



ARC CENTRE OF
EXCELLENCE IN
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AGEING
RESEARCH**

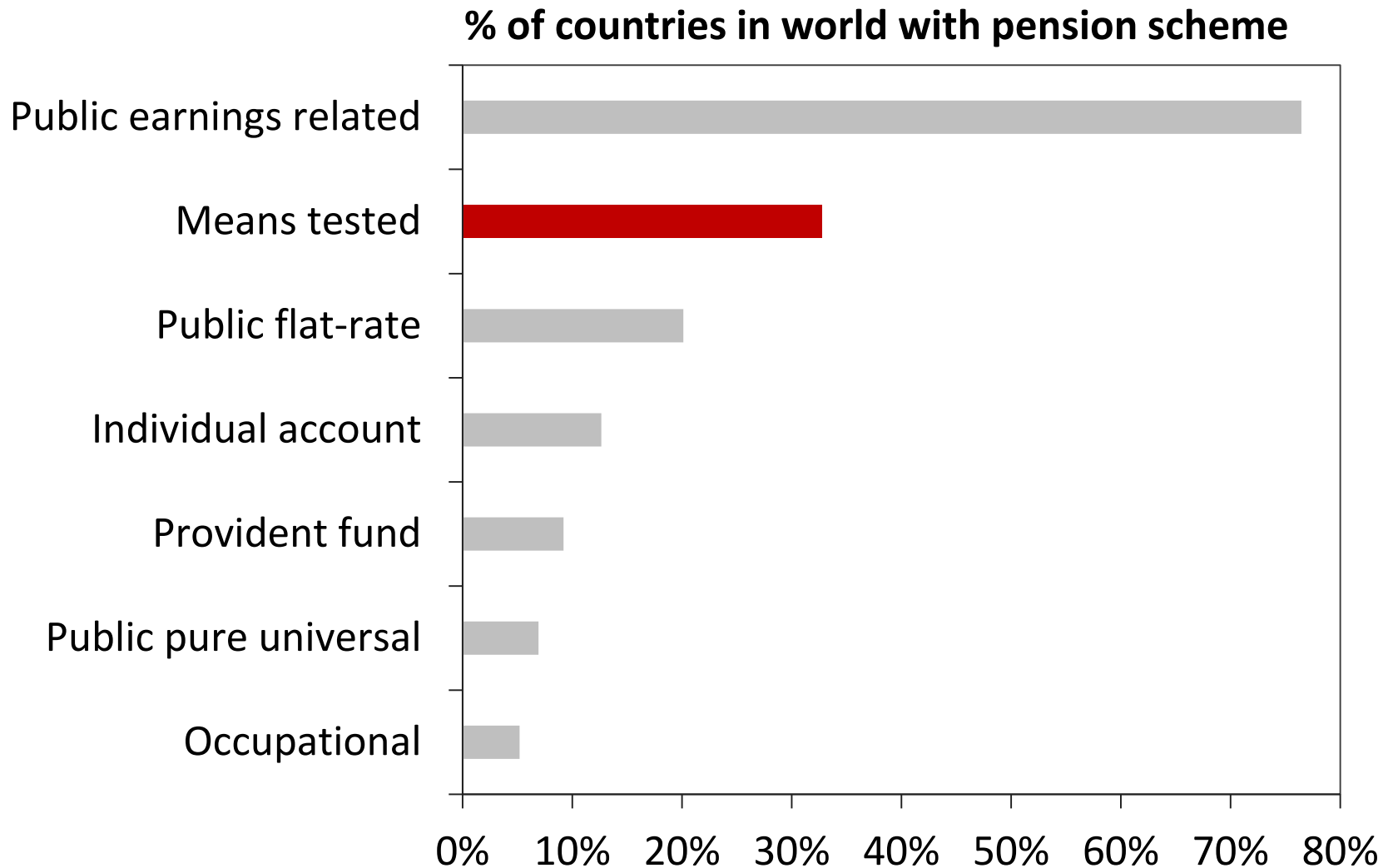
Targeting pensions: Who is affected?

