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The Future of Retirement Income Systems: Some Speculations

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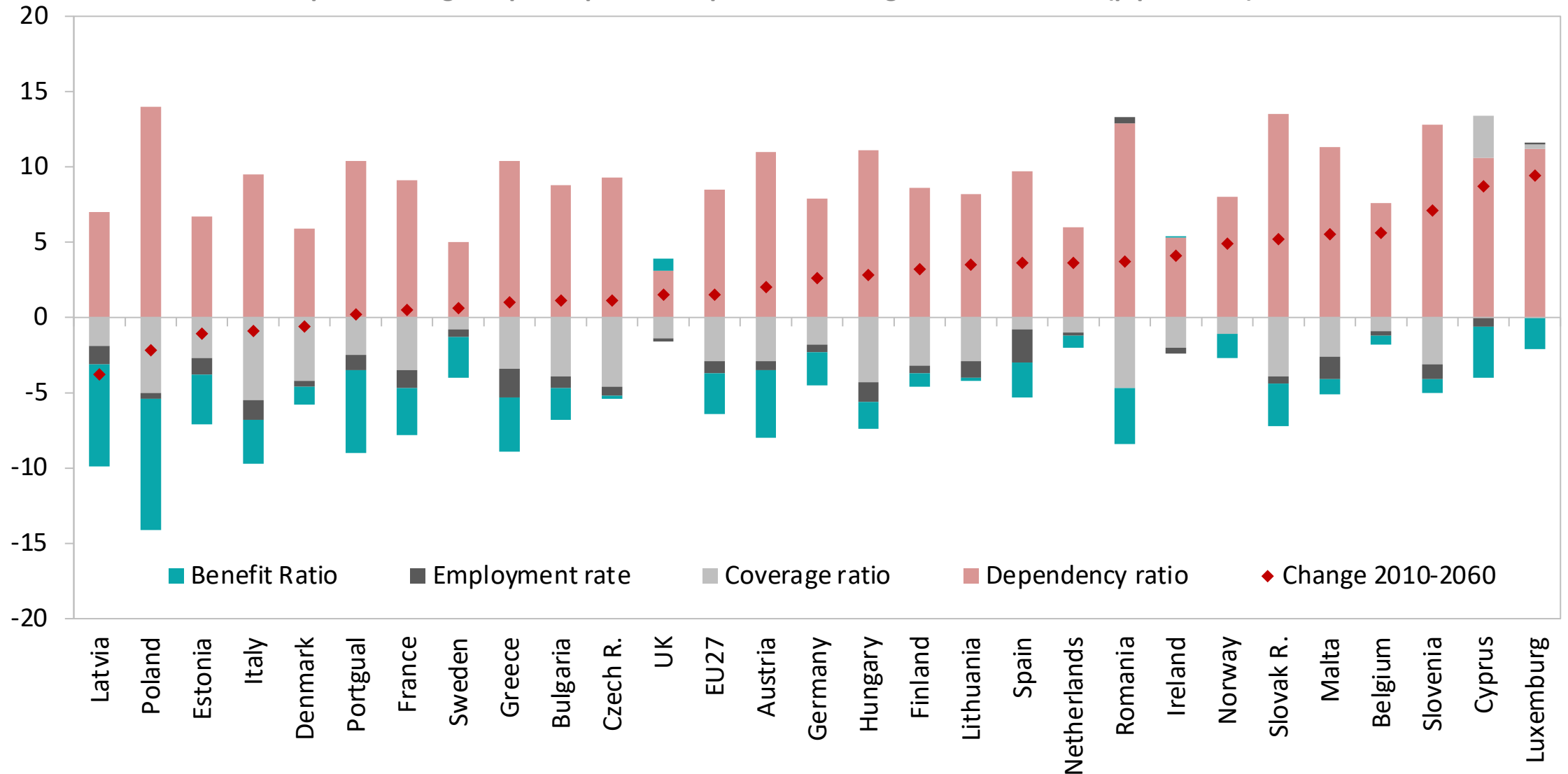


