



The Effect of NZ Superannuation eligibility age on the labour force participation of older people

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**Workshop on Labour Force Participation and Economic Growth,
Wellington 14 April 2005**

Outline of presentation

- The effects of public policy settings on retirement decisions
- International trends in labour force participation and retirement among older people
- New Zealand's dramatically different experience and the reasons for this difference
- Changes in the NZ public pension structure over the past 30 years have created a natural experiment
- Estimates of the effect of changes in the NZ Superannuation eligibility age
- Conclusions

Public pensions and the retirement decision

ref OECD: “Society at a Glance”, 2005 edition

- In many countries, the “official” age of entitlement to public pensions is now 65, for both men and women
- However, many people retire from the labour force earlier or later than this
 - OECD average “effective age of retirement” is 61.4 years for women and 63.3 years for men
 - In Korea and Japan the effective age of retirement exceeds the “official” age by more than 5 years, as people continue employment their old-age pensions
 - In some European countries, many people withdraw from the labour force in their 50’s

The role of pension policy design

- Clearly, many other factors influence individual decisions to move into retirement
 - Structural and cyclical conditions in the labour market
 - Health status
 - Spousal decisions and the nature of domestic obligations
- But the financial incentives incorporated in public pension system design can have a major effect on the decision when to retire
 - Compulsory retirement laws
 - Work-testing and tax treatment of pension entitlements
 - Options for early access to pensions
 - Pension levels relative to own earnings at a current age

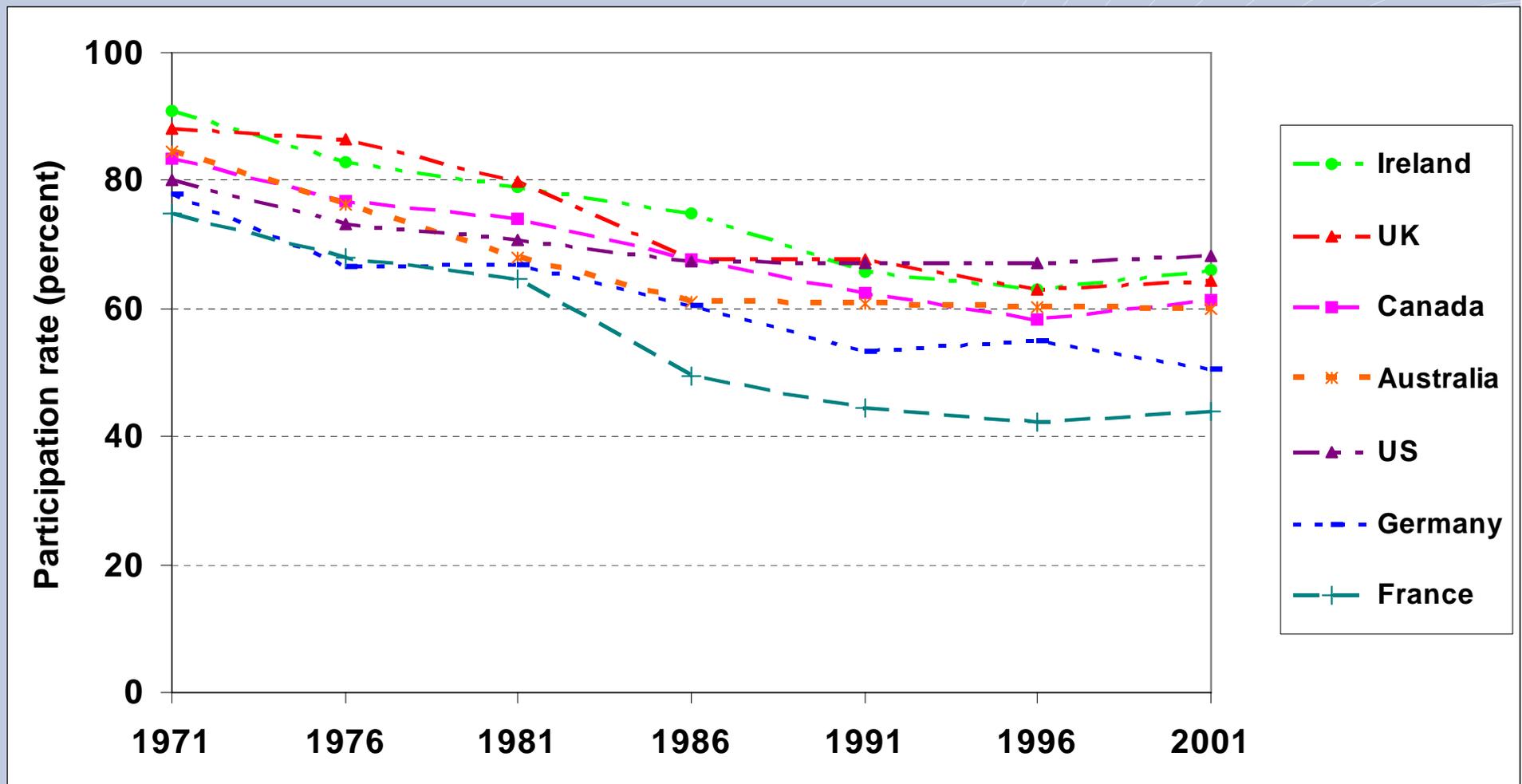
Implicit tax on an extra year's work

- The economic analysis of retirement decisions considers the NPV of alternative future earnings and pension streams, where pension entitlement varies with age and contributions
- The expected net return from working an extra year is equal to **Earnings \pm Change in accrued pension wealth**
 - In many countries this second term is negative:
 - i.e. the gain in pension benefit is insufficient to offset the loss of a year's benefit receipt, an implicit tax on work
- The absence of actuarially fair benefits from delaying retirement has discouraged working after the official retirement age and encouraged early retirement, in countries where this option is possible