Rafal Chomik and John Piggott



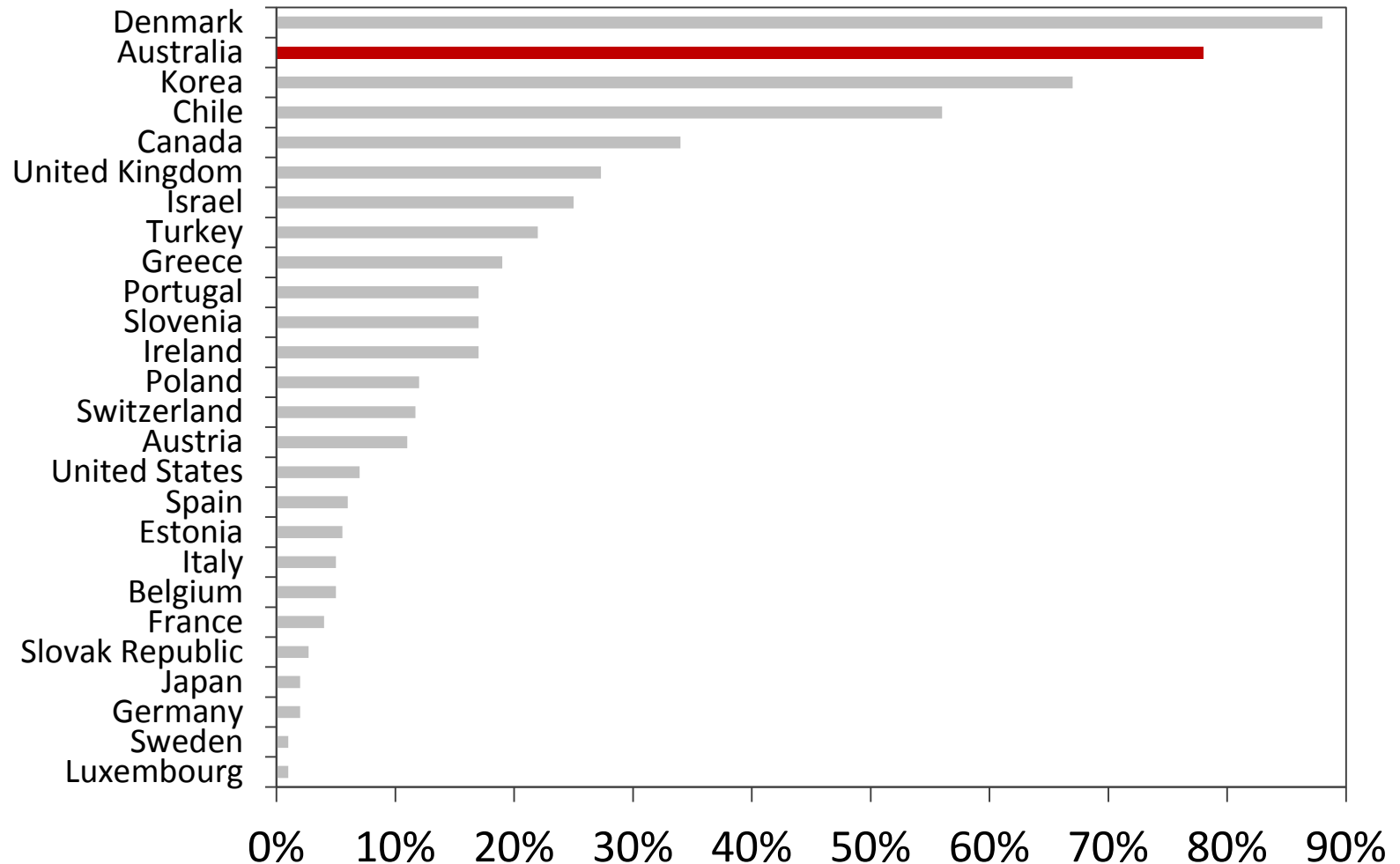
1. **Policy**: Design features and approaches
2. **Incentives**: Economic efficiency concerns
3. **Research**: Recent insights and remaining gaps

Means-testing is popular



But importance of schemes differs

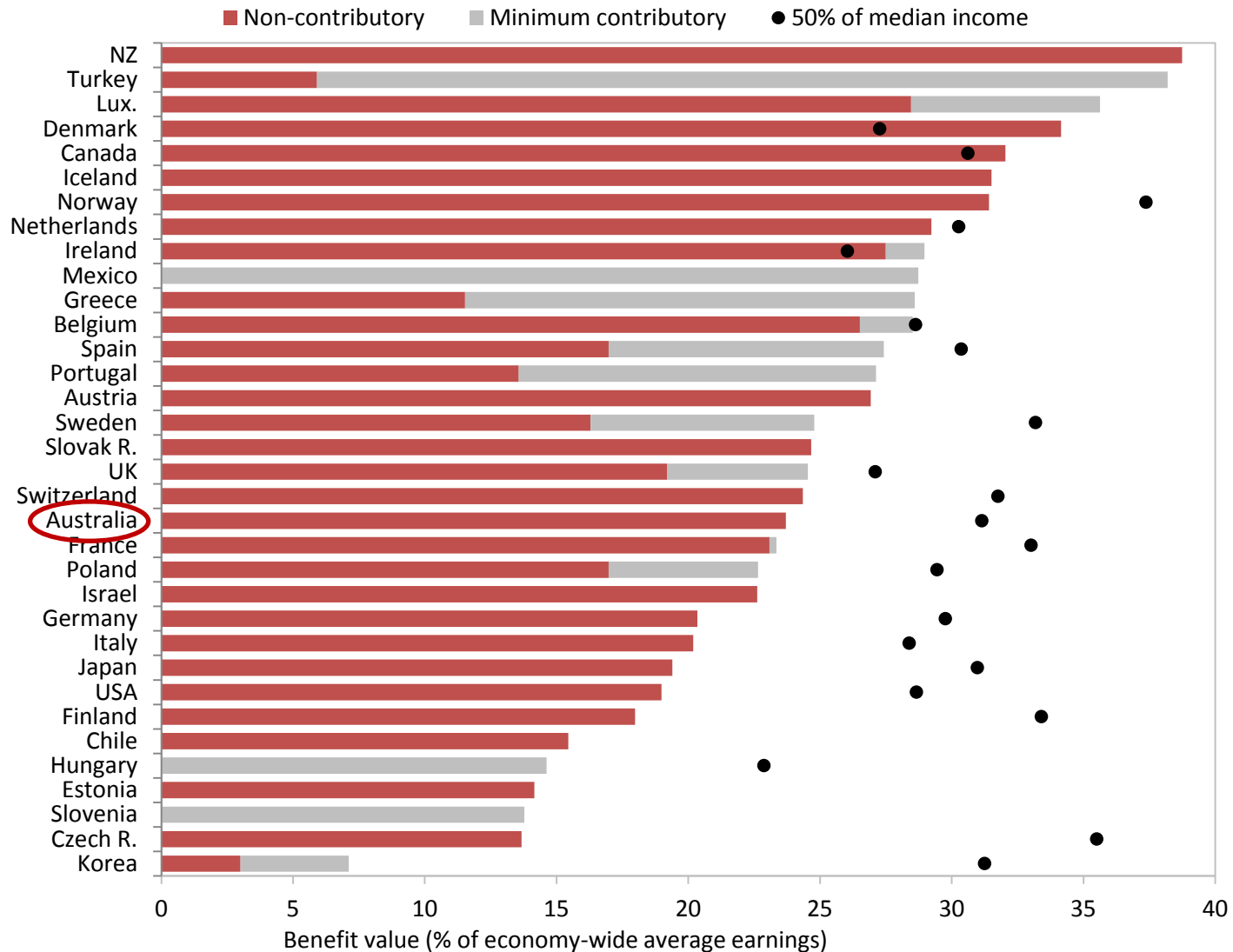
% of 65+ population receiving means-tested pension



