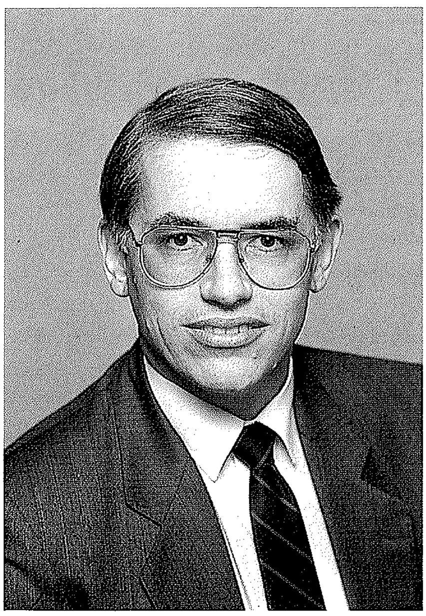
SUPER: POLICY IN SEARCH OF REALITY

IF THERE'S AN ANSWER, WHAT'S THE QUESTION?



By *MICHAEL LITTLEWOOD*

In both New Zealand and Australia, the planners of retirement-income policy cannot avoid the fact the people are likely to make their own decisions about how they save.

Any observer of the superannuation scene in Australasia would be excused for wondering how two countries which are so close geographically, culturally and historically could have arrived at such diverse positions on the superannuation issue. The observer might conclude that:

- New Zealand hasn't yet discovered what it wants;
- Australia hasn't really even asked the question.

There is a lot happening in Australia; but, as an interested observer, my concern is that much of the activity seems directionless. The symptoms of that are easily recognised by New Zealanders because we have endured directionless change for eighteen years. With each change of government since 1972, we have had a major reform of either public or private provision of retirement support — in one case, of both.

New Zealand is only now beginning to ask some relevant questions about messages, demography and our saving habits. Before looking at some of those messages, readers are invited to endure a short history lesson which will explain what has happened in New Zealand.

EET to TTE?

First, a word about tax. There are three major movements of money in a superannuation plan. The initials "T" and "E" are a convenient shorthand tag for the tax treatment of each.

- **Contributions:** Money is contributed to a plan by employees, employers or both. If they are deductible for tax purposes, they are "exempt" and are tagged "E". That was the position in New Zealand until 17 December 1987. From then, contributions effectively lost deductibility and so had to be paid from after-tax income. The tag changed to "T" or "taxed".
- **Investment income:** In a funded plan, the contributions are invested by trustees. If the investment income is tax-free, it is "exempt" and tagged "E". Again, that was the case in New Zealand until 31 March 1988. Since 1 April 1988, a superannuation plan has paid income tax of 33 per cent, which is the top marginal rate of personal income tax (and the corporate tax rate as well). The investment income is now "T".
- **Benefit:** The emerging benefit — usually, in New Zealand, a pension — used to be largely taxed as income. A retiree was able to exchange up to 25 per cent for a tax-free

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lump sum but the rest was taxed in the normal way. On 1 April 1990, all benefits from what is now called a "registered superannuation scheme" became tax-free, even if paid as a pension. "T" became "E".

Someone had persuaded the last Labour government that superannuation plans were only one way New Zealanders saved for retirement. Not many actually used them (the best guess was only about 30 per cent of employees, for reasons explained below); the tax concessions were expensive; and most employees resigned before reaching the age of 50. This last fact was significant because, inexplicably, no tax applied to their benefits so the tax system's investment in the savings built up was lost: EET became EEE.

People also saved for retirement through bank accounts. Those operated under a TTE tax regime (amounts were saved from after-tax income ("T"); the account-holder paid tax on interest ("T") and any withdrawals were not taxed ("E"). Why should a superannuation plan be tax-favoured over a bank account? The government was telling people, through the tax system, that a superannuation plan was better than a bank account. One vehicle was tax-preferred, the other was tax-neutral.

New Zealand now treats superannuation fôr tax purposes under a neutral TTE regime. Australia has adopted a tax-favoured "TTT" regime because reduced rates of tax are applied at each stage. The most powerful of the elements in the Australian system is the middle "T" — that is simply a commentary on the power of compound interest.

