Submission

By

BusinessNZ

to the

Savings Working Group

on the

Issues Relating to the Savings Working Group's Terms of Reference

15 October 2010

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ISSUES RELATING TO THE SAVINGS WORKING GROUP'S TERMS OF REFERENCE
SUBMISSION BY BUSINESSNZ[1]
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1. INTRODUCTION

1.1 BusinessNZ thanks the Savings Working Group (SWG) for its invitation to contribute on issues relating to the SWG's terms of reference.

1.2 Given the wide range of issues that need to be addressed, we support the Government setting up a group consisting of private sector experts on the issue of savings in New Zealand. While we address specific issues that the SWG will examine, we also believe there are some areas that the SWG must address to ensure a robust and comprehensive final report is presented to the Government.

2. SUMMARY OF RECOMMENDATIONS

2.1 BusinessNZ makes the following **recommendations** with regard to the terms of reference, namely that the Savings Working Group:

(a) ***Examine existing empirical evidence regarding savings in New Zealand (p.3);***

(b) ***Examine New Zealand Superannuation, welfare policy and student loans in the context of savings in New Zealand (p.5);***

(c) ***Identifies ways in which the Government could undertake further fiscal discipline, thus reducing the period of deficits and increasing the efficiency of Government spending (p.6);***

(d) ***Notes that surpluses beyond those required for identified fiscal expenditure and debt repayment should be returned to the taxpayer via lower tax rates (p.6);***

(e) ***Examines options for the Government to further reduce personal tax rates to increase competitiveness and boost the ability to save (p.7);***

(f) ***Does not recommend that a dual income tax system to be introduced in New Zealand (p.8);***

(g) ***Supports the indexation of the tax system, in particular for personal income tax brackets (p.9);***

(h) ***Notes any consideration of making KiwiSaver compulsory will require a significant and robust analysis of the issues compulsion will need to address (p.11); and***

[1] Background information on Business New Zealand is attached in appendix I.

(i) ***Notes that any changes to KiwiSaver subsidies should involve at a minimum the removal of the yearly government contribution of up to $1,042 per year per member (p.12).***

3. PREVIOUS BUSINESSNZ WORK ON SAVINGS

3.1 BusinessNZ's level of involvement in savings/superannuation/retirement issues has generally been restricted to those where the issues directly impact on employers. The last time BusinessNZ submitted on such issues was in 2006, when the KiwiSaver Bill was before the Finance and Expenditure Select Committee[2].

3.2 KiwiSaver introduced a fundamental step change in how New Zealanders save for retirement. BusinessNZ are supportive of the Government introducing a work based savings regime that would become available to all workers, provided it was warranted and would not place heavy compliance costs on employers. In light of this, our major recommendations at the time were that:

- The Bill did not proceed until further sound and objective research was conducted which overwhelmingly concludes that the KiwiSaver scheme is warranted; and

- The Government seriously considered future emphasis on financial literacy programmes for workers that the Retirement Commission was undertaking, including any necessary increase in funding given the apparently poor understanding of New Zealanders of the need to save for retirement.

3.3 While the latter recommendation has seen movement via financial literacy programmes established for both workers and students, it was disappointing to see that our former recommendation was not implemented. A comprehensive investigation into the issue of savings and KiwiSaver in 2006 would have assisted in answering many questions involving savings that still cause debate.

3.4 Notwithstanding the views expressed above, KiwiSaver has gone on to sign up over 1.6 million New Zealanders, as discussed in section 5 below. While the introduction of KiwiSaver has become a significant element of savings in New Zealand, the issue of savings remains complex and far reaching.

4. ESTABLISHMENT OF SAVINGS WORKING GROUP & TREASURY PAPER

Establishment of a Savings Working Group

4.1 BusinessNZ supports the establishment of a Savings Working Group (SWG), which in many respects is similar to the establishment of the Tax Working Group (TWG) in 2008. We found the process by which the TWG investigated issues, called for advice from both the private sector and from officials, hosted

[2] http://www.businessnz.org.nz/file/1040/060428%20KiwiSaver%20Bill%20Submission.pdf

a one-day conference and delivered a final report to the Government, created a useful blueprint which could be used for other policy issues of national importance.

Previous research undertaken

4.2 As the SWG rightly point out, *'other savings related areas include the availability and quality of relevant statistics, the drivers of saving in the government, household, business and external sectors, the significance of inflation, taxation (in various forms), markets and regulations'*. To assist the SWG in this regard, Treasury released a paper entitled *Saving in New Zealand – Issues and Options*, which provides a high level discussion of savings matters.

4.3 We accept that the paper is high-level, and designed to *provoke debate and discussion* by touching upon various issues the SWG should consider when examining saving in New Zealand. We agree with elements of the paper, especially the sections that argue for examining student loans and New Zealand Superannuation, both of which have a significant impact on national saving, as part of the broader debate (discussed below).

4.4 However, we believe Treasury missed an important opportunity to provide the SWG with a comprehensive summary of research involving savings in New Zealand. Despite the perceived view that the savings question remains largely unanswered, there have been a number of studies undertaken in recent years that try to ascertain whether there is a savings problem. These include:

- NZIER Working Paper 2007/01: Does New Zealand have a Household Savings Problem;
- MOTU: Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family Income and Employment
- New Zealand Treasury Working Paper 01/18: Household Saving Behaviour in New Zealand: A Cohort Analysis

4.5 What these papers tend to indicate is that the broad public opinion is far from certain that New Zealand has a savings problem. Therefore, we believe the SWG should take the opportunity to review recent empirical findings on savings in New Zealand

Recommendation: That the Savings Working Group examines existing empirical evidence regarding savings in New Zealand.

BusinessNZ paper on savings

4.6 One of BusinessNZ's recent developments has been the establishment of the Major Companies Group (MCG), which helps ensure that New Zealand's largest companies are heard in policy, business and economic debate. The MCG is a working group currently consisting of 60 members, with a collective weight of influence that enables it to provide strong counsel to Government and other key decision makers.

4.7 At the request of the MCG's CEO Forum, following the establishment of the SWG BusinessNZ prepared an information paper examining savings in New Zealand. From our perspective, our submission to the SWG and the information paper are interlinked to provide an overall view of where BusinessNZ sits in terms of the savings as an issue. However, given the SWG has requested that submissions be brief, the information paper has been included as appendix II of this submission. While our submission covers the main points for the SWG to consider, we would encourage the Group to also read the information paper as well.

5. SAVINGS WORKING GROUP TERMS OF REFERENCE

5.1 The terms of reference for the SWG will play a fundamental role in determining the approach the SWG will take to the practical menu of options to be presented to the Government by January 2011. As the SWG has invited comment on any of the issues within its terms of reference, we would like to comment on the following:

Out of scope areas

5.2 Any proper examination of policy should be based on sound research that covers the wide spectrum of issues relating to the policy in question. When the SWG was announced, the media release by the Minister of Finance stated that it *'has a wide brief to consider how New Zealand can improve its national saving'*, and *'we have deliberately set wide terms of reference for the Working Group'*.

5.3 However, the Minister went on to say that *'the only exclusions are New Zealand Superannuation, which this Government will not change, and broad taxation of capital gains or land, which we have previously said we will not introduce'*. We note that the restrictions placed on the SWG via its terms of reference go even further than he Minister indicated. They state that *'the group is not expected to discuss the parameters of New Zealand Superannuation or other specific forms of benefits/income support (which are currently being addressed by the Welfare working Group')*. <u>We strongly disagree with this stance</u>. New Zealand superannuation and forms of benefits/income support play a significant role in relation to savings issues in New Zealand. SWG's brief is nowhere near as wide as it needs to be.

5.4 For instance, the New Zealand Superannuation (NZS) fund within the context of savings will soon be one of the most important matters New Zealand will need to address. For the year ended June 2010, National Superannuation expenditure equated to over $8 billion per annum or around 13% of total Core Crown expenses. To put this expenditure in context, it is the third highest level of expenditure after Health ($12 billion) and Education ($11 billion). Forecasts show NZS payments increasing over time as the population continues to age. Just over 500,000 New Zealanders currently receive NZS (around 12% of the population). This is projected to increase to around 600,000 by 2013.

