

RETIREMENT INCOME POLICY and INTERGENERATIONAL EQUITY

THE DIFFERENCE DIFFERENCES MAKE

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Introduction

Have all generations been treated fairly (equally) by the Welfare State, Pensions?

- Ways of looking at the Welfare State

Gives implications for potential policy settings and their acceptability, both politically and for population

1. Static Income Redistribution and Poverty Relief

2. Life-time or Intra-Generational Transference

3. Intergenerational Income Redistribution

- Differences within Age Cohorts and Inter-Generational Transference of Life Chances

- Differential Birth Rates, by Income level or Ethnicity, Human Capital and Economic Growth

Static Income Redistribution

- Redistribution of income, from current rich to current poor, using pensions, benefits and taxes
- But some 'churning', people paying both taxes and receiving benefits
- Impact of cutting tax rates, tax take, on ability to redistribute
- Ageing of population increase requirement to redistribute, given current policy settings
- But reduce willingness of younger (with small asset base) & richer to pay higher taxes to redistribute
- Especially if increasing proportion 65+ in work with adequate incomes, or with a substantial asset base

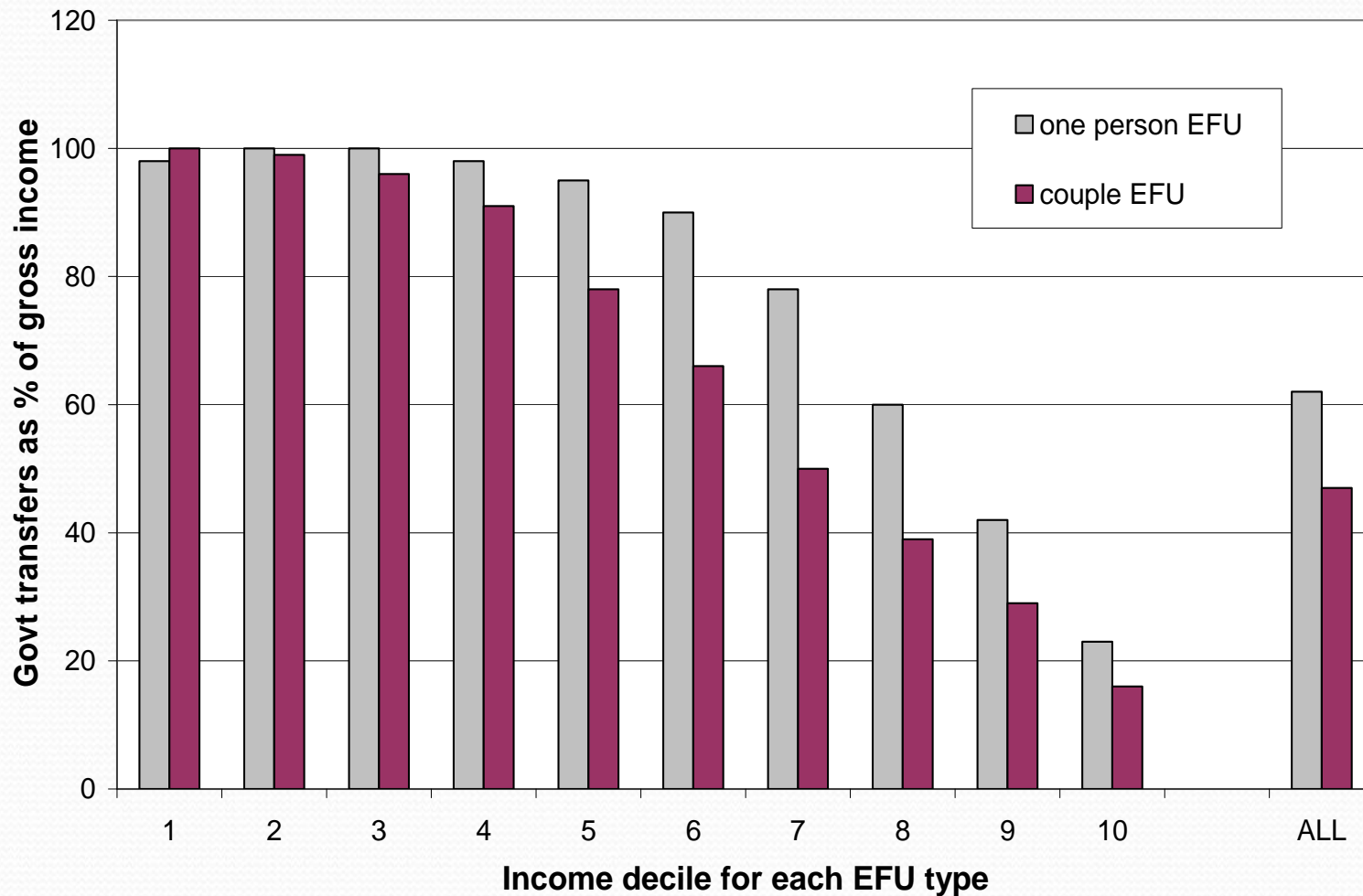
Poverty Relief

- One objective of pensions is to alleviate, or at least reduce, the current incidence of poverty
- In 2007, using 60% median income as poverty line, on just market income, 73% of 65+ poor,
- but 40% poor after NZS, on disposable income; pension just below poverty line. [relative measure] [Table 1]
- NZS alter re median: 67% 1994; 58% 1998; 51% 2007
- 40% pensioners have less than \$10 per week additional income, 60% less than \$120 per week [Table 2]
- Different poverty measures:
 1. 50% median, 6.1% at risk of poverty, OECD data
 2. adjust 1993 60% by CPI, 3.6% [constant value measure]
