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REVIEWS

Defusing the Age Pension Time Bomb

*Michael Littlewood, **Will You Still Need Me? A Retirement Income Primer for Politicians, Employers and Meddlers**, Planit Services Ltd, Auckland, 1997*

*Michael Littlewood, **Will You Still Need Me? Retirement-Income Lessons from New Zealand**, The IEA Health and Welfare Unit, Institute of Economic Affairs, London, 1998*

*Reviewed by **Michael James***

IN September 1997, New Zealanders voting in a referendum rejected by a huge margin a proposed Retirement Saving Scheme, a compulsory, funded and private income-retirement arrangement designed eventually to replace the country's generous pay-as-you-go national superannuation scheme. Michael Littlewood was a leading advocate of the 'no' vote. In his book (of which the British edition is essentially an abridged version) he puts forward a programme for converting New Zealand Superannuation (NZS) into an Australian-style means-tested safety net, while shifting working people's saving efforts very largely into private, funded but voluntary pension schemes.

From 1988 to 1997, Littlewood was employee benefits director for Fletcher Challenge Limited (New Zealand's largest employer) and in 1991-92 a member of the New Zealand government's Task Force on Private Provision for Retirement. In the former job he evidently learned how to explain the fundamentals and the details of retirement income in plain, even colloquial, English. This is one his book's greatest strengths. Another is its comprehensiveness: all the main aspects of the subject are covered, including the operation of the private saving industry and how it could expand in response to reform of NZS.

New Zealand's retirement income policy in recent decades has differed significantly from Australia's. The Labour government elected in 1972 attempted to set up a compulsory superannuation scheme; the National Party won the following election after promising to replace it with a greatly expanded state pension. The Muldoon Government's scheme, introduced in 1977, amounted to a one-off transfer to retired and older workers at the expense of younger ones that contributed to New Zealand's economic decline in the 1980s. Since 1979, governments have been trying to get the scheme under control, but with only mixed success: a tax surcharge imposed on the highest-income retirees in 1985 was abolished (with the acquiescence of all political parties) in April 1998, a substantial victory for 'grey power' in New Zealand. But pressure for reform will continue: without it, the cost of NZS is

expected to rise from 4.5 per cent of GDP today to about 10 per cent in 2040. Sooner or later, Michael Littlewood's proposals will have to be taken seriously.

New Zealand's private saving policy regime, in contrast, is superior to Australia's. Littlewood approves of the changes in the late 1980s that restored tax liability for contributions to, and earnings of, pension funds, and exempted from tax the benefits they paid; he argues that tax incentives for private saving are distorting and, as they do not turn out to be self-financing, they increase overall tax rates. Littlewood also effectively demolishes the case for compulsory private saving. Even schemes that avoid the peculiar complexities and associated costs of Australia's superannuation guarantee inevitably suffer from two major problems. The first is the moral hazard induced by the government guarantees (implicit or explicit) that unavoidably accompany compulsion. This is bound to lead to underperformance. As evidence for this, Littlewood cites the Savings and Loan debacle in the United States in the 1980s, which he attributes to the deposit insurance that government provided for small savers. The second problem is the ability of people to find ways around compulsion so as to restore their natural saving preferences. As well as reducing saving in other vehicles (such as housing), they can borrow back excess saving (Littlewood cites evidence that, as at March 1996, Australians had borrowed the equivalent of nearly 90 per cent of their after-tax income, up from 70 per cent ten years earlier) and in the last resort join the black economy. The upshot is that compulsory schemes are unlikely to increase private saving and could even reduce it.

This brings attention back to the state pension. Compulsory superannuation is often defended as itself a solution to the moral hazard that consists of the temptation not to save enough for retirement in order thereby to qualify for welfare state benefits. But, as Littlewood observes (p. 146), a sufficiently modest and strictly targeted state pension would itself counteract such moral hazard by signalling that only private saving could guarantee a materially comfortable retirement. The core of Littlewood's book is a set of proposed reforms for NZS. He aims for a level of benefits somewhat in excess of what is sufficient to prevent poverty, and suggests 55 per cent of the net average wage for a married couple and 35 per cent for a single person: a drop of around 20 per cent from present NZS levels. As this level is still quite generous and considerably above the unemployment benefit, Littlewood pushes the burden of fiscal restraint on to other reforms. These include a universal eligibility age of 68 from 2014 (beyond the present gradual rise to 65 by 2001) with (from 1999) the option of taking a reduced benefit from age 60 or a larger benefit if taken after age 68.

The most important proposed reform is a means test. To counteract some of the incentive to rearrange one's affairs artificially so as to pass the test, Littlewood recommends two devices used in Australia: allowing a 'free zone' of private income and, in respect of any income beyond that zone, offsetting the pension by less than 100 per cent. He rejects the assets test as self-defeatingly complicated, and suggests instead an extended income test that applies to the underlying returns on a wide range of assets. To provide credibility and stability to his reforms, Littlewood pro-

poses delegating responsibility for monitoring the state pension to a statutory body known as the 'Retirement Trustees', an idea which, as Littlewood notes, resembles New Zealand's Reserve Bank Act 1989 in insulating an area of policy from short-term political pressures while ensuring the responsibility and accountability of the policy-makers. All the reforms other than those affecting age of eligibility would be introduced in 2045, so that the saving plans of people aged 20 years or more would not be disturbed.

These reforms go in the right direction, but do they go far enough? The proposed level of the pension is probably too high to discourage serious effort to circumvent the means test. Littlewood admits that 'there's no real science' (p. 183) in his suggestion, and he offers no fiscal scenarios for the various options; but pitching the level no higher than some notional poverty-alleviating level would create a stronger incentive to save privately and reduce the gains from trying to get round the means test. A body of Retirement Trustees could be captured by the grey power lobby unless its aims were spelt out as narrowly and clearly as is the Reserve Bank's job of keeping inflation low. Postponing the benefit cut and the means test for 47 years weakens the credibility of the whole programme by exposing it to the prolonged risk of being undermined by political opportunism. The reforms could surely start earlier; for example, since the pension was targeted through the tax surcharge for 13 years after 1985, some sort of means-testing could be resumed within a few years without any violation of legitimate expectations. The pension expectations of younger working people will have started to fall well before 2045, by which time an unreformed NZS would have come under severe pressure from other claims on the public purse.

Littlewood has done a very good job of exploring the main issues raised by retirement income policy and identifying the aspects of it that will have to be addressed. It's unfortunate that the presentation of the book doesn't match its contents. Despite its plain and lively English, it is less accessible than it could have been. At 388 pages, it is too long (though partly because of poor formatting). The references are not usefully listed at the back but are scattered throughout the many footnotes and in many cases are incomplete. Worst of all, there is no index, or even a detailed list of contents. The author tells us he published the book himself; he may have been rushing to bring it out before the September 1997 referendum. But, with a subject as large and complicated as retirement income, many readers would want to explore particular topics rather than read the book straight through. They would be well advised to consult the British edition published by the Instutute of Economic Affairs, which contains an index.

Michael James is editor of ***Agenda****.*