Tax neutrality

The concept of tax neutrality is important in this debate. In this case, "neutrality" is defined as the tax treatment which would apply if the member invested the money directly, not through a superannuation plan. An ordinary, interest-bearing bank account is a convenient model in this regard. The compromises adopted in New Zealand include a withholding tax on the employer's contributions and income tax charged at the top personal marginal rate. Although that sounds penal, the penalty is real but not significant, since there is only a small difference between the average personal tax rate on most income (28 per cent) and the top rate of 33 per cent.

So, the playing field is now levelled; the economists are happy and everyone should be making his own decisions based on old-fashioned, enlightened self-interest. Why then does New Zealand now have a taskforce looking at the role of private provision for retirement? Is more change on the way?

To understand the reasons for the latest move, you need to understand a little of our background. There are some useful lessons to be learned by Australia from our painful preference for upheaval and uncertainty.

Messages of the past 50 years

Where we are at the moment is a function of where we have come from. It defines the policy options and limits the choices.

▒ **High home ownership:** Powerful financial messages have led to a very high ratio of home ownership in New Zealand. Seventy-one per cent of those over the age of 60 own a mortgage-free home. The reasons for this include no capital gains tax, death duty concessions for married couples, direct mortgage subsidies to low-income earners, the fact that there is no imputed "other income" for the purpose of calculating the income test for the age pension and continual political pressure to reduce interest rates.

▒ **High dependence on state income:** Since 1977, the state's national superannuation has been one of the most generous welfare-driven, age-based income transfer systems in the Western world. It has been the subject of much political opportunism. Between 1970 and 1979, the real value of the single person's benefit increased from about 30 per cent of the national average wage to about 45 per cent. For a married couple, the benefit increased to about 75 per cent of the average wage. Until 1984 there was no income or asset test. There is still no asset test.

Generosity has its rewards — retired New Zealanders are now heavily dependent on state intervention for incomes in retirement.

▒ **Low household savings:** As a result, private retirement savings in New Zealand have a low priority. Currently, New Zealanders are dissaving after a recent period of reducing rates of household saving.

However, we need to be extremely careful with definitions. For example, our statisticians do not regard paying off a house mortgage as "saving" and yet, clearly, owning a mortgage-free home is an important part of financial provision for retirement.

The state/private connection

New Zealand's recent history is a good illustration of the traditional "three pillars" model of retirement-income provision, but only in a negative sense. We have looked at each of the pillars (state income, employer-sponsored plans and all other private savings) as if they were separate issues to be resolved individually.

When we decided to level the playing field and adopt a tax-neutral regime for superannuation plans, we did not think about the impact of that decision on the demand for state-provided retirement incomes. Worse still, we did not even discuss the issue. As has tended to be the way in New Zealand, the decisions had already been made before the subject was aired as a serious public issue.

What, in the context of heavy reliance on state-provided retirement income, is the "neutral" treatment of retirement savings? The tax treatment is certainly part of that — but not all, by quite a long way. If the state's social obligation to ensure a reasonable standard of living in retirement can be met through a private superannuation plan, then the state cannot be indifferent to individuals' decisions whether or not to save for retirement.

What price then does the whole structure pay for a neutral tax system for retirement savings? The tax system may be indifferent on the issue but the welfare system should be very concerned. Allowing the tax system to go off in its own direction is, in my view, a very risky strategy for any government to adopt. Equally risky would be decisions to redesign private provision in isolation and without regard to the rest of the retirement income picture.

One large topic

Income support in retirement is one large subject and it is not just about pensions. It encompasses a number of different concepts:

- state age-based benefits — our "national superannuation";
- state welfare benefits — for example, special needs grants;
- benefits from employer-sponsored superannuation plans;
- other private savings;
- housing provision (which could involve state-provided subsidies such as cheap rentals, rates relief, etc.);
- health services — the retired population is clearly a big user of the health system and someone has to pay for it;
- subsidised public services — for example, bus fares, telephone rentals (these have been largely eliminated in New Zealand);
- advance provision for retirement consumption — for example, replacing household appliances before retirement, or saving for the retirement trip, a significant part of New Zealand culture.