 3. After Housing Costs, 2007 data: 60% 28.9%; 50% 9.6%: av. Housing costs 65+ \$50, cf. 35-44 \$280 per week
 4. Reducing home ownership on real value of pension?

**Table 1: Incidence, Effectiveness, Severity of Poverty, 2007:
60% Median Income Poverty Measure**

	Market Income	Disposable Income	Poverty reduct Effectiveness	Structure: Disposable	Poverty Gap effectiveness
<i>All People</i>	25.9	18.8	27.4	100.0	79.0
All Children	29.6	22.1	25.3	27.8	71.9
Child Couple	22.4	15.2	32.1	11.3	67.8
Child Lone	74.8	63.2	15.5	16.5	78.9
All Adults	24.9	18.8	28.9	72.2	82.5
Adults 15-64	16.1	13.6	15.5	46.8	55.0
Adults 65+	72.7	40.7	44.0	25.4	90.5

Table 2: Proportion of gross income coming from government transfers (NZS and VP):HES 2008



Static Income Redistribution

- Fiscal incidence methodology, 1997-98 data
- Redistribute income tax and cash benefits, by income deciles and by household type
- [Also all government expenditure and taxes]
- Table 3: low income deciles receive more cash benefits than pay taxes: 65+ in Deciles 2&3
- Decile 1 – many self-employed declaring losses, as well as unemployed and sole parents
- Table 4: those aged 65+ [63+] receive more in cash benefits (NZS) than pay income tax [also sole parents],
- But working age, with and without children, net tax payers. Children make little impact – low level financial assistance to families with dependent children

Table 3: From Market Income to Disposable Income, 1997-98, by Income Decile

Income Decile	Market Income	Cash Benefits	Income Tax	Disposable Income	Disposable % Market Income
First	2068	14452	2047	14474	698%
Second	5099	19637	3278	18758	367%
Third	16197	13543	5017	25223	155%
Fourth	25097	9929	6944	28082	112%
Fifth	32330	7770	8511	31589	97%
Sixth	41734	5980	10571	37143	89%
Seventh	51115	3938	12934	42119	82%
Eighth	62795	2934	16206	49523	79%
Ninth	76967	2783	20472	59277	77%
Tenth	141510	1701	42985	100226	71%
Average	45239	8229	12915	40553	89%

