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KiwiSaver or KiwiSucker? A Critical View

Phil Rennie

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- KiwiSaver is a pointless and hugely expensive straitjacket on the New Zealand economy. The incentives added last year have made the scheme expensive, distorting, regressive, unfair, unstable, and unsustainable.
- KiwiSaver represents a fundamental change to New Zealand's retirement system, which now combines one of the most generous pensions in the world with a heavily subsidised saving scheme. It represents a major shift in how people allocate money over their lives.
- The best available research shows that most people were already saving enough for retirement, with 80% of couples saving enough to maintain a level of consumption similar to or better than in pre-retirement. Savings are notoriously difficult to measure, and most attempts end up vastly underestimating the true level.
- With KiwiSaver and New Zealand Super combined, it is now possible for a young person on the average wage to retire on a *higher* income than they enjoy during their working life. It is a complete overload to have a subsidised saving scheme on top of an age pension that is the highest in the OECD.
- KiwiSaver largely benefits the wealthy, who can afford to save more, and burdens younger generations, who must now save and pay for a large part of their own retirement while also paying for today's retired generation.
- KiwiSaver politically and economically threatens the future of New Zealand Super. It adds to the cost of an aging population and makes means testing more likely in the future.
- Evidence from around the world suggests that subsidies for savings schemes do little to actually increase overall savings. Instead, people tend to shuffle around existing savings to take advantage of the subsidies.
- The link between savings and growth is weak, especially in a small, open economy like New Zealand. Higher savings will not necessarily guarantee higher investment, and in any event, what matters is the *quality* of investment rather than the quantity or the source of funding.
- People save in many different ways, not just by putting money in the bank. Yet it is now more rewarding for people to join KiwiSaver than it is to pay off debt or a mortgage, or to invest in business or an education. This is a major distortion, which could make New Zealand worse off.
- The requirement for employers to contribute 4% of a worker's salary will put downward pressure on wages and job growth.
- KiwiSaver is hugely expensive. The total cost will rise to $2 billion a year, which is more than New Zealand spends on its entire defence force. If used for tax cuts, it could provide a significant boost to incomes and economic growth.
- The easiest way to fix KiwiSaver is to scrap the generous incentives to contribute, and return it to its original incarnation as a simple and modest savings scheme.

Phil Rennie is a policy analyst with the New Zealand Policy Unit of The Centre for Independent Studies.

Introduction

KiwiSaver is one of the government's most popular and high-profile policies. In March this year, the 500,000th member joined up, placing pressure on the National Party to state their position on it. To date, they refuse to announce their exact policy, but have promised to keep the scheme and some form of government subsidy if elected to government.[1]

The original proposal for KiwiSaver announced in 2005 was a modest but innovative scheme. It was and remains a voluntary scheme, but all new employees are automatically enrolled and have eight weeks to opt out. Originally, the scheme gave a bonus of $1,000 for joining, and allowed some diversion of funds to pay for a first house.

The key to KiwiSaver's sudden popularity has come with the radical changes unveiled as the centrepiece of the 2007 budget. On top of the $1000 kickstart, an annual 'tax credit' of $1,040 from the government has been added, and soon employers will be required to make matching contributions of 4% of the employee's gross salary. In addition, employer contributions are tax-free up to 4% of the employee's gross salary .

Therefore it is no surprise that nearly every financial advisor is recommending people sign up, even to the extent of borrowing from a credit card or student loan if necessary.[2] As blogger David Farrar puts it, 'You have to be very very poor or very very stupid to turn down an up to 2:1 subsidy.'[3]

Popularity doesn't mean good policy, though, and what is good for the individual is not necessarily good for the country. So why were these incentives introduced? Clearly, the aim was to change behaviour—to encourage more people to join, and to save more. According to Finance Minister Michael Cullen, 'the truth is that New Zealand's savings problem is real and it is serious.'[4] KiwiSaver therefore represents a major shift that puts future consumption (in the form of savings) ahead of current consumption.

KiwiSaver represents a fundamental change to retirement policy.

