

Presentation to NZSA conference Blenheim, November 2010



**(1) OVERVIEW OF JOINT RETIREMENT
COMMISSIONER AND INSTITUTE OF POLICY
STUDIES CONFERENCE**

**(2) LIVING WITHIN OUR MEANS: A
FRAMEWORK FOR MAKING DECISIONS ON THE
AGE OF ELIGIBILITY FOR NEW ZEALAND
SUPERANNUATION**

**GEOFF RASHBROOKE, INSTITUTE OF POLICY
STUDIES**

Overview: Retirement Income Policy & Intergenerational Equity conference July 2010



- Retirement income policy is an intergenerational issue; link between generations was focus for the conference
- No attempt to provide a single perspective: each presenter and discussant looked at retirement issues from their own viewpoint
- Covered international, fiscal and social perspectives, as well as strategies and options to analyse the implications of intergenerational impacts of retirement incomes.
- Papers available at www.ips.ac.nz – also book due out 6 December

Overview: Retirement Income Policy & Intergenerational Equity conference July 2010



- **Kent Weaver, from Georgetown University, Washington, D.C., spoke on the political economy of retirement income policy**
 - Examined the behavioural/social and political challenges that must be considered in attempting to embark on effective and sustainable policy reforms
 - Outlined possible options for New Zealand
 - Provided a score card

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A REPORT CARD FOR NEW ZEALAND'S RETIREMENT INCOME SYSTEM		
<u>SUBJECT</u>	<u>GRADE</u>	<u>COMMENTS</u>
Long-Term Affordability	B+	
Administrative Effectiveness and Cost-NZ Super	A	
Administrative Effectiveness and Cost-Kiwisaver	B	
Poverty Prevention	B+	
Income Replacement	C	
Promoting Gender Equity	A-	
Clarity on Expected Retirement Income-NZ Super	B	
Exposure to Market Risk	A-	Exposure will grow
Clarity on Total Expected Retirement Income	C	
Encouraging Continued Work after 65	B	Mixed signals
Exposure to Political Risk	D	Shows improvement

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- **Discussants:**
 - Jean-Pierre de Raad (NZIER) provided New Zealand data to support arguments of future fiscal challenges and the need to make trade-offs for fiscal sustainability
 - Whereas independent consultant Peter Harris argued expenditure on pensions in New Zealand is low by OECD standards, poverty among pensioners is low, and the current system is equitable, hence no reason to alter the existing parameters of pension policies

Overview: Retirement Income Policy & Intergenerational Equity conference July 2010



- **Second keynote speaker, Peter Whiteford, from the Social Policy Research Centre, University of New South Wales**
 - Discussed inter- and intra-generational issues
 - Outlined the design features of retirement income systems in OECD countries, recent reforms, and their outcomes
 - Gave international comparisons on the basis of progressivity and replacement rates, with frequent comparisons to Australia
- **Discussants**
 - Andrew Coleman (Motu) suggested New Zealand tax system lacks incentives for private retirement savings compared to other OECD countries, & questioned the role of the New Zealand Superannuation Fund in terms of intergenerational equity
 - Susan St. John (Auckland University) took a contrary view, drawing upon Whiteford's 'goals of pension reform', where the primary goals of pensions were poverty alleviation and replacement of income while working, not savings incentives

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- **Gabs Makhoulf (Treasury) spoke on the fiscal position and added a 2010 update to demographic change and the challenge the ageing population poses**
 - Rise in the ratio of older people to the working age population will act as a drag on the economy's potential growth rate - even though New Zealand has a high labour force participation rate
 - Some serious trade-offs will be required to balance Crown finances, as current settings for spending and revenue, projected on the basis of historic growth patterns, are not sustainable over the longer term
- **Discussants**
 - Ganesh Nana (BERL) questioned use of labour force participation rates and dependency ratios in fiscal analysis. Suggested fiscal issues are about expectations of service provision
 - Economic consultant Suzanne Snively accepted analysis but also queried argument on expected declines in future labour force participation rates as well as the impact on health costs

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- Next moved on to the social perspectives
- Alison O'Connell spoke on people's expected length of retirement, based on her empirical NZ research
- Chris Cunningham gave a Maori perspective, pointing out that the relatively high proportion of Maori who are young, and their socio-economic position, differentiates the Maori population from the rest of New Zealand's population
- Judith Davey asked "what are we saving for" and discussed decumulation options – and precautionary savings
- Bob Stephens examined the objectives of the welfare state in relation to intergenerational equity, income redistribution and poverty alleviation, concluding that generations have not been treated equally

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- Final session on strategies and options
- Len Cook placed health issues into the mix
- Peggy Koopman-Boyden discussed older workforce participation and the factors there
- Ralph Stewart made a stirring call for supporting annuity provision
- Susan St John set out the argument for intra-generational equity, ie some form of means-testing to maintain an adequate level of NZS for the poorest
- Nigel Pinkerton gave the Gen Y perspective

