Means Testing Retirement Support

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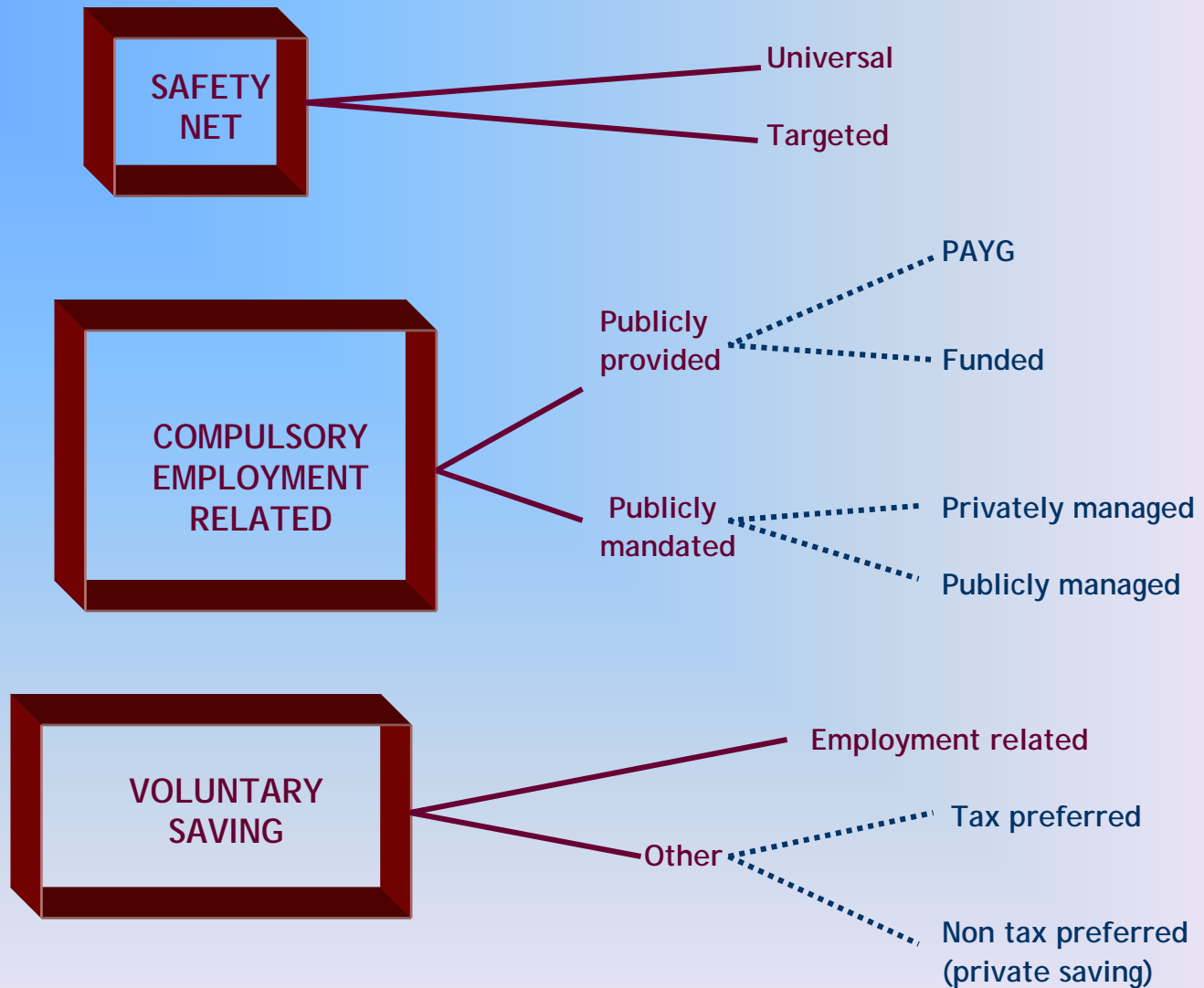
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**CENTRE FOR
PENSIONS AND
SUPERANNUATION**

Components of Retirement Provision

SAFETY NET
- Universal
- Targeted

COMPULSORY EMPLOYMENT RELATED
- Publicly provided
  - PAYG
  - Funded
- Publicly mandated
  - Privately managed
  - Publicly managed

VOLUNTARY SAVING
- Employment related
- Other
  - Tax preferred
  - Non tax preferred (private saving)

Safety Net Replacement Rates

- Japan: NK (National Pension) target at 16% net income by 2025 for single and 32% for married couple

- Sweden: about 20% for single and 35% for married couple

- USA: SSI (Supplemental Security Income) for 2003 single max. USD552 (20%) and married USD829 per month (30%). Means tested