But why are higher savings so desirable? Is it worth spending $2 billion a year of taxpayer money on these incentives?[5] Michael Cullen argues two main points. First, many New Zealanders are not saving enough (or anything at all) for their retirement, and will be left to survive solely on New Zealand Superannuation (NZ Super). Second, he argues that higher savings 'helps the strength of the economy generally' by encouraging investment and taking pressure off inflation and interest rates.[6]

Both of these arguments are controversial. Does New Zealand really have a savings 'problem,' and how exactly do we define a 'problem'? Even if we do have a problem, will KiwiSaver fix it? What are the supposed benefits of higher savings, and importantly, what are the real costs? Will higher savings really benefit the economy?

This paper first considers how KiwiSaver works as a part of retirement policy, and then how (if at all) it will affect economic growth.

Part 1: KiwiSaver as a retirement saving policy

KiwiSaver represents a fundamental change to retirement policy. New Zealand now has one of the most generous age pensions in the world, combined with a highly generous saving scheme. What does this mean for young people who have to pay the costs of both schemes? And what does it mean for the future of NZ Super? Can future governments afford to maintain both schemes? Who benefits from KiwiSaver, and is it fair?

The government's Super 2000 Taskforce set out five key goals for retirement policy, which are worth revisiting:

- adequacy
- equity
- sustainability
- stability
- efficiency

This section considers how New Zealand's retirement system measures up on each of these five priorities after KiwiSaver's introduction.

Adequacy: A decent income for retired people?

Perhaps the most basic goal of any retirement policy is to ensure that the elderly can live in dignity and comfort without necessarily having to work. So, is New Zealand's mix of government provision and private savings 'adequate' for retirees? What about for those yet to retire?

Of course, what is 'adequate' is subjective and impossible to define exactly. But we can look at some basic, widely accepted indications of well-being, such as comparisons with overseas countries, comparisons with pre-retirement income, and quality of life surveys.

New Zealand Superannuation is one of the most generous age pension schemes in the world. For a single person, the current rate is 43% of the net average wage, the highest proportion in the OECD. The next highest is the Netherlands (31%), and in Australia the equivalent rate is 26%.[7] In addition, Australia's age pension is income and asset tested, so that only half of all retired citizens receive the full amount, while another quarter receive a partial pension.

However, many other countries rely on a second tier of savings or support (often assisted by subsidies, and employer and/or government contributions) to make up a decent retirement income. With this second tier included, the average wage-earner in New Zealand retires on a net income worth 41.7% of their previous income, compared with an average of 70% in the OCED.[8] On top of this, though, in New Zealand around 80% of retired people own their own home mortgage-free, which is high by world standards.[9]

80% of couples aged forty-five to sixty-five are already saving enough to at least maintain their current level of consumption in retirement.

Evidence shows that most retired people are coping fine with these arrangements. Just 1% of over-sixty-fives are considered to be in 'severe' hardship, and a further 3% are considered to be in 'significant' hardship. This is a much lower level than reported by any other age group in society.[10]

For those about to retire in the next ten or twenty years, there is more concern. Michael Cullen warns against an over-reliance on property, because 'you can't eat your house' in retirement.[11] Likewise, economist Gareth Morgan warns in his book *Pension Panic* that relying on a house and New Zealand Super will only provide a meagre lifestyle, fine for those happy to 'eke six cups of tea from a single teabag and live on Milk Arrowroot biscuits for the duration of your twilight years.'[12]

However, the evidence does not necessarily match the scaremongering. A report prepared by the Treasury and the Retirement Commission last year estimates that 80% of couples aged forty-five to sixty-five are already saving enough to at least maintain their current level of consumption in retirement, presuming that NZ Super retains its value.[13]

This is a positive finding, given that most people can expect to consume less in retirement than they do while working. This is because retired people tend to be less active, have less debt, no children to support, and usually own their own home.

