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Retirement Income

John Hyde

Human societies are exceptional in that, with some lapses, they look after members who are neither productive, nor potentially so. Animal societies, on the other hand, tend to discard those who are too feeble to run with the herd. This human practice obviously has a high, and with increasing longevity, rising cost. It must not so overburden the workers that the next generation miss out on security, health, education or anything else important.

The New Zealand Business Round Table recently turned its attention to inter-generational transfers in a common-sense publication, "Retirement Income Provision". Most of their conclusions apply to Australians.

It is a measure of our times that the paper explicitly assumes that "adequate" living standards for the elderly are a government responsibility. Until as recently as the latter half of the nineteenth century, western societies got by without government retirement income schemes. Those people who lived to old age did not retire, but moved to less strenuous activities. To the extent that it was necessary, they were supported by their extended families and local communities.

The industrial revolution changed this. In the first place, its fruits---such as, better diet, plumbing, and medicines---enabled many more people to reach old age. In the second, the extended family structures, which had supported the elderly, broke down. Put more bluntly: the 'me-now' generations left their relatives destitute at a time when general affluence should have made destitution less acceptable. The new situation gave rise to demands for the state to intervene. Just 100 years ago the German Law of Insurance Against Old Age and Infirmity began a trend that has accounted for rapid growth in the budgets of western governments.

In those societies that have them, state pensions are now a safety net for people who might otherwise be neglected. But they also provide a widely enjoyed hammock---nearly everyone now adjusts his/her affairs to qualify.

In most OECD countries, in the 1960s and 1970s, the cost of state-funded benefits for the aged exploded as vote-seeking politicians raised the level of benefit, increased eligibility, and abandoned sinking funds in favour of taxpayer-funded, pay-as-you-go schemes. By the 1980s it was evident that the trend was unsustainable, particularly as the ratio of elderly people relative to working-age people was rising and expected to rise further. If the OECD societies were to continue to prosper, the interests of the young had to receive greater consideration---but how?

The key to this problem, like so many others, is economic growth. Future living standards will depend on economic performance in the meantime. They will also depend on the debts we leave our children to service. Our pensions, and our children's pensions, will depend on the policies we adopt now. These should lay the foundation for high sustained economic growth.

The current policies of state provision, however, themselves have high economic costs which militate against the necessary high growth rates. First, the readily available pension encourages people, who would have continued to work, to retire. Labour force participation rates for Australian males over 65 fell from 23% as recently as 1965 to only 9% in 1985. For males between 60 and 65 years old the participation rate is now only 48%.

Second, the prospect of a state pension discourages people from investing in income-earning property---instead they favour housing because it is not affected by the means test. On retirement it encourages people to cash up their income-earning investments. The pension is, thus, one of the reasons why Australian savings, and investment in productive assets, are insufficient to maintain living standards and service foreign debt.

Further, the taxation needed to fund the near universal provision of state pensions makes it more difficult than it need be to save. The effect of taxation on savings is made worse in Australia's case by over reliance on income taxes---New Zealand has recently shifted emphasis to a Goods and Services Tax.

Economic growth, and sustainable living standards for everyone, including the elderly, will be improved if there is greater reliance on private savings and investment by people providing for their own old age. The New Zealand Round Table makes three recommendations:

* Lower the level of the New Zealand benefit to around the Australian level---lower benefits are perhaps, therefore, not an option for us.

* Raise the age at which the pension becomes available. Obviously, this course will disrupt people's retirement plans, and changes should, therefore, be gradual. But the

United States and Japan are already moving, albeit cautiously, to raise the pensionable age to 67.

* "Target" the benefit by using a strict incomes and assets tests. This reduces government outlays initially---the Hawke Government has, by this means, reduced the proportion of over-70-year-olds in receipt of the pension from 99% to 85%. But, over time, people will avoid investments (in their own names) which disqualify them from the benefit. On the other hand, the Round Table argues that tight targeting and low marginal income tax rates allow people to calculate beyond the zone where withdrawal of the pension denies them much of the reward from saving. Maybe! But I think it could be a mistake to underestimate people's ability to make themselves poor-on-paper for assets test purposes, even when the home is included among the tested assets.

The Round Table recommends against funded government schemes. These offer much the same incentives to taxpayers as the present pay-as-you-go arrangements and put huge funds, ripe for mismanagement, into the hands of governments. Who, today, would trust the WA or Victorian Governments to run a pie stall?

By the year 2030 the proportion of the population that is aged---as currently defined---is expected to rise from 11% to 25%. We must not only, as everyone agrees, allow people to work longer; but we must also give them an incentive to do so. To do that, our best option would seem to be to raise the various ages at which people can claim government pensions.

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