NEW ZEALAND BUSINESS ROUNDTABLE

THE 2003 PERIODIC REPORT ON RETIREMENT INCOME POLICIES

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1 Overview

1.1 This submission on the 2003 periodic report on retirement income policies is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 The only hope of achieving consensus and stability on retirement income is to build policies on a sound conceptual foundation. Policies in the recent past lacked such a foundation and proved unsustainable. Flawed ideas like the compulsory retirement savings scheme could not withstand intense scrutiny and debate.

1.3 The framework contained in the 1997 Periodic Report Group (PRG) report was sound but the PRG failed to build on it. The 1997 PRG offered no advice aimed at promoting growth and its recommendations on the future direction of policy on retirement income were too general and timid. The 2003 PRG report should avoid these weaknesses and advance public understanding and debate by clearly articulating a sound direction for future retirement income policies.

1.4 The suggestion in the PRG's terms of reference that it will focus on private provision of income in retirement is inconsistent with the requirements of the Retirement Income Act 1993 and the multi-party basis of the PRG process. The PRG is required to report on current government policies, which includes New Zealand Superannuation (NZS) and the New Zealand Superannuation Fund (the NZSF).

1.5 The PRG should make economic policy a key focus of its report. It is the ability of the economy to produce the goods and services that future retirees require, rather than financial arrangements, that is the key to their material standard of living.

1.6 The design of NZS should be the second key focus of the PRG report. There is a strong case to reorient NZS as a needs-based safety net consistent with other income support. This requires the generosity of NZS to be reduced by lowering its level, extending the age of eligibility and reintroducing means testing. Existing superannuitants and people close to retirement should be protected from such changes which should be phased in gradually.

1.7 There is no convincing evidence that New Zealand's savings record is poor. The PRG should examine ways to reduce policy-induced impediments to private savings, especially a high overall tax burden, high income taxes and excessive regulatory burdens.

1.8 Tax incentives and compulsory savings proposals should be rejected as ineffective, distorting, inequitable and illiberal policies.

1.9 The balance of this submission is presented in 7 sections. The next section (section 2) discusses the scope of the PRG report. The recent direction of government policy on retirement income is assessed in section 3. In sections 4 and 5 we suggest that the PRG should focus on economic policy to boost living standards and on the design of NZS respectively. Section 6 examines private savings while section 7 addresses tax issues. Our main conclusions are presented in section 7.

2 Scope of the PRG report

2.1 The 2003 PRG review is mandated by the Retirement Income Act 1993. It gave statutory effect to the 1993 Accord and provides that "A report on the retirement income policies being implemented by the Government in New Zealand … shall be prepared by the 31st day of December 1997 and at 6-yearly intervals thereafter." This provision and section 23 of the Act indicate that the PRG is to report on current government policies, which include NZS and the NZSF. Those aspects of the public provision of retirement incomes must be examined in detail if the PRG is to fulfil its statutory mandate and be credible to all political parties and the public.

2.2 The suggestion in the PRG's terms of reference that it will focus on private provision of income in retirement is inconsistent with the requirements of the Retirement Income Act and the multi-party basis of the PRG process. In addition to being beside the point, it is not plausible for the government to argue that there was a wide debate on public provision of retirement income during the passage of the New Zealand Superannuation Act 2001. What debate was there, for instance, on the age of eligibility for NZS? Furthermore, the 1997 PRG report recommended that certain key issues relating to the public provision of income in retirement, such as means testing and the age of eligibility for NZS, be addressed in the 2003 review.[1] Those matters should not be disregarded or dealt with superficially just because the government of the day may not want them scrutinised. The PRG must uphold its a-political status and statutory mandate.

3 The direction of recent policy

3.1 Government policies on retirement income broadly moved in the right direction over the two decades to the mid 1990s but have since gone backward. The cost of NZS has been reduced by increasing the age of eligibility and lowering its level relative to wages. There is broader acceptance that, for the majority of people, retirement income should be a personal responsibility, not a taxpayer responsibility. There is also greater understanding that living standards in retirement are ultimately dependent on the productivity of the economy, not financial arrangements such as NZS or the NZSF. (The limited significance of the NZSF is noted in Appendix I.)