But NZ's pension structure embodies different work incentives

- Discourages early retirement
 - Only income-tested benefits are available, at a lower rate than NZS
 - Individual entitlements mean that younger spouses do not generally benefit from their older spouse's retirement
- No penalty for working beyond age 65
 - No legislated compulsory retirement age
 - No implicit tax on earnings beyond age 65, since you can receive NZS while continuing to work

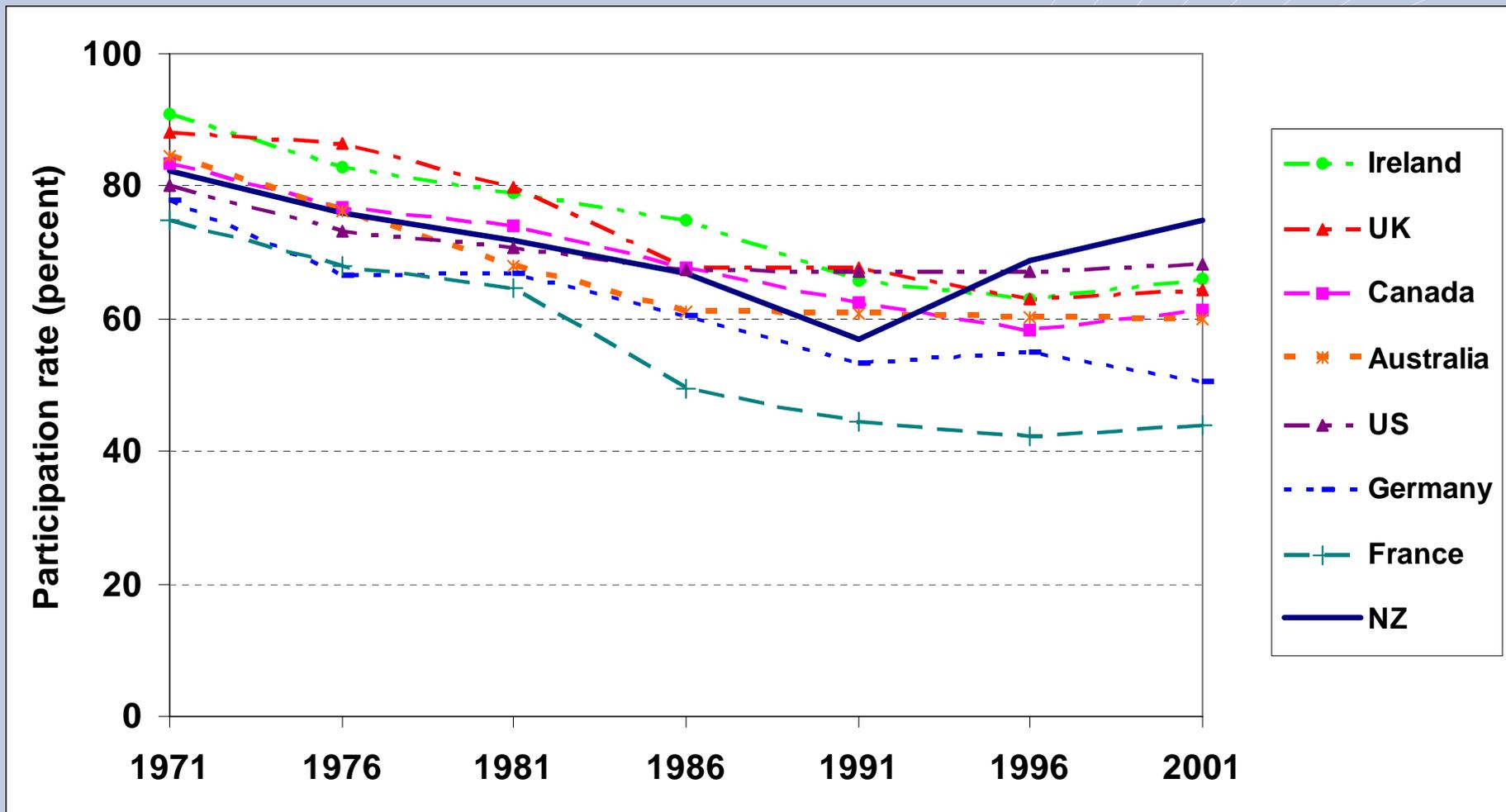
The trend to lower participation and earlier “full” retirement: Proportion of males aged 55-64 who are in the labour force



The trend towards earlier retirement

- “The decline in labour force participation of older persons is perhaps the most dramatic feature of labor force change over the past several decades” (Gruber and Wise)
- Reasons?
 - Increasing coverage and generosity of retirement benefits
 - Actuarially unfair returns from postponing retirement
- Some countries have introduced policies that are starting to slow or reverse this trend
- NZ followed this trend of declining labour force participation until 1991, when the the age of eligibility for the public pension started to be increased