- Australia- Old age pension. RR about 25% for single and 42% for married couple

First Pillar Support:
Taxation and Means Testing

- **First pillar support:**
  - mandatory
  - publicly managed
  - financed from taxes
  - defined benefit
  - redistributive

First Pillar Support:
Taxation and Means Testing

■ **Universal first pillar support:**

– Expensive

• requires high and distorting taxes elsewhere

– Affects the saving decisions of all individuals

• even the well-off need not save as much

– Limited monitoring

First Pillar Support: Taxation and Means Testing

- **Targeted or means tested first pillar**
  - Less expensive
    - reduced fiscal requirement means that taxes can be lower and therefore less distortionary
  - Well targeted redistribution
    - transfers go to those in need
  - Not everyone is affected by the transfer
    - overall, distortions may be reduced
  - Monitoring required

First Pillar Support: Taxation and Means Testing

- **Specific examples:**
  - No means testing (?):
    - US (except for "welfare") and SSI
  - "Clawback":
    - Canada
  - Full means testing:
    - Australia

The Australian First Pillar Targeted Age Pension

- Available to all

- Flat rate, but means tested (income and assets)

- High take-up

- Set at 25% of average male full-time earnings

First pillar support:
Taxation and means testing

- **Setting up the means test:**
  - How should we define the accounting unit?
    - Individual, family (married couple)
  - How is the non-means tested maximum set?
    - Below, at, above poverty line
  - What should the withdrawal rate be?
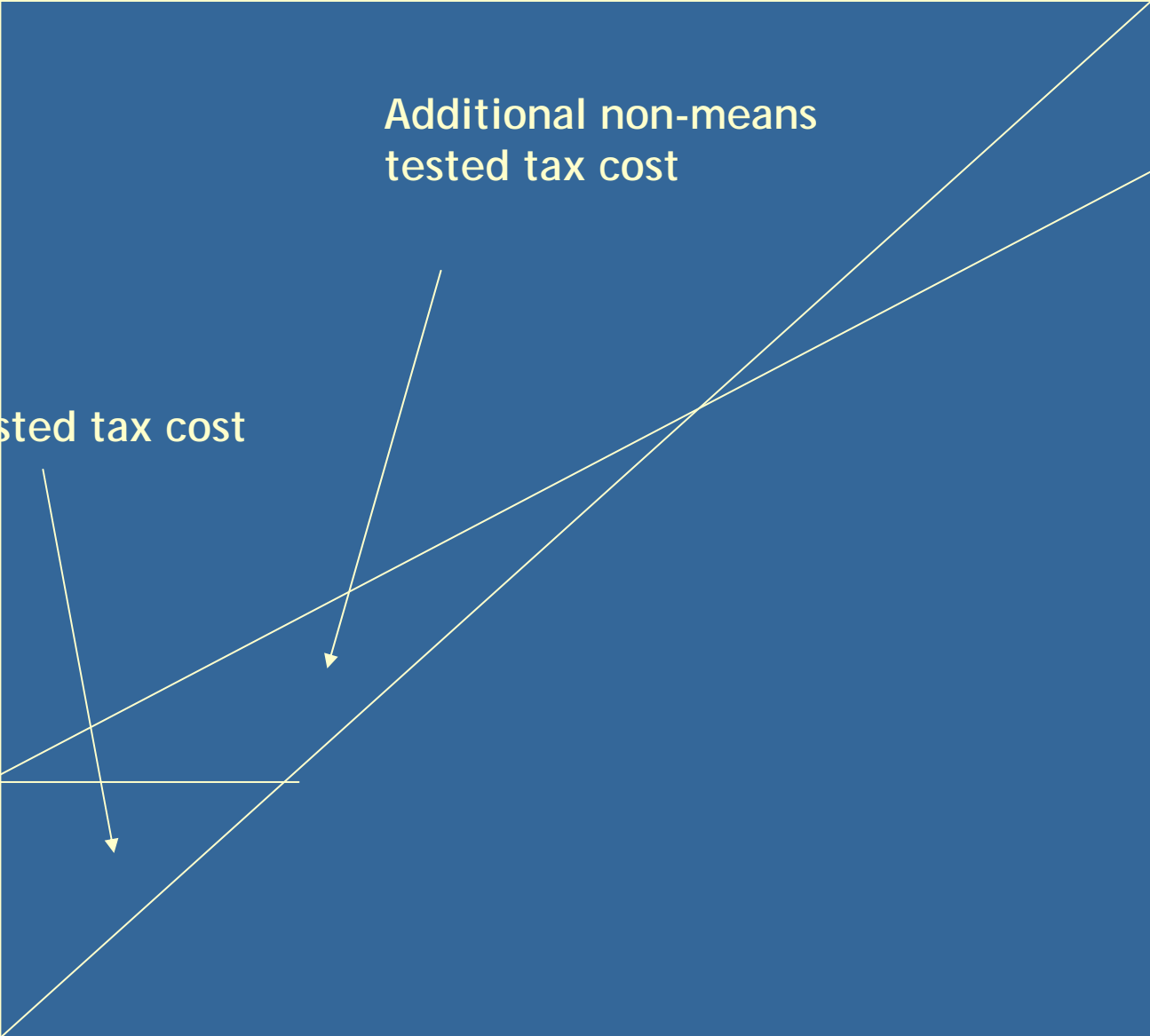   - This is the hardest question to answer.