This may come as a surprise, given the negative publicity around New Zealand's low rate of household saving. Last year, the average household spent $1.15 for every dollar earned, one of the worst scores in the OECD.[14] But, as following sections of this paper will explain in more detail, aggregate household saving is a narrow and flawed measure of true wealth. According to Grant Scobie and his fellow Treasury authors, 'little or no insight into retirement savings can be gleaned from aggregate measures of household saving rates. It is the accumulation of wealth at the household level that is the critical indicator.'[15] Likewise, the retirement commissioner, Diana Crossan, explains that 'we don't talk about saving any more, we talk about financial preparation for retirement.'[16]

According to Michael Cullen, a major goal of KiwiSaver is to boost retirement savings amongst low- to middle-income households.[17] Perhaps surprisingly though, it is those on low incomes who often have the least need to save, because NZ Super will provide them with a higher income than they earn now. Professor John Gibson of the University of Waikato explains:

> If these people are struggling to make ends meet now, and are going to receive a fairly adequate transition, is it sensible for us to be badgering them about trying to put away savings, when, assuming the rules of the game stay the same, we would predict they are going to be as well off, or possibly better off, in retirement than they are now?[18]

Finally, what kind of retirement can younger generations expect? It is difficult to predict accurately too far ahead, but if we assume that the current policies remain in place, then generations X and Y can expect a large boost to their retirement income thanks to KiwiSaver and the generous incentives it provides.

Michael Littlewood, co-director of Auckland University's Retirement Policy and Research Centre, uses the example of a twenty-five-year-old who joins KiwiSaver and earns the average wage for his entire working life. By the time they retire, they will have saved enough for an annuity of $22,000 a year after tax in today's money, with one third of that having come directly from taxpayer-funded subsidies. Presuming that our worker also receives NZ Super at its current level, they can then expect to retire on a total combined income of $36,400, which is a remarkable 105% of their current after-tax pay.[19]

This is a fundamental shift in consumption patterns for today's young workers, and the inevitable result of combining a generous age pension scheme with a generous savings scheme. It is worth noting that a boost to retirement income doesn't necessarily make people better off; it is simply rearranging when they spend their earnings, which may lower their lifetime utility as a result.

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Table 1: Summary—How are people going to cope in retirement?

Category	Condition
Currently retired	8% are considered to be in any form of hardship; 92% are 'fairly comfortable' or better.
Will retire within the next twenty years	80% of couples are saving enough (or more than enough) to maintain their current lifestyle.
People in their twenties	On the average wage and with KiwiSaver at current settings, can expect to have a higher income in retirement than in work.

So, why are politicians so determined to force higher savings given that most people are already saving enough for their retirement? Is this kind of change good for New Zealand? Will it make superannuation more affordable in the future? Is it fair on all generations? Do the economic benefits of increased savings outweigh the costs? The following sections will look at these questions.

Equity: How fair is KiwiSaver?

Equity, or fairness, is a slippery and subjective issue. We need to consider who benefits from KiwiSaver, and, importantly, who pays.

KiwiSaver represents a fundamental shift in how retirement policy is funded. From 1898, when the first age pension was introduced, there has never been any prolonged attempt to pre-fund it with savings, so instead a 'pay-as-you-go' (PAYG) system has developed where the government transfers tax payments from workers to the retired generation ahead of them.

Therefore, the first generation of retired workers received a windfall to which they hadn't directly contributed. Every other generation has continued to 'pay it forward' for those ahead of them, which provides an element of uncertainty. Workers have to rely

on an implicit contract with the generation behind them for their support in retirement, and hope there are no sudden changes in policy. It also means that an aging population will put an added strain on the system.

In response to these concerns, the New Zealand Superannuation Fund (NZSF) was established in 2001 as a way of partially pre-funding NZ Super. The government now saves around $2 billion annually as a way of preparing for the fiscal impact of an aging population.

However, the combined effect of KiwiSaver and the NZSF is an added burden for today's workers, who are not just paying for the current generation of retired people, but subsidising people of their own generation as well. As political columnist John Armstrong notes:

> Votes will be reaped in the young and middle-aged groups, who will be questioning why they are paying three times for their super—first, through KiwiSaver, second through tax for New Zealand Superannuation, and last through contributions to the [NZSF].[20]

This extra burden is inevitable to an extent, because an aging population will impose extra costs on society, but it puts a heavy load on today's workers. And the cost is substantial; NZ Super currently costs $8 billion a year, while KiwiSaver and the NZSF will add another $4 billion by 2016.[21]

KiwiSaver's incentives provide the most benefit to the wealthy who can afford to save more.