The New Zealand policy response: Proportion of males aged 55-64 who are in the labour force



NZ system differences from rest of the world makes the age of eligibility a very sensitive policy variable

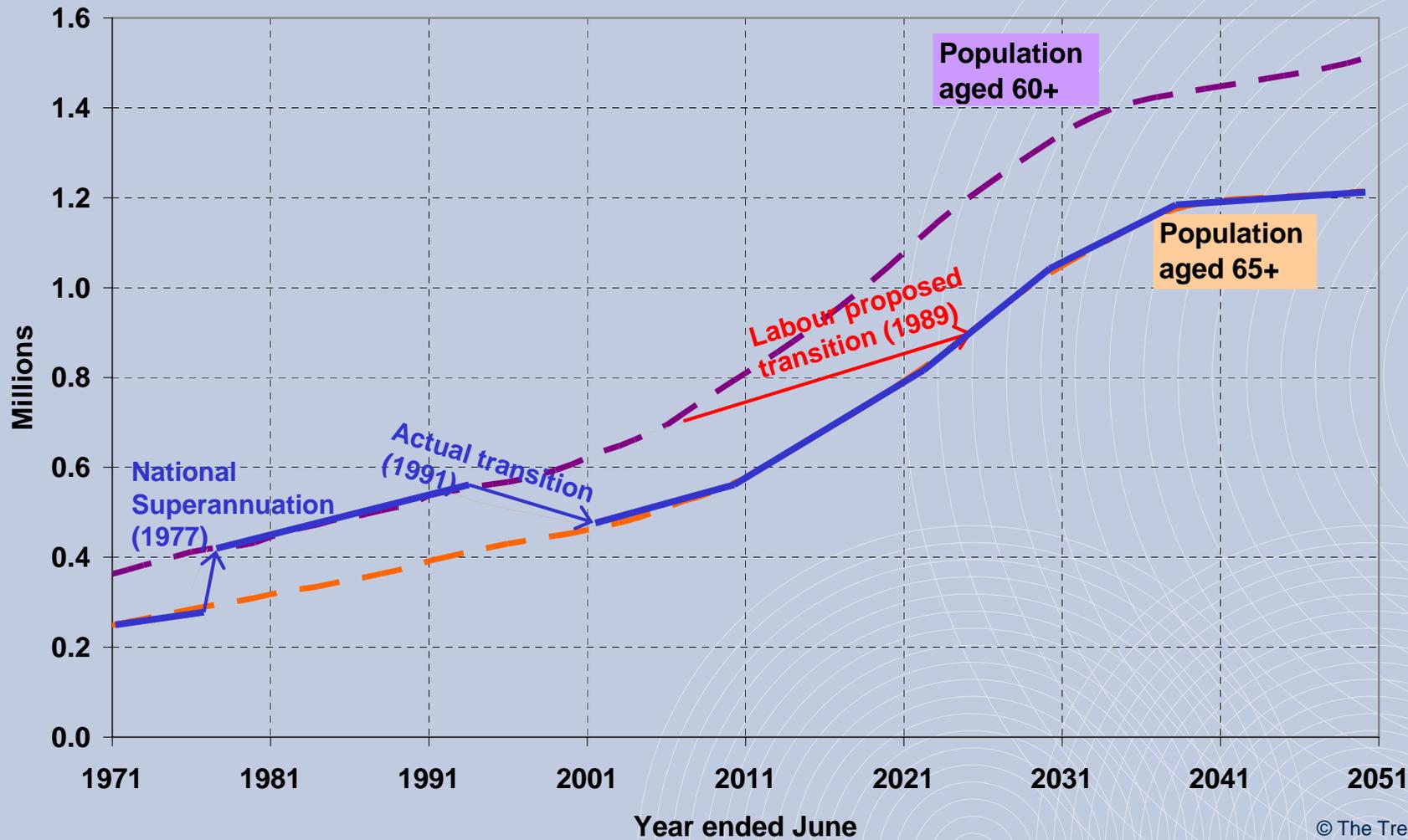
- NZ Superannuation is a simple, universal system
 - 98% coverage (only recent immigrants are ineligible)
- No eligibility for NZS before the “official” age of entitlement, i.e. no trade-off between the amount of NZS and when you start to receive it
- Low rates of private saving (associated with having a secure public pension guarantee) mean that fewer people can independently finance an early retirement
 - Only 40% of middle-age couples have superannuation assets, with median value of only \$30,000

Very rapid policy decision processes and transitions compared with other countries

Two policy changes in opposite directions help us to estimate the effects of eligibility age on labour force participation rates

- **Change 1** 1977: the qualifying age for universal superannuation was lowered from 65 to 60 years
 - Income-tested Age Pension was already available at 60 (claimed by about one-third of 60-64 year olds)
- **Change 2** 1992- 2001 : the qualifying age was increased progressively back up to 65 years
 - Short notice of the change meant disrupting the retirement plans of older workers
 - Transitional Retirement Benefit (income tested but not work tested) eased the transition