**Table 4: From Market Income to Disposable Income,
by Household Type, 1997-98**

Household Type	Age	Market Income \$	Cash Benefits	Income Tax	Dispos Income	Dis % Market
Single Person	<40	29119	2196	7563	23752	81%
	40-62	36179	2575	10131	28623	79%
	63+	4932	13750	3759	14903	302%
Couple, no Children	<40	70306	638	18596	52348	74%
	40-62	57609	3910	16230	45289	78%
	63+	15106	19936	7735	27305	181%
Couple with Children	30-39	44667	4564	11442	36004	80%
	40-49	81078	3412	22171	62298	76%
Sole Parents		19292	16992	6294	29990	155%

Intra-Generational Income Redistribution

- Income/expenditure over a person's life cycle [Table 4]
- UK: $\frac{3}{4}$ welfare spending redistribution of own income, $\frac{1}{4}$ life-time rich to life-time poor
- State operated social insurance scheme,
- Right to a pension based on past tax (and social security tax) contributions
- As well as social contribution through citizenship
- Original basis for welfare state to offset lifecycle effects,
- Have surplus of income over expenditure when no children, expenditure > income with children, when retired expenditure < income
- Family assistance, pensions, and now student fees, ?mortgages

Intra-Generational Income Redistribution

- But main growth social security expenditure SB and IB, unemployment, sole parenting; changes own lifetime /rich->poor ratio
- State uses taxes/benefits rather than savings/dis-savings (permanent income hypothesis)
- Savings for retirement based on equivalent permanent income
- Population ageing: contribute less in working life than receive in pensions, health care
- Not just rich to poor, but today's pensioners receive more than paid for when working, and tomorrow's pay more than receive
- Redistribution future to current retired generation -> Cullen Fund to the rescue, or budget deficit?

Inter-Generational Income Redistribution

- Welfare state implicit moral contract between generations: reciprocity, consistency through time, quasi-constitutional.
- Based on moral justice and fairness between generations
- Each generation pays taxes in the expectation that when they reach that stage of life that they will receive the same benefits as previous generation
- Thus consistency in parameters and settings of welfare state, for results to be acceptable to population, and willingness to support existing settings
- Consistency also required re pensions due to long lag time for alternate financing mechanisms
- But view does not take account of changing economic, social and demographic circumstances

The Selfish Generation

- Thomson (1991): Contract broken NZ -> changes in welfare settings explained by political strength of one generation
- NZ had a 'selfish generation' – born 1920s & 1930s
- Married young, high fertility-> baby boom, and policies to assist [but war, depression]
- 1950s and 1960s 'Youth state'
- -> generous family benefits, subsidised housing loans and state housing, low tax rates on families, modest pensions, tax subsidies for private pensions [Table 5]
- Impact of WW2, Depression, 'quest for security'
- Add industry and trade protection, full employment until 1984, labour laws, minimum wage
- Hills (2004) UK – most generations, benefits > taxes [Table 6], but 'selfish' generation broke even

Table 5: Social Security as % of GDP, 1951-2007

	1951	1961	1971	1981	1986	1992	2000	2004	2007
Pensions	2.8	3.5	3.2	6.8	7.4	7.5	5.0	4.8	4.6
Family	2.2	2.3	1.2	1.3	0.6	0.9	0.9	0.8	1.5
Income-Tested	0.6	0.6	0.6	2.1	2.6	3.4	4.2	3.4	2.7
Other	0.2	0.7	0.3	1.0	0.7	0.6	1.4	1.3	1.6
% Govt. Exp.			17.9		25.8	33.8	35.7	34.2	31.7
% GDP	5.8	7.1	5.3	10.2	11.3	13.2	11.5	10.2	10.4

Table 6:

Actual, Projected Lifetime Receipts and Taxes, UK

Cohort Born	Age 2001	Cumulative Receipts (GDP per capita)	Cumulative Taxes (GDP per capita)	Receipts % Taxes
1901-06	-	9.0	7.4	122
1906-11	90-94	9.6	8.3	116
1911-16	85-89	10.8	9.1	118
1916-21	80-84	11.9	10.3	115
1921-26	75-79	12.2	11.7	104
1926-31	70-74	13.7	13.5	102
1931-36	65-69	15.3	15.1	101
1936-41	60-64	16.7	15.7	107
1941-46	55-59	18.0	16.4	110
1946-51	50-54	18.6	17.0	110
1951-56	45-49	20.5	17.8	116
1956-61	40-45	21.6	18.3	118
1961-66	35-39	19.4	17.9	108
1966-71	30-34	18.5	18.1	102
1971-76	25-29	17.9	18.8	95