3.2 On the other hand, there has been important slippage in some areas since the 1997 PRG report was completed. That report was prepared on the eve of the abolition of the superannuation surcharge. In its interim report, the PRG stated it regretted the pending abolition of the surcharge (effective from 1 April 1998) and noted "There is a strong case for reintroducing an element of income testing on equity grounds, and in the interests of integrating public and

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1 Periodic Report Group (1997b), *1997 Retirement Income Report: Building Stability*, Concluding Report, Periodic Report Group, Wellington, pp 58 and 62.

voluntary private provision."[2] Instead of making specific recommendations on this matter it identified targeting as an issue to be reassessed in the PRG's 2003 report.

3.3 The return to a universal benefit and the level of NZS, together with the establishment of the NZSF (which was said to increase the security of NZS), is undermining efforts to encourage private savings for retirement and the public's acceptance of the need to make NZS more affordable. Publicity programmes that are inconsistent with the incentives that people face cannot be expected to be successful.

4 PRG should focus on economic policy

4.1 Looking forward, we submit that the PRG should make economic policy a key focus of its report. It is the ability of the economy to produce the goods and services that future retirees require rather than financial arrangements that is the key to their material standard of living (see section 2, Appendix II). Nothing will do more to undermine the income security of present and future retirees than a failure to address the decline in the quality of economic management since the early 1990s.

4.2 Although the government has adopted the laudable goal of restoring New Zealand's per capita income to the top half of the OECD, it has not implemented the policies that are necessary to enable the required level of growth to be achieved. The government's growth forecasts to 2013 contained in the 2003 budget fiscal strategy report indicate that forecast growth is expected to fall well short of the government's goal. In its 2002 review of New Zealand the OECD said that policies in all areas must have a growth-promoting focus if higher living standards are to be achieved.[3] The adoption of a credible growth strategy is vital for retirement incomes and should be recommended by the PRG.

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[2] Periodic Report Group (1997a), *1997 Retirement Income Report: A Review of the Current Framework*, Interim Report, Periodic Report Group, Wellington, pp 85 and 117.

[3] OECD (2002), *OECD Economic Surveys: New Zealand*, OECD, Paris, p 20.

4.3 The key policies required to promote growth are openness to international trade and capital flows, price stability, a sound fiscal position, and low spending and regulatory burdens. The PRG should emphasise the scope to enhance growth by, for example:

- Reducing spending and taxes. Much government spending is of low quality and poorly targeted, and the deadweight costs of taxation are substantial, particularly in today's more open economy. Excessively generous welfare policies that discourage work and encourage welfare dependency, and tax incentives for savings are inconsistent with such a strategy.

- Privatising government businesses such as NZ Post and electricity generation and transmission businesses. Roading and other infrastructure need to be provided on a more commercial basis.

- Implementing further regulatory reform such as a first principles review of the Resource Management Act, the re-introduction of competition for ACC and a genuine effort to address business compliance costs. The poor performance of the education and health sectors also needs to be addressed.

- An early return to full employment (broadly where everyone who is willing to work and available for work can obtain a job) is critical to improving the economy's growth performance. Labour market and welfare reforms are the key to full employment. Continued unemployment is essentially a political choice.[4]

4.4 The minister of finance has argued that economic growth would not assist the government to finance NZS because the level of NZS is indexed to wages. The minister has observed that a rise in productivity would lead to higher wages and a commensurate rise in the level of NZS.[5] While this is true, an increase in growth arising from an increased labour force input, for instance higher

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4 Sloan, Judith (1994), *Towards Full Employment in New Zealand*, New Zealand Business Roundtable, Wellington, p 1.