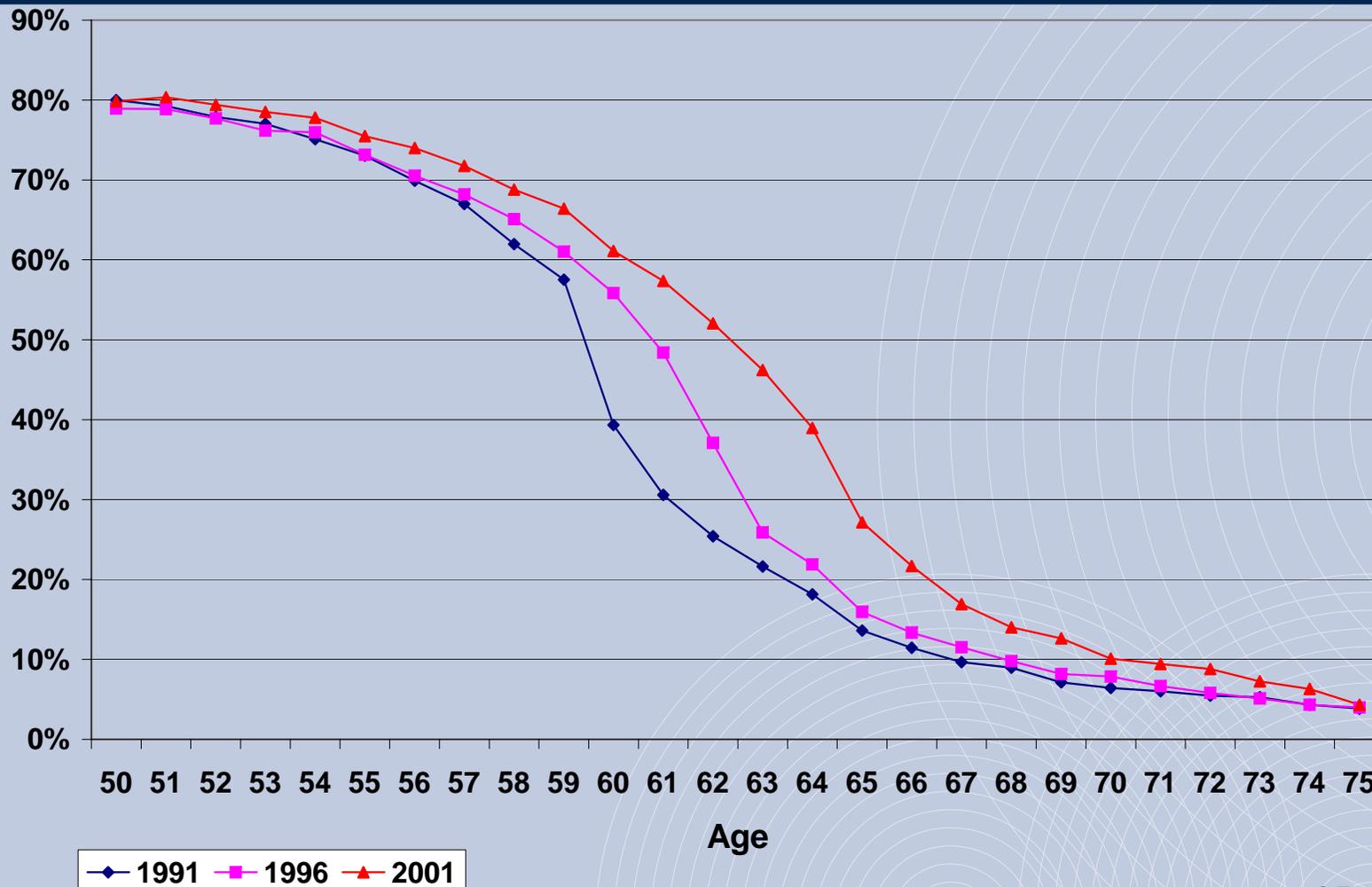
Superannuation age transitions in New Zealand