On top of this, in recent years the government has funded capital spending (large physical items like roads, schools, and hospitals) out of general taxation. In effect, this is another form of forced saving, because previous governments have used debt to spread this cost over time. Last year, the government used $1.8 billion for this purpose, which means the taxpayers of 2007 paid the total cost of many projects that future generations will enjoy.[22]

If continued, all these policies will cost a total of $14 billion a year by 2016. To put into perspective how big this figure is, last year the government collected just over $24 billion through income tax in New Zealand.[23]

Of course, many taxpayers will benefit from these policies once they are retired. But this forces an enormous shift in spending patterns by making taxpayers delay spending until they retire, thereby reducing their living standards in the present. National Party deputy leader Bill English is right to warn that 'we can't win the hearts and minds of 20-year-olds by telling them that the best thing about New Zealand is retiring into a plush rest home.'[24]

Many taxpayers, especially those on lower incomes, will not benefit from this forced investment, because KiwiSaver's incentives provide the most benefit to the wealthy who can afford to save more or who have the flexibility to move existing unfavoured savings into the favoured KiwiSaver scheme. According to Waikato University's School of Management, more than 45% of the working-age population earn below $30,000, and they will get just 15% of KiwiSaver tax incentives.[25]

In effect, workers who do not join KiwiSaver (and in most cases this will be people who cannot afford to give up 4% of their salary) will be subsidising those who can afford to save.

Sustainability: Can it last?

KiwiSaver and the NZSF are going to become highly expensive policies. With the added burden of an aging population, how affordable will our retirement policies be in the future?

In 2006, Treasury published the first in a series of reports on how demographics will affect New Zealand's long-term fiscal position. Together, increasing life expectancy, declining fertility rates, and the baby boomer generation reaching retirement age mean that by 2050 the number of people aged over sixty-five will triple. For every retired person, there will be just two workers, compared to five today.[26]

With the contributions of the NZSF to smooth costs, Treasury estimates that the cost of NZ Super will rise from just over 4% of GDP today to around 6% by 2050.[27] An aging population also puts pressure on health spending, which is expected to double over the same period, rising from 6% to 12% of GDP.[28]

Given this increased pressure, it seems strange for the government to increase its future commitments, especially when other nations are trying to contain the cost of retirees' entitlements. An OECD report last year noted 'a clear underlying trend towards a reduced pension promise for today's workers when compared with past generations.'[29] Many countries are gradually raising the age of retirement to sixty-seven, while others are tying the value of the pension to prices rather than wages, which will slow the increase.

The Retirement Commission has expressed unease at the unknown future cost of the new KiwiSaver incentives, and has urged Treasury to prepare costings. In its annual review for 2007, it asks:

> Can New Zealand continue to afford the current level of KiwiSaver incentives? The costs of KiwiSaver beyond 2017 are not available … This is a serious problem, given that KiwiSaver is an expensive policy, and that retirement income planning is a long-term issue … the danger is that these costs become too high, and something has to change.[30]

Given the high future cost of KiwiSaver, can we rely on future governments being able to afford NZ Super as well? Michael Cullen insists that both schemes can co-exist:

> KiwiSaver also helps to assure the future of NZ Super. That's because, having contributed extra savings throughout their working lives, New Zealanders would rightly be outraged if a future government were to come along and tax them for their efforts later by, for example, trying to means test or abate NZ Super.[31]

Others disagree, such as Michael Littlewood, who argues that KiwiSaver will make means testing of NZ Super more likely in the future. 'Tomorrow's government could say, reasonably, that we have already helped our saver to pay for that KiwiSaver annuity,' he says. 'We have set off down the Australian compulsory saving path so an income- and asset-tested NZ Super pension seems a logical conclusion.'[32]

Any time a government changes policy, it hurts people who have made investment decisions based on different assumptions.

Stability: Will it last?

Stability in retirement policy is crucial because citizens need to plan long-term for their retirement, up to fifty years in advance. Any time a government changes policy, it hurts people who have made investment decisions based on different assumptions. Therefore, any changes should be widely consulted on and signalled in advance. Political stability is just as important as the economic issues.