5 Cullen, Michael (2001), 'Speech on Superannuation to the Annual Conference of the Life Brokers Association', 25 July.

immigration and lower welfare dependency, would not necessarily lead to commensurately higher wages and a rise in the level of NZS. More importantly, as acknowledged by the minister, there is no necessary reason to retain over the medium term the present relationship between wages and the level of NZS. The level of NZS should be set to provide at least an adequate standard of living for retirees. This does not necessarily require the level of NZS to double if per capita income doubles.

5 The PRG should also focus on the design of NZS

5.1 The design of NZS should be the second key focus of the PRG report. It is directly relevant to any desire to promote private saving. There is no reason to expect people to save for themselves if they think the government is doing an adequate job for them. Furthermore, many struggle to save given existing levels of taxation, including the effect on their disposable income of the tax required to fund NZS. It makes no sense to claim that a 'voluntary approach' to retirement income provision has failed given the income adequacy provided by NZS. The problem has been compounded by the government's promotion of the NZSF, which suggested that people could rely for the foreseeable future on NZS being available on a '65 at 65' basis. In these circumstances, it is not surprising that a recent survey undertaken for Sovereign found that around the same proportion of New Zealanders are saving for their retirement as they were five years ago but the proportion of people who believe the government will provide an adequate retirement income has tripled over the past three years to 18 percent.[6] For all these reasons the PRG cannot credibly ignore the central issue of NZS.

5.2 A main role of the government in relation to retirement incomes is to provide a safety net. The critical elements of any scheme of public provision of retirement incomes are whether benefits should be universal or targeted, the level of benefits, and the age of eligibility.

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[6] Sovereign (2003), media release, 24 February.

Universal or targeted?

5.3 NZS remains a generous benefit relative to other forms of income support and policies in other countries. A study prepared for the Ministry of Social Policy, *Living Standards of Older New Zealanders*, concluded that "Overall, the results show that most older people were doing quite well and had relatively few material restrictions and difficulties. A minority (around 5 percent of the sample) had quite marked material hardship, and a further 5-10 percent had some difficulties."[7] [8] The report also noted "Older people – both Maori and non-Maori – tend to report fewer material restrictions and difficulties than younger people."[9] These and similar findings suggest that people with dependent children on low incomes are a higher priority in terms of welfare spending than the elderly.

5.4 The long-run tradition in New Zealand has been to view policies for income security in retirement as part of the general safety net. Unlike many other countries, benefits have always been flat-rate rather than income-related. New Zealand's initial Old Age Pension of 1898 provided benefits at a very modest level to claimants who were 65 or more years of age – a high qualifying age relative to life expectancy at that time.[10] Moreover, the benefit was subject to strict income and assets tests, and to tests of reputable behaviour – there were strong incentives for personal responsibility. Retirement income policies remained generally sound and stable until the electoral bidding wars of the 1970s.

5.5 Viewed in safety net terms it is hard to see how the government's welfare responsibility for people in old age differs from its role in respect of those facing other lifetime contingencies, namely to protect people from hardship. Families are normally expected to be responsible for providing for their own

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7 Fergusson, David *et al* (2001), Living Standards of Older New Zealanders, Ministry of Social Policy, Wellington, p 5.

8 Older Maori experience a higher level of hardship than older people in general. See Cunningham, Chris *et al* (2002), Nga Ahuatanga Noho o te Hunga Pakeke Maori, Ministry of Social Development, Wellington

9 Fergusson, David *et al.* (2001), p 5.

10 According to *The Economist* it was calculated in 1881 that the average man worked for more than 150,000 hours over his working life. In some European countries this figure is now down to 65,000 hours. Rising living standards and a longer period in formal education are reflected in the fall in working hours. See *The Economist*, 25 October 1997, p 15.

incomes, and the role of the government is limited to providing an adequate income to those without other means in the event of contingencies such as sickness, invalidity or unemployment. The only difference from most other benefits is that in the case of old age there is no need for an explicit test of incapacity to earn an income once a certain qualifying age is reached.

