MEDIA RELEASE

FinancialServicesCouncil.
growing and protecting the wealth of New Zealanders

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Economists need to engage in the discussions on how best to fund the costs of an ageing population

New Zealanders accept that with a rapidly growing population over 65 living longer in retirement, there will be in future increasing taxes to fund pensions, health and age care costs, shared between fewer working age taxpayers.

Most New Zealanders would be surprised if you told them that using savings to prefund post retirement costs like pensions, health and aged care is likely to be twice as efficient as funding those same costs from future taxation.

Economists who are familiar with the work of Nobel Prize winner Peter Diamond and former Council of Economic Advisers Chairman for President Reagan, Martin Feldstein, will know that provided the return on our invested savings is greater than New Zealand's productivity growth rate, then funding from savings is a lot more efficient than paying for those costs out of taxation. It will also be a fairer allocation of costs between the generations. In remarks prepared for delivery at the NZ Association of Economists Conference in Palmerston North he asked economists to speak out in the community wide discussions on the future funding of superannuation, health an aged care costs about the options available.

Later this year the Treasury will be reviewing its long term fiscal forecasts using a reference group of advisers. To get the best value out of that review it should include an examination of the work of Peter Diamond, Martin Feldstein and our own Andrew Coleman. They should also extend the usual time horizon for the long term fiscal forecasts out to the end of the century to see if a transition to more reliance on Save-As-You-Go, SAYGO (savings) than Pay-As-You-Go, PAYGO (taxation) is feasible, affordable and can be fair between generations.

In the conditions of New Zealand it is likely that using savings rather than taxation can fund more pensions, health or aged care for the same contributions or meet the same costs with lower contributions.

When we undertook the project that produced our report *Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders* I was surprised that the work of Peter Diamond and Martin Feldstein on the advantages of prefunding had not been part of the New Zealand fiscal sustainability and retirement policy debate to date.

