

Comment on Peter Whiteford's presentation
*Retirement Income Policy and intergenerational equity:
an international perspective*

**From Andrew Coleman, Motu Economic and Public
Policy Research**

This paper is a superb broad-ranging examination of pension provision and associated equity issues across the developed world.

I think Peter and Kent have done us a big favour by focusing on the differences between the New Zealand tax-pension scheme and those operated in most OECD countries. Which system is most suited to New Zealanders is of course the theme of the conference; the beginning of this process is to understand the strengths and weaknesses of different systems around the world.

The focus of Peter's paper is the extent to which pensions provide a minimum income and the extent to which they facilitate income replacement in old age.

The evidence shows:

- (1) New Zealand has a low cost system: 4.4% of GDP currently, before tax reclamation.
- (2) New Zealand has a high minimum provision (39% of average earnings in gross terms) and has very low poverty (as defined by 50% of median income)

- (3) New Zealand is highly unusual in not having a second tier, so average provision relative to average income is low – and retirement incomes are concentrated around pension level
- (4) New Zealand has very low gender gaps, reflecting the absence of a second tier.

Peter demonstrated very well that the total cost of the pension system must incorporate the effects of the tax paid by retired people and any tax concessions. In addition to mandatory retirement saving/ pension systems, most OECD governments provide a tax system that is favourable to retirement savings. In particular most governments offer some form of an expenditure tax or EET system (labour income is exempt from tax when earned, investment returns are exempt from tax, but the final payments is taxed) rather than a TEE comprehensive tax system. New Zealand is unusual not to provide its citizens with this tax system; in fact it is generally acknowledged that the NZ tax system is the least favourable towards supplementary retirement savings in the OECD, despite being the country that is most reliant on them.

One of the well known curiosities of non-mandatory retirement saving systems is that the only class of EET equivalently taxed assets in New Zealand are residential houses; in most other OECD countries people saving for retirement can invest in almost all classes of assets under concessional EET tax rules. It is perhaps strange that the New Zealand politicians and public servants who appear

so concerned that New Zealanders overinvest in residential housing assets compared to people in other OECD countries have for so long advocated a comprehensive income tax that is at odds with OECD norms.

This particular of the system aside, the key point is that the tax concessions to private retirement saving schemes are an additional aspect of the retirement system; and since the tax incentives affect people when they are working, they are a major part of the intergenerational equity issue whose ramifications extent across the whole economy. It is likely to be the case that the structure of the taxes we have to fund public pensions and to provide incentives to accumulate private savings affect the structure of the capital stock and the productivity of the economy. As Acemoglu and Zilibotti noted, anything that reduces the quantity of capital available to working age people in the economy lowers their wages and contributes to intergenerational tension.

Professor Whiteford also raised several questions about options going forward. One of these concerns the effectiveness of pre-funding?

This question is important to New Zealand now that the Cullen fund has become the Culled fund.

Prefunding is a way to change the nature of intergenerational transfers and to reduce the overall cost of the retirement pension system. It is vital to know if there are institutional arrangements that can reduce the

political influence over pre-funding arrangements, and to ensure any prefunding schemes are wisely invested.

This issue is important for NZ for reasons identified by Samuelson in his famous over-lapping generations model. He showed that a PAYGO (pay as you go) tax-pension scheme is most appropriate if the returns to capital are lower than the growth in wages (plus population growth). Given the glacial wage growth we have had in New Zealand over the last 30 years, a PAYGO system has proved a dreadful idea for successive generations of New Zealanders. New Zealanders entering the workforce since 1980 would have been better off if their tax deductions had been invested in a broad-based investment fund rather than given to retirees in exchange for a promise to be a paid a pension when they turn 60 or 65 or 67 or whatever. The decision to adopt a PAYGO rather than a SAYGO (Save as you go) system has been a millstone around the necks of all but the first generation (who, having survived wars and depressions may have been deserving), and while there is no easy way to make the transition, it is likely to be welfare enhancing to all new people entering the workforce. Failure to tackle this aspect of our pension scheme is to ignore a major source of intergenerational inequity whereby young New Zealanders are forced to enter an inefficient system prevents their tax deductions from earning a reasonable return.