Living within our means



**A FRAMEWORK FOR MAKING DECISIONS ON
THE AGE OF ELIGIBILITY FOR NEW
ZEALAND SUPERANNUATION**

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Living within our means: Outline



- **Discuss the constraints of PAYG financing**
- **Brief outline of model**
- **Caveats re job creation**
- **What no change means**
- **Exploration:**
 - Follow the Aussies
 - No tax increase
 - One possible acceptable option
 - Longevity improvement

Living within our means: PAYG constraint



- PAYG equation

Number of pensioners $NP(t)$ times average pension amount $P(t)$

equals

number of workers $NW(t)$ times average wage $W(t)$ times average tax rate $T(t)$ needed for balance

Living within our means: PAYG constraint



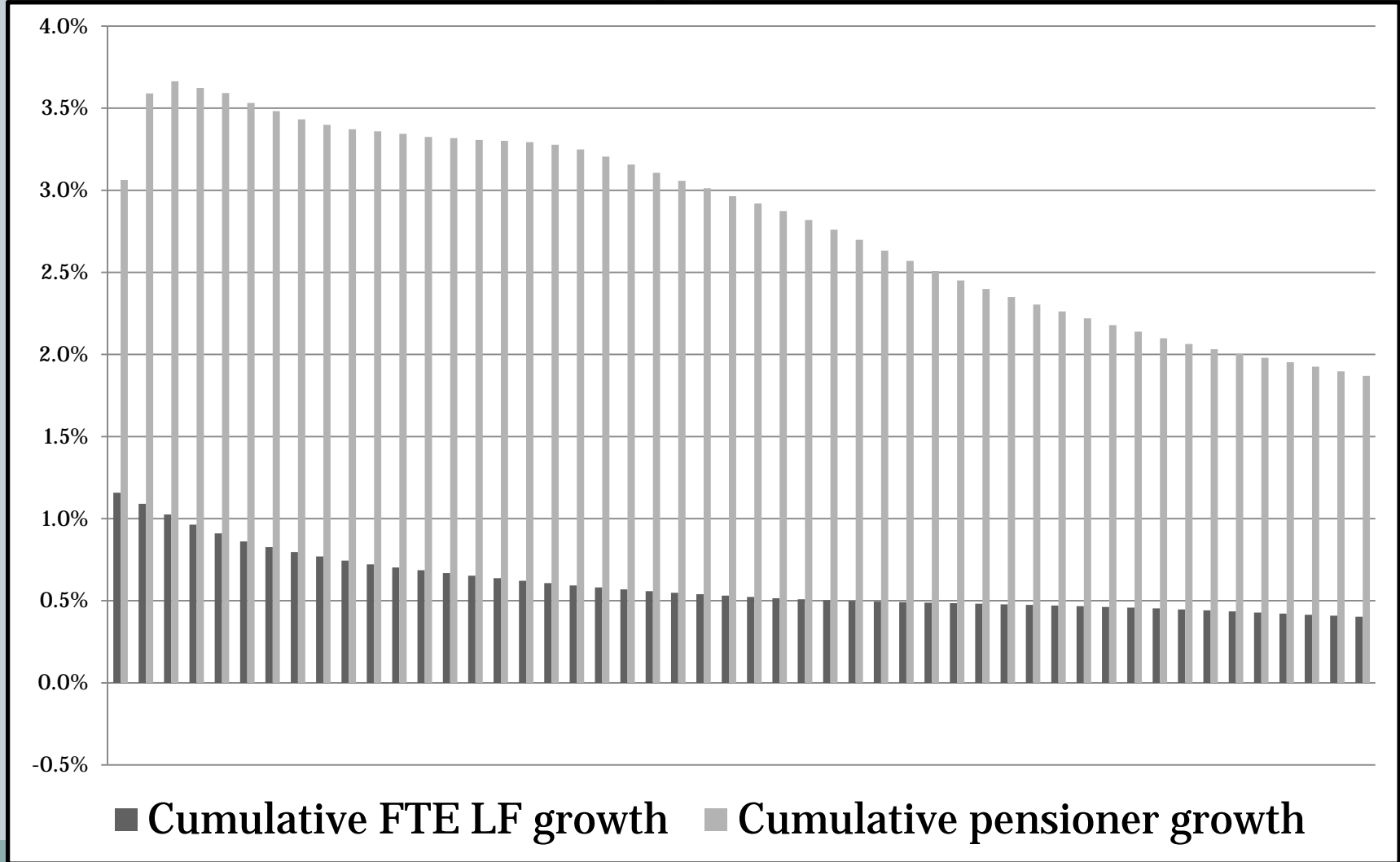
- $[P(t)/W(t)]$ is constant for NZS (more or less)
- Hence $T(t)$, the average tax rate on worker income for balance, depends on $[NP(t)/NW(t)]$
- Statistics NZ project cumulative rate of growth in NP to be four times as much as the cumulative rate of growth in NW over the period to 2051

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- So Houston, we have a problem