5.5 Social assistance programmes such as Working for Families (WFF) is currently apply to about 300,000 New Zealand households, equating to a total cost of around $2.2 billion for 2010. In addition, the student loan scheme has become anything but a loan. As the Treasury paper correctly points out, in 2009/10 the Government lent $1.5 billion in student loans, but the expected cost to Government is $728 million. Therefore, nearly half of the value of the loan is written off when it is drawn down.

5.6 Similar groups established by Government have examined and noted such problems. In one of its final recommendations to Government, the TWG stated that there should be a comprehensive review of welfare policy and how it interacts with the tax system, with the objective being to reduce high effective marginal tax rates.

5.7 In summary, any discussions and conclusions reached by the SWG will fall short of reaching a well informed and comprehensive solution if 'gorillas in the wardrobe' such as NZS, WFF and interest free student loans are not considered. As we will mention below, once the fundamental question is asked regarding the future direction of KiwiSaver as one of the key aims of the SWG, any prohibited areas will produce an ill-informed outcome.

Recommendation: That the Savings Working Group examines New Zealand Superannuation, welfare policy and student loans in the context of savings in New Zealand

Policy aims of the Savings Working Group

5.8 The most important section in the terms of reference relates to the three broad policy aims that the SWG is expected to consider:

1. **Fiscal policy** - the role of Government saving as an important component of national saving, including potential long-term saving/debt targets and any offset between Government and private saving.

2. **Taxation** - the impact of the tax system, particularly taxation of capital income, on the level and composition of national saving and investment decisions, and options for improvement. These will include, but are not limited to:

    - The case for moving to a dual income tax system, whereby labour and capital income might be taxed at separate rates;
    - Indexation or partial-indexation of the tax system so that real, rather than nominal, income is taxed.

3. **KiwiSaver** - the role of KiwiSaver in improving national saving outcomes. This will include, but is not limited to:

    - Considering options to improve the operation and outcomes of KiwiSaver. This will include options where KiwiSaver is both voluntary and compulsory; and
    - The fairness and effectiveness of current KiwiSaver subsidies.

5.9 BusinessNZ agrees that each of the three broad aims identified in 5.8 above are critical in developing sound public savings policy for the future. Therefore, we wish to comment on each.

FISCAL POLICY

5.10 BusinessNZ agrees that the role of Government saving is critical in national savings, including potential long-term saving/debt targets and any offset between Government and private saving.

5.11 We support the Government's intent to return to a surplus position, as Government needs to ensure spending discipline that increases the effectiveness of spending, as opposed to raising more revenue.

5.12 However, as mentioned above and discussed more broadly in appendix II, the SWG is essentially hamstrung regarding the proper examination of the Government's fiscal policy because of areas it may not examine. These areas combined, make up a sizeable proportion of current Government expenditure.

5.13 We have noted similar concerns with the TWG process, where the tight terms of reference under which the TWG worked essentially meant engaging in a balancing act between revenue raised and revenue spent. Like a business, this is looking only at one side of the equation, the issue of expenses also needed to be examined. While this Government has announced various cost saving measures since it came into office, there does not appear to be a sizeable drive towards making the most efficient use of the estimated $59b the IRD collects annually.

5.14 From BusinessNZ's perspective, there are various components of Government expenditure that the SWG could note as ways in which to bring about further fiscal discipline, and hasten the speed at which the Government will move out of persistent deficits and begin to record surpluses.

Recommendation: The Savings Working Group identifies ways in which the Government could undertake further fiscal discipline, thus reducing the period of deficits and increasing the efficiency of Government spending.

5.15 Notwithstanding our recommendation above, the other point we wish to make regarding fiscal policy is that while a drive towards annual surpluses is welcomed, we would want the SWG to recognise the fact that <u>expanding</u> surpluses should not be the core aim of Government. Technically, any surplus above that needed to fund fiscal policies and pay off debt is essentially an economic loss to the taxpayer, and can create the type of inefficient and politically charged spending that occurred during much of the last decade.

Recommendation: The Savings Working Group notes that while the push towards Government surpluses is welcomed, surpluses beyond those required for identified fiscal expenditure and debt repayment should be returned to the taxpayer via lower tax rates.

TAXATION

5.16 In relation to the issue of fiscal revenue/expenditure, BusinessNZ believes the best policy direction the Government can take involves a continued push towards lower company and personal tax rates. This was recommended by the TWG, with steps down that route introduced for the 2010 Budget. In our letter to the Minister of Revenue regarding the TWG's final report, we advocated for tax rates that are internationally competitive, primarily funded by an increase in GST given the Government's fiscal neutral stance.

5.17 However, we also stated after the announcements in the 2010 Budget that the proposed changes should be viewed as the first round of tax policy modification. New Zealand simply cannot afford to consider its current settings good enough to remain internationally competitive, especially if we wish to compete with Australia and aim towards achieving income parity with our Trans-Tasman neighbours by 2025.

5.18 Therefore, we would encourage the SWG to examine tax policy changes that would encourage the Government to further reductions in tax rates.

Recommendation: That the Savings Working Group examines options for the Government to further reduce personal tax rates to increase competitiveness and boost the ability to save.

5.19 The terms of reference outline two further taxation issues to be examined by the SWG:

Dual income tax system

5.20 The SWG has been asked to examine the case for moving to a dual income tax system, whereby labour and capital income might be taxed at separate rates. We note that the TWG already examined this issue as part of their 4th session in October 2009. The summary notes of the session concluded that:

> *The group considered that the dual income tax (Nordic) system was not a good option for New Zealand, primarily due to its bias against risky investments and entrepreneurship. Other concerns with dual income taxes included the treatment of employee shareholders (for example, in closely held companies), and the differences between NZ and other tax systems that have implemented dual income taxes (in particular, NZ's high labour mobility). The group also noted the complexity of the system for administration.*

5.21 The final report of the TWG summarised the advantages and disadvantages of the dual income system, with the latter significantly outweighing the former. In addition, the TWG also examined a hybrid version of the dual income tax system with allowance for corporate equity (the Sorenson & Johnson model). However, a number of additional problems were identified, with the TWG noting *'that if company and personal tax rates could be reduced to moderate levels as suggested in this report, the extra complexity and implementation risk of the Sorenson and Johnson proposal would not be warranted'*.

Therefore, it was no surprise that no form of dual income tax system was recommended in the TWG's final report to Government.

5.22 Last, consideration of the dual tax model is nothing new. The McLeod Tax Review of 2001 also examined the dual tax system, and concluded that it did not have merit in the New Zealand context. When compared with the TWG report, its irrelevance received even greater recognition, with the option omitted from the 2001 Review's issues paper, and not discussed in any way in its final report.

5.23 Given this system has been examined by experts involving two separate reviews, we believe the model has already been adequately discussed, and found not to be suitable for the New Zealand context.

Recommendation: That the Savings Working Group does not recommend that a dual income tax system to be introduced in New Zealand.

Indexation of the tax system

5.24 BusinessNZ has long advocated the introduction of some form of indexation of the tax system, so that real, rather than nominal, income is taxed. While a combination of tax cuts and changes to thresholds over recent years have helped mitigate some of the negative consequences of failing to introduce indexation, the absence of systematic indexation can quickly erode taxpayer earnings. This usually happens by way of 'bracket creep', where more and more wage and salary earners move into higher income bands.

5.25 To illustrate this point, in 1998 there were a significant number of tax changes. However, it was not until October 2008 that any further changes were made for the benefit of wage/salary earners. From 1998 to 2008, average incomes rose by approximately 61%[3], and cumulative inflation increased by around 27%[4]. Compounding this was the introduction of the top tax rate of 39% for those earning more than $60,000 in 2000. Although originally intended to apply to the top 5% of income earners when introduced, by 2008 the top tax rate ended up capturing 15% of income earners.

5.26 At one level, we would expect the Government to continue tax reduction policies and take steps to move tax brackets further up the scale. Such policies would assist in alleviating bracket creep. However, history shows that reductions in tax rates and changes to tax brackets often occur irregularly. While we accept that yearly indexation would involve certain administrative and compliance costs, we would support moves by the SWG to consider some form of tax indexation, though not necessarily yearly. Tax indexation would apply often enough to balance the administrative/compliance costs with changes that ensure business/personal income does not suffer adversely from inflation.