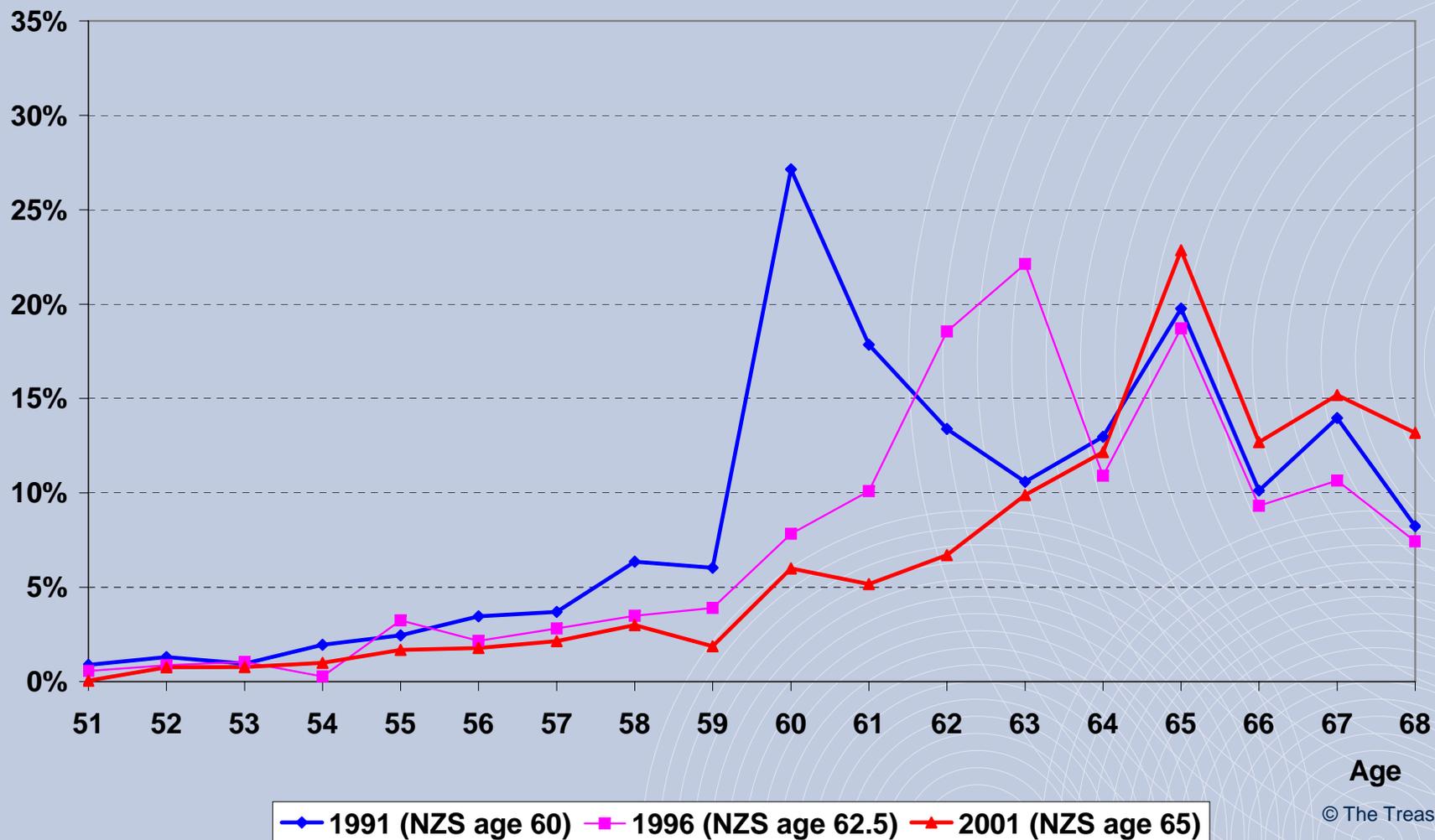
Stage 1: Change in labour force participation rates when age of eligibility fell to 60 years

| | Aged 45-49 | Aged 50-54 | Aged 55-59 | Aged 60-64 | Aged 65 + |
|----------------|-------------------|-------------------|-------------------|-------------------|------------------|
| Males | | | | | |
| 1976 | 97.8% | 96.0% | 90.8% | 59.6% | 19.7% |
| 1981 | 97.3% | 95.8% | 89.8% | 49.8% | 14.0% |
| Change | -0.3% | -0.2% | -1.0% | -9.8% | -5.7% |
| Females | | | | | |
| 1976 | 52.3% | 46.9% | 36.5% | 22.8% | 12.1% |
| 1981 | 64.4% | 54.4% | 39.2% | 16.5% | 3.2% |
| Change | +12.1% | +7.5% | +2.7% | -6.3% | -8.9% |