The whole goes to make up a complex, inter-connected structure in which change to one part will tend, over a period, to produce an equivalent and compensatory change in another part. Any reduction to our national superannuation (such as has happened recently with the strengthening of the income test) could, then, produce a countervailing pressure on one or more of the other parts of the structure. Some of the pressure points may be state-funded, so that the initial "savings" could turn out to be illusory in the long run.

Retirement income hierarchy

The 50 years to 1987 saw a reasonably logical retirement income hierarchy develop in New Zealand for the provision of income support in retirement. The broad "bargain" saw the state encouraging the purchase of a home which should be paid off by retirement age. It then effectively discouraged the accumulation of private saving for cash income by the provision of a reasonable, but not generous, indexed pension paid out of general tax receipts. Only the better-off, who needed additional retirement income, tended to make use of tax-favoured superannuation plans. The health system was largely free. Though each element of this structure could be criticised, the whole presented a reasonably coherent answer to the retirement income issue.

During a long period of relative economic prosperity, the old hierarchy served New Zealanders reasonably well. However, governments of the past 50 years had unwittingly painted New Zealand into a policy corner, one which gives New Zealand governments a smaller number of choices in our recently acquired policy of fiscal probity.

The coming demographic deluge also requires us to face up in this century to the issues of the next century. Over the next 60 years, the number of New Zealanders over the age of 65 is expected to grow from one-in-nine to two-in-nine of the total population. Our choices are further constrained.

The lessons for Australia?

The Task Force on Private Provision for Retirement is now looking at some of the lessons for New Zealand of these past 50 years. There are no easy answers but some general principles are not so difficult to identify:

- **Rational behaviour:** Governments on both sides of the Tasman should expect people to behave rationally — in this case, to maximise their personal economic benefit, preferably at someone else's expense. There is no moral opprobrium intended by this principle; for example, if tax/welfare policies encourage people to save by buying a house rather than by depositing money with a bank or other institution, then buying a house is completely rational and an unsurprising outcome. However, in this context, it is difficult to understand why we in New Zealand do not count paying off a mortgage as part of household saving. I do not know if that is the case in Australia but it is in the US.
- **Public vs private policy:** Decisions which may seem private in nature really have public-policy implications which we have to understand before we start making policy on either public or private provision. Should people be allowed to spend their retirement savings before retirement? The freedom-of-choice argument may say that is none of my business, but if the result of that freedom is to maximise state benefits then I say it is my business as well. Freedoms need to be matched by countervailing responsibilities.
- **A continuum:** In both countries, the provision of retirement income is a continuum from wholly public (at one extreme) to wholly private (at the other). This is achieved by differing forms of income tests. The debate should be about where the division is drawn along that line and about how smooth the transition can be from one state to the other. What is the "best" mix? Against what measures is "best" to be tested? Is it really about spreading risks or is it about changing behaviour? Or both?
- **One cake:** The strength of the economy as a whole will determine our ability to support the retired. Both private and public provision are slices from the one cake — making one slice bigger and the other smaller does not necessarily affect the size of the cake. The economists seem not to know which comes first — growth or savings. Whatever the truth of it, the two seem related.
- **Change is disruptive:** Saving for retirement income and spending it should be a 50 to 60-year project for an individual. Constant change is expensive and disruptive, particularly if there are no nationally agreed objectives. Change also runs the risk of immobilising the decision-makers: savers in New Zealand seem to be suffering from the "possum in the headlights" syndrome.

As an outsider, it seems to me that Australia needs to return to some

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should be reconciled to the fair market values of the identifiable net assets comprising the business (both tangible and intangible) and the resulting goodwill. The reconciliation should be reviewed to ensure that all the assets and liabilities have been properly valued and that there is sufficient allowance for goodwill, if appropriate (the accounting recognition of goodwill is subject to the requirements of AASB 1013).

