

KiwiSaver Plus

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It is now well recognised that New Zealand has a serious savings challenge. This is becoming increasingly apparent in outcomes like New Zealand's large current account deficit, small capital markets, and stretched household balance sheets.

New Zealand's current hands-off approach to personal savings is now widely seen to be delivering poor outcomes. Increasingly the view is that a much more deliberate approach to encouraging household savings is required. Without meaningful policy action to raise household savings, the New Zealand economy will continue to be exposed to significant risks and more importantly will not be positioned for real economic strength going forward.

For these reasons, the New Zealand Institute has welcomed the introduction of the KiwiSaver scheme as a step in the right direction. Michael Cullen deserves credit for introducing this scheme to encourage household savings, along with establishing the Superannuation Fund and the State Sector Retirement Scheme.

However, although KiwiSaver is a step in the right direction, it is only a modest first step. KiwiSaver is a voluntary workplace savings scheme, where individuals can elect to contribute either 4% or 8% of their income, but with no financial incentive to do so except for a \$1000 up-front payment for joining the scheme.

Without an ongoing financial incentive to save, participation rates are unlikely to be high even with the 'automatic enrolment' design feature. The government's projection, which is likely to be on the optimistic side, is for 25% participation by 2014. But even if 25% of the employed population do contribute 4% of their income, the increase in savings will only be about 1% of employment income (about \$630 million or 0.4% of GDP).

This is progress, but it will not deliver a meaningful improvement in New Zealand's national savings performance, the strength of New Zealand's capital markets, or the state of household balance sheets. A much more ambitious savings policy response is required.

Indeed, there seems to be an emerging consensus that KiwiSaver should best be regarded as a platform on which a more ambitious savings scheme can be built. With the KiwiSaver Bill currently in Select Committee, it is a good time to consider how the KiwiSaver scheme can be expanded so that the KiwiSaver legislation can be written with this in mind.

To this end, the New Zealand Institute's KiwiSaver Bill submission contains a proposal for an expanded KiwiSaver scheme – KiwiSaver Plus – that is based on required employer contributions and voluntary individual contributions.

In this KiwiSaver Plus scheme, employers would be required to contribute 4% of each employee's income into the employee's savings account. This employer contribution would be financed, at least in part, by a company tax rate cut. This employer contribution may also be partly financed through slightly lower wage growth in future years.

A required employer contribution element serves a few purposes. First, it means that everyone in employment will have an account with contributions being made. It responds to a standard

objection to compulsory savings schemes that people on low incomes will be placed in real hardship by the requirement to contribute. Here, the required contribution will be made by employers rather than by individuals. And second, it is a way of transferring money from the government to individuals in a non-inflationary way by directing that the tax cuts be used to boost personal savings.

Required contributions are a necessary part of the New Zealand response because of the scale of the challenge we face. Generating a material increase in personal savings cannot be achieved simply through a voluntary approach, even with very aggressive incentives. Indeed, required employer contributions are in place in many OECD countries from Australia to Iceland, and have just been recommended in the UK by the Turner Commission on pension reform.

In the KiwiSaver Plus proposal, individuals can also elect to contribute an additional 4% of their income. As with the existing KiwiSaver scheme, there would be automatic enrolment into this part of the scheme with an opt-out clause. However, KiwiSaver Plus would include an incentive to contribute in the form of an ability to make contributions out of pre-tax income. Contributors would not pay income tax on the 4% contributed voluntarily until the funds are withdrawn from the account. This tax advantage makes participation in KiwiSaver Plus much more likely than in the current KiwiSaver scheme.

KiwiSaver Plus would deliver a much larger increase in private and national savings than the existing KiwiSaver scheme. The required 4% employer contributions would amount to about \$2.5 billion a year, or 1.7% of GDP. Because of the tax advantage on voluntary contributions, a participation rate of 50% in this part of the scheme seems reasonable. This would generate additional annual savings of \$1.25 billion, or 0.8% of GDP. Taken together, KiwiSaver Plus could generate an increase in savings of a bit under \$4 billion a year, or 2.5% of GDP, over six times the likely effect of KiwiSaver.

The positive impact on national savings due to this increase in personal savings may be offset by reduced government savings because of the tax cuts given to finance the employer contributions. However, the offset is unlikely to be large because if these tax cuts were not made, the revenue would likely have been spent by the government.

KiwiSaver Plus would make a material contribution to New Zealand's savings performance. After a decade in operation, KiwiSaver Plus would have generated accumulated personal savings of over \$40 billion in real terms, much of which will be new savings. Given that there are 2 million people currently in paid employment, this means that a New Zealander on the average income would likely have a KiwiSaver Plus account balance in excess of \$20,000.

There is currently a window of opportunity to take meaningful action to increase savings with a healthy fiscal position, low rates of unemployment, and strong wage growth and corporate profitability. We need to seize this opportunity to expand the KiwiSaver scheme, and thereby strengthen the New Zealand economy and move New Zealand forward.

Dr David Skilling is the chief executive of the New Zealand Institute, a policy think tank. The Institute's KiwiSaver submission is available at www.nzinstitute.org