

Saving and older (65+) people

Andrew Coleman, December 8 2010

Introduction

It is natural to assume that savings policies mainly affect working-age people, because most people stop working when they are older, and live off a pension or retirement savings. This need not be the case, however, as

- (i) retired people own a lot of the capital and earn a lot of the capital income in the economy;
- (ii) retired people can have a large effect on national saving rates, both because some save from their “incomes” and because the rate that they run down their wealth is an important component of dissaving;

This note outlines how saving policies could affect the asset holdings and saving rates of retired people.

(1) Asset holdings of retired people.

New Zealanders 65+ obtain between 60 and 70% of income from New Zealand superannuation (Statistics NZ, 2004). In addition, according to 2006 SOFIE data, (processed by Scobie and Henderson 2009) people over 65

- (i) are 17% of population over 15
- (ii) own 22% of net wealth in NZ;
- (iii) have average net wealth of \$320 000, 53% in housing, 9% in business assets, 9% in bank loans, 29% in other assets;
- (iv) have 35% of net bank loans and 27% of housing wealth in NZ
- (v) increased their *average* wealth by \$32000 between 2004 and 2006, mainly because of housing appreciation, and were responsible for 13% of total increase in wealth in NZ over this period.
- (vi) increased their *median* wealth by \$8000 between 2004 and 2006, but median wealth decreased by \$6000 excluding house price appreciation.

These figures exclude the implicit value of their New Zealand superannuation entitlements.

The data show retired people own a disproportionate amount of housing wealth and bank loans. Even though the average saving was positive, excluding housing wealth revaluations, most retired people are modestly dissaving.

(2) Aggregate saving and retired people

The aggregate household saving rate comprises the saving (and dissaving) of working age people plus the saving (and dissaving) of retired people. Changes in the number, resources and behaviour of retired people can have a major effect on the aggregate household and national saving rate. Unpicking how the spending of retired people affects national saving is a particularly thorny problem, however, as it goes to the heart of the private saving-government saving issue.

(a) If government pensions are funded on a PAYGO basis and are considered “income,” retired people appear to have saving rates near zero; different surveys measure them as small positive or negative numbers. The taxes paid by working age

people to fund these pensions are not considered saving either, even though working age people are not consuming this fraction of their income.

(b) If government pensions were prefunded, retired people would have large negative saving rates, as their spending would be financed by running down their prefunded pensions. (Jappelli and Modigliani 1998; Bosworth et al 2004). Working age people would have much higher saving rate, as the taxes they pay to fund pensions would be counted as saving. The total saving position added up *across* both groups would be the same, but the underlying income-consumption-saving flows would be much better identified.

For this reason, when making cross country comparisons of saving rates in countries with PAYGO funded health and pension systems, it is useful to examine consumption as a fraction of pre-tax income rather than saving rates out of after-tax income to ascertain whether working age people appear to be saving adequately.

(c) The rise in US health spending is responsible for 6 percentage points of the decline in saving in the US between 1960 and 1990. (Gokhale, Kotlikoff, and Sabelhaus 1996) In NZ, health spending increases have been smaller and only account for 1 percentage point of the decrease in national saving rates. (Coleman 2006). If government health expenditure were prefunded, it would become apparent that retired people have very large negative saving rates (old people consume much less than they produce), while working age people have much larger positive saving rates (they consume much less than they produce).

(d) U.S. evidence suggests that saving rates among the elderly rise with age. This is in part because older people reduce their spending in fear or anticipation of expensive accidents or health problems late in life. For this reason, the decumulation of assets slows as people get quite old.

(d) Older people leave inheritances of approximately \$4b per year (2% GDP) to non-partners (Briggs 2008). These are a non-trivial part of wealth flows. International evidence is unclear the extent to which these affect the saving of recipients, but it may be part of the reason why micro wealth data and macro flow data are so difficult to reconcile. (Bosworth et al 2004)

(3) Policy implications.

Policies that affect older people have both direct and indirect effects on aggregate saving rates. They have a direct effect on the saving rates of older people by altering their income streams or their consumption. They have an indirect effect on aggregate saving rates by altering the saving rates of working age people.

- (a) Economic policies can affect the labour and capital incomes earned by older people. The tax and benefit structure affect labour force participation rates, while the tax system affects the earnings from capital. Older people have a disproportionate fraction of the assets in loans, and thus are disproportionately affected by the lack of indexation. A move towards an expenditure tax (EET) rather than income tax (TTE) based system would ultimately increase the capital earnings of older people. The effect on saving depends on whether

older people raise their consumption or their saving. Nonetheless, reducing tax rates on capital income is likely to produce a modest increase the wealth of the country, even if old people spend all of their additional earnings. This is wealth is evenly spent during retirement (as it might be if it were paid out as an annuity) average wealth is increasing in after tax returns as a greater fraction of consumption withdrawals are capital income and a smaller fraction are capital consumption.

A reduction in capital income taxes would also provide greater incentives for old people to live in smaller houses and hold more of their assets in other investment forms, as the tax differential between owner-occupied housing and other assets is reduced. Over time, this would to increase the net foreign asset position (Coleman 2010)

- (b) In a PAYGO funded healthcare system, policies that increase health expenditure, which is disproportionately used by elderly people, tend to reduce saving rates. This is because taxes have to increase to pay for the health care, and some younger agents will lower their saving to pay them.

The overall effect of healthcare policies on national saving rates is difficult to ascertain. While microeconomic surveys suggest that old people dissave relatively little, macroeconomic evidence suggests that countries with higher fractions of old people save less. This is true even accounting for the way savings are estimated in countries with PAYGO pension schemes. Weil (1994) suggests the difference is due to the way working age people save when they expect or receive a bequest: in particular, bequests are partially consumed, and saving rates of those anticipating a bequest are low. The evidence is hard to unravel.

Trusts further complicate the situation. Older people requiring residential care can have part of the cost paid by the government if the value of their assets (including their home) is below a certain threshold. If a family home is owned by a trust, the value of this home is excluded from the asset test. Thus by placing a family home in a trust, older people can reduce the private cost of residential care. This policy is likely to reduce national saving, as rather than being used to pay residential care expenses, which are picked up the government, the family home supports the consumption expenditure of the other beneficiaries of the trust.

The overall effects of health expenditure on saving rates and wealth are unclear, but are likely to be detrimental to saving. This area warrants detailed investigation, as the health sector is a large part of the economy and it is likely to become more important as the number of older people increases.

References

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