Living within our means: PAYG constraint



Living within our means: The model



- **Projects pensioner numbers**
- **Projects worker numbers**
 - Incorporates increases in participation, including 65+
 - Assumes increase in participation when age of eligibility increased
- **Expresses costs in current wage terms**
- **Calculates cost per worker net of recoveries**
- **Allows for NZSF as a smoothing mechanism**
- **Parameter driven**
- **Also age-related increase in health costs ditto**
- **Paper is available!**

Living within our means: Caveats

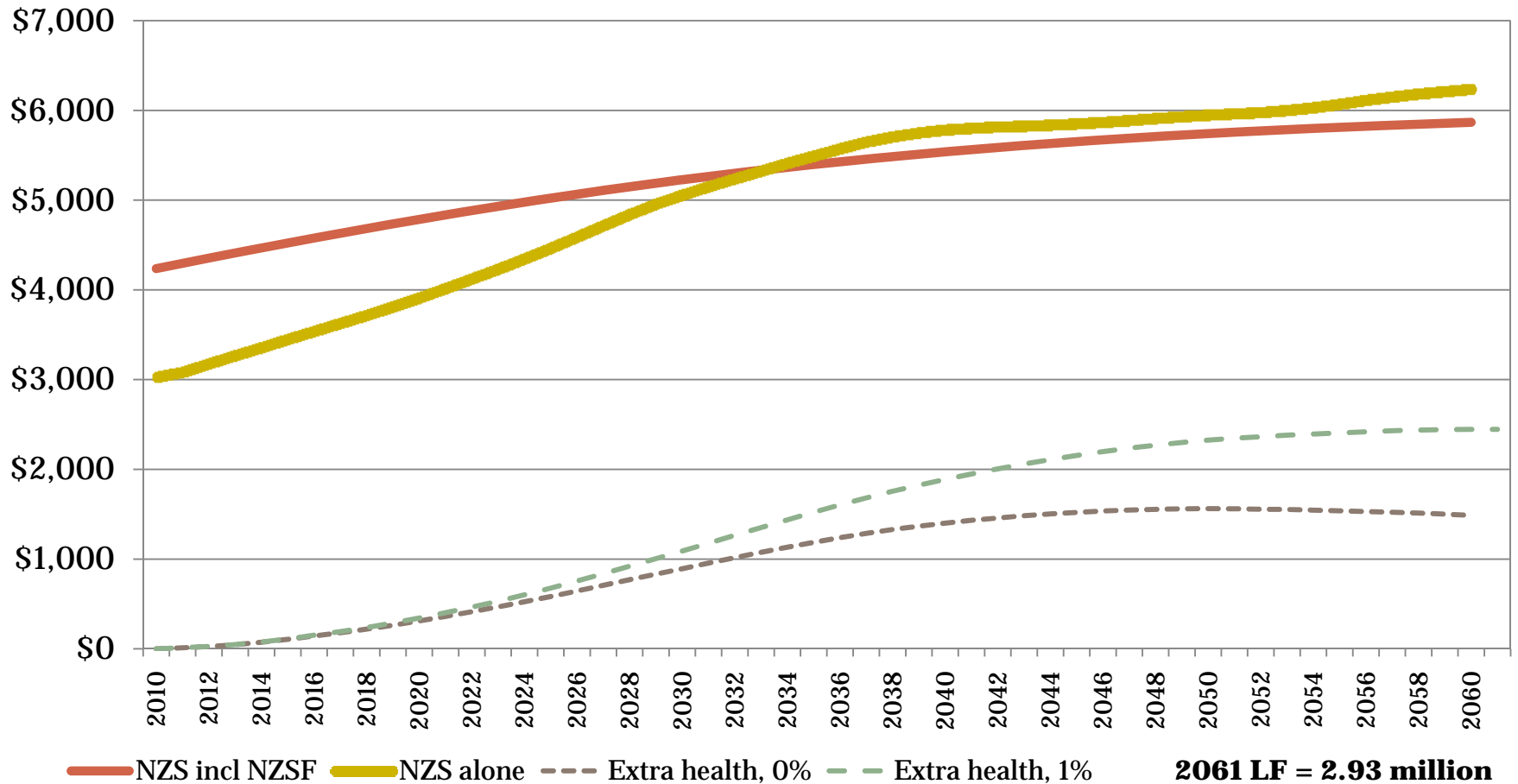


- Assumes increases in workers – but need jobs for them
- And must be private sector jobs
- Increase in age of eligibility may not be associated with jobs for all who want them
- Increase in age of eligibility has disproportionate effect on lower socio-economic groups
- Essential that older people have additional income to buy goods and services – hence KiwiSaver an important policy intervention

Living within our means: What no change means



Cost per head of the working population, in \$real wage
StatsNZ medium projection: no change in eligibility age