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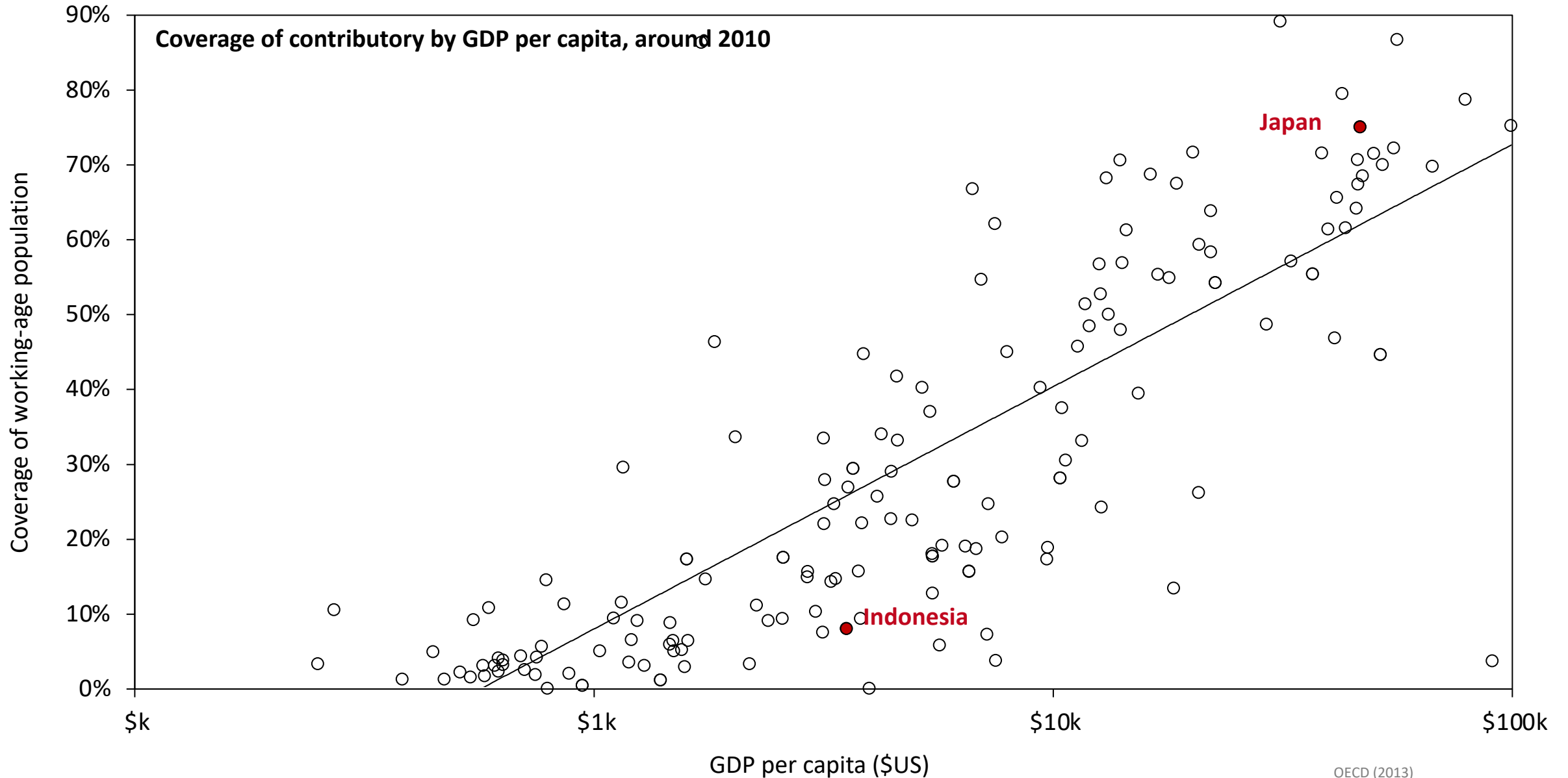
WHAT ARE THE CHALLENGES?