5.6 There are no sound efficiency or equity grounds for a universal benefit, and the fiscal costs and deadweight losses associated with such a scheme are large. Why should a retired millionaire's income be supplemented by taxes on low-income workers who are struggling to support their families? But in the case of the next group, the broad category of middle-income earners, all that is happening with a non-targeted benefit is that the government is taxing one group of people only to return the money to people in a similar category, with all the compliance, administration and deadweight costs associated with such 'churning'. It is only the category of low-income earners and people without resources who should be the object of public policy, on either efficiency or equity grounds, through targeted assistance.

5.7 The only significant advantage of a universal benefit over a targeted benefit is that it is not abated against other income and retirees do not face a 'penalty' for saving. This advantage, however, is more than offset by the higher taxes and therefore general savings disincentives for all taxpayers associated with having to fund a universal scheme.

5.8 The arguments against a straightforward targeted benefit do not stand up. It sits logically with the rest of the welfare system which is needs-based; it is the option most consistent with an ethos of individual responsibility; and because it involves the lowest fiscal cost it is the option most conducive to economic growth. It also happens to be the option historically favoured in New Zealand and accepted as the appropriate form of public provision, without significant political controversy, in Australia. The Australian scheme includes an assets test which is a logical element of any targeting scheme, as experience with the surcharge showed.

The level of NZS

5.9 Outside observers such as the OECD have commented on the excessive level of NZS. A high level of NZS discourages private provision. It is hard to see the grounds for a level of benefit higher than the invalids benefit, which is intended to provide long-term support for a person who is unable to work because of illness or injury. Consistent with a safety net approach, the 1988 Royal Commission on Social Policy proposed that NZS be set at the (lower) level of the invalids benefit.[11]

5.10 A reduction in benefits for people in or near retirement who are fully dependent on them is not proposed, with the important proviso that New Zealand does not lapse into stagnation or economic crisis again. In that case all bets would be off. For that reason, organisations like Grey Power should support a sound and affordable approach to the future shape of NZS. It is hard to see why future cohorts of retirees should not be required to plan on the basis that public provision will be no more generous than the general safety net. This requires the phase in of a lower level of assistance to be clearly signalled and credible. The PRG report should recommend an appropriate phase in programme.

5.11 The gap between NZS and the invalids benefit is not large – currently around 11 percent for a couple – and it could be narrowed gradually. Once the level of NZS has been reduced to that of the invalids benefit, it should be indexed to the CPI in the same way as the other forms of income support.

The age of eligibility

5.12 The increase from 60 years to 65 years in the qualifying age for NZS proceeded smoothly (assisted by some transitional measures). It is the main reason for the reduction in the fiscal costs of NZS as a proportion of GDP from what it would otherwise be. It has also encouraged workforce participation by those over 60, a positive factor for economic growth and arguably beneficial in social terms.

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[11] Royal Commission on Social Policy (1988), *The April Report: Future Directions*, Report of the Royal Commission on Social Policy, volume III, part two, p 643.

5.13 With better health and rising life expectancy there is scope to extend beyond 65 the working life of most people who would otherwise be dependent on NZS. People who are in poor health or are otherwise unable to work would automatically qualify for assistance under the general safety net. The 1989 New Zealand Business Roundtable report suggested that the eligibility age should be progressively extended to around 70, although people would, of course, be free to retire earlier on their own savings.[12]

5.14 The minister of finance stated "We recognise that changes in life expectancy and medical science may lead some future government to consider raising the age above 65 but would expect that any such review would be 25 to 30 years away."[13] This timeframe is unrealistic. The issue needs to be addressed now so that an increase in the age of eligibility can be phased in gradually and help to reduce the cost of NZS as the population ages.

5.15 The OECD reported that in 1995 that Denmark, Iceland, Norway and Ireland had a standard age of entitlement to public old age pensions above 65 years. They all had an age of 67, except for Ireland which had 66 years. The United States is moving progressively to age 67.[14] All these countries are wealthier than New Zealand, which is less well placed to afford expensive welfare policies. A number of other countries (for example France, Austria and Germany) are reviewing their entitlements to state-funded retirement income, including whether to increase the age of entitlement to as high as 70 in Germany's case.