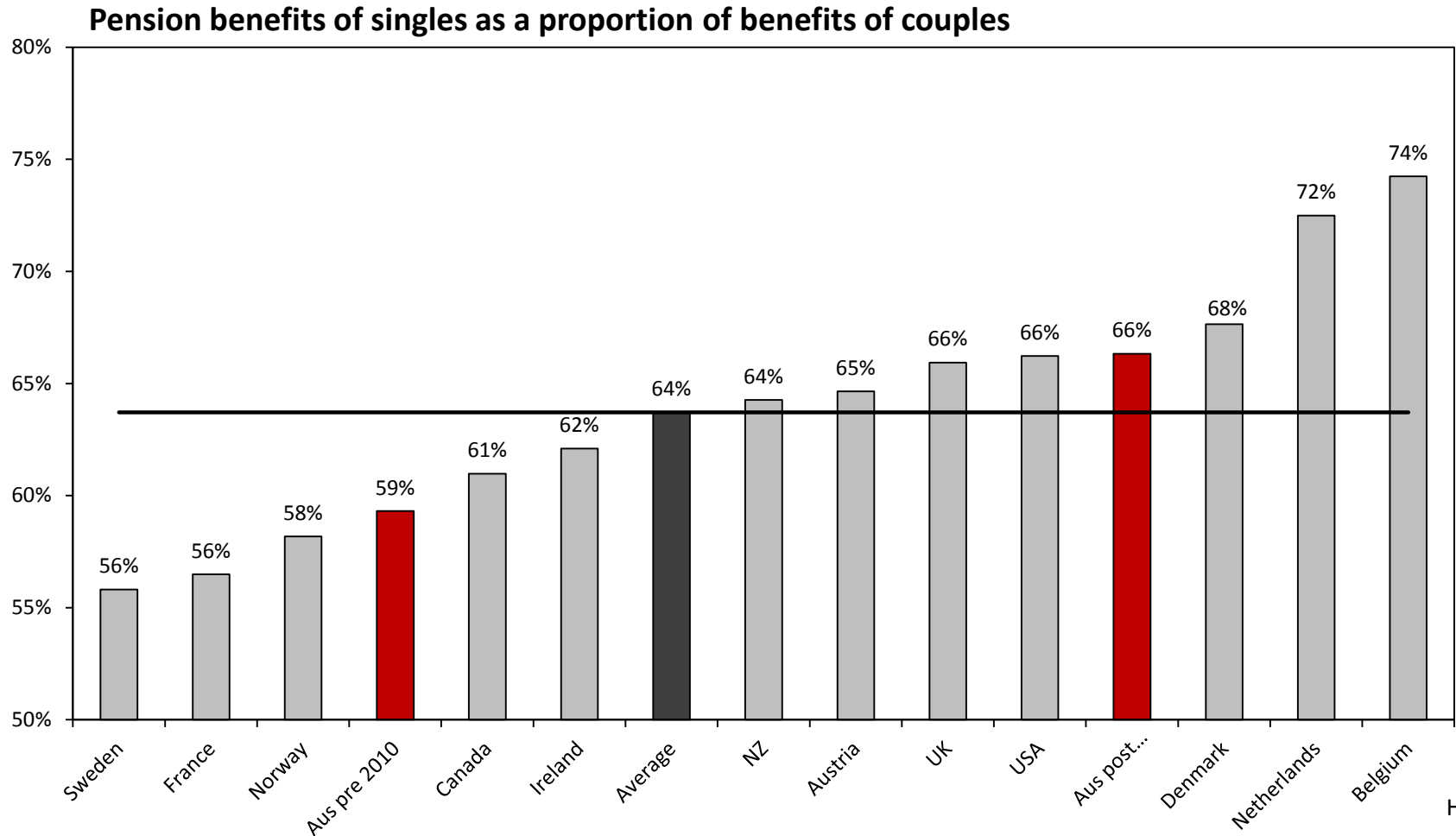
Which depends on means test design

- **Who is eligible?** (residency, age)
- **Which resources are tested, how?** (pension, capital, and/or labour income; liquid or illiquid, and/or including home asset; actual or deemed)
- **Unit of analysis?** (individual, family, or hh)
- **Max benefit** (rel or abs benchmark; indexing)
- **Disregard** (by income and/or asset source)
- **Taper** (shallow, steep, 100%, or non-linear)