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[3] According to Statistics NZ's *New Zealand Income Survey*, average weekly incomes rose from $425 per week in the June 1998 quarter to $684 per week in the June 2004 quarter.
[4] According to Statistics NZ's *Consumer Price Index*, the CPI rose from 833 for the December 1998 quarter to 1061 for the June 2008 quarter.

Recommendation: That the Savings Working Group supports the indexation of the tax system, in particular for personal income tax brackets.

KIWISAVER

5.27 As discussed in section 3 above, BusinessNZ submitted on KiwiSaver when it was in discussion document and Bill format. It has now become a fundamental component of private savings for retirement. However, there are various elements to KiwiSaver that we believe require examination by the SWG.

If compulsion is the answer, what is the question?

5.28 When the Government announced the establishment of a SWG to the general public, various commentators and organisations tended to engage in knee-jerk reactions regarding the possibility of making KiwiSaver compulsory. Instead, we believe it would be better to ask some fundamental policy questions when examining whether or not compulsion is needed.

5.29 Probably the key policy question that should be at the forefront of this discussion is <u>**why should KiwiSaver be made compulsory?**</u> In other words, what form of market failure has there been that requires a fundamental shift in Government policy? Some of the reasons for compulsion outlined by various commentators have tended to concentrate on:

- Greater level of overall savings
- Enhanced capital markets
- Decrease in the need to borrow
- Greater understanding and education about financial markets and products.

5.30 However, the list above all involves <u>outcomes</u>. In other words, it addresses the question of what might occur if KiwiSaver were compulsory. The reasons given do not indicate why KiwiSaver should be made compulsory. From our point of view, if we were to break the issue down to its simplest form, compulsion should only be implemented for the following reason:

A compulsory KiwiSaver scheme should only be introduced if there is an identified significant lack of future funds to ensure most at risk workers will receive an adequate level of retirement income.

5.31 Therefore, rather than focus on issues such as enhanced capital markets and boosting overall savings levels, we prefer to break the issue down to its core, and examine whether a worker receiving the average income in New Zealand will receive an adequate level of retirement income from Government in the future if a compulsory workplace savings scheme is not introduced. If the SWG were to examine the issue from this perspective, then the relationship between fiscal, taxation and KiwiSaver policy becomes crucial.

5.32 To illustrate the importance of examining fiscal, taxation and KiwiSaver issues together, any of the bullet points raised in 5.29 above can be achieved via other policy outcomes. For instance, a greater level of overall savings could be reached via reduced tax rates so that people have additional after-tax income. Capital markets can be assisted by Government looking to part or fully privatise various State Owned Enterprises. Decreasing the need to borrow can come about by further moves towards financial literacy and education, while the last point can be enhanced by greater public/private sector collaboration.

5.33 One could argue that what we have proposed could also be achieved via other policy outcomes. We agree. That is why we have highlighted at the start of section 5 the need to have no 'no-go areas', and to allow for all major fiscal spending areas to be examined.

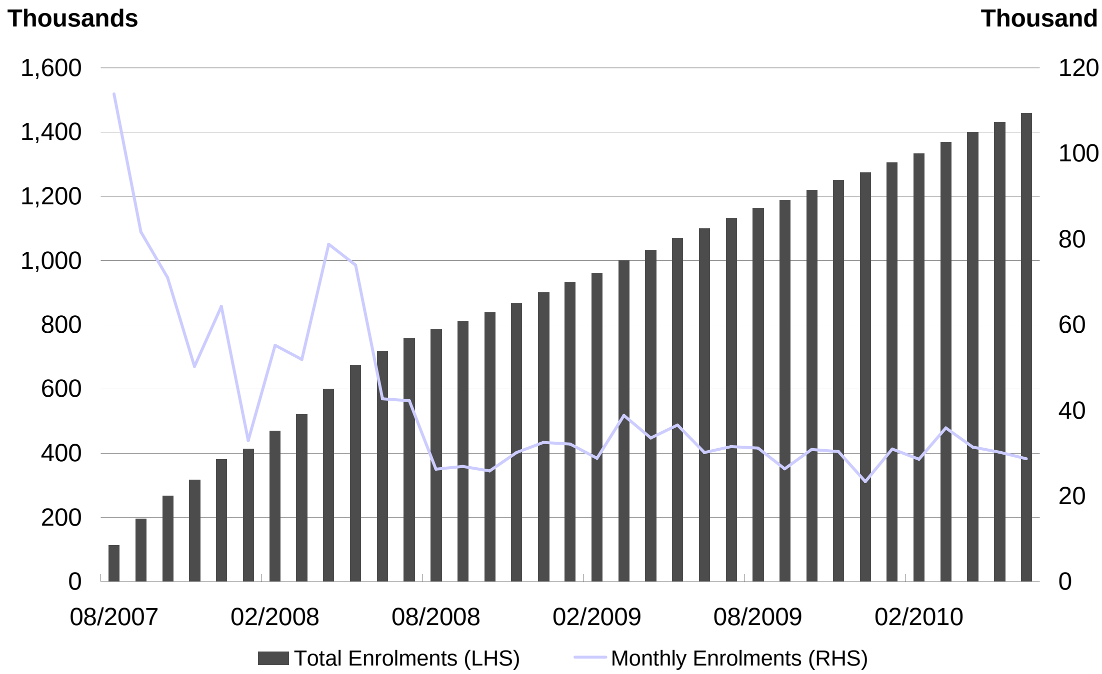
5.34 BusinessNZ believes any moves towards compulsion have significant wide-ranging policy hurdles to overcome before compulsion is given any serious consideration by either the SWG or the Government.

KiwiSaver enrolments – numbers talk

5.35 Putting aside the fundamental policy questions we have raised above regarding compulsion, if looking simply at KiwiSaver from the view of how successful it has been with its track record of enrolments, one can claim it to be very effective in getting New Zealanders to save some of their income for their retirement.

5.36 Figure 13 of the Treasury paper (copied below) outlining KiwiSaver enrolments from 2007-2010 show an upward and consistent trend in terms of enrolments. Latest statistics show the working age population to be 1,662,000 in the June 2010 quarter. Those in the total labour force come to 1,234,000[5]. KiwiSaver enrolments as at the end of June come to 1,460,000. While total enrolments do not equal the total number still in the scheme due to retirement or contribution holidays, around 85% remain with the scheme.

[5] Household Labour Force Survey, June 2010 Quarter, StatisticsNZ.



5.37 Simply put, the graph creates a compelling visual argument in terms of anyone questioning the need for compulsion. Monthly enrolments have averaged out at around 30,000 since November 2008. What is even more interesting is that the recent economic recession appears to have had little effect on people signing up for KiwiSaver.

5.38 Overall, the policy hurdles required to introduce compulsion, combined with the reality of where current enrolments sit, means BusinessNZ does not support KiwiSaver becoming compulsory until there has been a significant and robust analysis of why this should happen.

Recommendation: That any consideration of making KiwiSaver compulsory by the Savings Working Group will require a significant and robust analysis of the issues compulsion will address.

KiwiSaver subsidies – a necessity or an addiction?

5.39 From BusinessNZ's perspective, the current subsidies provided to those who join KiwiSaver are considerable, and in many cases provide a persuasive reason to sign up. As well as the $1,000 initial contribution, the Government then provides up to a maximum of $1,042 per year, depending on the contribution level of the individual member. There is also an employer contribution of 2% to match the minimum employee contribution. However, over time this will typically be treated as a cost inclusion in an employees remuneration package, rather than cost-plus. In addition, those not in the labour force (but younger than 65) can still sign up and receive an initial $1,000 from the Government, including those under 18 years of age.

5.40 Looking at a counterfactual of no subsidies, it is obviously difficult to establish how successful or otherwise KiwiSaver would be in terms of enrolments.

However, given the generous subsidies currently available, it makes intuitive sense that the enrolments for KiwiSaver would most likely be significantly lower than those we see today.