Since the introduction of Statement of Accounting Standards AAS18 "Accounting for Goodwill" in March 1984, some cynics have suggested there has been a tendency in the market to allocate an excessive portion of the value of the pool of intangible assets to identifiable intangibles such as mastheads. Such allocation avoids the requirement to amortise goodwill over a maximum 20-year period in the profit-and-loss account. Interestingly, relatively few media companies reflect any value for goodwill in their balance sheets.

Company directors need to consider each year whether they have fulfilled their obligations under Section 294(4)(a) of the Corporations Law, which requires that the carrying value of a non-current asset not be greater than it would have been reasonable for the company to expend to acquire that asset. In essence, this is a "recoverable amount" test. This suggests that it is important that directors of media companies review the carrying values of mastheads each year.

The revised AASB 1010 "Accounting for the Revaluation of Non-Current Assets" (issued in September 1991) seeks to clarify the application of the "recoverable amount" test. However, the wording of the standard is not yet tight enough to force directors to write down the value of mastheads where the book value exceeds the fair market value. This is due mainly to the failure of the standard to clarify the meaning of "recoverable amount" in net present value terms. It is hoped that such clarification is not far away.

Further tightening by the Accounting Standards Board of the rules relating to the carrying values (and amortisation) of intangible assets will have major implications for public companies which are tempted to carry identifiable intangible assets in their accounts at excessive values. This should avoid a recurrence of the situation where mastheads are carried at artificially high values in balance sheets and then largely disappear in times of financial crisis. This phenomenon occurred in many sectors of the media industry (particularly in respect of TV and radio licences) in the 1980s.

A simple solution to the problem of overvalued mastheads and other identifiable intangible assets would be for the Accounting Standards Board to impose the same amortisation/depreciation requirements to all intangible assets, regardless of whether they are identifiable or unidentifiable.

Conclusion

The valuation of a masthead, if conducted properly, should in my view ensure that:

- those persons involved in the preparation of prospectuses (and accounts) are in a better position to discharge their duties under the Corporations Law;
- investors are fully informed (especially if the valuation is made public);
- share issues are priced correctly; and
- ASC (and other) concern is avoided.

To ensure that investors are fully informed, prospectuses which include masthead valuations should include a copy of the supporting valuation. Alternatively, the prospectus should disclose the valuation methodology, the major assumptions adopted and a sensitivity analysis of the major assumptions underlying the valuation.

Both the NCSC and ED49 concur that an identifiable intangible asset should only be brought to account where:

- it is probable that the future benefits or service potential embodied in the asset will eventuate; and
- the asset possesses a cost or other value that can be measured reliably.

In the event that an identifiable intangible asset (such as a masthead) fails to meet one or both of these fundamental asset recognition criteria, the NCSC, quite correctly, concluded that it *should not be recognised in the accounts* (emphasis added).

The correct principles which should be applied to the valuation of identifiable intangible assets are understood by only a handful of people in the marketplace. Directors, lenders, auditors, underwriters, investors and analysts should therefore treat values attributed to mastheads (and other identifiable intangible assets) with extreme caution.

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basic issues. Daryl Dixon recently gave the present structure a comprehensive pasting when he said:

"Present superannuation policies are inequitable, inefficient, resource allocation distorting and poorly designed and conceived. The proposed 12 per cent of salary projected to the year 2000 will make them worse." (*Tax Matters*, Australian Tax Research Foundation, Newsletter No. 30, February 1992.)

It is not for me to say that Australia has got it wrong, or that recently suggested changes may make things better or worse, however those concepts may be defined. However, there seem to be some fundamental questions which Australians need to identify before they can be asked and then answered. Based on the New Zealand experience, I think that creating political debate out of the superannuation issue is a sure way to avoid identifying those questions.

A lasting solution to this multi-faceted problem is unlikely to emerge from our adversarial political systems. While one party's view may be technically superior to the other's, without some objectives which have been agreed to by the community as a whole, I fear that change will be constant and that superannuation, as an issue, will tend to remain directionless.

In any issue of public concern, the "government" is really no more than a synonym for "us all". The central authority is in no better position to resolve this issue than are we all, individually; and able to do no more than we are prepared to allow. What about finding out what the public thinks?