To date, the progress of KiwiSaver has not been promising. The major changes from last year were introduced under secrecy, to the ire of business groups. Business NZ head Phil O'Reilly labelled the introduction of employer contributions as 'the worst political ambush in 20 years,' a move that would threaten consensus around retirement issues.[33]

To date, the National Party refuses to say whether it will keep the changes to KiwiSaver if elected, or how it would modify them. Auckland University economist Susan St John is concerned at this, telling the *New Zealand Herald* the changes are

> too much, too soon and do not have the buy-in of the electorate, which raises the chances of instability down the track. St John says cross party talks have in the past yielded good policy on superannuation, but unilateral decisions rarely produce the same result.[34]

The Retirement Commission also worries that 'KiwiSaver has made retirement income policy more complicated and unstable.'[35]

KiwiSaver has also reignited the debate around compulsory super. In 1997, a public referendum resulted in 93% of voters rejecting the concept, but now the issue is once again being promoted by politicians. New Zealand First leader Winston Peters and United Future leader Peter Dunne have both called for KiwiSaver to become compulsory, but have failed to explain how NZ Super would fit into the equation.[36] The Retirement Commission is unhappy, complaining that 'such calls are unhelpful to the stability of policy.'[37]

The efficiency of KiwiSaver

The major changes to KiwiSaver are yet to fully take effect, but the uncertainty and compliance costs imposed on employers are significant. In particular, the rushed and secretive way in which the government introduced the changes has created administrative headaches.

For example, an early loophole (since closed) allowed visiting Australians to sign up and claim the government's $1000 kickstart.[38]

According to employment lawyers Aaron Lloyd, the law is also unclear on how KiwiSaver fits in with existing employer superannuation schemes:

> It's almost impossible to understand. We've got four tax partners in our firm and, between them, they don't even have the same interpretation and that's just one law firm. It's hideous to understand and I would expect some tweaking, whether it be National or Labour.'[39]

Business New Zealand warns that KiwiSaver will see more industrial action and litigation as uncertain parts of the law are tested in court.[40]

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Another contentious issue is the performance of the managed funds industry in New Zealand. Michael Littlewood argues that the financial services industry has done little to earn the windfall that KiwiSaver provides,[41] while Gareth Morgan describes many providers as 'bastards' because of their high fees and lack of transparency.[42]

Part 2: KiwiSaver, savings, and economic growth

Besides boosting the income of New Zealanders in retirement, KiwiSaver has a distinct secondary motivation for attempting to boost savings: to increase economic growth.

Advocates such as David Skilling of the New Zealand Institute and Michael Cullen strongly argue that higher savings will boost economic growth for the following reasons:

- More saving means more investment, because the cost of capital (borrowing) will be lower. If we are not saving enough to finance our own investment then we have to borrow from overseas lenders, who charge a 'risk premium' to reflect that New Zealand is a small country with a heavy reliance on borrowing. This lack of investment is a major reason why New Zealand's productivity and wages lag behind Australia's.[43]
- Increased savings will mean more local ownership of companies, rather than profits flowing to overseas owners. Known as 'hollowing out,' critics warn that New Zealand risks becoming a 'branch office economy' of Australia as Australian super funds acquire more of our local companies. This is a major driver of New Zealand's high current account deficit.
- More saving means less spending, which eases pressure on inflation.[44]

But every policy has costs, too. In recent years, a determined team of researchers and economists has been challenging the savings mantra, highlighting three major concerns:

1. Measurements of savings are far too narrow and don't reflect accurately how much wealth people really have.

2. Government attempts to encourage extra savings rarely succeed.
3. The relationship between domestic savings and growth is doubtful.

Does New Zealand really have a savings 'problem'?

The first issue to consider is New Zealand's current level of savings. As explained earlier, most people seem to be making adequate provision for retirement. But our household saving rate has been in decline for the last twenty years, and last year the average household seemingly spent $1.15 for every dollar earned. Consumer spending has also greatly increased, and average household debt is now 155% of disposable income.[45]

Michael Cullen relies on these figures heavily in speeches and press releases. 'We simply need to increase our levels of household savings,' he warned after introducing KiwiSaver.[46]

However, while household savings receives the most publicity, it is a highly unreliable estimate. The problems with defining and measuring true levels of 'wealth' have been catalogued in a paper by Trinh Le of the New Zealand Institute of Economic Research.[47] Her paper convincingly outlines some major flaws in the data that the government has relied upon:

- Household savings do not measure the 'hidden' economy, involving tax evasion and illegal activity. This is likely to be significant—especially since the increase in the top rate of personal income tax.[48]
- Many New Zealanders hold significant amounts of money in trusts and companies that are not counted as part of household savings. The Reserve Bank estimates that assets held in trust are worth close to $90 billion, and interest in farms is worth $38 billion.[49]
- Household savings also fails to measure wealth held overseas, which again is likely to be significant, given that New Zealand has experienced high immigration and that a large number of people spend time living and working overseas.
- Household saving is just one part of overall national savings, which is largely unchanged over the last two decades. Corresponding with the fall in (measured) household savings has been an equivalent large increase in government and business saving.