5.41 From BusinessNZ's perspective, we would not recommend further subsidies be added to KiwiSaver as these are already significant. Of the three broad subsidies mentioned in 5.39 above, the employer subsidy took some time to work through and is now at a stage where we would not want further change. That leaves the initial $1,000 contribution and the yearly subsidy of up to $1,040 as the two main areas for change.

5.42 In terms of long-term cost, we do not believe the initial $1,000 subsidy provides a significant fiscal issue for Government. It is a one-off cost, which in nominal terms has cost Government close to $1.5 billion from 2007 to June 2010. However, the yearly government contribution is an area which we believe does need revision. Simple put, the greater the enrolment number, the greater the annual cost to Government the subsidy will be given around 81% of KiwiSaver members are in the labour force. Current numbers would mean the annual cost to Government could reach as high as $1.2 billion, or 2.1% of total revenue collected by IRD.

Recommendation: Any changes to KiwiSaver subsidies should involve at a minimum the removal of the yearly government contribution of up to $1,042 per year per member.

APPENDIX I

6. About BusinessNZ

6.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association, Employers Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), its 60 member Major Companies Group comprising New Zealand's largest businesses, and its 76-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is New Zealand's largest business advocacy body. BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

6.2 In addition to advocacy on behalf of enterprise, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

6.3 BusinessNZ's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.

APPENDIX II

SAVINGS AND INVESTMENT INFORMATION PAPER

SUMMARY

Issues surrounding savings and investment have been given significant oxygen of late, with the recent establishment of the Savings Working Group headed by Kerry McDonald (supported by a secretariat from the Treasury), which is scheduled to report back to the Minister of Finance in January 2011. A copy of BusinessNZ's submission to the Savings Working Group is attached as an Appendix to this paper for your information.

It is important that increased saving should not be seen as an end in itself but more as a means to an end. Ultimately, there is no optimal level of savings in an economy, or necessarily for households, as the level of savings required will be depend on a huge number of factors and the trade-offs individuals and Governments are prepared to make.

It is important to note that *if* BusinessNZ does in the future support the introduction of compulsory superannuation (either as a stand-alone scheme or subsidised as is the current KiwiSaver scheme), there will be implications, by default, for our policy positions on other major government expenditure decisions, namely unemployment, sickness and invalids benefits, as well, potentially, for our policies on education and health (given an ageing population). This point should not be taken lightly.

There is no silver bullet to improving savings rates. Changing tax rates and/or tinkering around the margins with the rules relating to investment in housing are simply likely to encourage individuals to shift to whatever investments are the most favourable at any particular time.

Fundamentally, the more important issue which we as a nation should address is to how to raise productivity in the NZ economy to improve income levels and hence the ability to make choices in respect to savings and consumption over time. The focus clearly needs to be on improving the competitiveness of the NZ economy as outlined in Section 4(a)(i) – (viii) of this paper.

<u>Introduction</u>

The purpose of this paper is to unbundle the issues and make them more digestible. <u>The paper deliberately avoids making specific recommendations as the intent is to inform and guide policy discussion. The issues are significantly more complex than is often realised and knee-jerk reactions can be unhelpful.</u>

For ease of reference, the paper is divided into the following sections:

(d) ***Compulsory Superannuation savings e.g. making Kiwisaver compulsory)***

- ***(i)*** ***Impact on employers***
- ***(ii)*** ***Impact on self-employed and employees (ability to pay)***
- ***(iii)*** ***Impact on the net savings rate***
- ***(iv)*** ***Implications of compulsion on broader Government policy decision-making and funding***

Section 1. Common myths surrounding savings

There are four common myths surrounding savings that need to be debunked up-front.

(a) Higher savings improve economic performance

Data from the Organisation for Economic Cooperation and Development (OECD) show that there have been countries which have traditionally performed well with relatively low savings rates (e.g. the United States), and there have been countries with high savings rates (e.g. Japan) which have had mediocre economic performance.

The data which shows country savings rates and growth in per capita output between 1997 and 2007 tends to suggest that there is little direct relationship between savings and economic performance.

This should not be interpreted as meaning savings do not matter but rather that there are many ways of financing investments. With international markets open for investment, it is relatively easy to re-allocate investments (savings) from one country to another.

(b) NZ has a major savings problem

There have been a number of studies undertaken in recent years that try to ascertain whether or not there is a savings problem. These include:

- NZIER Working Paper 2007/01: Does New Zealand have a Household Savings Problem;
- MOTU: Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family Income and Employment
- New Zealand Treasury Working Paper 01/18: Household Saving Behaviour in New Zealand: A Cohort Analysis

What these papers tend to indicate is that broad public opinion is far from certain that New Zealand has a savings problem. Hence, one of BusinessNZ's key recommendations to the Savings Working Group was that they take the opportunity to review recent empirical findings on savings in New Zealand.

(c) Compulsory savings will raise national savings

There is little concrete evidence to suggest that compulsory savings will impact on the overall savings of a country.

Australia's experience suggests that national savings may increase slightly as a result of savings compulsion but the evidence is mixed. It appears that Australia's Superannuation Scheme has had a small impact on the country's savings rate but it is clear that many Australians have simply switched savings vehicles, or offset savings with higher debt.

As stated later, the determinants of a country's savings rates are complex and will be impacted upon by a number of factors.

(d) Compulsion is the best policy for raising national savings

This is highly debatable, given the number of tools which can be used to impact on savings (e.g. taxation policy, government re-distribution (social welfare) policies etc). Given evidence from overseas, including Australia, compulsory superannuation is unlikely to be a panacea for NZ's relatively low savings rate.

Given the high take-up of KiwiSaver to date (likely to be largely driven by Government subsidies) as outlined later in this paper, it could almost be concluded that NZ has a quasi-compulsory savings scheme anyway.

Section 2: What is NZ's savings and investment position?

There are a number of key indicators to NZ's savings and investment position.

At the outset, it is important to understand that debt can be broken down into household, business and government debt. While from an international perspective it probably does not matter significantly where the debt lies, in international markets it is government debt that more often raises concerns and generally comes in for greater scrutiny than private sector debt.

Given the recent global financial crisis, there is significantly more concern about sovereign risk and the importance of maintaining prudent levels of debt.

(a) NZ's overseas debt position

According to figures sourced from the Reserve Bank of NZ, New Zealand's overseas debt in March 2010 stood at $244 billion (130%) of GDP. The bulk of this debt was owed by the corporate sector ($220 billion or 117% of GDP) with official Government debt making up the balance.

As Table 1 below shows, total overseas debt has continued to rise over the last 15 years despite some change in its distribution.

Table 1: NZ's Overseas Debt

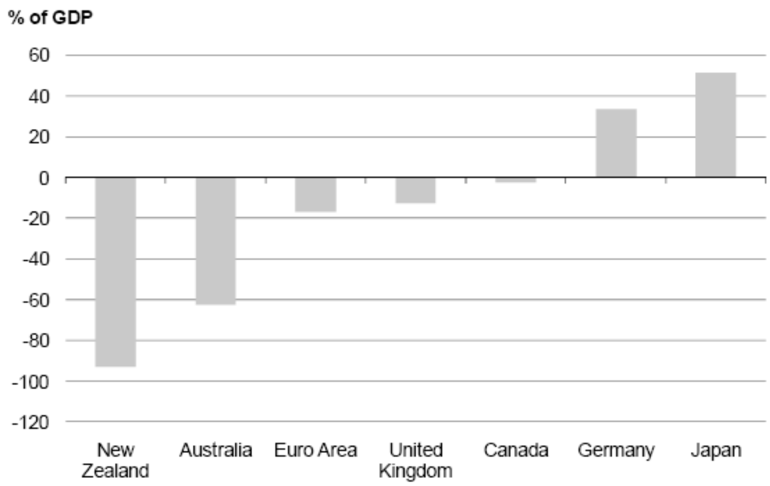
	Corporate Sector		Official Government		Total	
Year	($m)	% of GDP	($m)	% of GDP	($m)	% of GDP
1995	46,557	52.5	23,418	26.4	69,975	79.0
2000	92,696	83.6	16,268	14.8	109,064	98.3
2005	150,147	99.0	16,444	10.8	166,591	109.8
2010	219,171	117.0	24,397	13.0	243,568	130.0

While the NZ Government's net debt is relatively low by international standards, this is largely offset by significant household and business debt.