Inter-Generational Income Redistribution

- 1970/80s, 'middle- and elder-age' state, children left home, planning retirement, political power/majority
- Family benefit eroded, 1976 election 'bribe': Pension age -> 60, pension level increase [Table 5]
- 1984 and Washington consensus.
- Baby boomers in power in stable employment, rise top wages, increasing market and disposable income inequality, at top end, tax rates lowered for higher earners
- 1984 change occupational pension tax rules EET to TTE, [EEE for retired],
- Though surcharge, and rise of Grey Power
- For Gen X, unemployment, market interest-rates for mortgages, fees for tertiary education for younger age groups. Hills (UK) $B < T$
- 1991 benefit cuts, family benefit cut, tightening? surcharge

Breaking the Trend

- Hypothesis partly broken post-1990,
- 1990: 'Selfish Generation' into retirement, gained net benefits
- 1990s, pension age to 65, level lowered,
- Winston to the rescue!, surcharge removed - universal; perceived equity of past contributions rather than future equity
- Early baby boomers may break even from Welfare State, with some housing assistance, low cost tertiary education, lowering of tax rates in 1986, reduced pension entitlements
- But paying taxes for fewer pensioners
- Shift in emphasis to families: 2004: Working for Families, Child Care – intergenerational transmission of life chances
- Recognition of changed economics, demographics
- Table 5: increase family assistance - increased number of births as baby boomers have children [Gen Y], reduction pensions,
- Cullen Fund, KiwiSaver
- Impact on Gen X and Gen Y
- or 'not while I am PM'

Inter-Generational Impacts within each Cohort

- Inequalities of income within a cohort, irrespective of life-cycle effects, by gender, ethnicity, household size, housing tenure [Table 7]
- Also incidence of poverty and material hardship, and persistence through time [Table 8]
- Differences in potential for savings and asset accumulation within a cohort
- Workplace inequality spreads into retirement, but ? effectiveness of affluence testing – avoidance, admin costs
- KiwiSaver maintains workplace inequality, but reduces overall, cf. just occupational pensions [for white collar]
- Lack of assets, especially housing, increases risk of poverty after housing costs,

Trends in Income Distribution: Real Equivalent Household Disposable Income, 1984-2004, 1996 prices