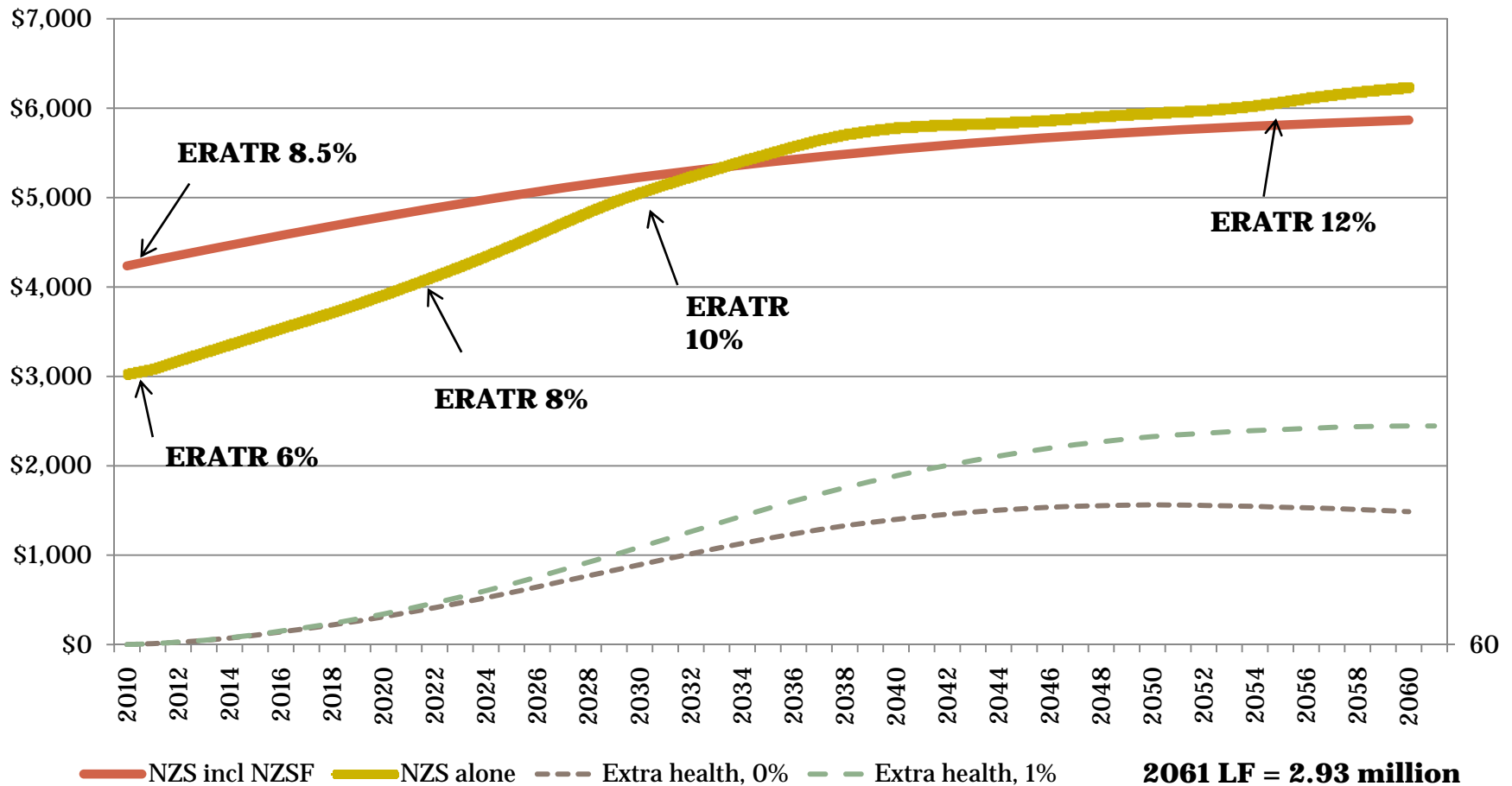
2061 LF = 2.93 million

Living within our means: What no change means



Cost per head of the working population, in \$real wage with estimated required average tax rate (ERATR)