(b) International assets and liabilities by industry

Net overseas foreign liabilities (assets minus liabilities) stand at around 90% of GDP or around $175 billion. This compares unfavouably with many of our trading partners as the graph below shows. In fact, NZ has one of the highest net foreign liability positions in the world – reflecting a combination of household, business and government debt.

Net international investment position



Note: As at 30 June 2009.

Sources: IMF, Statistics New Zealand, Ministry of Finance Japan, The Treasury

Out of a total $144 billion, NZ's main international assets are concentrated in financial and insurance services ($90 billion) and to a much lesser extent in the manufacturing sector ($17.5 billion). The remaining international assets are thinly spread amongst a wide range of other sectors.

The bulk of NZ's $317 billion international liabilities are made up of Financial and Insurance services ($192 billion) and Manufacturing ($27 billion) with the remainder again spread amongst a range of sectors.

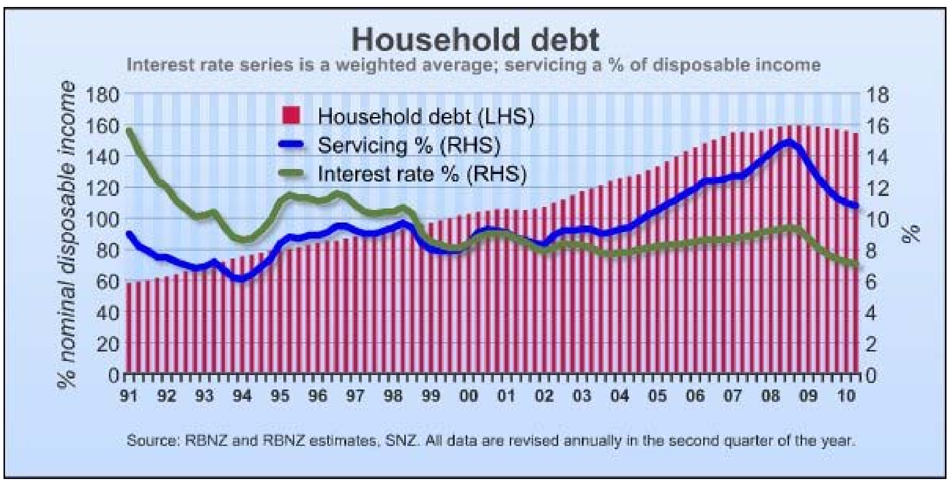
It is somewhat ironic that total international liabilities for Agriculture, Forestry and Fishing are around $4.8 billion (or 1.5% of total international liabilities) yet foreign ownership of land has raised significant public debate over recent times.

To be fair, the Government's international debt position is relatively low, which has greatly assisted NZ in terms of international assessment of the country's riskiness both from an investment and risk rating agency point of view. However, notwithstanding successive government efforts from the mid-1980s to lower government debt to more prudent levels, net government debt is on the rise again as operating deficits are forecast out for the next 5-6 years.

Debt servicing costs for the NZ Government are currently around $3 billion per annum but are forecast the rise to over $5.5 billion by 2017.

(c) Household debt

Household debt (mainly reflecting mortgages on housing) is also a significant issue in New Zealand. Household debt remains at around 150% of disposable income with debt servicing costs over 10%. While there has been a slight reduction in household debt of late which partially reflects reductions in interest rates (debt servicing costs) over the past few years, high levels of household debt leave households vulnerable to any increase in the cost of capital or to any other factors which may impact on ability to service current debt levels (e.g. unemployment/sickness or general reductions in real income levels).



Despite generally high levels of household debt, it is important, given the nature of business enterprise in NZ (with a large number of sole-traders), to note that many businesses use mortgages on housing to fund their business activities. So by definition, at least a sizeable portion of household debt is being used for the purpose of productive activity.

<u>Section 3</u>: <u>What are the possible implications of relatively high debt (low savings) rates?</u>

While high levels of debt are not bad per se, the potential exists for high debt levels to impact on costs and choices facing governments and its citizens.

The following is not an exhaustive list of the implications of high levels of debt but does provide a flavour of the potential impacts.

(a) Availability and cost of capital

Probably the most openly acknowledged issue with high levels of debt is their potential impact on the availability and cost of capital. Although unlikely to be solely related to NZ's high debt levels, the Savings Working Group considers that interest rates in NZ are probably around 1.5 to 2.5 percentage points more than they should be.

Some countries, such as Greece and Spain are already feeling the impact of high levels of sovereign debt, reflected in both the cost and availability of capital. In simple terms, the higher the risk of default the greater will be the required return (interest rate) on any capital invested. Beyond a certain point, investment simply dries up, irrespective of the return.

International investors use a number of mechanisms to assess a country's risk. These include (but are nor limited to):

- international credit ratings agency assessments;
- the state and transparency of government decision-making in respect to fiscal and monetary policy (NZ generally scores well on this); and
- the level and direction of the current account deficit. Current account deficits exceeding 10% generally cause alarm bells to sound.

Looking at all the above, NZ has generally been in a reasonably sound financial state, particularly in respect to the Crown's financial position which, as noted, tends to attract the greatest international attention. However, NZ has run current account deficits for the best part of 40 years (i.e. has been a net investment borrower since 1973).

(b) The ability to make choices

For households and governments with high levels of debt the effect on choice is a key factor.

In simple terms, high levels of debt constrain households and governments in the choices they can make given ongoing burdens associated with debt servicing costs. As shown above, around 10% of an <u>*average*</u> household's disposable income is spent purely on debt servicing costs. Certainly, debt servicing costs in relation to investment and consumption are unavoidable but beyond a certain point they leave society vulnerable to any interest rate shocks or changes in income levels, impacting on the debt-servicing ability of households, businesses and government. In short, high debt servicing costs increase risk. This equally applies to the Government in respect to the current account deficit.

(c) Economic sovereignty

Not only do high debt servicing costs increase risk, potentially they can lead to a loss of economic sovereignty, limiting the ability of New Zealanders to control how they use resources.

For example, higher levels of debt constrain the returns that existing businesses can gain from local investors, leaving the door open for foreign interests to buy up "cheap" assets at a discounted price, simply through lack of local capital in a market.

The current debate surrounding foreign ownership of land (and specifically the possible sale of the "Crafar farms") to foreign interest is *potentially* an example of this.

The lack of available capital in New Zealand (some would argue through a lack of domestic savings) means that foreign ownership provides a very useful source of capital when domestic investors do not have the capital base or the willingness to invest in large scale activities. For example, the agricultural sector is around $47 billion in debt so there are not the savings available to buy significant assets, or if there are, it becomes much more difficult to put a financial package together. Therefore, almost by default, foreign ownership becomes a realistic option, certainly in respect to maximizing revenue from the sale of tracts of land etc.

It is important to understand that while some might ne concerned about foreign ownership of NZ assets, the point here is that high levels of debt restrict New Zealanders' choice. The issue is whether New Zealanders wish to retain sovereignty over certain large scale assets rather than an argument about whether foreign investment is good or bad.

While the issue of foreign investment is still contentious for some New Zealanders (and a minority of political parties), key contributions from FDI include: transfer of capital, positive impacts on employment and training, technology transfer and innovation, enhanced competition and consumer choice, and more innovative management practices. Some studies suggest that around one-third of the NZ workforce is likely to be in employment created by the direct and indirect impact of FDI. The NZ economy was built, and continues to be built, on the back of foreign investment.

While some opponents of foreign investment argue that it will lead to a loss of economic sovereignty, it should be noted that the majority of the major companies (insurance oil, shipping, and telecommunications etc) which service our international requirements are largely foreign-owned. If this situation is considered to represent a loss of sovereignty, then in a sense it could be argued that NZ has already lost control. Further, whether foreign-owned or not, there is a general requirement to abide by the regulatory framework that applies to doing business in NZ (e.g.

Commerce Act). Therefore arguably, whether something is domestically or foreign-owned is largely irrelevant.

