

Good, but what's next?

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Initiatives to encourage personal savings were a centrepiece of yesterday's Budget. The announced changes to the KiwiSaver scheme represent a significant expansion to the scheme, and make it much more likely that KiwiSaver will have a material impact on New Zealand's overall savings performance.

The government's decision to match voluntary employee contributions up to about \$1000 a year, and to require employers to match the voluntary contributions of their employees up to 4% of their income within the next four years, will make employee participation in KiwiSaver much more likely. Combined with previous government decisions to provide a more favourable tax treatment of employer contributions to employee savings schemes, this will generate a substantial increase in personal savings.

There was fiscal room to do more. For example, the government could have announced steeper cuts in the company tax rate, say to 25% or 28%, to compensate employers for the increased wage bill generated by the required matching contributions, and there was fiscal room for personal tax cuts that could have been directed into individual savings accounts.

Nevertheless, the Budget announcements represent a very significant commitment to promote individual and national savings. This approach also allows for moderate tax relief to be given in a way that does not generate inflationary concerns.

Encouraging savings will have a range of important benefits. For individuals, increased savings will strengthen their personal financial position as well as providing them with a more significant ownership stake in the New Zealand economy – helping to ensure that New Zealand is a nation of owners not just of employees.

Increased savings will also strengthen the New Zealand business environment. Over time, increased personal savings will strengthen New Zealand's capital markets and provide a much larger domestic pool of capital that can finance the growth of New Zealand firms. Goldman Sachs JB Were estimates that the expanded KiwiSaver scheme will generate increased funds flow of between about \$5 and \$7 billion a year by 2013.

A larger pool of domestic capital will also reduce New Zealand's very heavy reliance on foreign capital, will place downward pressure on New Zealand's cost of capital, and also allow for a larger New Zealand ownership stake in the New Zealand economy.

However, increased savings on its own is not a silver bullet that will transform the New Zealand economy. If New Zealanders do not have profitable opportunities in which to invest with these savings, the existence of a larger pool of domestic capital is unlikely to generate a substantial improvement in New Zealand's growth rate.

Savings is better seen as a prerequisite for stronger economic performance – without a larger pool of domestic capital and vibrant capital markets, New Zealand will not be positioned to capture as much of the upside from any future improvement in growth and productivity. It is the interaction of a larger domestic pool of capital and a strengthened productive base that will generate improved economic performance in New Zealand.

The Budget contains some initiatives that contribute to a stronger economic base in New Zealand. For example, the reduction in the headline corporate tax rate from 33% to 30% as

well as the ongoing increases in infrastructure investment. Similarly, the significant R&D tax concession will assist firms active in developing knowledge intensive goods and services and will make it easier for New Zealand to attract and retain such firms.

In Export Year, there is some modest financial assistance for internationally-engaged firms in terms of international market development assistance. Even more significant are the changes to the international tax regime that provide a much more helpful tax environment for New Zealand firms operating in international markets.

But overall, while the significant commitments to savings policy are very welcome and will address some major exposures in the New Zealand economy, there is a real lack of urgency in yesterday's Budget.

New Zealand faces some major economic challenges. New Zealand's per capita income is now 22nd out of 30 OECD countries, having just been overtaken by Greece. And New Zealand's per capita income is about 30% lower than Australia's, with the consequent pressure for people and firms to relocate across the Tasman. The New Zealand economy is gradually detaching itself from the income levels of the developed world.

New Zealand is operating in an intensely competitive global environment, and lifting our income levels will require deliberate, sustained effort with a very clear strategic focus on positioning New Zealand to compete in the global economy. Yesterday's Budget has some very positive features, but much, much more is needed to grow a strong, competitive New Zealand economy.

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