CAN COUNTRIES IMPROVE THE DESIGN OF FINANCIAL INCENTIVES TO PROMOTE RETIREMENT SAVINGS?

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BETTER POLICIES FOR BETTER LIVES

Context

- Most countries use financial incentives to promote retirement savings
  - Tax incentives (deviation from "TTE")
  - Non-tax incentives (matching / subsidies)
- Financial incentives are costly

➔ Time has come to review the design of financial incentives and see whether there is room for improvement

Main conclusions

- Most common : “EET” tax incentive
- Positive overall tax advantage for average earners in all countries, usually varies with income
- Can be effective tools to promote retirement savings, with low-income earners more sensitive to non-tax incentives
- Total fiscal cost remains in the low single digits of GDP
- People may perceive economically equivalent incentives differently

→ Policy guidelines to improve the design of financial incentives

Financial incentives are useful tools to promote retirement savings

- Less effective at raising participation rates than compulsion and AE but still have an impact
- Higher public pensions could be paid by using the financial resources embodied in financial incentives
  - This would require individuals to contribute to non-incentivised plans, although at a lower rate, to reach the same level of retirement income
  - It is not clear whether, without financial incentives, individuals would save enough

Tax rules should be straightforward, stable and common to all retirement savings plans in the country

- People do not understand well different tax properties
  - Complex tax regimes that vary according to who contributes, the type of plan or the income level
  - Upfront taxation vs. taxation upon withdrawal
  - Tax credit vs. matching contribution

  ➔ Confusion
- Frequent changes to tax rules may reduce people's confidence in the system

The design of tax and non-tax incentives for retirement savings should provide at least tax neutrality between consuming and saving for all income groups

- The overall tax advantage is not the incentive to save
- The tax treatment of retirement savings should at least not discourage savings
- Need to check interactions with the public pension system and the general tax system as people will refrain from saving for retirement if doing so reduces their entitlements to public pensions or other forms of tax reliefs

Countries with an "EET" tax regime already in place should maintain the structure of deferred taxation

- "EET" tax regime: higher upfront fiscal cost at the introduction of the pension system
- Once the system is mature, rewards in the form of large tax collection on pension income arise

Countries should consider the fiscal space and demographic trends before introducing a new retirement savings system with financial incentives

- Fiscal cost depends on
  - Share of the population participating
  - Contribution levels
  - Tax regime (larger upfront cost with deferred taxation)
  - Maturity of the pension system
  - Demographics

Identifying the retirement savings needs and capabilities of different population groups could help countries to improve the design of financial incentives

- Provide an equivalent tax advantage to all income groups
  - Matching contributions (substitute or complement to existing tax incentives)
  - Tax credits
  - Fixed-rate tax deductions
- Low-income earners save too little compared to their savings needs
  - Non-tax incentives, in particular fixed nominal subsidies

Countries using tax credits may consider making them refundable and converting them into non-tax incentives

- Individuals with a low tax liability do not benefit from non-refundable tax credits
  - Make them refundable to increase the attractiveness of saving for retirement for low-income earners
- The value of the credit may not be saved in the pension account
  - Pay the credit directly into the pension account to help individuals building larger pots to finance retirement ➔ matching contribution/subsidy

Countries need to update regularly tax-deductibility ceilings and the value of non-tax incentives to keep the attractiveness of saving for retirement

- Tax-deductibility ceilings for contributions tend to be updated yearly in line with inflation only
  - More individuals are likely to reach the ceiling over time and reduce their contributions to retirement plans
- Keeping the same value of non-tax incentives over time may reduce the attractiveness of saving for retirement and lower the positive impact on participation
  - Maximum matching contribution, subsidy

QUESTIONS / DISCUSSION

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