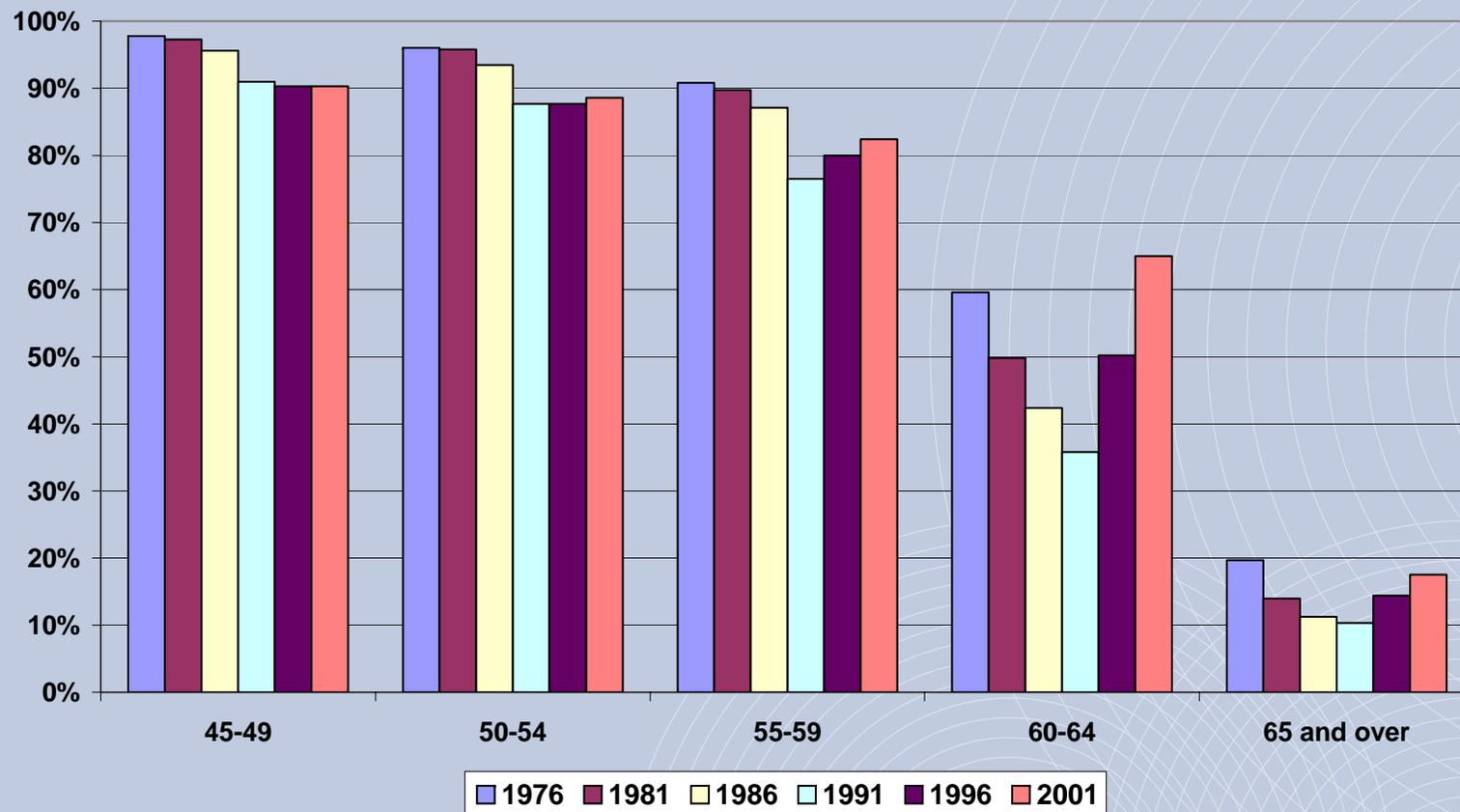
Changing full-time employment rate of males, by single year of age during the transition



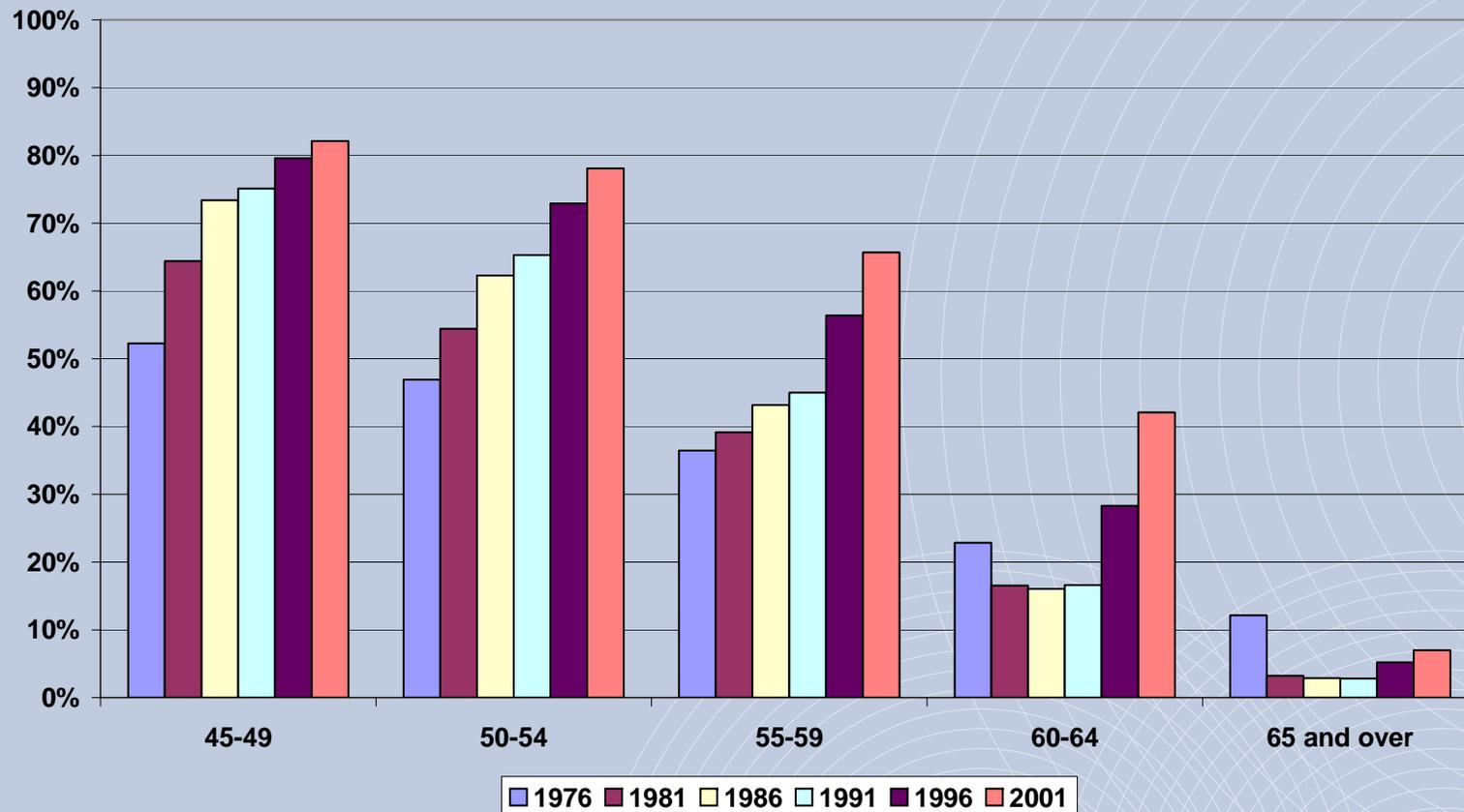
Exit work hazard rates for males: 1991, 1996 and 2001