Some people work on the basis that we should only allow people to invest in NZ land and assets provided the investing country does likewise (a reciprocal arrangement). But this makes no sense. Why would a country restrict maximizing the value of domestic assets by potentially restricting the sale price through limiting what people can purchase? Even if foreign ownership could somehow be confined to countries with open policies on land sales (putting aside potential WTO implications), limiting investment would not be in our interests. In the same way, restricting tariff removal to the speed of reductions in tariffs from our trading partners makes no sense. NZ is not in a position to dictate how some consider the rest of the world should ideally operate. Restricting foreign ownership might be a feel good factor to some New Zealanders but would come at a considerable cost.

If there are so-called strategic assets which the government or New Zealanders do not want open to foreign ownership/control, these should be clearly designated so that investors have some certainty. More importantly, New Zealanders should be fully-informed about what they are signing up to when placing restrictions on foreign investment – about the potential implications for economic growth and ultimately, for the standard of living to which most aspire. In economist speak there is no such thing as a free lunch here!

(d) Implications for long-term growth

One of the consequences of the low levels of savings (for government, businesses and households) is their effect on the ability to finance worthy projects which may assist in New Zealand's long-term growth potential.

Putting aside the important issue of what the appropriate role for the government (taxpayer) might be in financing projects, tightly constrained budgets limit choice both for government and the private sector (whether acting separately or in combination).

In some respects, constrained budgets encourage a greater focus on what projects to finance and can encourage better resource allocation. But seriously constrained budgets limit the potential to finance new investment that may be in the country's long-term interests.

None of the above should be taken as assuming that New Zealand is currently at that point, or is necessarily close to it. However, any difficulty in financing desirable infrastructure developments, both at the central and local government level, could raise the question: is NZ as a country is approaching the limit of its ability to live beyond its means?

Section 4: Why might savings be an issue?

While Section 2 outlined some of the reasons why a relatively low savings rate may have ongoing implications for the NZ economy, the legitimate question needs to be asked: why does NZ appear to have a relatively low savings rate?

(a) Declining real incomes relative to the rest of the world – ability to save

One of the reasons for NZ's relatively low level of savings (and hence build up of debt) could be the fact that while household and consumer expectations have increased markedly over the years, our collective incomes have not. NZ's per capita income continues to decline relative to our major trading partners, including Australia, while many of the traditional developing economies are showing strong growth in output and consequently incomes. New Zealand in contrast has experienced relatively modest growth over the last 3 decades, apart from 4-5 good years in which growth exceeded 4 percent per annum.

In crude terms, relatively low incomes mean the ability to save (for anything) is tightly constrained. On the other hand, higher incomes over time provide greater opportunities to save and to make consumption choices.

This suggests that a key policy goal should be to improve economic growth and by definition the ability the increase incomes over time. A fundamental objective should be to increase New Zealand's low rate of productivity growth.

(b) Government versus (crowding out) private savings

One argument is why save if the Government does it for you! This is particularly the case given that until recently, successive governments have, for the best part of 20 years, generally run budget surpluses and continued to retire debt, while at the same time, building up savings via the NZ Superannuation ("Cullen") Fund to partially pre-fund future retirement income. At the same time government is providing universal NZ Superannuation irrespective of income or assets, guaranteed at 65 years of age and at two-thirds of average income.

The current Government has stated that it will not tinker with NZ Superannuation, so it is reasonable to suppose that if government saves on taxpayers' behalf (i.e. through collection of taxes and then regurgitating them through universal hand-outs) taxpayers will not necessarily bother to provide for their own long-term needs in retirement. Similar thoughts could also be expressed in respect to the funding and provision of healthcare, social welfare assistance, education provision (interest-free student loans) and accident insurance coverage. Clearly there is a deeply entrenched mindset (supported by government statements) that government will go on providing as it has in the past.

(c) Tax treatment of savings and investment

A significant amount of work has been undertaken by various parties on the appropriate taxation treatment of income and savings (e.g. the Taxation Working Group). This has resulted in some changes to taxation (e.g. a move towards consumption taxes and away from income taxes, and moves to address perceived inequities in investment in housing (e.g. decisions to effectively end the ability to claim depreciation on investment housing).

While the issues are complex, and indeed the Savings Working Group will no doubt be working through them, it is fair the say that some forms of savings and investment are effectively taxed differently from others. And some asset classes avoid being taxed at all; government has stated that capital gains taxes have been ruled out of the equation.

Notwithstanding the above, the Government should tread very carefully in respect to making ad hoc changes to the taxation system without careful thought as to their full ramifications, particularly on the incentives for businesses to expand and be entrepreneurial in their behaviour.

Section 5: What are the potential policy options moving forward?

It is important when looking at possible options to raise savings rates, that doing so should not be seen as an end in itself. A more important policy objective is to raise productivity and hence New Zealanders' earnings, thereby enabling individuals to make easier decisions as to how and when they save.

(a) Raising productivity, and hence incomes and savings choice

Why does productivity matter?

In short, productivity is a measure of how efficiently the economy is using inputs to produce outputs.

Growth in productivity means that a nation can produce more output for the same amount of input, i.e. increase its non-inflationary standard of living income and ability to shift consumption/investment over time).

Recent figures released by Statistics NZ demonstrate a trend to relatively low productivity for both labour and capital. Putting aside measurement problems, and the fact that the measured sector accounts for only about 75 percent of the New Zealand economy, the latest results continue to present a relatively disappointing picture.

While there are many theories as to why New Zealand's productivity is low, including economies of scale, distance from international markets etc, there is no one silver bullet that will turn our productivity performance around. Reforms are needed over a wide range of areas with the objective of creating a more efficient and competitive economy and hence contributing toward greater income growth and the ability to pay our way in the world.

It is not solely the role of either government or business or individual households to improve NZ's productivity record. Some issues are best addressed by business, some by government, and some by households.

The issues below are fundamental to improving our productivity and hence our ability as a nation to make potentially better, or at least more flexible, decisions in respect to savings/investment and consumption choices.

(i) Competition policy

Competition is a crucial discipline on firms and management to ensure that production and processes meet international best practice. Competition provides the necessary spur so that firms constantly innovate or die.

(ii) Secure and transparent property rights

One of the fundamental principles on which a market economy like New Zealand is based is that property owners (including businesses) have relative security of their property rights, with the right to use their property in any manner they choose (respecting the rights of other property owners).

As well, investors must have confidence that any assets they purchase or improve upon will be safe from confiscation and unreasonable restrictions on use, or alternatively, that the investor will be compensated for any erosion of property rights. If this is not the case, there will be limited incentives for anyone to undertake long-term investment.

(iii) Regulatory policy

The ability of Government to regulate (including legislation and regulations) can play a significant role in determining productivity growth. While regulation, by itself, cannot improve productivity outcomes, it can have a significant impact on the decisions of businesses to invest, and on what to invest. It does this by affecting the costs businesses face or, in some cases, by creating uncertainty about particular regulations/policy decisions that may have the effect of stifling new investment.

There can be incentives for governments under tight fiscal constraints to try and put some of their expenditure "off-budget" in the form of added regulatory/compliance burdens on the private sector. In the absence of strong incentives to minimize regulatory constraints, there can be a tendency to impose more and more costs on business knowing that such costs are not directly accounted for in the government's accounting frameworks (or official budget).

(iv) Tax and expenditure policy

Tax policy has a major impact on productivity in the sense that it can significantly influence investment decisions and the allocation of resources.

To an extent, all taxes are distortionary and impact on economic behaviour. Taxes can impose significant compliance and administrative costs associated with their collection, quite apart from deadweight costs where resources are deployed away from their most highly valued uses.

If tax rates are unduly high or inconsistent, this can create distortions and lead either to under-investment or just as importantly, to misinvestment, where investment is attracted to those sectors where special privileges or options are available. This can result in low productivity growth.

(v) Flexible and responsive labour markets

The need for flexible and responsive labour markets to improve productivity almost goes without saying. Flexibility makes it possible for resources to shift quickly to more productive activities as these emerge.

In order to increase productivity it is important to remove barriers to improving productivity, thereby maximising the productive capability of the workforce.

(vi) Human capital (skills/education) and management capability

Increasing the educational levels of the population – the human capital – is one way of raising productivity and increasing living standards over time. Wealth is created, and employment generated, by enterprises with a highly skilled, customer focused and innovative workforce.

