodities and timber have a combined benchmark asset allocation.
(2) Investments in commodities began in August 2005
(3) Investments in timber began October 2005
(4) Timber assets are only valued periodically

Source: New Zealand Superannuation Fund (2010).

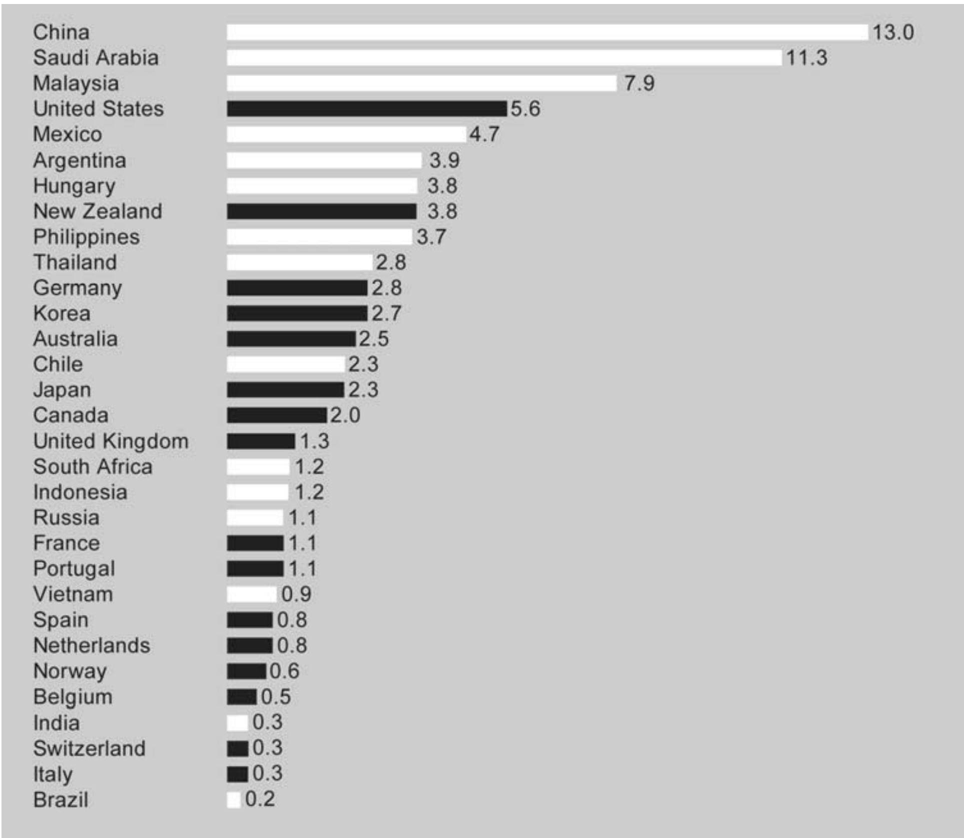
Administrative capacity

The government has maintained social security entitlements despite a sizeable fiscal deficit (provisional estimates put the deficit at 5 per cent of GDP in 2009 (Economist Intelligence Unit (EIU, 2010)) and higher unemployment. Tax revenues are lower (the tax take is forecast to drop from approximately USD42 billion in 2008 to a projected low of USD39 billion in 2011, before rising above USD43 billion in 2013) and expenditure on social security benefits is greater as a result of the crisis. There has also been demand for additional front line social security and employment service delivery staff; approximately 300 additional staff have been deployed to increase job search assistance and seminars.

Responses to the crisis

As a percentage of GDP, New Zealand's total fiscal package in 2009 was 3.8 per cent (International Labour Office (ILO, 2009)). Among developed countries, this is relatively generous (as depicted in Figure 2). Thus to stem the country's rising budget deficit, the government announced on 28 May 2009 that regular annual payments to the Superfund will be suspended until there is a budget surplus. Treasury projects that contribute to the Superfund are likely to be suspended for nine years, with contributions expected to resume in 2018/19.

Figure 2. ***Fiscal package as a percentage of GDP in 2009***



Source: ILO (2009).

Within the fiscal package are various broad and deep initiatives:

Accelerating infrastructure projects

The government approved an accelerated package of "ready-to-roll" infrastructure projects spanning the housing, transport, education and energy sectors at an estimated cost of about USD352 million, of which around USD71 millions' worth of projects start in 2010.

Business relief

The government also announced a USD352 million relief package for small and medium-sized businesses (which make up the largest proportion of businesses) in order to improve the business environment. The package includes the following elements:

- a suite of 11 tax cuts costing USD335 million over four years;
- an expansion to the export credit scheme;
- extended jurisdiction for the Disputes Tribunal to reduce the number of disputes going through lengthy court processes;
- expansion of business advice services and a prompt-payment requirement for government agencies;
- wholesale Funding Guarantee and Retail Deposit Guarantees for the banking system.