A Treasury study from 2006 that took house values into account actually found a positive level of household savings overall, and no negative trend over the last decade.[50]

All of this shows the problems with trying to find the right definition of 'wealth' beyond simply money held in the bank or in traditional vehicles like superannuation schemes. As a result, Treasury concedes that 'until better measures become available there is little we feel that can be confidently concluded about household savings.'[51]

A country's level of saving tends to be fairly stubborn no matter which policies governments try.

Will KiwiSaver raise aggregate savings?

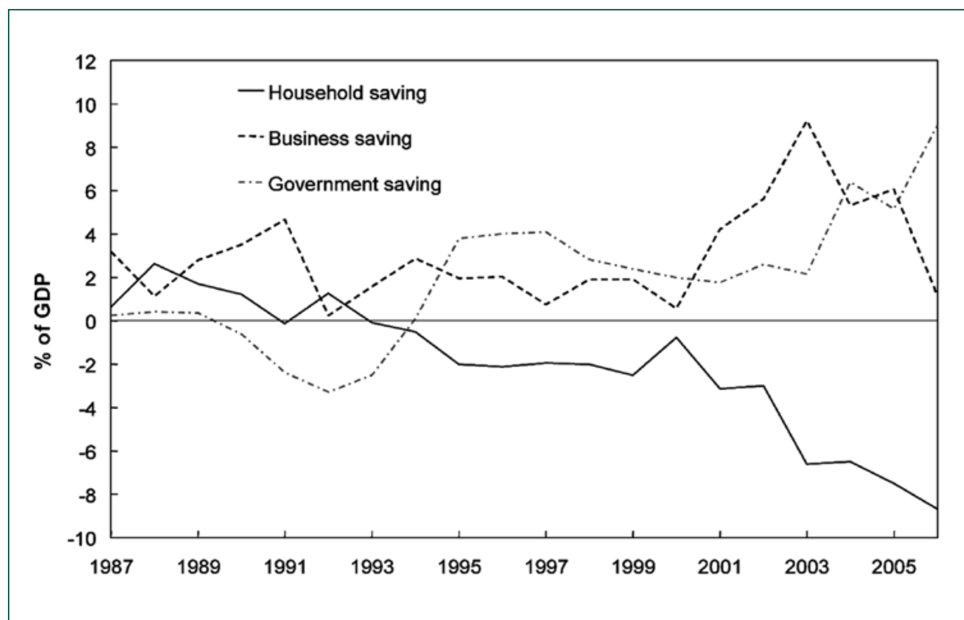
Even if we were to accept that New Zealand has a savings 'problem,' the question remains—will KiwiSaver actually increase savings? Financial writer Mary Holm worries that 'the government is spending huge amounts of money persuading thousands of people to do what they were going to do anyway.'[52]

Evidence from around the world shows that a country's level of saving tends to be fairly stubborn no matter which policies governments try. Auckland University's Retirement Policy Centre has gathered a range of studies showing that saving incentives do change behaviour, but it tends to come in the form of substituting one kind of saving for another.[53]

Perhaps surprisingly, even compulsory schemes tend to have only a modest impact on overall saving rates. In Australia, it is estimated that for every dollar saved via the compulsory scheme, other savings fall by thirty to fifty cents.[54] Despite compulsion, Australia's pattern of saving is remarkably similar to New Zealand's, with negative household savings and a large current account deficit.[55]

Even when the government saves directly, through budget surpluses and the NZ Superannuation Fund, the rest of the community tends to adjust in response. Figure 1 clearly shows this happening in New Zealand. As the government has increased savings, household saving has (apparently) declined. This is a trend apparent throughout the world.[56]

Figure 1: Household and government saving—An inverse correlation



Source: NZIER[57]

It is important to remember that household saving is only one component of overall national saving, which in New Zealand's case is positive and has been since 1993.