We've long known that traditional PAYG pensions can become unaffordable

Decomposition of gross public pension expenditure change over 2010-2060 (p.p. of GDP)



And raising coverage remains difficult at lower levels of national income



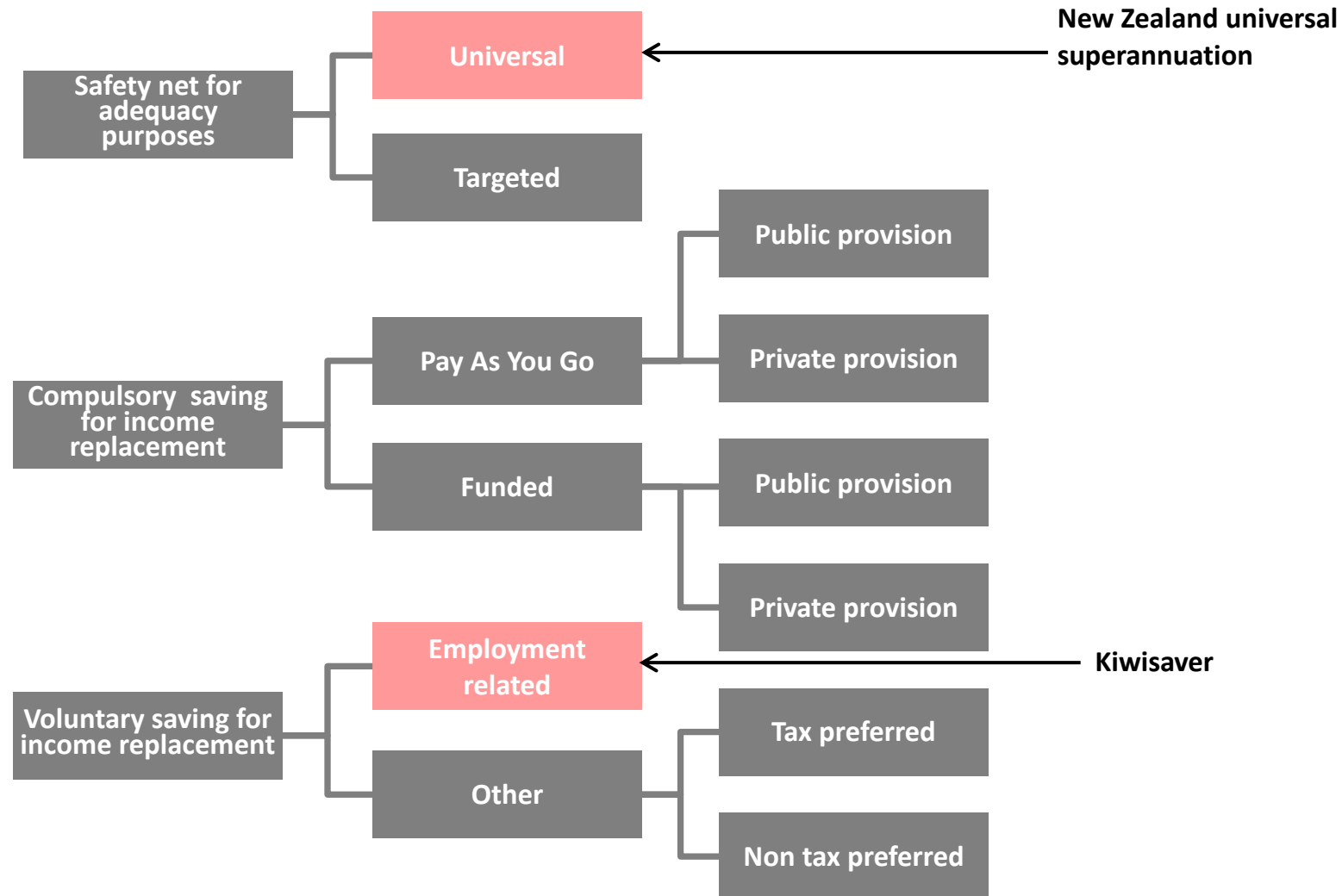
SO, WHAT MIGHT WE NEED?

