POLICY POINT

Borrowing to Save: Retirement Income Policy After Covid-19

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Introduction

The Government's response to the economic challenges of Covid-19 has primarily focused on new spending which will balloon public debt from 19% of GDP in 2019 to 30% in 2020 and peak at nearly 54% of GDP by 2024. It is only expected to modestly fall to 42% of GDP by 2034.

A clear choice has been made to defer paying the costs of the Government's economic response to the Covid-19 crisis into the future, either by lower levels of public spending or higher levels of taxation. This choice may be correct, but given the inevitability of future crises, not to mention the costs of servicing higher levels of debt, it is prudent to consider if the country's wider policy priorities should remain the same. Savings can be made by reducing existing low-value Government spending and looking for new opportunities to meet policy objectives more efficiently.

One area where evidence suggests significant savings could be made, with little impact on public policy objectives, is retirement income policy concerning KiwiSaver, New Zealand Superannuation and the New Zealand Superannuation Fund.

KiwiSaver

Introduced in 2007, KiwiSaver is a voluntary, defined contributions savings scheme built to increase the retirement wealth of its target population. Its key features include automatic enrolment of new employees, a minimum employee contribution rate, compulsory matching contributions by employers and other Government incentives to join and contribute. In 2019, Government subsidies to KiwiSaver totalled $951 million.

KiwiSaver's performance has been rigorously evaluated with two studies focusing on five important dimensions of the scheme's performance.[1] The studies used a survey designed specifically to evaluate KiwiSaver along with the Survey of Family, Income and Employment (SoFIE) following a large group of individuals over eight years. SoFIE measured changes in the individuals' assets and liabilities both before and after the introduction of KiwiSaver.

The key findings:

- Only a third of contributions to KiwiSaver represented new savings, while two thirds would have happened without the scheme due to substitution between KiwiSaver and other forms of saving (such as paying down a mortgage);

[1] Law, D., Meehan, L., & Scobie, G. (2017). KiwiSaver: An evaluation of a new retirement savings scheme. *New Zealand Economic Papers*, 51(3), 262-280.
Law,D., & Scobie, G. (2018). KiwiSaver and the accumulation of net wealth. *New Zealand Economic Papers*, 52(1), 1-20.

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- KiwiSaver membership had no effect on net worth accumulation on average (controlling for other factors that might alter net worth accumulation);
- KiwiSaver membership also did not affect expected retirement income outcomes;
- In terms of standard measures of programme efficacy, which measure how good a policy is at reaching those it is intended to help versus those who do not benefit in the way the policy envisaged (target effectiveness and leakage), KiwiSaver performed poorly. Leakage to the non-target group was estimated to be 93%;
- After accounting for other factors, including the scheme's impact on public saving, KiwiSaver's effect on national saving (the sum of public and private saving) was negligible.

Overall, KiwiSaver has performed poorly and Government subsidies represent poor value for money. In the current dire economic context, it would make a great deal of sense to end Government subsidies to saving through KiwiSaver. If this were to happen in 2021, Government debt as a share of GDP in 2034 would be approximately 4.5 percentage points lower, all else equal.

New Zealand Superannuation

New Zealand Superannuation (NZS) is a universal Government-funded pension scheme intended to ensure a basic standard of living for the elderly. Currently, the age of eligibility for NZS is set at 65 and payments are indexed to wages. NZS contributes to low old-age poverty rates but comes at a considerable cost. In 2019, spending on NZS was approximately $14.6 billion, or 4.7% of GDP, but due to population ageing its costs are projected to increase to 7.9% of GDP by 2060, according to the latest long-term fiscal statement from Treasury.

However, analysis using long-term population projections from Statistics New Zealand suggests that even relatively modest changes to NZS can lead to significant fiscal savings over time.[2] Three policy options to reduce the costs of NZS were considered and compared.

The first option was to increase the age of eligibility by two years from 65 to 67. The second was to gradually reduce the generosity of NZS over time by indexing payments to the average of wages and the general price level (consumer price index, or CPI). Today, NZS payments are indexed only to wage growth which typically outpaces growth in the CPI. The third was to make KiwiSaver compulsory and use those accumulations to reduce NZS entitlements. All three options included enough time for people to adjust their affairs.

To generate fiscal savings in the medium term, the first option was the clear winner, delivering steady annual savings of about 0.75% of GDP. Indexation changes in the second option could also reduce the costs of NZS over time but would take about 14 years to match those generated by lifting the age of eligibility. The third option would take 30 years and makes less sense considering the weak efficacy of KiwiSaver.

Many of New Zealand's peers in the OECD have already reformed their superannuation systems to account for increases in life expectancy and continued population ageing. Since the last changes to NZS (increasing the age of eligibility from 60 to 65 between 1992 and 2000) life expectancy has increased by around two years and will continue to do so. Now would be a good time to act.

If, for example, the Government raised the age of eligibility for NZS by two years from 2025 and slowed the growth of individual NZS payments slightly through indexation adjustments

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2 Law, D. (2016). Retirement income policy and national savings. *New Zealand Economic Papers,* 50(1), 29-50.

from 2021, Government debt as a share of GDP in 2034 would be approximately 12.4 percentage points lower. Furthermore, indexing the age of eligibility to changes in life expectancy would reduce the need for periodic re-evaluation of NZS settings and provide greater certainty to future NZS recipients. Of course, making people rapidly plan for an additional two years before retirement would be a tough ask. But phasing in increases in the age of eligibility over a longer period could help to get to a similar place.

The New Zealand Superannuation Fund

The New Zealand Superannuation Fund (NZSF) is a public savings vehicle created to help meet the future cost increases of NZS due to population ageing. While it is true the superannuation costs as a share of GDP are expected to rise over time, they will remain much lower than the OECD average. If changes are made to NZS now, as described above, the case for keeping the NZSF would be even weaker.

The NZSF currently holds about $44 billion for a rainy day. Despite the Covid-19 situation, the Government still plans to borrow an additional $10.4 billion over the next five years to make further contributions to the NZSF. At the least, contributions to the NZSF should be suspended as happened during the 2008 Global Financial Crisis.

Rain is already here and thunder and lightning are flashing on the horizon. Serious consideration should now be given to winding up the fund early. The expected balance of the NZSF in 2024 is approximately $60 billion which would just about pay for what the Government expects to spend on its Covid-19 recovery.

Conclusion

Public debt is expected to rise from 19% of GDP in 2019 to nearly 54% by 2024 and remain elevated for decades to come. Servicing that debt will put the country at greater risk when another crisis arrives. Looking at New Zealand's retirement income policy settings is a good place to start for cost reductions since Kiwis are essentially contributing to their savings accounts by topping up the national credit card.

Taken together, ending subsidies to KiwiSaver, increasing the age of eligibility for NZS and slowing the growth of individual NZS payments slightly could reduce Government debt to about 25% of GDP in 2034 instead of 42% as is currently projected. The Government already has resources at its disposal to deal with the Covid-19 economic crisis that is currently being diverted to the NZSF for a rainy day in 40 years' time. Meanwhile, it is raining cats and dogs in New Zealand right now, so it is time to rethink the country's retirement income policy settings.