Comments on "Focusing on the Future; A discussion document 2013 review of Retirement Income Policy"

The Discussion Document is generally an excellent coverage of the issues, with Recommendations that basically follow the logic of the arguments presented in the paper. Well done, and one can only hope that one day a government will actually listen to what you are saying. But let us not hold our breath for too long. It is interesting that the simplest of pension schemes is the one most subject to political policy change – maybe it is the only policy that politicians can actually understand!

There were little bits of very important history that were missing, or just skimmed over. One of these was Muldoon's lowering the age of retirement to age 60, and then Richardson raising it again, over 10 years, to age 65. To my memory, apart from some noise from Grey Power, most of the population felt that this shift to 65 was sensible policy, and thus it was implemented with limited political and popular recrimination [one may argue that the retirement age change was small compared to other aspects of Ruthansia]. In other words, governments need not have the seemingly great fear of raising the age of eligibility. [Len Cook and I gave a paper in 1977 just after the age was lowered to 60, with a resulting newspaper headline '2 into one won't go': i.e. the problem of affording NZS has been around for a long time].

Most of those 65+ feel that they have a quasi-right to a pension from the state. They have contributed through their taxes (and even earlier the social security fund contribution) all their working lives, and the pension is one way of rewarding past efforts to New Zealand society – society is the operative word as contributions to society are far wider than just tax payments – raising of children, voluntary work etc.

It was the raising of the age of eligibility that had a major impact on labour force participation rates for those 60-65, with that increase in labour force participation rate now spilling over to the 65+ age group. This history gives greater weight to your arguments about labour force participation rates. Adding to that is the points that Ganesh Nana made in the 2010 conference, that there is a substantial untapped labour force in the 25-65 age group, especially given the lower labour force participation rates among females. As we know, the required tax rates to fund super is PD/wL, with P the pension rate, D the number of superannuitants, w the wage rate [as NZS is indexed to wage rates], and L is the working labour force. The variable with the greatest impact on affordability is L, and this needs to be given far greater recognition in the document.

Of much greater concern during the late 1980s and 1990s was the surcharge, first at 25% of income above a threshold, and then at effectively 70% for income above the UB level. Both of these income-tests brought about immediate incentive effect responses: I can remember National Ministers giving advice on how to avoid the surcharge, and this advice is a major reason for the high levels of trusts in New Zealand. There is a small comment on means testing (income+ assets), but the incentive impacts of that surcharge on the probability of avoiding the income tests are not really put forward: income tests appear quite often in the news etc. but are not a solution. Administration costs are also very, very high. Using selectivity as the way of reducing the cost of NZS should not be a viable policy option: the small fiscal savings do not outweigh the impact that the absence of a universal pension scheme would have on the life style of those 65+: many may cut back on their spending, reducing their measured standard of living, due to fear of running down their savings.

There is a reasonably strong recommendation that pensions be effectively indexed against inflation, not average wages. Jenny Shipley tried this in the 1990s, with the result that NZS quickly fell from 65% of average wages to 60%. The work that the New Zealand Poverty Measurement Project did showed that very quickly this policy led to a high degree of income poverty among the 65+ age group, for those with limited other income [the majority of 65+ group]. This data was the basis for Clark to raise the rate back to 65% [and Winston to 66%]. The 65+ age group are powerful lobby group, with considerable voting power, and increasing their relative poverty may lead to considerable backlash.

Decumulation of assets. There is discussion on the lack of annuities market, with discussion on how that lack may be overcome by government guarantees etc., none of which are satisfactory. Given the information, most (many) are capable of decumulating their own asset portfolio – I have given the Commission my own very simple spread sheet, where different scenarios of accumulated wealth (cash), after-tax interest rates, desired income during retirement [in addition to NZS] can be entered, with a resulting length of time that the asset will take to run down. The desired income during retirement can then be adjusted to give a better approximation to life expectancy, and obviously the desired income can be adjusted at any stage in the run down period. For risk aversion, or unexpected expenditures, one should only decumulate some of one's assets, requiring several separate portfolios of wealth. Too often people only use the interest proportion of their wealth, not decumulate the principal as well, which gives a far greater net income in retirement. The amounts of required savings put forward by financial analysts seem to be rather self-serving – with decumulation of assets, the required level of savings to maintain the pre-retirement standard of living is quite a bit lower. Moreover, the calculation of the income living standards seems erroneous: the pre-retirement standard of living should be [market income less tax and LESS savings], not just after-tax income. The required income level in retirement is thus less than the financial analyst models portray. Furthermore, lifestyles change quite dramatically when retired: travel to work costs disappear, many leisure activities can be undertaken inexpensively, especially with the Gold Card, plus home-grown vegetables etc.