StatsNZ medium projection: no change in eligibility age

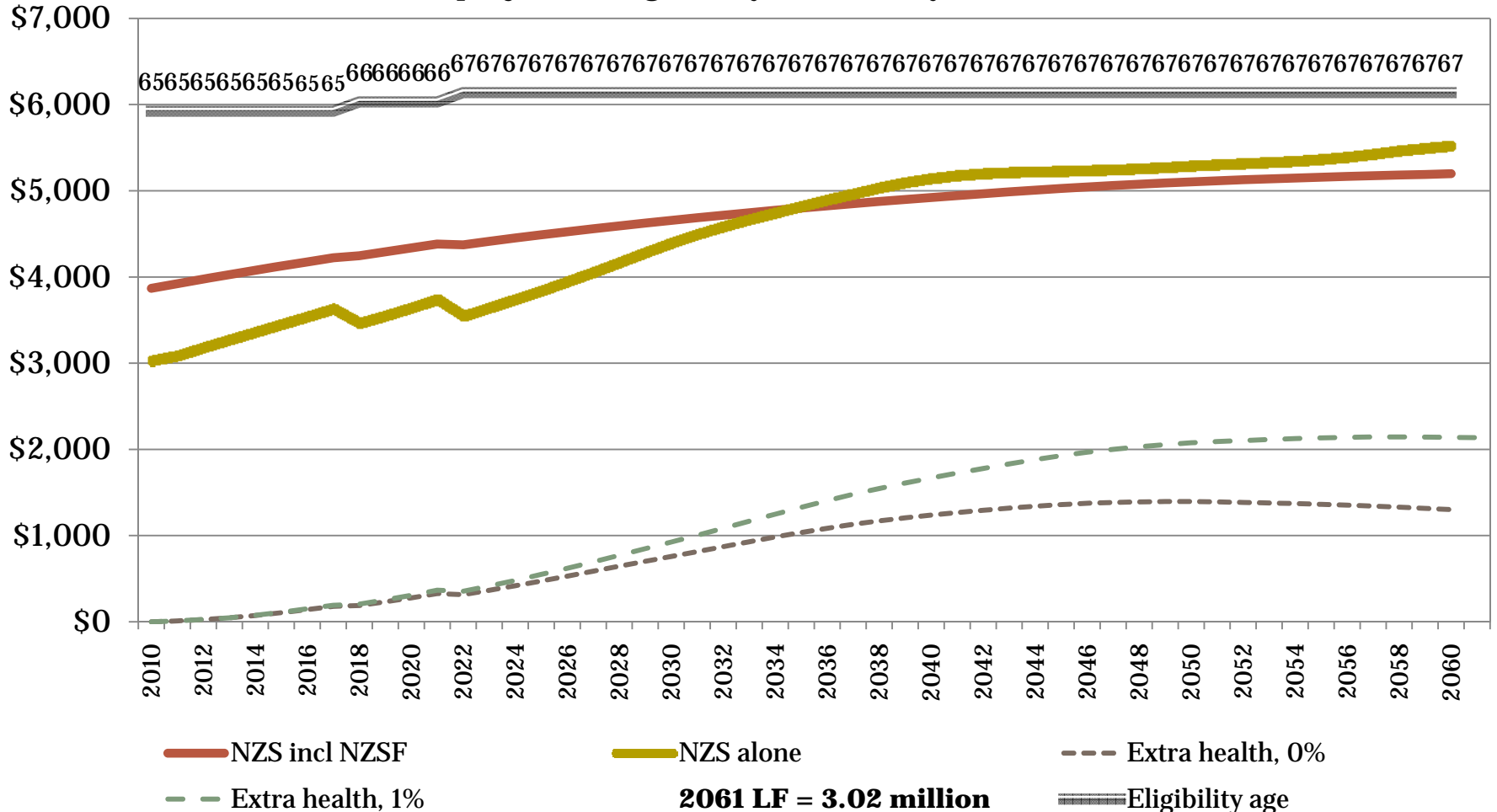


Living within our means: Do like our neighbours?



Cost per head of the working population, in \$real wage

StatsNZ medium projection: age 66 by 2018, 67 by 2022 (Australian action)