Although in principle it is not growth in human capital that creates employment and output growth – it is rather, jobs that stimulate the need for ongoing learning, skills development and training in its many forms – there are nevertheless very clear links between a market driven, flexible education and training system and a buoyant, productive and internationally competitive economy. Job expansion, unemployment reduction and higher standards of living require a buoyant, productive and internationally competitive economy.

(vii) Global "connectedness" through trade and immigration

In order to improve productivity outcomes, New Zealand businesses must be able to source the best inputs available on the international market.

NZ, like other countries, must use its limited resources efficiently if it is to promote further productivity growth and thereby improve its standard of living.

Greater trading opportunities generated through CEPs and the lowering of trade barriers have resulted in greater choice and cheaper prices to final consumers, whether they be businesses or individuals. Reducing barriers to trade has forced some sectors to improve efficiencies knowing that a more open economy requires constant innovation and the ability to develop and source new technologies and processing techniques.

Immigration policies also need to reflect the importance of the international transfer of ideas, technology and innovative techniques which, if successful, they can achieve.

(viii) Innovation

There are two major and interconnected forces driving changing business needs: new technologies and the globalization of markets. For enterprises today, in all sectors of the economy, the reality is that they must innovate or die. They must harness technology for business growth, striving all the time for continuous improvement and quality. The need for NZ to compete in the global market means that standards of innovation, quality and service are being set internationally. All enterprises are being exposed more and more to the standards established by the most successful enterprises elsewhere in the country and in the world. Other countries are defining our skill and knowledge requirements.

(b) Taxation of income and savings

It is understood that the Government has asked the Savings Working Group to consider the case for moving to a dual income tax system, where labour and savings and investment income might be taxed at different rates. It will also look at the case for indexation or partial indexation of the tax system so that real, rather than nominal, savings and investment income is taxed. Obviously, depending on whichever proposal is developed, the outcome would likely impact on savings vehicles. But whether it would result in a net lift in savings is debatable.

Issues surrounding taxation of income and savings are discussed more fully BusinessNZ submission to the Savings Working Group (see Appendix)

(c) Reform of NZ (state provided) Superannuation

The OCED Economic Survey of NZ (April 2009) had the following to say in respect to preparing for changing demographics, namely an ageing population:

"Policy action to contain future pensions and health spending should likewise be undertaken fairly rapidly, to allow time for the required behavioural adaptations as well as to reduce the need for prefunding through the Super Fund. As in other OCED countries, controlling health care costs is the most pressing fiscal challenge…The basic universal public pension (currently around two thirds of the average wage for a couple and one third for an individual) minimises economic distortions insofar as it avoids disincentives to private saving associated with means-tested old-age assistance observed in other OECD countries. However, universal benefits are very expensive. To make significant long-run savings, the universal benefit should be indexed to the CPI rather than wages, a step that has already been

taken by many OECD countries. Furthermore, the retirement age should be indexed to rising life expectancy, an "actuarial fairness" feature increasingly recognized as essential to sustainability and justice of public pension systems in other OECD countries. Although the retirement age was raised from 60 to 65 in the 1980s reforms, a further rise to at least 67 (as in the United States) could soon be envisaged and thereafter be aligned with longevity gains. (OECD Economic Surveys – New Zealand, p.48)

Perhaps the most important issue (and perhaps the most obvious) is the size of the problem.

For the year ended June 2010, National Superannuation expenditure equated to over $8 billion per annum or around 13 percent of total Core Crown expenses. To put this expenditure in context, it is the third highest level of expenditure after Health ($12 billion) and Education ($11 billion).

Forecasts show NZ Superannuation payments increasing over time as the population continues to age. Just over 500,000 New Zealanders currently receive NZ superannuation (around 12 percent of the population). This is projected to increase to around 600,000 by 2013.

In summary, clearly Superannuation payments are a major concern and will be so for the foreseeable future.

The issue regarding the future funding of Superannuation has been given added emphasis with the Budget 2009 announcement that contributions to the NZ Superannuation ("Cullen") Fund, which was targeted towards partially pre-funding the increased burden of NZ Superannuation beyond 2030, will be suspended until fiscal conditions improve. Expectations are that contributions will not be re-established until around 2020, unless fiscal conditions radically improve in the intervening period.

As an aside, it will be politically very difficult for a future government to reintroduce contributions to the NZ Superannuation Fund given that there will always be pressure to spend the money on other "priority" areas. It will be all the more difficult in that government under an MMP system increasingly requires trade-offs.

While the NZ Super Fund was expected to cover around 15 percent of the costs associated with retiring "baby boomers", the decision to postpone payments, while completely rational in economic terms given NZ's fiscal position, will considerably erode that objective. Future superannuation payments will come mainly from future taxpayers. The longer the delay in recommencing payments into the NZ Super Fund, the less partial pre-funding of future superannuation there will be.

(i) Options for reform of NZ Superannuation?

There are clearly a number of options available in respect to the future provision of superannuation.

The general thrust should be on tightening the criteria for age-related benefits which could be in the form of the following (or possible combinations):

- extending out the age of eligibility (either in line with increases in life expectancy or on an ad hoc basis to keep costs manageable).
- having (possibly) a tiered approach to superannuation depending on when a person opts to take superannuation (as advocated recently by Dr Don Brash). e.g. the later someone "opts in" the higher the level of payment for the rest of their life.
- stepping the level of benefit depending on age e.g. 50 percent of average income at 65 years of age, 70 percent of average income at 75 years of age.
- reducing the amount paid (currently two-thirds of the average wage) over time either through freezing benefits or indexing them to the Consumers' Price Index (CPI) rather than wages.
- means testing benefits either through asset(s) and/or income testing.
- discontinuing NZ Superannuation payments by simply phasing them out over time e.g. those currently below the age of 50 will not be entitled to any state provision.

While all the above approaches have pros and cons, the big issue lurking in the background, apart from the economics, is the politics. Progressively increasing the age of eligibility would appear to be a no-brainer. With individuals generally living longer, on average, and with medical advances, living with improved quality of life, it is reasonable to expect that the age of entitlement could be increased to close to 70. Many other countries are increasing their age of pension coverage (Australia to 67 over 14 years while Britain is already at 68 and the US is 67.)

However, many of the other approaches have significant drawbacks e.g. in the case of freezing benefits – the impact this would have on those dependent on NZ Superannuation as a sole source of retirement income. Different levels of benefit depending on age can raise issues of ethnicity (given differing life expectancies) while the pitfalls of income and asset testing are generally well known. Often the wealthy are in the best position to manipulate the system to the detriment of taxpayers in general.

(d) Compulsory Superannuation savings (e.g. making Kiwisaver compulsory)

(i) Impact on employers

While some employer surveys suggest there is support for a compulsory workplace saving scheme, responses still fall well short of what could be described as a mandate for a compulsory scheme. Recent results would suggest employers are roughly 50:50 in respect to compulsion.

The requirement for compulsory contributions from employees and employers under the current KiwiSaver arrangements (minimum of 2% contribution from employees and the same for employers) would raise significant issues for both. employers and employees.

Obviously for employers, a requirement to fund at least 2% of employee earnings has an impact on total labour costs as it is the total cost of employing labour which affects business investment decisions, not wage rates per se. The total cost of employing (including non-wage labour costs (NWLCs)) is the relevant benchmark for employers.

Notwithstanding the above, given that employers can adjust the total costs of employing labour over time, subject of course to normal market-related constraints, whether an employees package is made up of wage/salary/fringe benefits e.g. medical insurance/provision of a company car etc, will be of little long-term interest to employers (apart from the obvious administration costs etc of including such items). In some respects, a compulsory scheme would arguably minimise any compliance costs such as opting in and out.

The point is, from an employer's perspective, whether an employee receives "benefits" via salary or through contributions to KiwiSaver etc should not really be an issue. In this respect, employers may, over the longer-term, be largely indifferent as to whether or not the government mandates compulsory contributions to KiwiSaver. However, as with any compulsion, on the margin at least this will affect the ability of employers (on the margin at least) to provide benefits which reflect the unique preferences of their employees. Clearly, many employees will have other sources of retirement income and therefore would rather have their income from employment up-front than wait until they retire to access it.