Labour force participation rates of males, by age group, 1976 - 2001



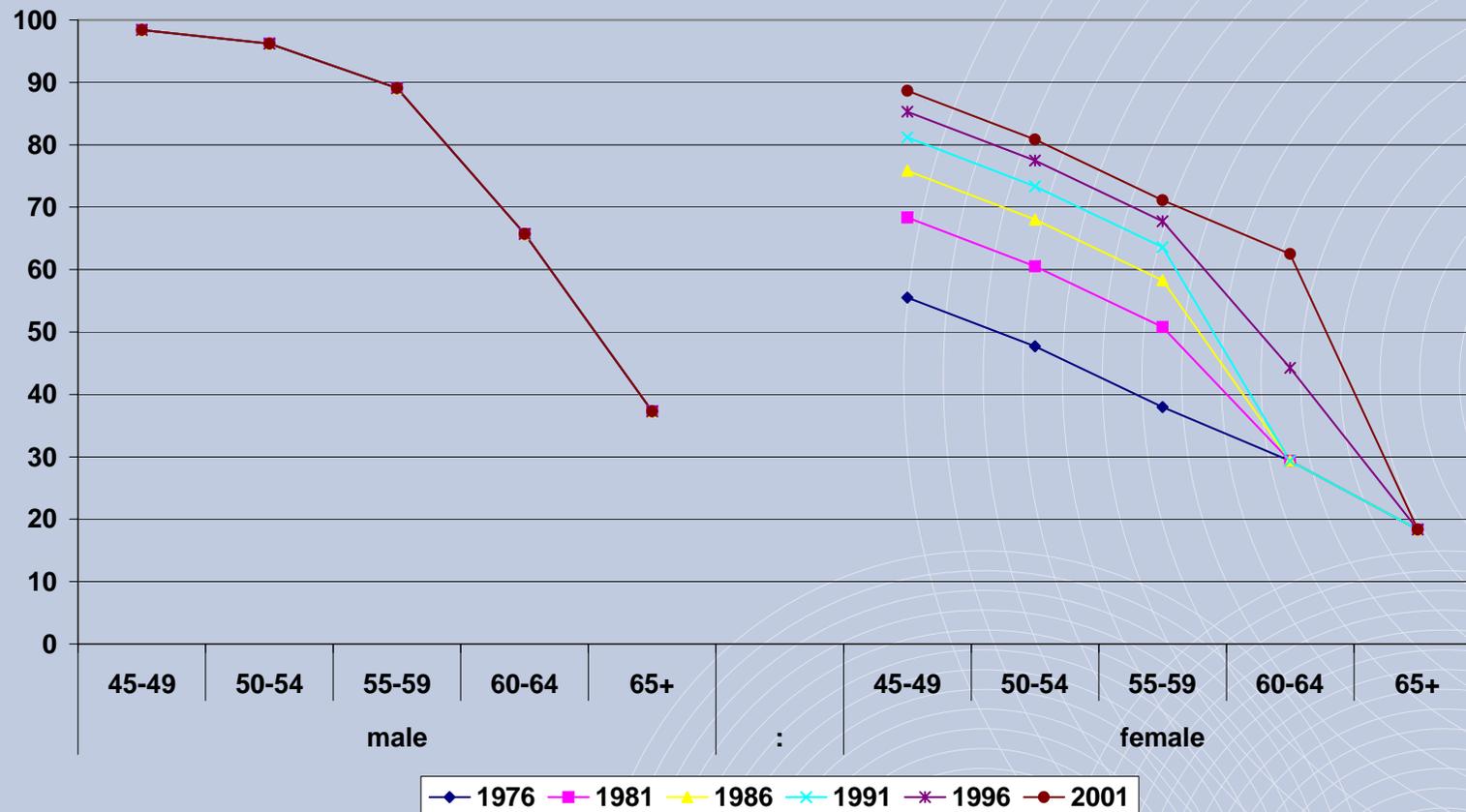
Labour force participation rates of females, by age group, 1976 - 2001



Estimating the effect of pension age eligibility on labour force participation

- Model to explain the participation rate of each gender/age group in each census year since 1976
 - 2 genders, 5 age groups, 6 census years = 60 observations
- Factors that influence a group's LFP:
 - Underlying age-related patterns of participation
 - Unchanging pattern in the case of males
 - Rising rates of participation among working age females (log time trend)
 - The general unemployment rate in each particular census year
 - High unemployment depresses LFP
 - The proportion of an age group that is eligible for a public pension in a particular census year (usually 0% or 100%, but sometimes mixed)
 - Whether a female is in the age group that is just prior to the eligible age group