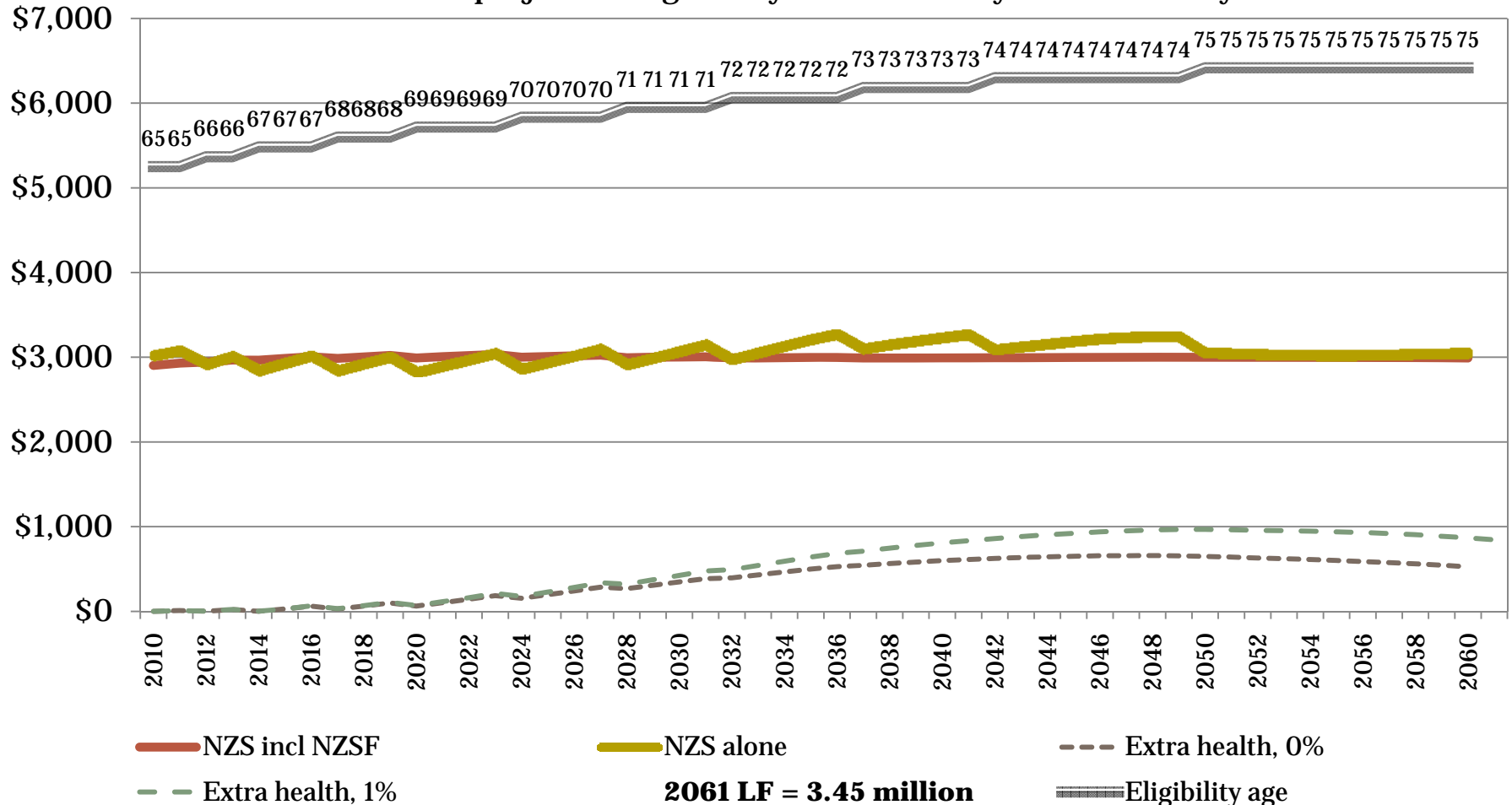


Living within our means: Hold cost at \$3,000 per head



Cost per head of the working population, in \$real wage

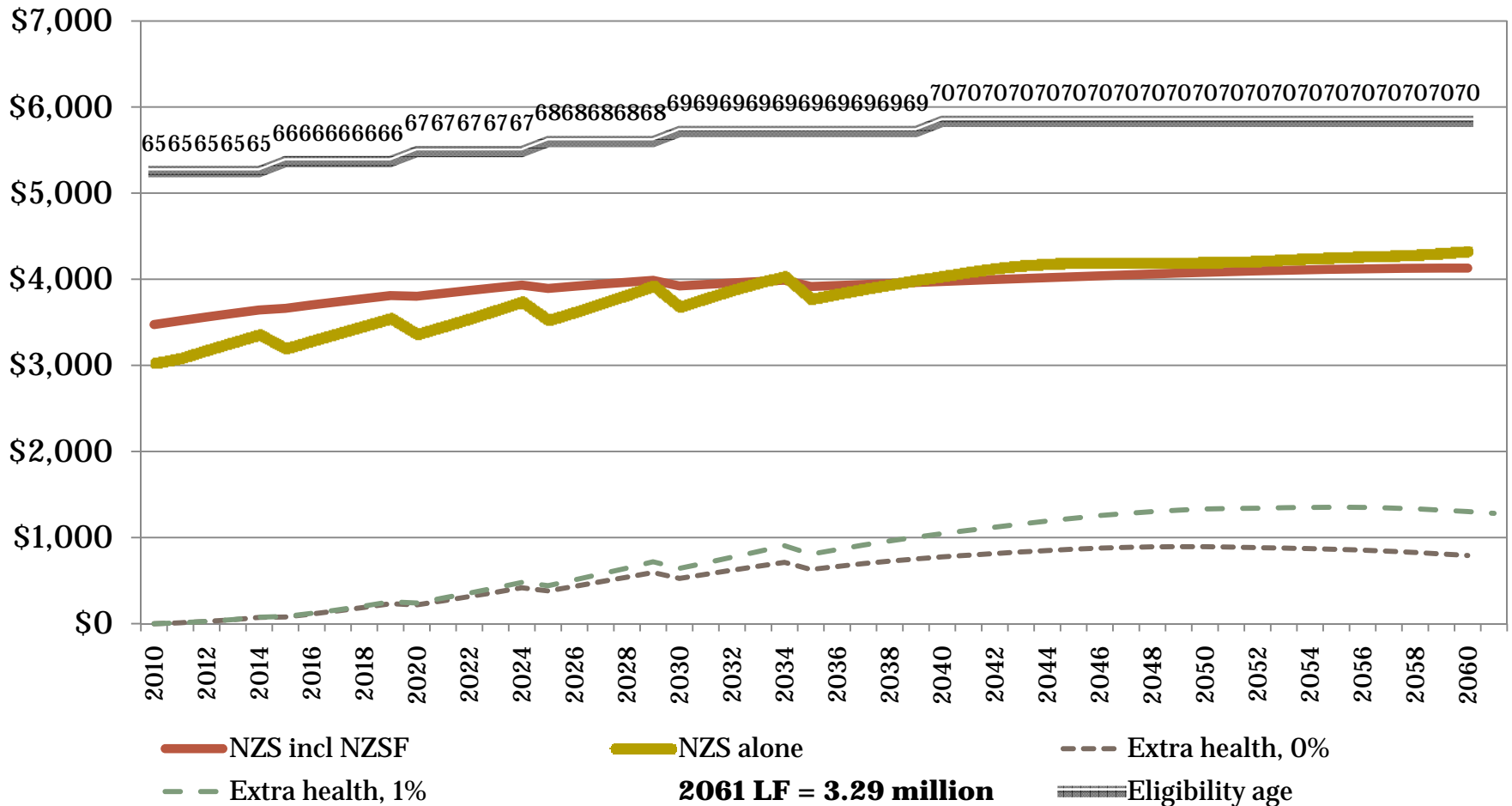
StatsNZ medium projection: age 66 by 2012, ..., 70 by 2024, ..., 75 by 2050