5.16 Consistent with the 1997 PRG report, the PRG should examine seriously the age of eligibility. We think it should propose a gradual increase in the age of eligibility for NZS to between 67 and 70 years. The PRG should also recommend a phase in programme that protects those who are over 65 years of age or are approaching that age and are unable to adjust their retirement plans in response to a change in the age of eligibility for NZS.

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12 New Zealand Business Roundtable (1989), *Retirement Income Provision*, New Zealand Business Roundtable, Wellington, p 31.

13 Cullen Michael (2000), 'IMF Report Welcome But Shows Familiar Mindset', media statement, 28 October.

14 OECD (1998), 'The Retirement Decision in OECD Countries', working paper, AWP 1.4, pp 15 and 23, and Table III.1, p 60.

5.17 One option might be to adjust the new age of eligibility in line with further increases in life expectancy – effectively an indexation mechanism.

5.18 The residential qualification for NZS should also be tightened.[15] It enables residents who have been overseas for most of their working lives and made little contribution to taxes to return and qualify for NZS.

5.19 Viewing NZS in safety terms as envisaged by the Royal Commission on Social Policy would treat all groups, including women, Maori and Pacific Island people, fairly. Women would be supported by the safety net on the basis of need in the same way as men. Groups with different life expectancies would not be discriminated against. People who were not able to work until they reached the qualifying age and who needed income support would be eligible for other benefits. A transitional benefit could again be put in place as the qualifying age was raised.

6 Private savings

6.1 The third area of the PRG report should relate to private savings. This area is of less importance than the first two.

6.2 The question of whether the level of aggregate savings in New Zealand is adequate continues to be debated. This issue is examined in detail in Appendix III where it is concluded that:

- There is no convincing evidence that New Zealand's savings record is poor.
- The measurement issues with savings are well known, and there has long been scepticism that, given appropriate adjustments, savings rates across countries vary as widely as is often assumed.

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15 Section 8 of the New Zealand Superannuation Act 2001 contains the residential qualification to be eligible for New Zealand Superannuation. A person is required to be ordinarily resident in New Zealand at the date at which New Zealand Superannuation is applied for, be both resident and present in New Zealand for a period or periods aggregating not less than 10 years since attaining the age of 20 years and be both resident and present in New Zealand for a period or periods aggregating not less than 5 years since attaining the age of 50 years. There are some exceptions to the general requirements.

- Theory and evidence indicate that domestic saving and investment is but one source of economic growth, of less importance in advanced countries than productivity-enhancing factors. A legitimate concern for New Zealand's inadequate growth performance should focus systematically on growth issues.

- There are no clear grounds for government efforts to alter people's consumption and savings choices, given a policy environment in which choices are distorted as little as possible.

6.3 NZS provides at least an adequate standard of living in retirement for most New Zealanders, and for such people current consumption is a higher priority than private saving for retirement. Moreover, the level of the overall tax burden, which is only a little lower than in 1997, constrains personal choices including the scope to save. Until the incentives faced by New Zealanders are changed, there is little prospect that people will significantly change their saving habits.

6.4 The PRG should focus on ways to reduce policy-induced impediments to private saving, especially a high overall tax burden and income taxes, to give people more scope to save from higher after-tax income. Excessive regulatory burdens, for instance related to the disclosure of information on saving products, should also be addressed.

6.5 We consistently advised that the costs of the mandatory product and adviser disclosure requirements that were enacted in 1996 far outweighed any conceivable benefits. Professor George Benston confirmed this view.[16] It was also recognised by the PRG. In its 1997 report, the PRG recommended "the Ministry of Commerce undertakes an assessment of the effectiveness of the disclosure requirements with the results available for the next periodic review in 2003.[17] It is not surprising that fewer employer sponsored superannuation schemes are now on offer. The Securities Commission is seeking to tighten

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16 Benston, George J (1997), *Voluntary vs Mandated Disclosure*, New Zealand Business Roundtable, Wellington.