1. MORE SOCIAL PENSIONS
2. WITH BETTER TARGETING
3. SMARTER SAVINGS
4. WITH STRONGER GOVERNANCE

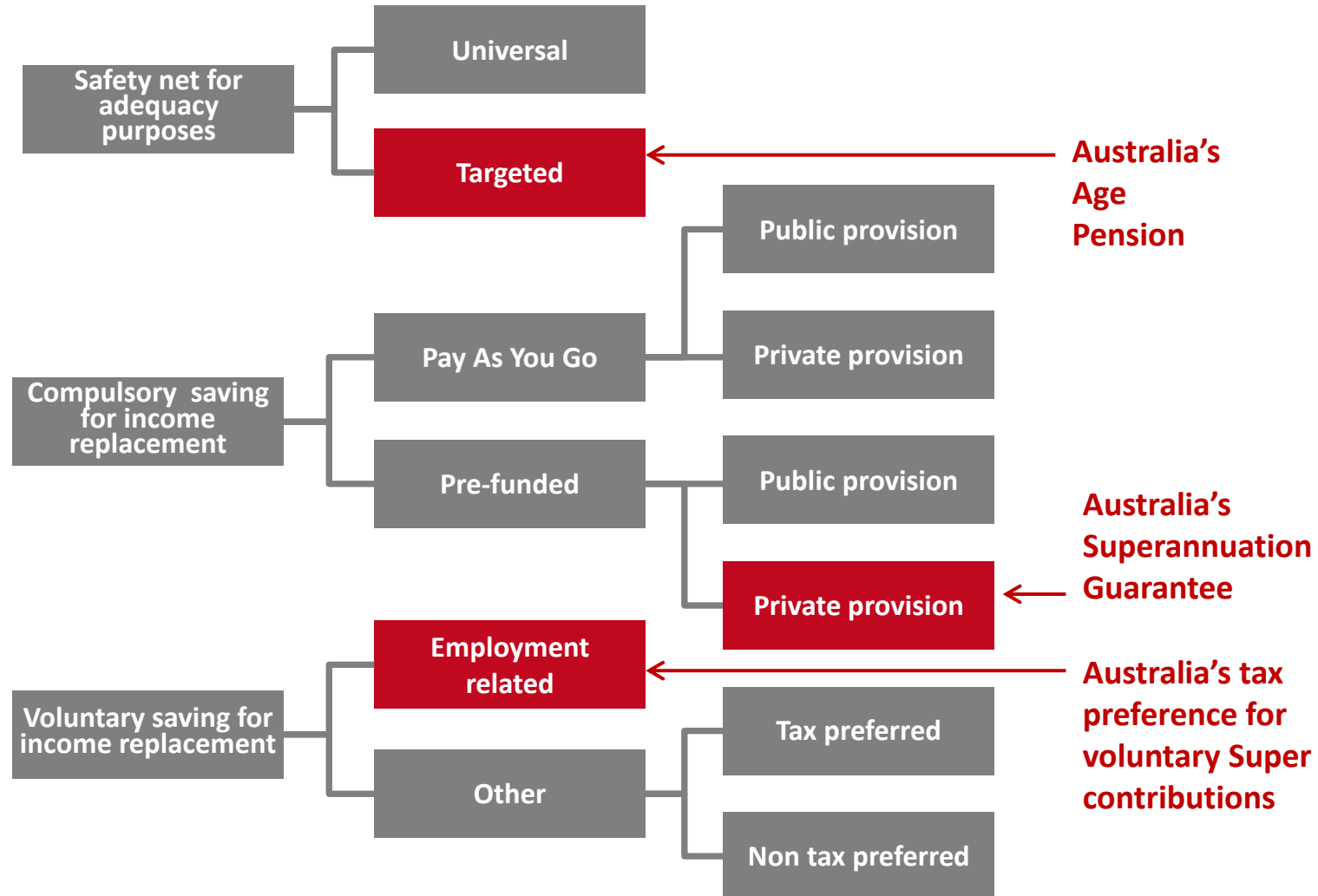
The case for more social pensions

- Protects the most vulnerable whose earning capacity has been exhausted
- Has much broader reach or coverage now than in the past
 - Smart phones and IT
- Covers contingent workers
 - Expanding casualisation, insecure employment, and fractured careers
- Reduces inequality, especially in older cohorts
- Covers the missing market of longevity insurance
- Sustainable with population ageing, if
 - Means tested (pensions tested?)
 - Combined with pre-funded earnings related scheme
- Can be funded from any tax base