With ageing and decumulation, aggregate savings could well decrease, as retirees spending of their asset base exceeds the inputs from the younger generations. This may have quite large macro-economic implications if the exhortations that we need to increase aggregate saving levels to improve economic growth have any validity.

Intergenerational equity: the very small section on that is misleading. Intergenerational equity can either mean the average amount that is contributed by one generation to their receipt of NZS when retired, or the amount that current tax payers are contributing to today's retirees. On the former, today's retirees paid less in tax revenue than is needed to pay for their own pensions, in aggregate. When today's retirees [the baby boomers and a bit earlier] were working, there were a large number of workers, and relatively few 65+. The baby boomers relative tax burden was quite light in respect of their future NZS expenditure. This was a major basis for the Cullen Superfund [another was to stop spending ministers getting too carried away]. Highlighting this intergenerational aspect may reduce Bill English's reluctance to top up the Fund – also important here is the relative rate of return on the Fund compared to the interest on the government debt.

Point 8, page 19, 'sound fiscal position' is not really a superannuation issue per se.

P.21 – reduced by overseas pensions: surely this should just be PUBLIC pensions, rather than occupational etc. pensions. Then there comes the issue of the border between occupational and public pensions: the UK SERPS, or the Australian pension are both mandated by the government, but operate as personal schemes. The effect is the same as a private scheme, and thus should not be used to reduce NZ pension payments. [And those overseas forms are bloody complicated and very intrusive – have a look at the Oz one with listing of spousal assets, and then the last Q is whether you want to apply for a pension!] Many of us who worked in the UK whilst on OE have no idea who we worked for, the amounts contributed and thus potential pension from the UK is minimal, and generally the firm is no longer in existence.

P.41: NZS is affordable by international comparisons. The real issue is whether we collectively want to spend that amount of money – a matter of social choice – and what are the alternatives uses to be made of that money if the cost of NZS is reduced.

P. 53 SAYGO reduce the long-term cost. Nick Barr wrote a paper in the 1970s about Myths my Grandpa taught me, showing that SAYGO and PAYGO are both subject to the same macro-economic and population dynamics. After all, it is the rate of economic growth that determines the rate of return to accumulated capital. And, as the paper indicates, there is at least a 30 year transition period in moving from PAYGO to SAYGO, with the double taxation of today's earners having a negative impact on their willingness to save a fund today's pensioners. These two approaches should be seen in the Tier 1 and Tier 2 format, not as alternatives.

P.59 women's savings. In a stable couple relationship, it is the total savings that matters, not how much for man/woman. The policy should be that savings go into a joint account, wherever possible.

The impact on KiwiSaver amounts and contributions when on ACC, UB/SB/IB needs to be discussed in greater depth.

There is a tendency to highlight the impact of cumulative interest rates on total savings, and thus start young. True, but that ignores the life cycle effects of income and expenditure. The real objective is to get greater equality of material standards of living within a family over one's lifetime. When young, income low, often just one earner, setting up home etc., so material standards of living require current income, not potential future income; but when 50+, kids have left home and mortgage repayments often low/zero, giving a greater opportunity and ability to save and impending retirement gives a greater incentive. Sure, make KiwiSaver compulsory, but do not forget life cycle patterns. The problem is when the life cycle gets broken as is increasingly happening – divorce, sole parents, unemployment. These may be the areas for policy to concentrate upon, not us middle class who have ability to make the rightish decisions.

Yours

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