So, will KiwiSaver make any difference to our national saving rates? The new model is barely a year old, but the early evidence is not promising. A recent study by Waikato University found between only 9% and 19% of KiwiSaver cash was 'new' savings. According to the study's author, Professor John Gibson:

A recent study by Waikato University found between only 9% and 19% of KiwiSaver cash was 'new' savings.

> The rest is either reshuffling among existing saving and debt by KiwiSaver members, or else taxpayer and employer transfers which decrease national saving elsewhere. When the deadweight loss of tax incentives is taken into account, along with the administration, compliance and implementation costs, then KiwiSaver is likely to lower rather than lift national saving.[58]

Will more savings boost growth?

Even if we accept that New Zealand has a savings 'problem,' and even if we accept that incentives will increase savings, the crucial question remains—will greater savings actually boost economic growth?

New Zealand does not save enough to fund all our investment, which means we rely upon borrowing from overseas. Theoretically, this does not present a problem, as long as the returns are good. But critics like David Skilling argue it has two major drawbacks—(1) the cost of borrowing is higher and (2) investors have a natural bias towards their home countries rather than foreign ones. Therefore, he argues that 'one of the best documented results in economics is the persistent correlation between domestic savings and domestic investment.'[59]

Once again, though, trying to prove this is difficult. A Treasury research paper last year attempted and largely failed to find any evidence that our economy is suffering from a lack of investment money (known as 'capital'). In particular, it found:

- Little or no evidence that firms struggle for access to capital unless they perform poorly.
- Little demand for capital: in a recent survey, 93% of businesses reported no intention of growing their business. This seems to be a much more serious concern for economic growth.
- A slightly higher cost of capital compared to other OECD countries, due to higher interest rates. Yet it is 'unclear on how responsive investment would be to a fall in the cost of capital … There is also some controversy about how much the real cost of capital matters for investment and, therefore, GDP growth.'[60]

Will KiwiSaver mean more local ownership of companies? It may well do, as funds build up and look for investment opportunities, but it is likely to be a drop in the bucket compared to the enormous overseas funds already in existence. The Reserve Bank notes that 'we are currently seeing a phenomenon where considerable private equity is roving the world looking for investment opportunities.'[61] Australia is estimated to have close to a trillion dollars in assets, and in any event much of KiwiSaver's funds will be diversified and invested overseas—just as the NZSF is.[62]

Infometrics ... concluded that 'no evidence was found to suggest that [compulsory super] has generated higher savings, stronger wealth accumulation or higher rates of economic growth in Australia.'

Australia's economic boom is widely used as an example of the benefits of savings. But how much of that can be directly attributed to compulsory super? In other words, would that growth and investment have happened anyway? This is a crucial question. For new savings programs to boost the economy, three things must happen:

1. There must be a higher rate of savings than would otherwise be the case (as explained above, this is uncertain).
2. That extra funding has to be delivered into more and better investments in the local economy.
3. The resulting investments must lead to an increase in output.[63]

Last year, New Zealand's Retirement Commission hired Infometrics to find out if this has happened in Australia. They concluded that 'no evidence was found to suggest that [compulsory super] has generated higher savings, stronger wealth accumulation or higher rates of economic growth in Australia than might have developed in the absence of [compulsory super].'[64]

Likewise, it is hard to find any Australian evidence that credits compulsory savings for boosting growth. Instead most commentators and government bodies point to the reforms of the 1980s and 1990s, in particular deregulation, privatisation, reducing trade barriers, tax reform, and allowing more flexibility in the labour market.[65]

What really seems to matter is the *quality* of investment rather than the quantity or source, and this should be the main priority for New Zealand. A clear warning comes from Japan's plight: it has a surplus of domestic savings but offers poor returns on investments.[66]

An interesting illustration of this comes in a recent column in the *New Zealand Herald* by investment manager Brian Gaynor. He bemoans the decision of Prime Minister Muldoon to scrap a short-lived compulsory savings scheme in 1975, arguing that