Setting the max safety-net benefit

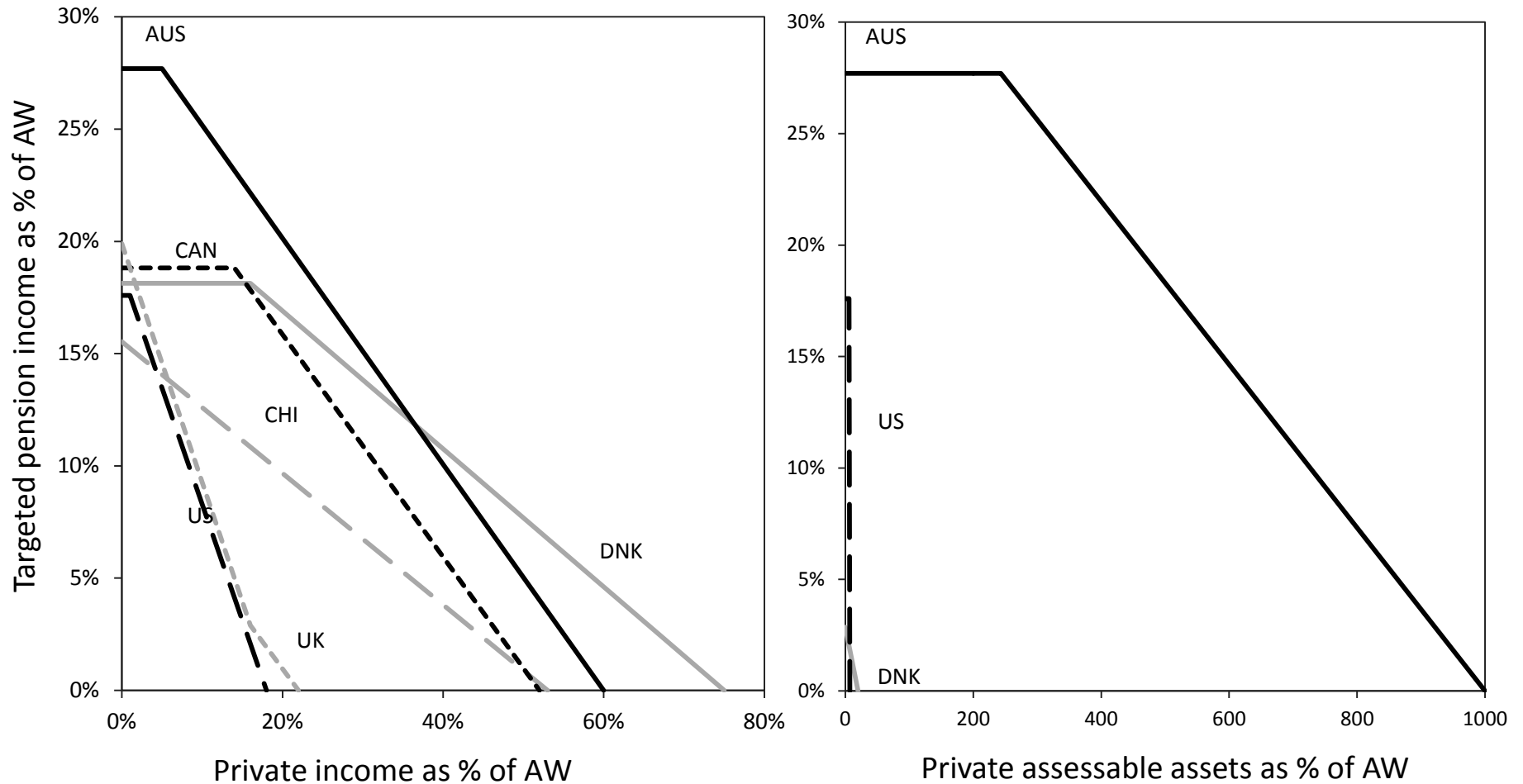


Setting single v couple benefit level



Combining benefit, disregard, & taper

Income and asset tests in selected OECD countries (2012-2014)