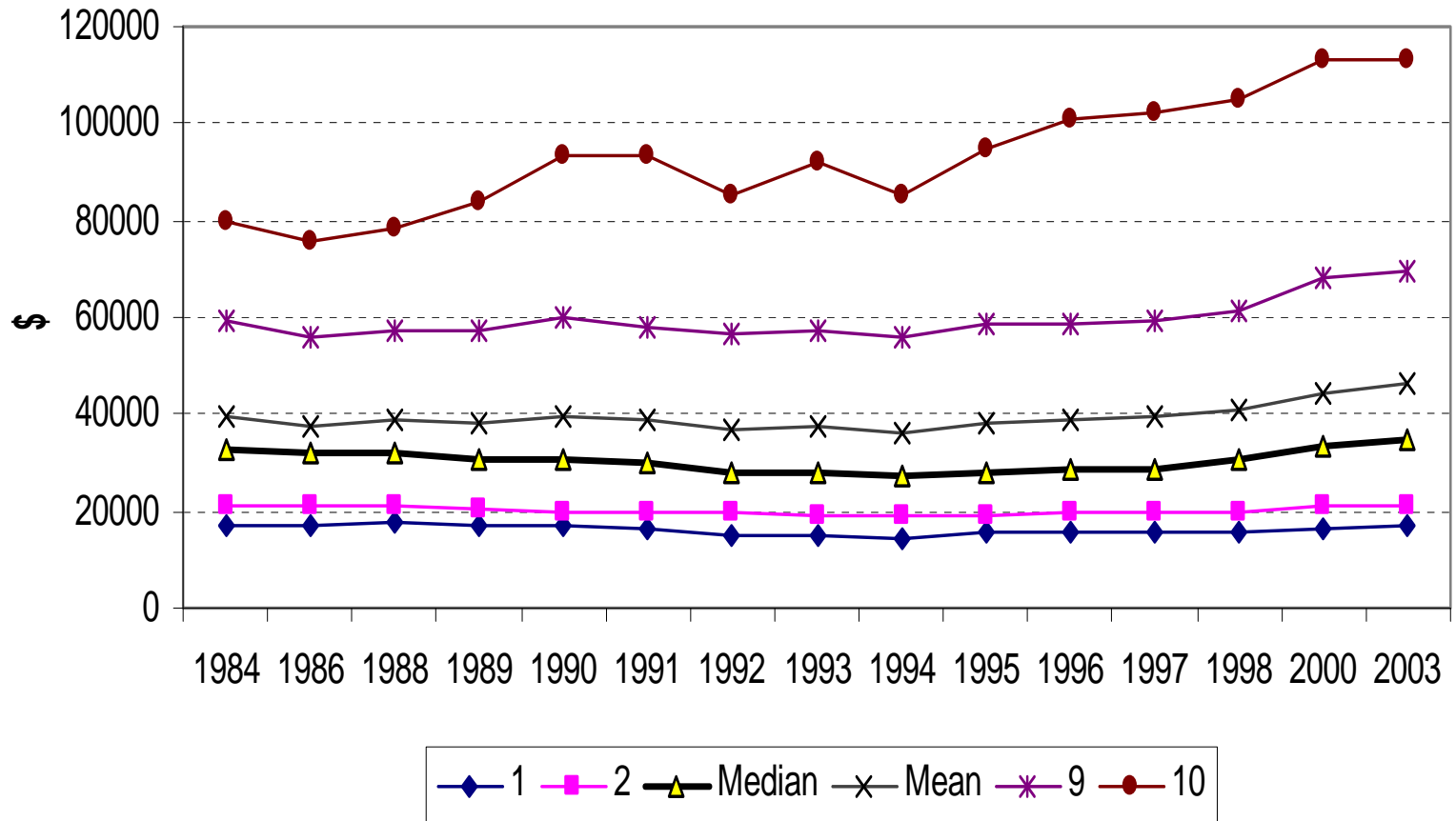
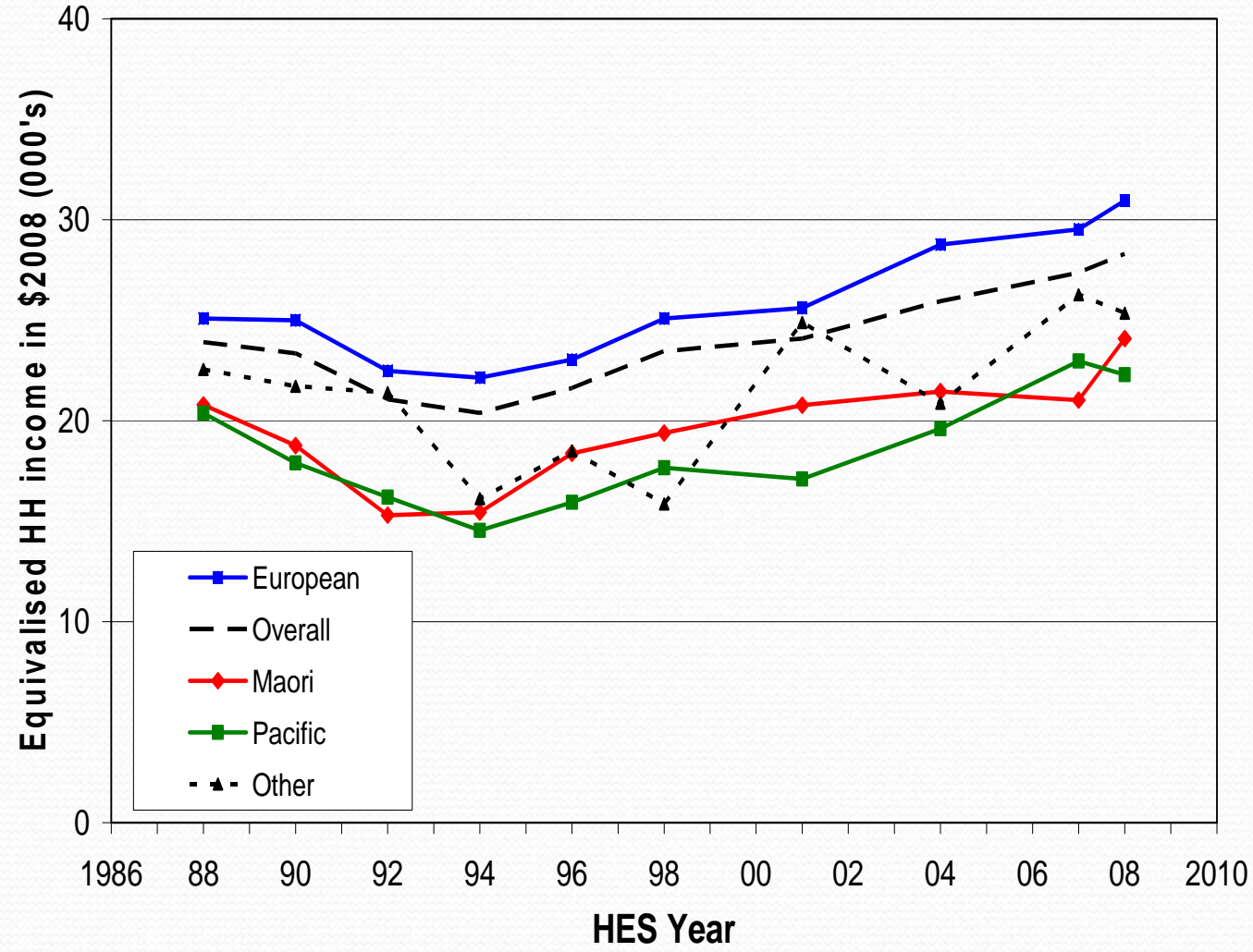