We have lessons from atypical existing systems



We have lessons from atypical existing systems



Important design features

- Adequate maximal benefit
- Highly targeted
- Comprehensive resource base to measure means
- Steep taper
- Indexed to changing social norms:
 - Access age indexed to RLE
 - Benefit indexed to wages/earnings

And still needs to be complemented with earnings-related savings

1. Need to smooth consumption and manage retirement risks. But behavioural biases inhibit this, resulting in under-saving
2. At same time govts / employers walking away or finding it difficult to implement DB (or even DC) pensions, especially in developing country settings
3. What innovations are there?...

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Saving through spending: Examples

	Spain	China	Mexico	Australia	Chile
Year launched	2013	2016	2017	2018	Proposed
Programme	Pensumo	Personal Consumption Pension Compliance Management Plan (PCPC)	Miles for Retirement	Supersuper	Value-added Pension Account
Saving sources	% of purchases from merchants + rewards from completing challenges	% of purchases from merchants + shopping points	% of monthly consumption from users + promotion from merchants and brands	% of voucher purchased from Supersuper	1pp of VAT (reduce VAT to 18% + 1% VPA or keep VAT at 19% + 1% VPA)
Government subsidies or other extra contribution			Voluntary extra contribution from users		Progressive top-up to 4 lowest income quintiles
Payment methods (when spending)	No restriction	Scan QR code to pay via AliPay or WeChat	A debit card or a credit card	Vouchers on app	A debit card
Minimum/Transfer ceiling			Minimum saving is MXN 50 per week		\$20,000CLP/month and \$100m CLP for total amount (State will collect 1% VAT)
Withdraw age	At least 5y, earlier with penalty	Same as retirement age: 55 females, 60 males	Retirement.	Same as superannuation	
Nature of platform	For-profit	For-profit	For-profit	For-profit	Government

Saving through spending:

Economic advantages

- **More efficient:** In all real-world economies, taxing consumption is more efficient, that is, will allocate resources more efficiently than taxing labour
- **Consumption** includes in the tax base the returns to existing capital, and effectively taxes this as a lumpsum (non-distortionary) tax
- **Labour supply** will be higher under a consumption tax
- **Potentially progressive:** In developed countries, where social protection structures are indexed, consumption taxes are progressive, because transfers, received predominantly by the poor, aren't taxed at all
- **Potentially easier and cheaper:** As cashless payment becomes more universal, it may be a better base for the informal sector and administratively efficient. If this happens, A revenue-neutral move from payroll to VAT will reduce informality, increase wages, output, and welfare

Saving through spending:

Program advantages

Incentivises saving

- Present biases means people overvalue present gratification → not saving enough
- A powerful intervention turning spending behaviour (behavioural challenges) into a saving habit (solution to inadequate retirement income)

Increased coverage/funding base

- Allows people to save regardless of employment status
- Workers in informal sector can be covered
- Contingent workers can have a continuous contribution to their pension
- Parents on parental leave
- Allows people to start saving from a young age

A marketing opportunity for merchants and brands

- Attracting customers
- Establishing customer loyalty

Saving through spending:

Investment advantages of expenditure matching

Potential for matching investment profile with post-retirement consumption profile

- Information is available about working life consumption preferences
- Assume there is a corresponding retirement consumption profile
- It would be possible to create investment profiles to immunise against relative price risk of consumption items

So, if you like bananas, invest to immunise against increase in banana prices

But these are small examples

Some points to bear in mind

- What is the unit of consumption? If one person does all the buying for a household, then you need to have a household-based system
- You need to impose the tax even after benefit drawdown. Otherwise, the elderly will do all the buying

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Case for stronger governance

- Pre-funding retirement income from early in the work life requires a governance structure strong enough to protect capital over decades
- This has probably to be developed alongside more general financial security
- Without strong governance, long term contractual saving will be very risky

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