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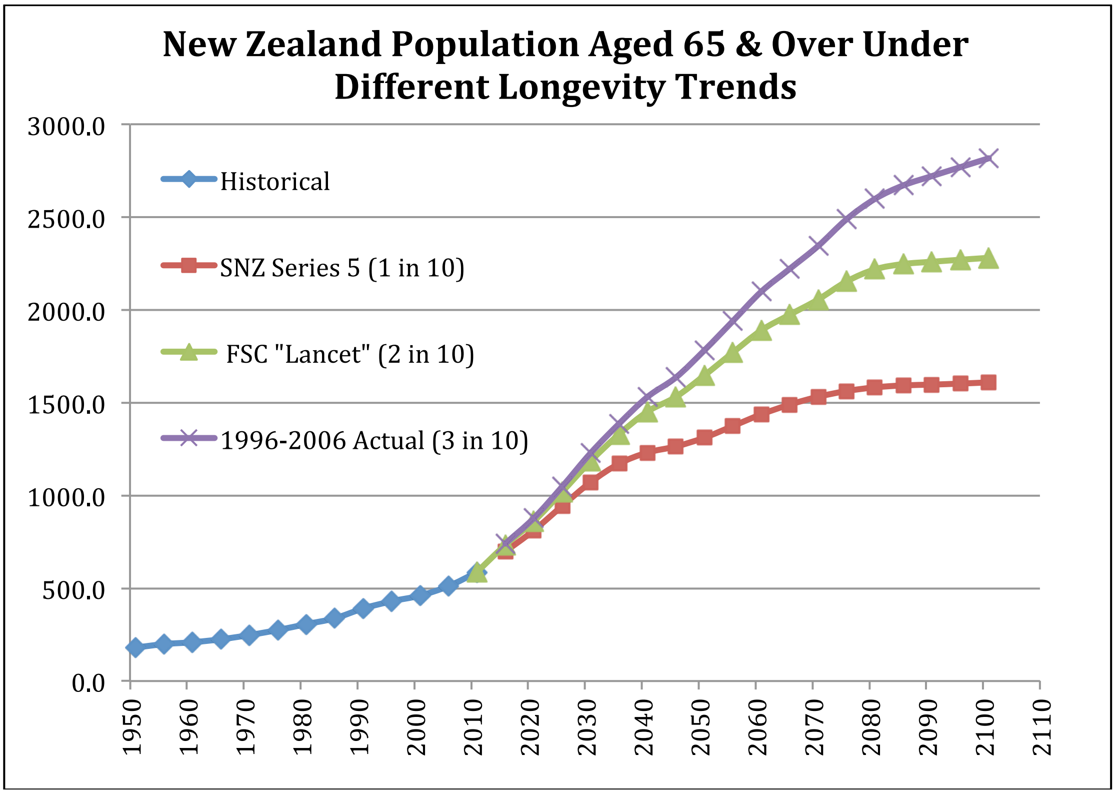
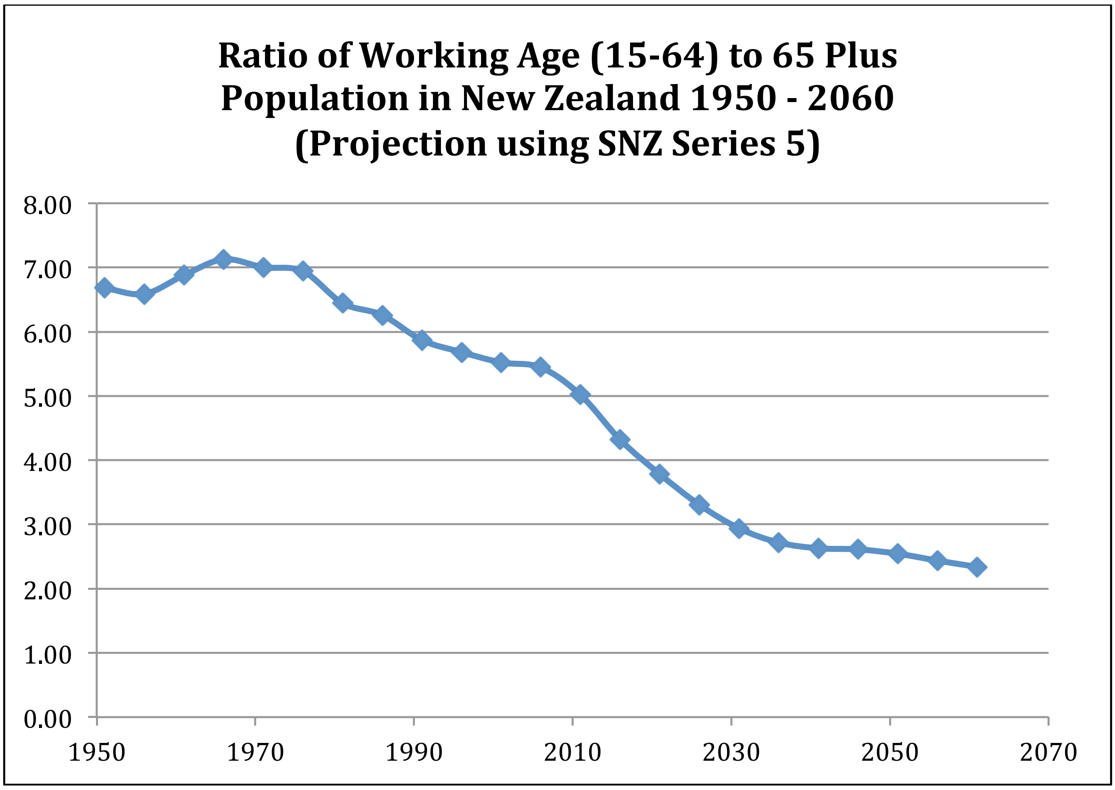
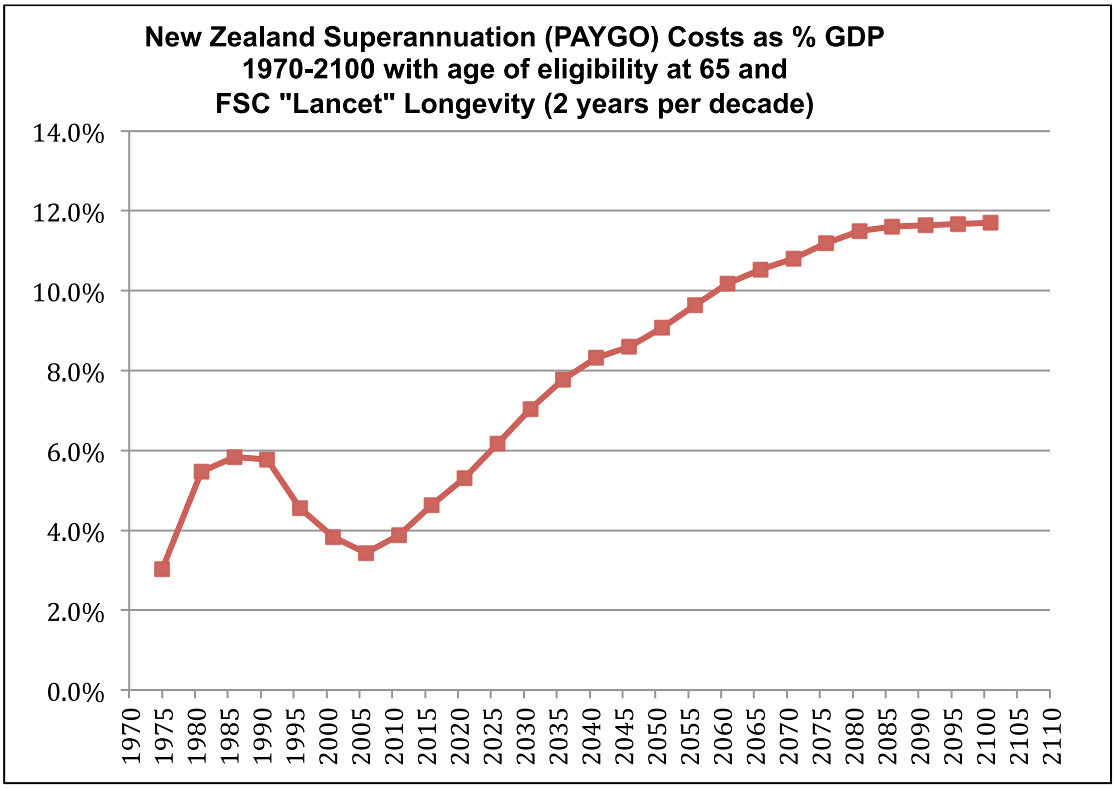