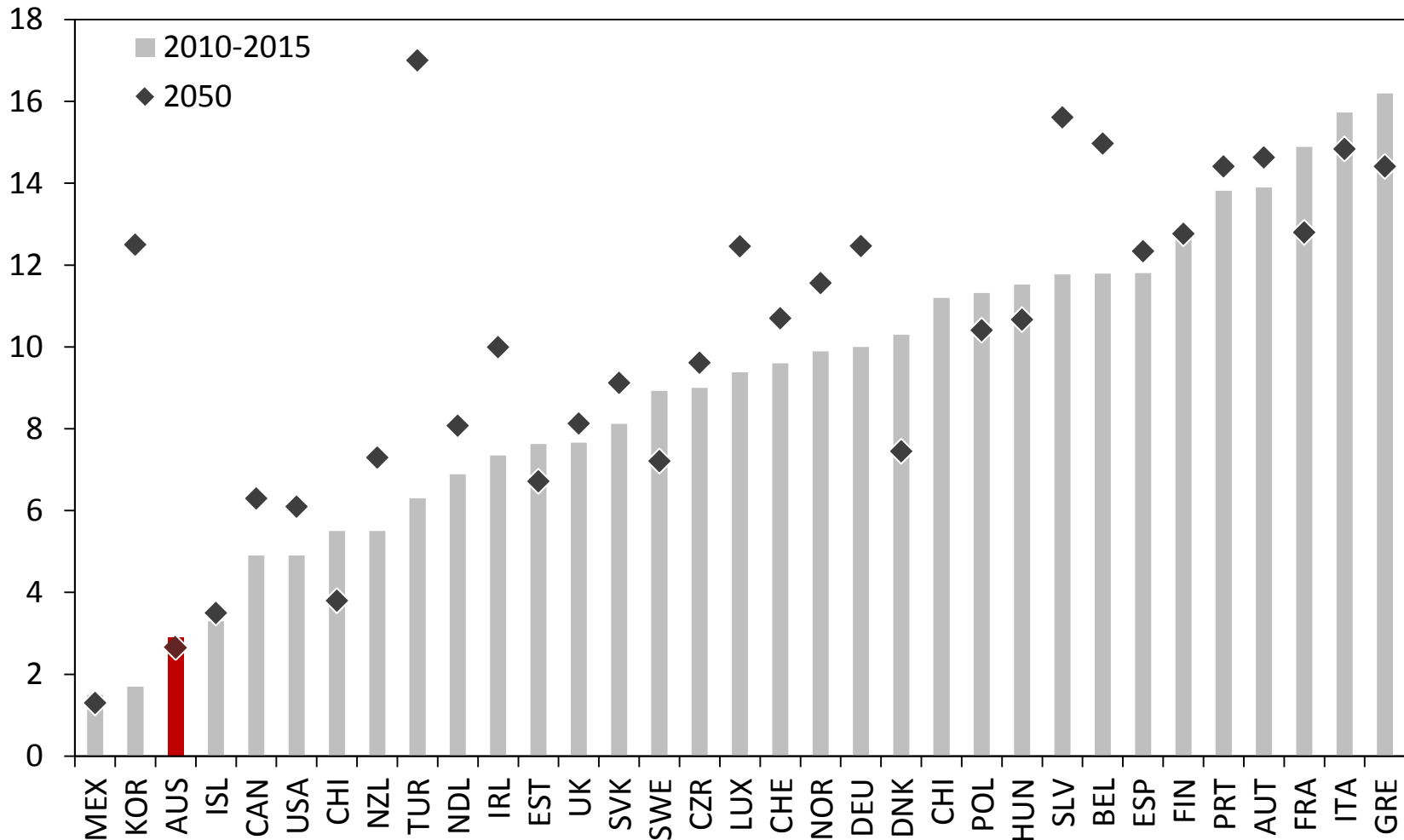


Poverty outcome of means-testing (after accounting for housing cost)

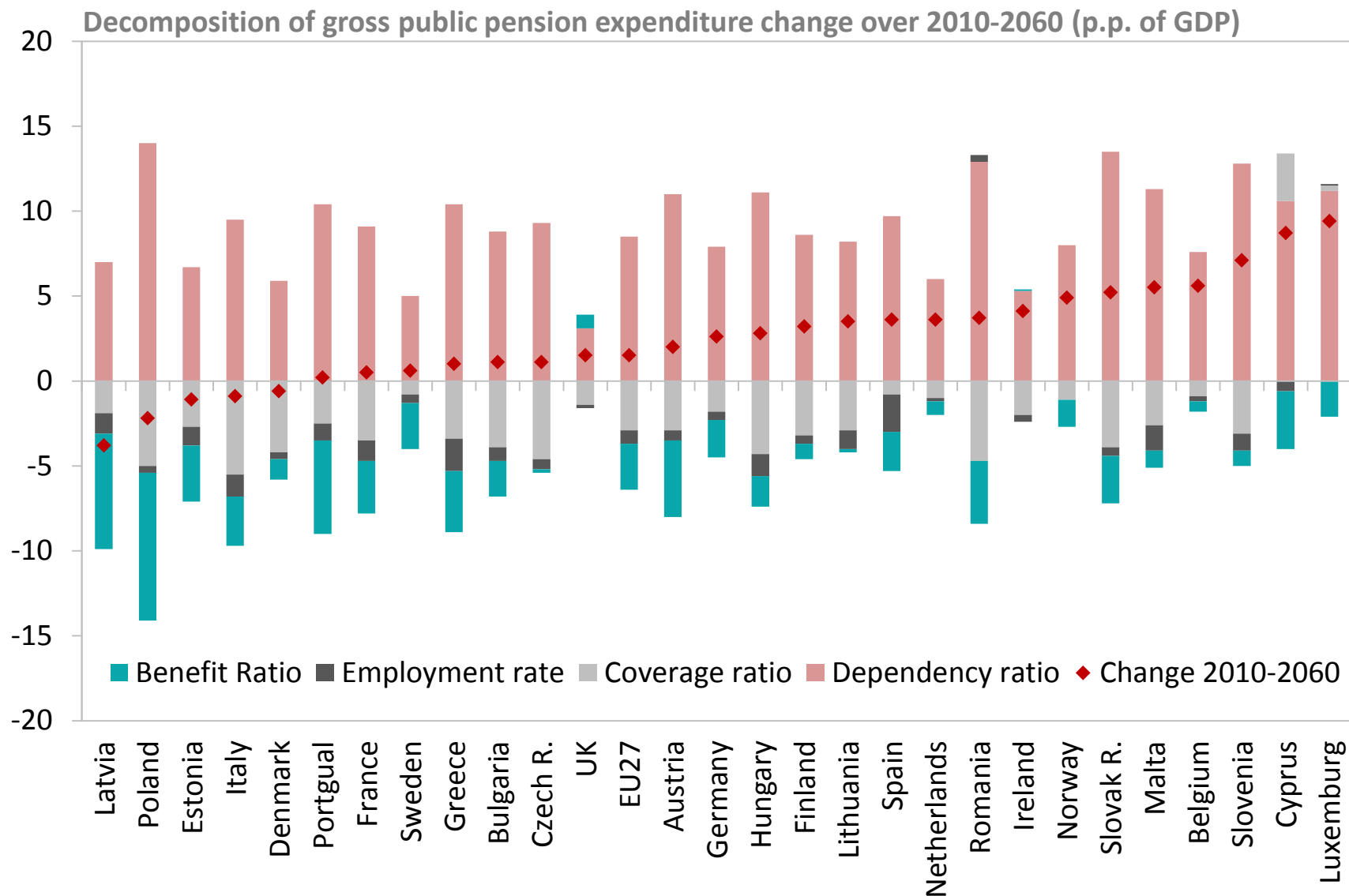
	Equivalent disposable income before housing costs	Equivalent disposable income after current housing costs	Equivalent disposable income after current housing costs and principal repayments
Poverty rates of older households			
Australia	19.9	17.2	13.5
Canada	4.8	11.3	–
UK	15.1	–	17.0
USA	18.7	–	21.1
Italy	10.8	–	18.7
Finland	10.6	15.1	–