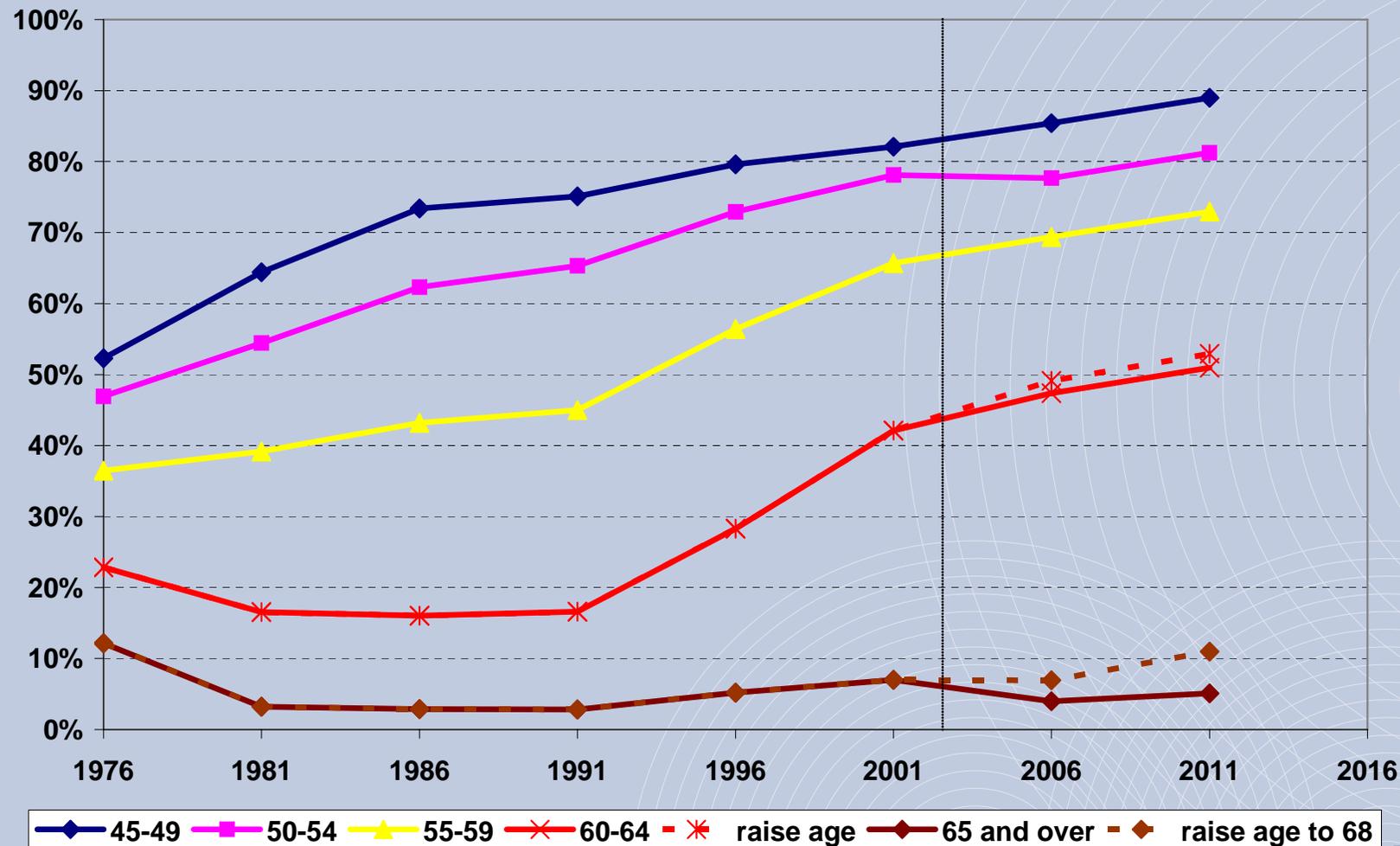
Estimated shape of the age/ participation curves for males and females (before NZS eligibility)



The estimated effect of NZS eligibility on labour force participation

- Males:
 - NZS eligibility for a particular age group reduces LFP by around 21 percentage points for that age group
- Females:
 - Being eligible for NZS reduces LFP by around 7 percentage points (from a lower base)
 - Being “close” to eligible reduces LFP by around 11 percentage points
- In 1991, if the eligibility age had been 65, not 60, then:
 - LFP of males aged 60-64 would have been almost 60% instead of under 40%
 - LFP of females aged 60-64 would have been over 30% instead of 17%, assuming they would have shared in the rising participation trend of working age females

Simulated participation rates of older females to 2011 (pension age 65 vs 68)



Conclusions

- NZ has succeeded in reversing the downward trend in LFP among older workers and enhancing the long-term fiscal sustainability of its public pension system
- The strength and rapidity of the response was due to some unique features and might not be repeatable in other settings
- Transitional adjustment assistance probably helped in ensuring public acceptance of the change
- The experience of delayed eligibility might induce greater voluntary saving in future amongst those wishing to finance an early retirement
- The structure of NZS avoids penalising those who choose to continue employment beyond age 65