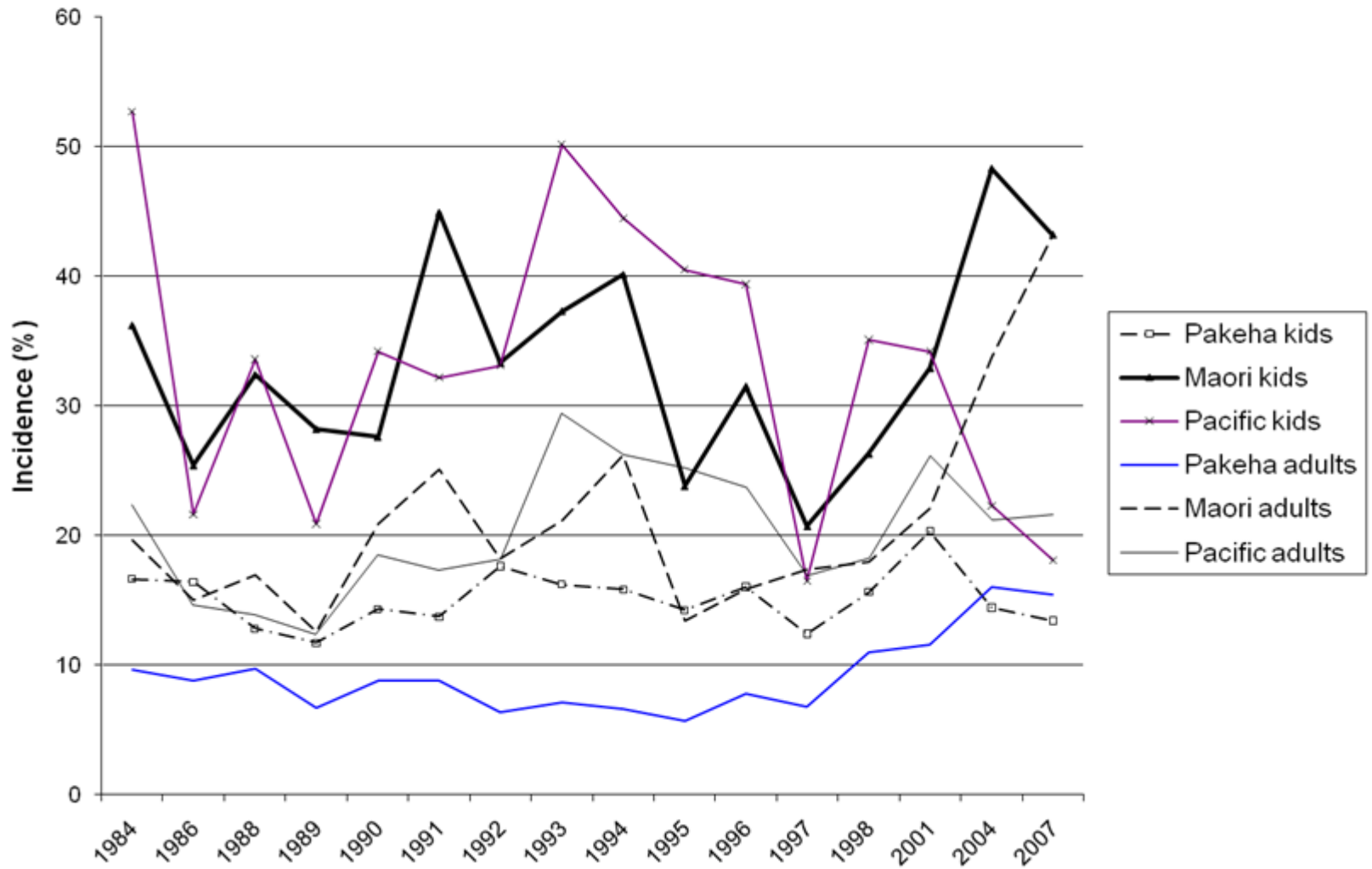