Living within our means: Fix cost at \$4,000 per head



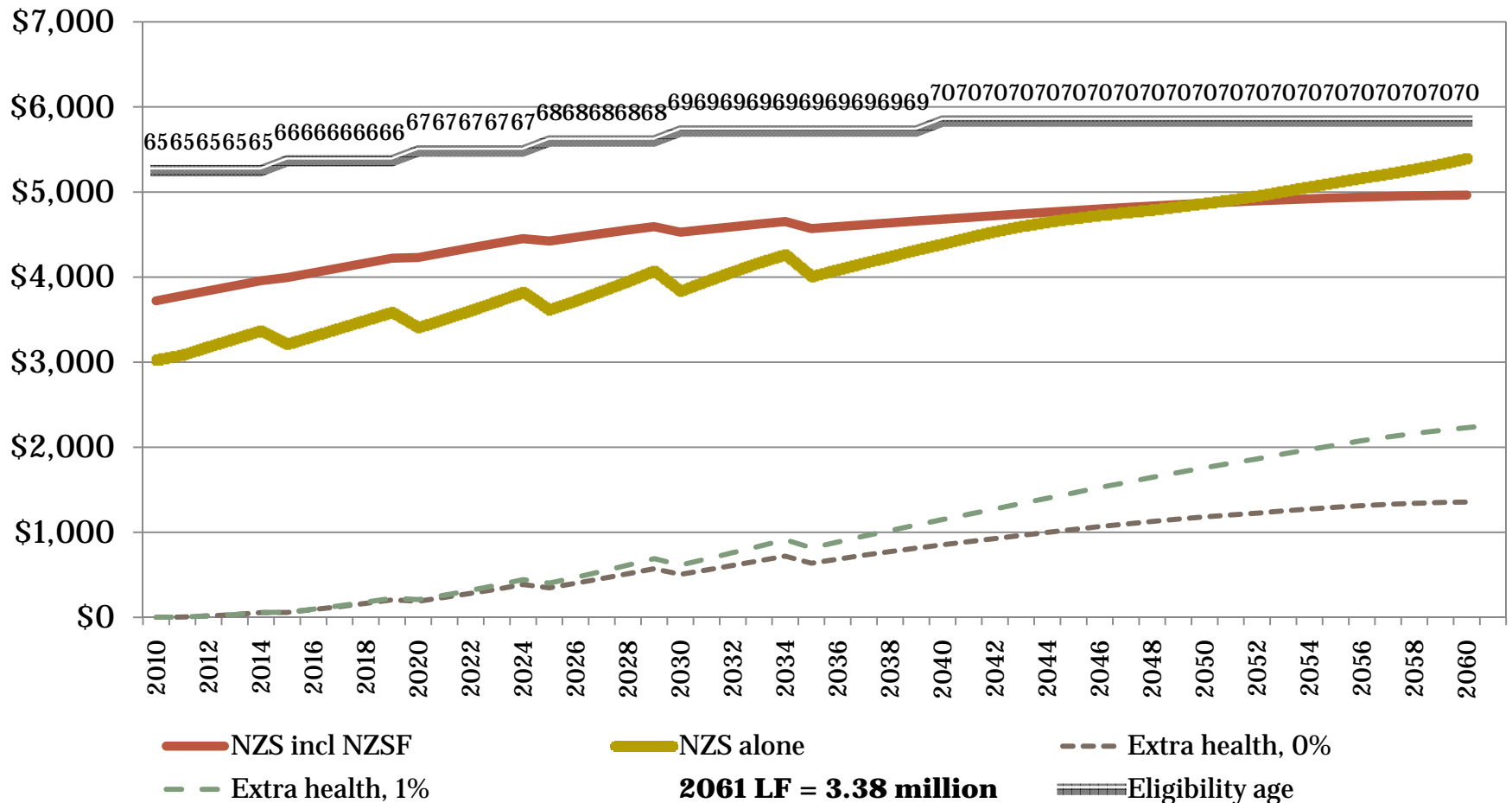
Cost per head of the working population, in \$real wage
 StatsNZ medium projection: age 66 by 2015, 67 by 2020..., 70 by 2040