(ii) Impact on the self-employed and employees (ability to pay)

For the self-employed, a requirement to pay a certain contribution toward KiwiSaver could well affect their ability to expand their business. Alternatively, they might have to borrow from financial institutions to cover such expenditure. Given that the returns from KiwiSaver might well be lower than the amount they have to borrow from financial institutions, the requirement to provide contributions to KiwiSaver would result in a net loss to the self-employed person. This is the precise reason why the current Government has delayed making contributions to the NZ Superannuation Fund; it would need to borrow to do so, which makes little if any economic sense.

In respect to employees, every individual and household is relatively unique with different risk profiles and attitudes to saving etc.

Requiring individuals to contribute towards KiwiSaver takes no account whatsoever of their unique circumstances and what sort of trade-offs or income profiles they may have over time. For example, some individuals can reasonably be expected to receive windfall gains through inheritance. This might affect current expenditure decisions knowing that a future income stream is more or less guaranteed. Others might want to bring forward investment in education hopefully to boost their total lifetime earnings potential.

Despite all of the above, there are a couple of positives which might make moving towards a compulsory savings scheme a lot easier than was the case a decade or so ago.

First, thanks to the Kiwisaver scheme with its array of various subsidies, the voluntary take-up has been nothing short of phenomenal. In this respect the number of people in the scheme means that the transition and transactional costs of expanding it may not be as great as would have been the case in the past. For example, there are numerous fund providers offering a range of superannuation options.

As of 31 August 2010, over 1.5 million New Zealanders (over one-third of the entire population) had signed up with KiwiSaver. Given that those over 65 years of age make up over 500,000 (12% of the population), this means that close to 50 percent of eligible New Zealanders have signed up to KiwiSaver since it commenced just over 3 years ago.

KiwiSaver statistics as at 31 August 2010

Demographics of KiwiSaver members

Age band	Members
0-17	280,039
18-24	234,728
25-34	244,493
35-44	244,189
45-54	244,136
55+	260,251
No information	8,934
TOTAL	1,516,770

While there are obvious incentives for individuals to sign-up to KiwiSaver (principally an upfront $1,000 contribution from Government and up to $1,040 per year "one-for-one" subsidy), the rate of take up is still pretty impressive.

The requirement for younger people who have signed up to contribute when they start employment means that to all intents and purposes they will be locked in, although individuals will be able to have contribution holidays.

Providing individuals continue their impressive take-up of KiwiSaver, there will be significant opportunities for government to revisit the extent to which it needs to fund the NZ Superannuation scheme. Therefore it is likely that contributions can be reduced over time, and the criteria for eligibility tightened up as suggested earlier.

However, given that those that haven't signed up to Kiwisaver are more likely to have difficulty in funding contributions, any move towards compulsory savings would have potentially significant implications for what, for many households, are already tightly constrained budgets.

Government, via the NZ Superannuation "Cullen" Fund has a reserve of around $16 billion put away which could be used as a "sweetener" to start every New Zealander into a compulsory scheme. For example, with a population base of just over 4 million, government could transfer the equivalent of around $4,000 into each individual account. Alternatively, a phased approach could be pursued whereby government paid a contribution (from the Cullen fund) supplemented either by employees and/or by employers.

A phased approach would provide the opportunity for individuals to adjust and would lessen the potential for difficulties relating to contributions from employees and/or employers. These are not only economic issues (the ability to pay) but also employment relations issues (bargaining issues) such as normally come to the fore when significant changes are made over a short period of time.

Having individualised accounts and distributing the proceeds of the NZ Superannuation fund would almost completely eliminate any risk that future governments might try and use such funds for other purposes. With the current NZ Superannuation Fund, there is real potential for (a future) government to interfere in investment or even utilise the fund for other than superannuation purposes.

(iii) Impact on net savings rates?

In respect to KiwiSaver, and more particularly any form of compulsion, BusinessNZ has maintained the view that if it can be proved through <u>sound research</u> that there are evident market failure issues in respect to the provision of retirement income and/or savings concerns, it would be willing to look at the possibility of compulsion. However, in the absence of sound evidence supporting a market failure argument or a generalised savings problem, BusinessNZ would not support compulsion. It should be noted that some research by Grant Scobie and others (The Treasury) suggested that there is not a generalised savings problem in NZ, although more recent research suggest that savings levels may be an issue.

Obviously, one of the key issues in respect to savings is whether a compulsory regime would actually lift savings rates or simply transfer savings to different savings vehicles (investment churn) as appears to be the case in other jurisdictions.

A recent Treasury Discussion Document produced for the Savings Working Group said that introducing compulsory Superannuation contributions could lead to a modest lift in national savings, although it rightly raised difficult issues of ability to pay and fairness.

The Savings Working Group Chairman, Kerry McDonald, in a recent media conference, stated that in reference to Australia's compulsory superannuation scheme (which it has had since 1992), the data was unclear as to whether it had boosted Australia's overall level of savings: *"The data I've seen at this stage is* *pretty equivocal on whether it increases savings or not – I need to be pretty clear that's work in progress"*

(iv) Implications of compulsion on broader Government policy decision-making and funding

It is important to note that any broad move by the business community to support a compulsory savings superannuation scheme, or indeed any compulsory savings scheme per se, raises from a policy perspective, significant issues surrounding compulsion for other social welfare benefits and individual provision for the funding of health and education externalities (i.e. compulsory insurance).

These issues should not be considered lightly, given the implications for what have been to date, largely state-funded benefits.

BusinessNZ has generally taken little interest in issues concerning the provision of social welfare benefits in New Zealand although it has raised issues around some benefits, e.g. elements of the Working for Families package. To be fair, this is probably owing to the emotive elements associated with social welfare benefit provision and a general view that business organisations should confine themselves to specific issues impacting on employers and business in general rather than delving into what are very political debates that can backfire.

Our level of involvement in superannuation/retirement issues has usually been restricted to those where superannuation directly impacts on employers, such as Kiwisaver and issues relating to compulsory employer contributions, as well as technical issues which might impact on bargaining arrangements (i.e. the debate surrounding total remuneration).

BusinessNZ generally does not support compulsion of any sort, believing that individuals and businesses should be free to make their own decisions where possible. This reflects BusinessNZ's general policy support for flexibility in business arrangements, with compulsion used as a backstop or last resort when all other options have failed.

For example, BusinessNZ opposed the Ministry of Transport's proposals for compulsory third party insurance on a number of grounds and some points made in our submission are particularly relevant if there is any suggestion that we should support compulsory adoption of KiwiSaver (or some other) similar scheme. The arguments relating to compulsory third party insurance (i.e. to try and internalise the costs associated with driver behaviour by trying to ensure that individuals pay for the costs associated with damage to the vehicles and property to third parties) also have relevance to any debate, whether about a compulsory superannuation savings scheme or compulsory insurance for health, education or other areas where individuals costs may not be internalised.

"….the question needs to be asked as to why the focus on compulsory third party vehicle insurance when individuals are not required to obtain compulsory insurance for other activities which may impose significant costs on them personally, their families, and ultimately the general public (taxpayers)? While individuals can, and often do, insure for many such risks, it is purely of a voluntary nature.

Many people fail to obtain appropriate cover for a whole host of risks they may face (e.g. loss of income from employment, health difficulties, property damage as a result of storms etc). This may result in significant cost to them personally, their families, and often the Government via taxpayer-funded social welfare benefits and the provision of public health services. Taken to the extreme, one could argue that those who undertake risky activities e.g. are obese or undertake a sedentary lifestyle should be required to take out mandatory health insurance to minimise the costs on general taxpayers in case they need expensive health treatment later in life. While voluntary insurance is available in respect to both health-related risks and many other risks, generally it is not compulsory (apart from ACC levies covering workplace accidents, accidents to earners outside the workplace and motor vehicle accidents, with the taxpayer picking up the bill for personal injuries to non-earners).

In summary, the above statement by Business NZ should not be taken lightly and underlies the difficulty of picking out one particular item of expenditure (in this case superannuation) as opposed to having a general policy approach across the board.