Means testing the first pillar

Gross income

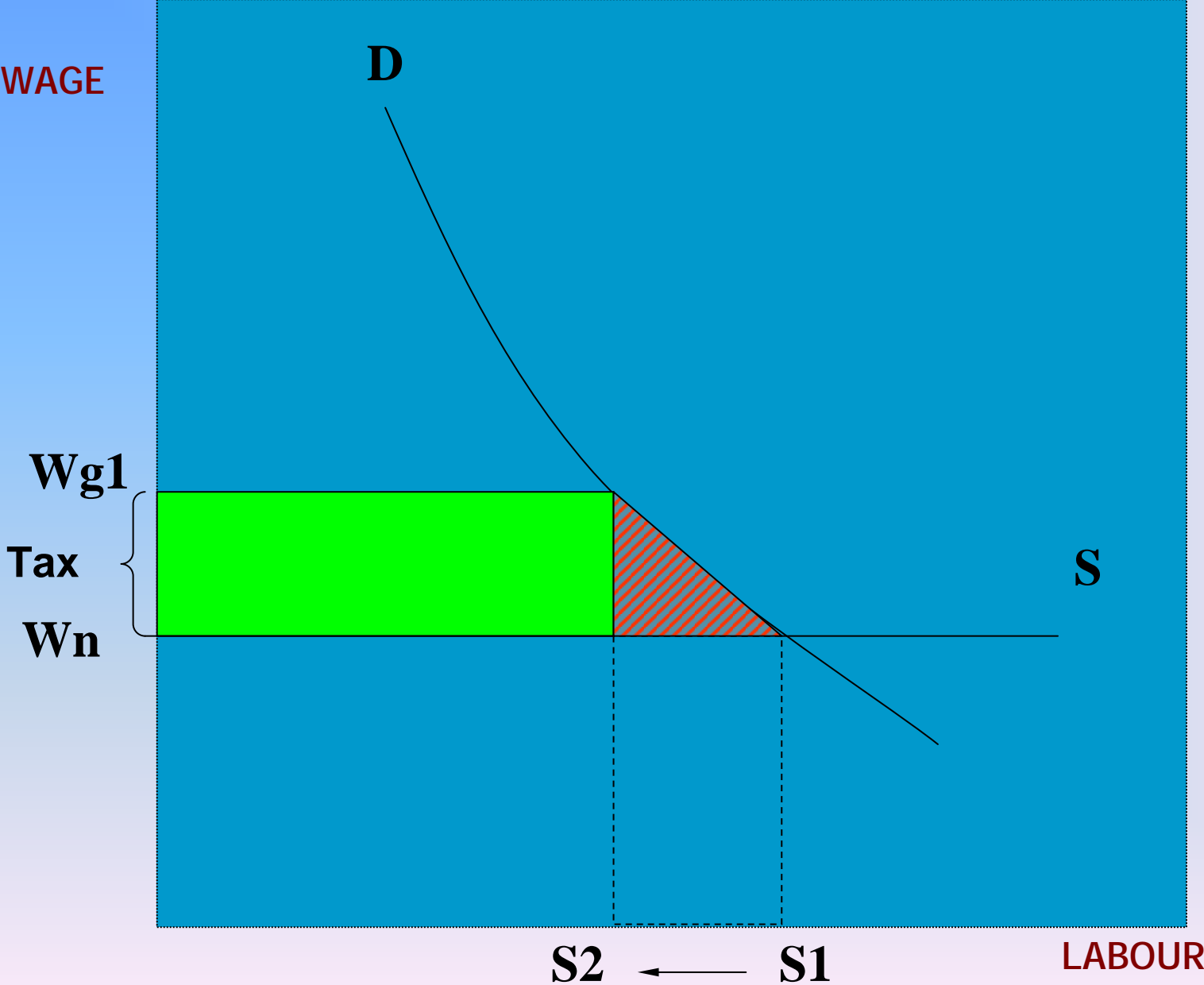Additional non-means tested tax cost
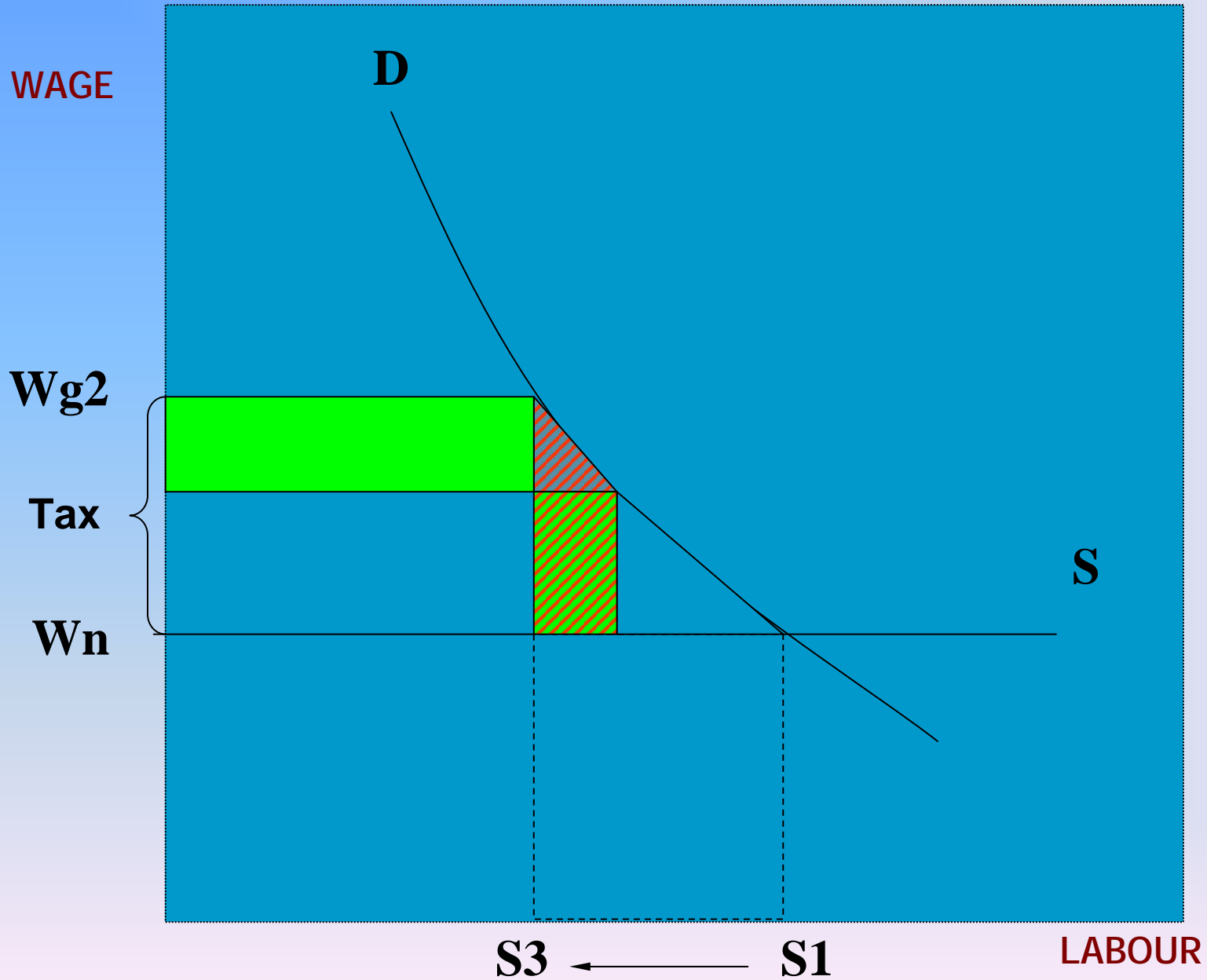
Means tested tax cost

M

Net income

Introduction of Income Tax

WAGE

D

Wg1

Tax

Wn

S

S2 ← S1

LABOUR

Impact of marginal tax increase

Notches and Tapers

Gross income

Additional non-means tested tax cost

Means tested tax cost

M

Net income

Conclusion

- Means testing is more common than is generally thought

- Necessary to consider the full differential impact of alternatives, for a given minimum income target

- A much better policy than many (especially economists and actuaries) think