Fiscal outcome of means-testing

Public pension spending in OECD countries, 2010-2050 (% of GDP)



When pensions become unaffordable



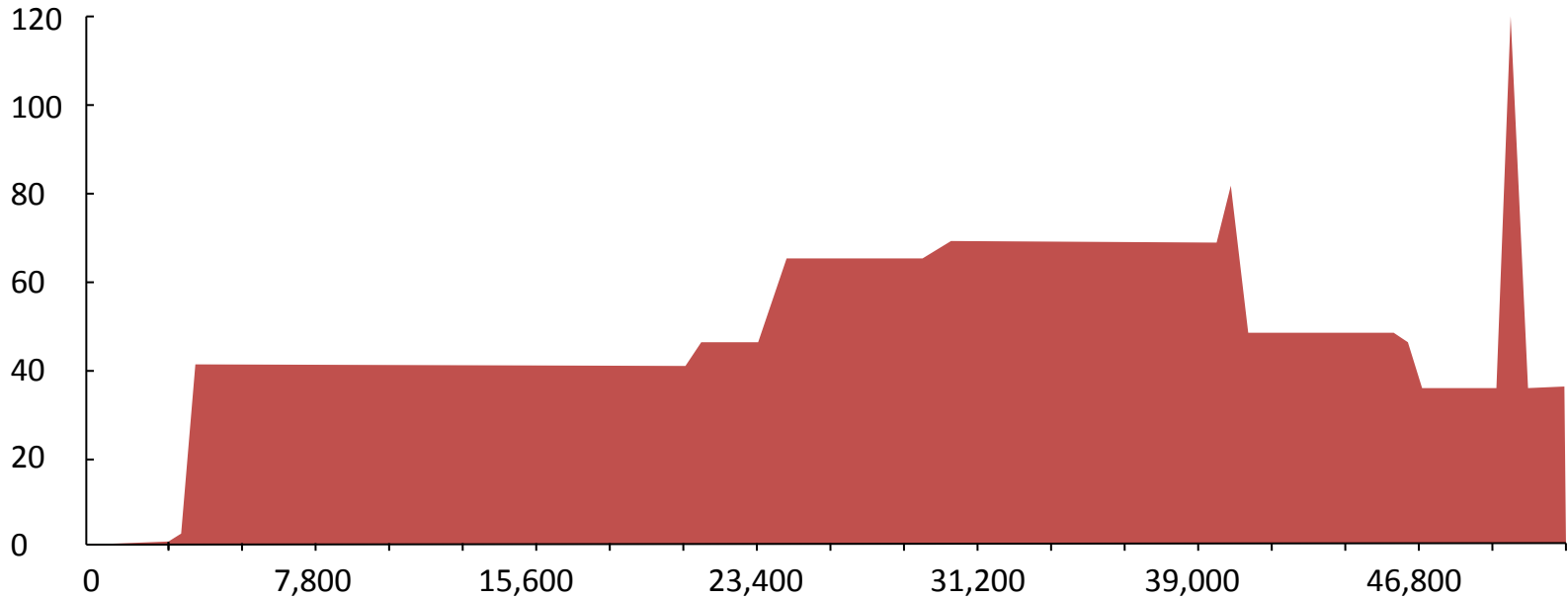
Administering the means-test

- **Integrating operations** (e.g. single customer facing gov dept., piggyback on existing: e.g. tax)
- **Streamlining assessment** (e.g. auto-reassessment, customer segmentation, online self-reporting)
- **Quality control frameworks** (detecting systematic fraud & error)
- **Simplifying design** (simpler inc test binding by design)
- **Costs** (Estimated AU 3.6%, UK 4% vs US 1.4% NZ 0.3%)