Table 7: Real equivalent median household incomes (BHC) by ethnicity, 1988 to 2008 (\$2008)



Trends in the Incidence of Poverty, by Ethnic Background, 60% Median Income, 1984-2007



Future Level of Retirement Incomes

- Not just population ageing effects on tax base relative to working age,
- but also size of GDP, from productivity improvements
- Problem of inter-generational transmission of human capital, low income, income differentials, benefit use
- Also lack of physical asset inheritance, plus family breakup, -> future skill development, productivity
- US, UK data – 40% grow up in low income households have low income
- Need for up-skilling, education
- NZ: Maori, Pacific: lower age structure, higher fertility; by 2050 35% population cf. 20% 2010.
- on average, low skill levels, high poverty rate.
- Economic growth more dependent on Maori, Pacific

Demography and future pensions

- NZ: Maori, Pacific: lower age structure, higher fertility; by 2050 35% population cf. 20% 2010.
- on average, low skill levels, high poverty rate.
- Economic growth more dependent on Maori, Pacific attainments [Social Report 2008 shows significant improvement on most socio-economic dimensions]
- If current differentials remain, then lower economic growth, smaller absolute NZS, increased 'political fight' over share of output workers/retired
- Maori, Pacific youth and worker/taxpayers cf. European pensioners

Conclusions

- Generations not treated equally by the Welfare State
- Depends upon view taken on income redistribution
- Redistribution from current rich to current poor, but mainly redistribution of own income over life time
- Ageing and different size cohorts makes redistribution comparisons through time more difficult,
- Thomson's 'selfish generation' hypothesis holds for NZ
- Gen Y most likely losers under current settings
- Policy: Intergenerational equity requires shifting pension tax burden from Gen X and especially Gen Y
- Raise age, reduce pension, expand Cullen fund for tax equalisation across generations