> Without this decision we would now be called 'The Antipodean Tiger' and be the envy of the rest of the world. We would have a current account surplus, one of the lowest interest-rate structures in the world and would probably rank as one of the top five OECD economies.
>
> There is little doubt the abolition of the Superannuation Scheme was our worst economic decision over the past 40 years. The economy would be in a much stronger position today had the far-sighted scheme stayed.[67]

Once again, this raises the question: if the scheme had stayed in place, how well would that money have been invested? In the late 1970s, the major recipient of domestic

investment was oil and gas, into which the government poured billions of dollars in a scheme known as 'Think Big.' Of course, the scheme was a disaster, and it wasn't until the mid-1990s that the government finally paid off the crippling debts it incurred. Had compulsory super been in existence at the time, it is more than likely that its funds would have been used on Think Big and that a generation of New Zealanders would consequently have lost their retirement income.

This helps to explain why there is significant evidence from around the world that growth causes savings, not that forced savings causes growth.[68] All of this makes KiwiSaver a risky and uncertain proposition for the government to spend $2 billion a year on.

The costs of saving

'There is no such thing as a free lunch.' —*Milton Friedman*

Much of the attention paid to KiwiSaver has focused on the lucrative benefits it offers individuals, and the claimed benefits of higher saving. Less attention has been paid to the *costs* of higher saving. It is important to remember that every policy has a cost, and that every government action produces reactions, many of which can be unexpected and harmful.

These potential drawbacks of KiwiSaver need to be considered by policymakers:

- Incentives to save will distort people's rational decision-making. For many New Zealanders, it is now more rewarding to invest in KiwiSaver than it is to save in other ways, such as by paying off debt or a mortgage, buying shares, or investing in their business. In fact, one financial advisor says it is now logical for some people to borrow money on a credit card if necessary to take part in KiwiSaver.[69] The economic damage caused to a country by these distorted decisions is known as 'deadweight cost,' and is likely to be substantial.
- Employers will soon be faced with an extra bill of 4% of wages for every employee who signs up to KiwiSaver. Putting this extra burden on employers is likely to hurt job and wage growth.
- More saving means less spending by people today. This may help reduce inflationary pressures, but it also removes stimulation from the economy.
- The opportunity cost of KiwiSaver is significant—$2 billion is more than the Defence force's entire budget for 2007.[70] Financial writer Mary Holm is advising people to join KiwiSaver, but is uncomfortable about the choice of priorities. 'I just wonder,' she says, 'if the thousands of dollars I'm going to be getting for investing in KiwiSaver should have been spent on better breakfasts for children in South Auckland or something.'[71]

The economic benefits of tax cuts are much more established in theory and in practice than those of saving.

If this $2 billion was used for tax cuts instead, it would give people the flexibility to make decisions in their own best interests, by paying off debt, investing or saving—whatever purpose they see fit. The economic benefits of tax cuts are much more established in theory and in practice than those of saving.[72]

Conclusion: Scrap the incentives

To summarise, KiwiSaver has the following faults:

- *Adequacy*. Most New Zealanders are already saving enough, and many young people may now end up with a *higher* income in retirement than in work.
- *Equity.* KiwiSaver largely benefits the wealthy, who can afford to save more, and penalises younger generations who must now save and pay for a large part of their own retirement while also paying to support today's retired generation.
- *Stability and sustainability*. KiwiSaver politically and economically threatens the future of New Zealand Super by adding to the cost of an aging population and making means testing more likely in the future.

- *Economic growth*. The impact of KiwiSaver is highly uncertain. There is little evidence that New Zealanders are poor savers, that KiwiSaver will increase savings, or that higher savings will boost growth. The economic costs of KiwiSaver have not been fully explored.

The original KiwiSaver, as announced in 2005, was an innovative policy. The 'opt-out' provision was an original way of overcoming most people's natural inertia while still allowing people flexibility in how they saved and organised their lives.

The problems have come with the addition of subsidies. By rushing changes through, it seems the government has failed to fully define the problems KiwiSaver is meant to fix, and it has failed to consider the wider ramifications of tinkering with retirement policy.

Therefore, the conclusion of this paper is simple: the expensive KiwiSaver subsidies, whether funded by employers or taxpayers, should be scrapped because of the high costs they will incur while providing only uncertain benefits.

Endnotes

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