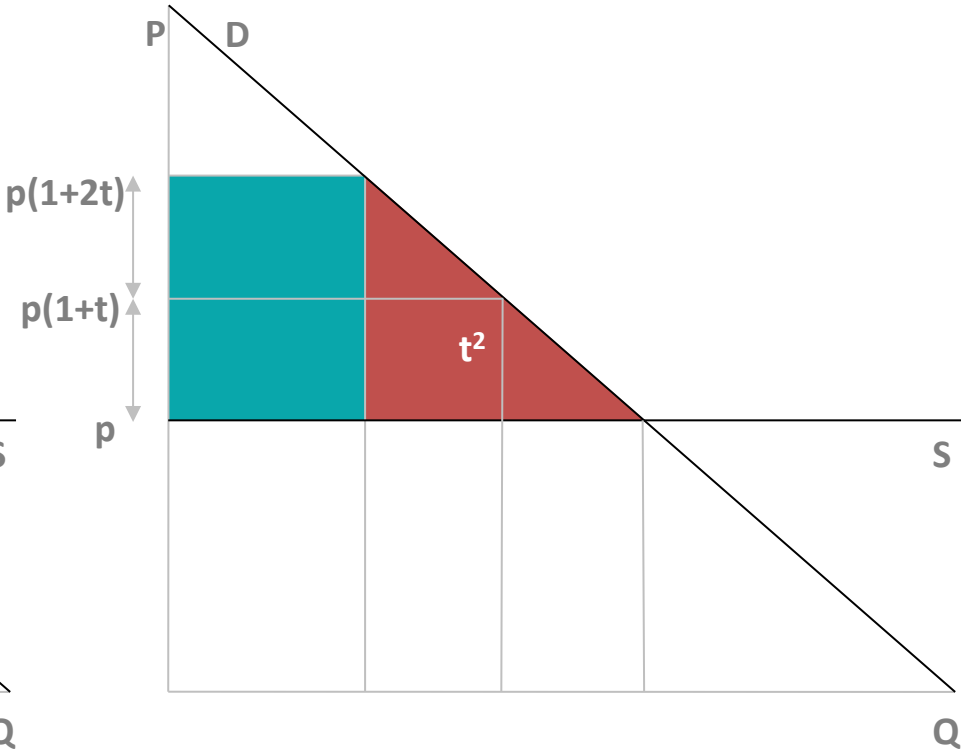
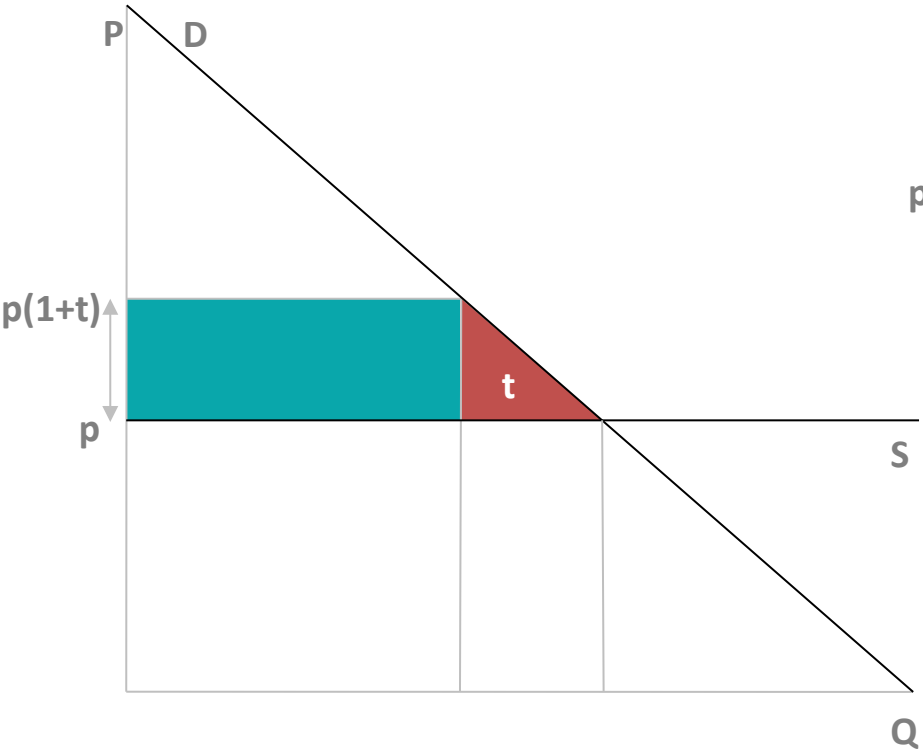
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Issues in means-testing