Labour market and social security

The government has implemented numerous changes to directly sustain labour demand including through expanding job subsidies, and expanding short-time work schemes (OECD, 2009).

The main measures associated with social security are:

1. The ReStart assistance package

   An initiative providing support to find employment and additional financial assistance for people who have been made redundant. ReStart provides temporary assistance for up to 16 weeks, or until the recipient finds another full-time position (whichever occurs first).

2. The Job Support (or nine-day fortnight) Scheme

   The Ministry of Social Development makes a direct payment to employers to supplement the income of workers who have accepted reduced working hours by up to ten hours per fortnight for up to six months (Ministry of Social Development, 2010c). From 27 April 2009, the Job Support Scheme was extended to include employers with 50 or more employees.

3. The Youth Opportunities package

   Youth Opportunities is a USD107 million suite of initiatives announced in August 2009 that provides employment and training opportunities for 16- to 24-year-olds up to the end of 2011. In particular, the Job Ops and Community Max initiatives subsidize the employment of low-skilled young people in business and community programmes. The initiatives aim to foster confidence and discipline, integrate young people into their communities, provide appropriate and relevant training, develop work skills and avoid long-term dependency (Ministry of Social Development, 2010d).

4. The Future Focus reforms

On 23 March 2010 the government announced a comprehensive package of reforms aimed at breaking the cycle of dependency. It delivers on pre-election commitments by rebalancing expectations, obligations and incentives. Those still receiving unemployment benefit after a year will be expected to reapply and sole parents receiving the Domestic Purposes Benefit with a youngest child six years and over will be required to look for part-time work. In 2011, Sickness Beneficiaries assessed as being able to do part-time work will face the same obligations. There will also be stricter eligibility criteria for Invalid's Benefit (Ministry of Social Development, 2010a). The package also introduces increased benefit abatement thresholds to encourage work effort, a new study loan for sole parents and changes to out of school childcare rules to make it easier for home-based providers to get funding (Ministry of Social Development, 2010b).

Personal and company tax reform

In the May 2010 Budget, the government introduced a tax reform package designed to boost growth by:

- improving incentives to work, upskill, train and save;
- improving the financial incentives to remain in, move to, or invest in New Zealand;
- addressing tax preferences on depreciable property that have distorted the pattern of investment.

The package uses revenue from increases in Goods and Services Tax (GST), the removal of certain tax preferences on property and the tightening of some tax deduction rules for foreign investments to fund reductions in all personal income taxes, and a lower company tax rate.

Lessons learned

As New Zealand's pensions and benefits depend on general taxation, the key government message regarding the economic crisis has been the need to move the economy into a more stable growth position.

Prime Minister John Key has made clear that the government's priorities will be to boost the country's long-term economic growth rate, improve efficiency of public services and reform the tax system.

Losses in the Superfund in 2009 and the decision to suspend further contributions during fiscal deficits place further pressure on the fiscal decisions to be made. However, the government does not consider the returns from the single worst performing year in the Fund's history to necessitate revisiting its strategic asset allocation. The view of the Superfund's guardians is to remain focused on the long-term investment target, and to that end it intends to maintain a diversified portfolio of global investments.

Conclusion

Although other benefits are not unusually high in their coverage or levels, New Zealand's old age pensions are exemplary in their coverage and levels – with generous entry thresholds, adjustment for inflation, and linking to after-tax average wages. According to the IMF, close to half of general government expenditure is spent on public social protection and health expenditure. Moreover, the government has successfully targeted support to those most vulnerable to the crisis such as youth and the long-term unemployed.

The outlook for the post-crisis situation is mixed. The government's latest half-yearly economic and fiscal update, which was released in May 2010, states that recovery from the recession is expected to be gradual. Growth is forecast to rebound from -0.3 per cent in March 2010 to 3.2 per cent in March 2011, and then stay at around that level for the next three years. Net debt in the June 2009 was 9.3 per cent of GDP and is expected to continue rising to a peak of 27.4 per cent in 2015 as the operating balance returns to surplus the following year. The government's long-term fiscal objective is for net debt to be brought back to a level no higher than 20 per cent of GDP by the early 2020s.

In responding to the crisis, the government has adopted a long-term perspective, seeking to strengthen New Zealand's future economic performance rather than focusing on introducing initiatives to mitigate the effects of the crisis. What is clear is that in response to the crisis New Zealand's policy-makers have attached importance to laws, regulations and programmes relating to social protection and job creation.

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