This study is in the development stage. Following approval of the study at the June meeting the OECD Secretariat has developed the initial set of methodological approaches that are presented in the document. They will now consider any comments and begin to undertake the analysis presenting draft or interim results at the June meeting.

The current document outlines the methodological approach that is proposed for two of the five main elements of the project – to develop comparable indicators of the value of the incentives that are provided in various countries and to estimate the total costs of financial incentives. The document initially presents some very theoretical discussion and analysis of different forms of tax treatment that vary with the provision of tax exemption at different stages of a retirement savings system (income receipt, investment earnings and distribution). It then compares tax exemption to provision of credits (or matching contributions) to illustrate how the value of the form of incentives (or subsidies) varies by income – making the general point that credits provide a different distribution of value that may be less a function of income and provide greater value to lower income groups.

The document then proposes the development of two indicators to evaluate the level of the financial incentives afforded to qualified retirement savings in a country: (1) the value of a monetary unit of contribution and (2) the total value of financial incentives per individual. It proposes a third part of the analysis to measure the costs of “tax expenditures” for retirement savings in different countries.
The first two parts of the study are proposed to be done by calculating the present value over a defined period of incentivized pension savings in comparison to two benchmark non-retirement savings vehicles, the most popular non retirement savings instrument in the country and a standard savings account. The first indicator would estimate the value of incentives by positing a constant contribution by a hypothetical individual at five year age intervals, estimating the implied taxes that would be paid on each contribution over the full cycle from accumulation to distribution. A simple average of the present value of taxes for all of the age intervals would then be used to estimate the tax that would ultimately be paid on the accumulated saving. A similar calculation would be made for an equivalent flow of savings in the two benchmark vehicles that are not afforded the preferential tax treatment. The difference between the estimated taxes would provide an indicator of the value of the incentive. Each of these calculations would use a combination of assumed parameters (e.g. portfolio composition and returns for asset classes) and observed average parameters such as the tax rates for different age intervals and family status in each country. This would then be extended to a parallel analysis that divides the contribution between the individual and contribution from an employer and public source. This would utilize the potentially differing tax treatments between the sources to provide an alternative indicator.

The second part of the analysis would estimate the total value of the lifetime incentives provided to different types of individuals. It would first calculate the total present value of the incentives for an individual at the average income and other characteristics. It would then vary a wide range of these characteristics to estimates how much the value would change for individuals with differing characteristics.

The final analysis proposed would estimate a fiscal indicator by calculating the “foregone revenue” resulting from the tax treatment (and presumably any other financial incentives) that are provided. This would be the net of revenues foregone on contributions and subsidies and those collected on distributions from the retirement system.

**Proposed Comments**

1) In general the proposed methods contemplate a very ambitious and complex set of analysis that will involve extensive data collections and calculations. The original project planning document distributed at the June meeting defined objectives for the project ranging from documenting the different types of incentives provided in OECD countries, developing some comparable indicators of the value of these and evaluating the relative effectiveness they are having in facilitating retirement savings. It is not clear how the measures that are proposed in the current document will contribute to the key policy evaluation issues of the relative effectiveness of incentives. Given the likely challenges of obtaining the
relevant information and undertaking the complex calculations that are proposed, consideration should be given to a less ambitious initial approach. It is not clear from the presentation the number of countries that are anticipated to be covered in this initial phase and what type of information defining the parameters of the tax system are available or have been collected. A more prudent approach to such a study would be to define the scope and collect the descriptive information about the differing tax regimes or other incentives before seeking to undertake such an ambitious analytical effort. Assembling this descriptive information is one of the objectives of the study and would be a valuable product by itself that would be available much earlier than such a complicated analysis.

2) As noted in the comments from the Investment Company Institute (ICI) that were provided in their presentation at the meeting, the overall approach uses two concepts in an interchangeable manner resulting in some confusion. The methods proposed estimate the tax benefit derived from saving within a tax qualified retirement savings vehicle relative to a benchmark alternative. This is measure is then interpreted as the incentive to save. This appears to be confusing the two concepts. The incentive to save is the after tax rate of return. These concepts should be clarified and clearly distinguished in the formulation and interpretation of the analysis.

3) In the second element of the methodology employer contributions are treated as subsidy or alternative incentive. In general, mainstream economic theory treats employer contributions as an alternative form of compensation that is fully offset by a reduction in other compensation rather than an addition to overall compensation. While there remains a divergence of opinion on where the incidence of these costs actually resides (especially over the short term), this mainstream equilibrium formulation should be addressed in any methodology that seeks to consider employer matching contributions or even matching contributions from a public source.

4) In some of the forward looking measures that are proposed the assumed rate of return is greater than the discount rate. It is not clear what the justification for this difference may be and it will skew any analysis of the value of the tax benefit upward. There should be a clear justification for any differences or the rates should be equivalent.

5) There is no discussion of how the indicators that are proposed might be used to compare the outcomes and relative effectiveness of the differing types of financial incentives which is the ultimate objective of the study. At a minimum it should be made clear in the presentation how the proposed indicators would be interpreted and how they would provide a statistic that enables comparison of the various systems. Ideally some discussion of how they would be employed in
the effectiveness analysis would enable some consideration of whether such a complex analytical effort is worth the resources required.

6) The indicators that are proposed use a combination of observed parameters (eg marginal tax rates, family status) common assumptions (eg portfolio composition) and behavioral assumption (form of distribution at retirement age). Implicit in this approach seems to be an effort to evaluate the outcomes specific to an individual country to estimate the value of the incentive. Introducing behavioral parameters that will be determined by a wide array of factors specific to any country environment however risks reducing the comparability of the indicator across countries. It would be very helpful to better understand the rationale behind the decisions that have been made about these choices and the inherent tradeoffs behind the decisions.

7) The usefulness and feasibility of the alternative indicator that assumes a combination of employer and government matching (para 42 and 43) is not obvious. For most countries there is no established tax treatment for such a contribution and the division among the two sources appears to be arbitrary. Some further explanation of linkages to the broader purpose of the project to understand the relative effectiveness of tax exclusion versus matching contribution is required to understand why this particular method is deemed to worth the effort.

8) The final element of the methodology, the calculation of foregone revenue as a measure of the overall level of “tax expenditure” appears to be inconsistent with the objectives of the project and potentially misleading. While a common measure used as fiscal scoring of legislation or year to year measurements of changes in individual countries this measure, as noted, is determined by the individual demographic, system design and other factors that would not seem to make it very useful for a cross-country comparison of the effectiveness of incentives.