

Hands-off savings policy must go

By David Skilling

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Falling household wealth is a big problem that demands bold intervention, writes Dr David Skilling.

A big challenge requires a bold solution. The New Zealand Institute recently proposed policy solutions to help many more New Zealanders get ahead financially and to raise the level of national savings. These proposals have generated significant debate. So I'd like to take the opportunity to explain why these proposals are necessary and proportionate, and respond to some concerns raised about the proposals.

First, some background. Many New Zealanders don't have an ownership stake, with 800,000 adult New Zealanders estimated to own less than \$20,000. Over the past decade, household savings and financial wealth have declined, household borrowing has increased steeply, home ownership rates have declined, and student loan debt has risen.

At a national level, New Zealand has the lowest household savings rates in the OECD, has generated large and persistent current account deficits, and is one of the most indebted countries in the developed world.

And this despite strong economic growth, tax cuts, reduced public provision, and other factors conducive to increased personal savings and asset ownership. The clear lesson is that New Zealand's unusually hands-off policy approach to savings has not worked, and that deliberate support is required – as in Australia, the US, the UK and most other OECD countries, where such policies are widespread and successful.

Left unchecked, New Zealand's savings and ownership outcomes will impose increasingly significant economic and social costs. Serious social pressure will be generated if many New Zealanders do not have a meaningful asset ownership stake. And low national savings and high external debt generate high interest rates and constrain investment and growth.

This is one of New Zealand's most pressing economic and social challenges. To say, as both Michael Cullen and John Key have recently, that addressing this challenge is not a first order priority and does not require a significant policy response, is simply not good enough.

Unfortunately on this issue, as with many others, New Zealand is the country of the substantial challenge and the modest solution. We are great at identifying problems – recent examples include low per capita incomes, infrastructure and congestion – but lousy at developing solutions that will generate material improvements. Too often we settle for half-measures that won't fix the problem.

The New Zealand Institute's view is that a big challenge demands a bold solution. So we have made a bold proposal for a system of individual savings accounts that can be used over a lifetime for education, home ownership, and retirement.

This proposal includes the automatic creation of individual savings accounts for all New Zealanders at birth, funded by government and by individuals, so that all young New Zealanders will have an ownership stake. Assisting young New Zealanders to build an asset is a better approach than using resources to assist them into debt through the student loans scheme.

We also propose an across the board tax cut of 2% that will be used to finance these individual accounts, so that people can save without reducing current consumption. This approach reflects a judgement that it is better for this money to be in an individual's account than in the government's hands, and that requiring this money be saved is an appropriate response to the risk that unrestricted tax cuts will be spent – causing inflation and reduced national savings. Unsurprisingly, this balanced approach has made those on both the left and the right uncomfortable.

And lastly we propose that the government match voluntary savings of up to \$1000 a year at the rate of 50c:\$1, and \$1:\$1 for lower income New Zealanders. This is a powerful way to encourage voluntary savings and promote a savings habit.

This is a largely voluntary scheme with individuals able to participate or not as they wish. The only element of compulsion is the required saving of the tax cut. We believe this is an appropriate mix between encouragement and compulsion to save.

Indeed, these proposals to promote personal asset ownership are intended to allow individuals to exercise much more, not less, personal independence and control. So despite the element of paternalism in the design of the proposed policies, the primary motivation is not paternalistic.

Our proposals simply reflect the overwhelming international and New Zealand evidence that improved savings and ownership outcomes are more likely to arise in the context of policies that deliberately promote savings. New Zealand's completely hands-off approach has delivered poor savings outcomes and a more deliberate approach is needed. Although, as the Herald recently editorialised, freedom of choice is a desirable principle, it does not always trump all other considerations. And in the context of savings policy, there is a compelling case for imposing some restrictions on choice.

These proposals will generate a material improvement in savings and ownership outcomes. Individuals will be able to get ahead financially much more rapidly, and an increase in national savings of at least a few percentage points of GDP is likely.

This obviously comes at a cost. When fully operational, the kids' savings accounts may cost up to \$350 million p.a., the tax cuts about \$1.4 billion p.a., and the matched savings scheme up to about \$1.5 billion p.a., for a total of about \$3.25 billion p.a.

Much has been made of this fiscal cost. Michael Cullen deemed the proposals "totally unaffordable" and John Key also regards the proposals as too expensive. However, this spending will be phased in over several years, not immediately, and can be implemented in a fiscally responsible manner. The important thing is that we commit to a response that reflects the size and importance of the savings and ownership challenge.

Michael Cullen notes that government borrowing may need to increase slightly to finance the cost. But slightly lower public savings to finance increased private savings is a worthwhile trade-off. For one thing, personal asset ownership will generate benefits that public savings cannot. And over time this is likely to lead to higher national savings as personal savings habits are developed.

Ultimately, this is about allocating resources according to strategic priorities. To benchmark our proposals, consider the \$2-2.5 billion p.a. that the government commits to the Cullen Fund, to meet a public savings objective, and the \$1.1 billion p.a. committed to the Working for Families package. Given the scale of the ownership challenge, we believe our proposals are a measured, proportionate response and that they will deliver a substantial improvement in the asset ownership position of many more New Zealanders and in the level of national savings.

There is currently a window of opportunity to invest in the future, with strong economic growth and a healthy fiscal position. Full advantage should be taken of this opportunity to implement bold initiatives that will be sufficient to materially improve savings and ownership outcomes.

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