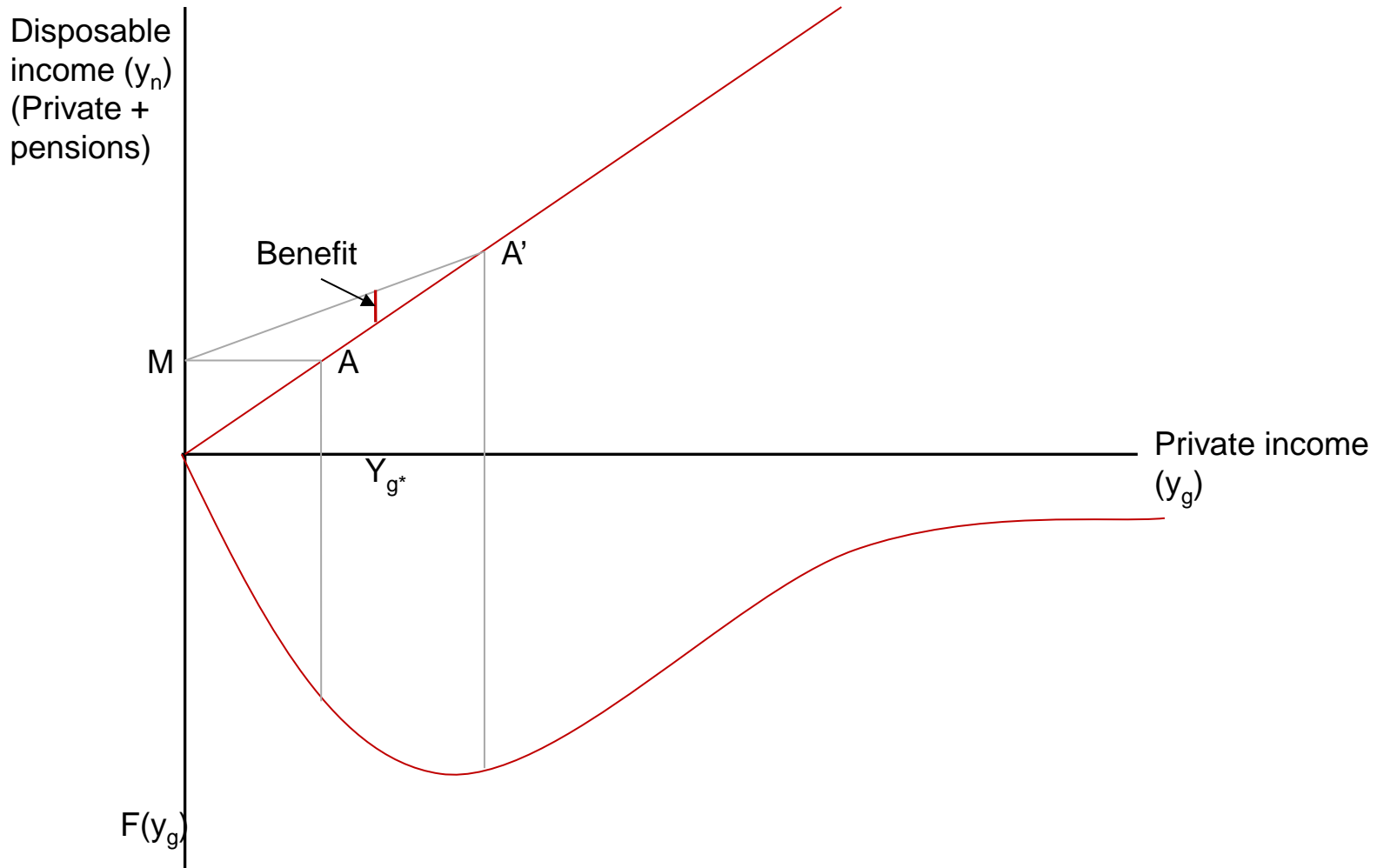
Effective marginal tax rates—single age pensioner, January 2009



Revenue requirement implications



The tradeoff



Optimal tax and means-testing

Include **capital income in tax** but nothing on differential rates (Haig 1921 and Simons 1938)

Don't tax capital income to avoid distorting $S \rightarrow I \rightarrow GDP \rightarrow W$ (Judd 1985; Chamley 1986)

Since retirement saving & retirement leisure are complements, **means test may be an efficient tax on capital** (Kumru and Piggott, 2010)



Including capital income **limits tax expenditures**, seen as lacking oversight (Surrey 1973)

Age-specific taxes are less distorting (Erosa and Gervais 2002)

In absence of age-specific taxes, OLG shows **should tax capital income** (Conesa et al. 2009)

1. Policy: Design features and approaches
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3. **Research: Recent insights and remaining gaps**

Recent research insights

Uninsurable risks suggest that public pensions superior to self-provision
(Hugett & Venture, 1999; Hugett & Para 2010)

Targeted pension is superior to universal pension
(Kumru & Piggott 2009; Tran and Woodland 2014; Kudrna, 2015)

Excluding more earnings from means test has a positive but small effect
(Kudrna, 2015)

Self-provision superior to any public pension because of distortions
(Auerbach & Kotlikoff 1987)

a steep taper is superior to a shallow taper
(Kudrna, 2015; Dabbs, Kumru, and Piggott 2015)



Remaining research gaps

- **Unit of analysis**: Taking better account of incentives and equity effects across individuals, families, hh
- **Access age**: Impacts of access age variation and interactions with other programs
- **Income source**: Effect of exempting labour income
- **Rationality**: Relaxing assumptions in OLG models



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