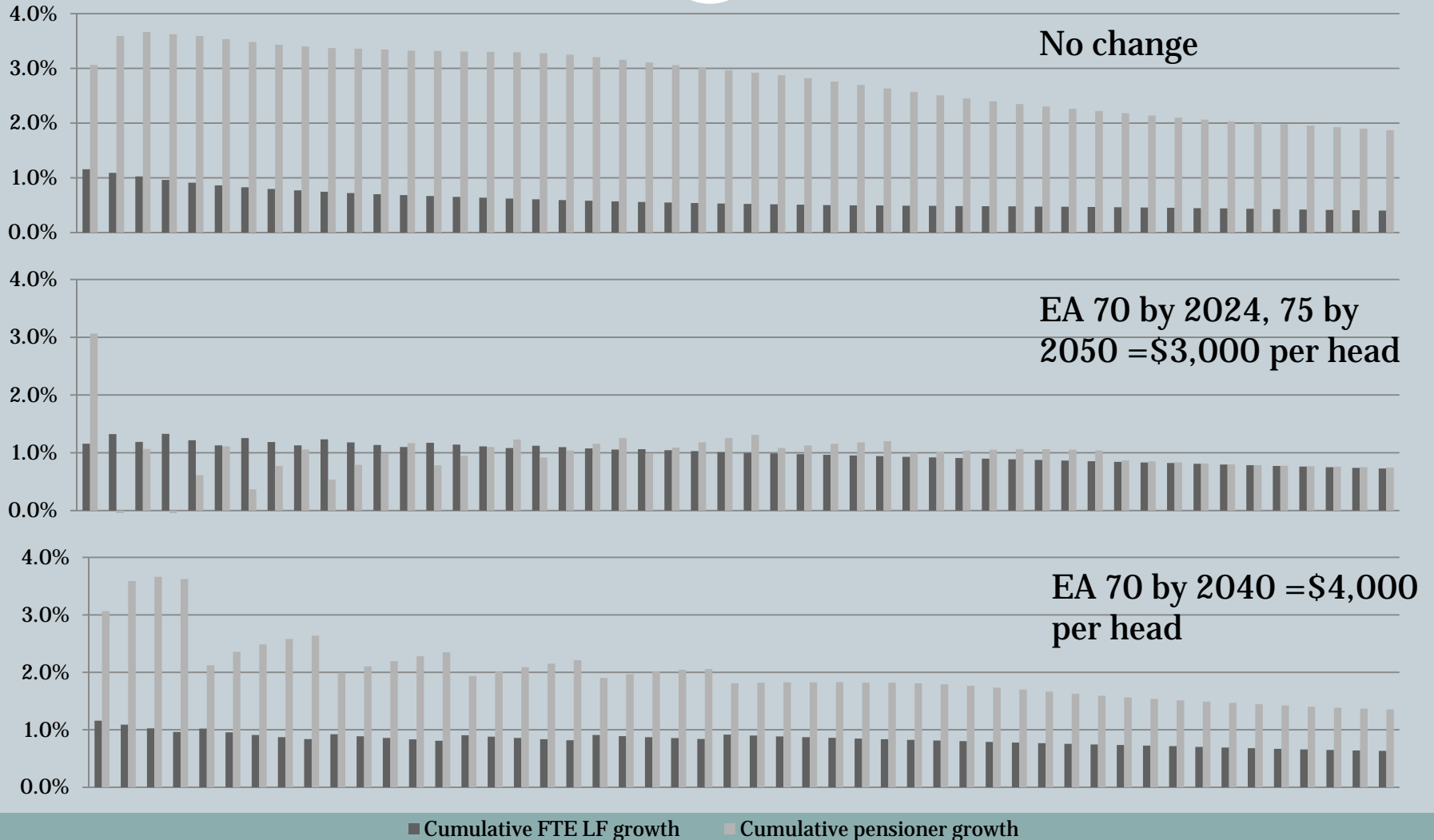
Living within our means: Fix cost at \$4,000 per head



Cost per head of the working population, in \$real wage
 StatsNZ very low mortality : age 66 by 2015, 67 by 2020, ..., 70 by 2040



Living within our means: Growth in NW(t) & NP(t)



Living within our means: Conclusions



- Intergenerational equity can be addressed by holding amount available for pensions to a fixed proportion of labour income
- The trade-off is increase in the eligibility age against the fixed contribution level (or other taxes/means-testing etc)
 - Model suggests current \$3,000 per head requires eligibility age of 75 (by 2050)
 - a one third increase in per head cost needed to bring it down to 70 (by 2040)
 - could consider higher increase in per head cost and less increase in age
- If fix an increase over current, need to invest the short/medium term difference sensibly
- Job creation is key – need to ensure older people can be active in the economy, both earning and spending
- If change age, must look after those disproportionately affected – including chronically ill

The report card – what do people think?



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