Sources:

- *Historical – NZ Stats*
- *Statistics NZ Series 5 - 1 extra year of life after each decade*
- *FSC "Lancet" Projections – 2 extra years of life after 65 each decade*
- *Recent NZ 1996-2066 Trend (ELL) – 3 extra years of life after 65 each decade*



Source: Infometrics from Statistics New Zealand



Source: Infometrics

Do we need to think about prefunding to smooth out tax burdens

The relative size of SAYGO and PAYGO pensions when rates of returns and productivity change.*

Real return	Labour Productivity growth rate	SAYGO Pension	PAYGO Pension	Ratio SAYGO PAYGO
Unfavourable conditions for SAYGO (low capital returns, high growth)				
3.0%	2.0%	35738	25982	1.38
Average conditions for SAYGO				
3.0%	1.0%	32072	16678	1.92
3.0%	1.5%	33804	20828	1.62
3.5%	1.5%	39921	20828	1.92
4.0%	1.5%	47252	20828	2.27
4.0%	2.0%	49638	25982	1.91
Favourable conditions for SAYGO (high capital returns, low growth)				
4.0%	1.0%	45111	16678	2.70

The pensions assume the average wage begins at $45000 and grows at the productivity growth rate. Each year a person contributes 10 percent of their income to either an accumulated SAYGO pension fund or to the government to fund a PAYGO pension. Pensions increase at the productivity growth rate. The working life is 45 years and the retirement period is 19 years. When the working age population increases by 0.25 percent per year, the cost of providing a PAYGO pension reduces by 10 percent.

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