17 Periodic Report Group (1997b), p 12.

disclosure rules which would further discourage savings. The disclosure regime should be examined afresh.

6.6 Particular forms of superannuation or saving (such as employer-provided superannuation schemes) should neither be encouraged or discouraged. People should, as far as feasible, be presented with an unbiased choice of saving opportunities and providers should be required to compete on a neutral basis. Savers can then choose among the options available to them.

6.7 While voluntary employer-provided superannuation schemes may offer some advantages to employees, for instance in terms of convenience, they have never provided income for more than a small proportion of retirees in New Zealand. Experience in New Zealand and elsewhere shows that such schemes are not problem-free:

- In some cases employer superannuation schemes have been invested excessively in the employing company's shares. This is a poor policy from a risk management perspective. If the company fails, employees could lose their job and their superannuation savings.
- Some employer schemes have benefited longstanding employees at the expense of people who are employed for a relatively short period.
- During the bull market some firms in other countries were able to reduce their contributions to defined benefit schemes. Those schemes are now substantially under-funded.

For these and other reasons we believe that the PRG should promote a neutral approach to different forms of savings and superannuation schemes.

The case for saving to remain voluntary

6.8 The question of whether private savings for retirement should be compulsory or voluntary is examined in Appendix II.

6.9 The key arguments for voluntary savings are as follows:

- There is no principled role for the government to dictate people's lifetime consumption patterns. Its role should be confined to the provision of a safety net (in the same way that it is an underwriter of last resort at other stages of people's lives) and to helping individuals understand the implications of the choices that they and the country face. Paternalism is not a valid ground for government action and is a threat to individual freedom.

- There is no reason to believe that the vast majority of people make irrational judgments about consumption and savings decisions over their lives. Thus people should generally be free to run their lives as they see fit. It is important to uphold moral norms and people cannot be held responsible for their decisions if they are not free to choose.

- With the kind of safety net described above, most people would have a strong incentive to make provision for their own retirement, out of a desire to enjoy more than a basic level of consumption in old age.

- A compulsory savings requirement on top of a safety net is inconsistent with these principles. The scale of the intervention in people's lives with a compulsory savings scheme is massive – it is second only to taxation in the effect on people's gross income. Compulsory savings schemes distort the form and timing of savings and consumption.

- To the extent that people do not save on a voluntary basis at the required rate each year and in the required form, compulsory savings schemes exhibit many of the features of a tax.

- There is no persuasive reason to force people to save more money than is required to provide an income at the safety net level. It is the safety net which sets the minimum acceptable income.

6.10 The 1997 referendum on compulsory superannuation established that private provision for retirement income (that is, provision beyond the public safety net) should be voluntary. The 1997 PRG report, prepared in the wake of the referendum, also concluded that private provision of retirement income should be voluntary. There are no persuasive grounds for introducing compulsory

savings. Moreover, it is politically infeasible for any government to contemplate a compulsory scheme at least for the foreseeable future.

7 Tax issues

7.1 There is no recognised support for tax incentives for private savings in the economic literature and little political constituency for them. The Accord acknowledged that a stable taxation regime is an important component of a policy conducive to long-term savings. It went on to state "Accordingly, the current income tax treatment of savings known as the TTE Regime (where, in general, contributions to savings are not deductible for tax purposes, earnings on savings are taxed, and payments to savers are tax free) should continue to apply." This approach was endorsed by the PRG in 1997. It reported that the desired framework for retirement income policy should include a neutral tax environment for saving.

7.2 To its credit, the Investment, Savings and Insurance Association (ISI) stated in 1999:

> The ISI is not looking for favoured tax treatment for the products its member companies sell. New Zealand does not need more inequities in its tax system.[18]

However, there are still suggestions from time to time that savings for retirement should be taxed on a concessional basis. There are several key reasons for continuing, as far as practicable, to tax retirement savings on the same basis as other savings:

- Lower taxes on retirement savings would require higher taxes to be imposed on other activities. It is likely that this would reduce overall welfare.

- There is little evidence that tax concessions generate higher national savings (see Appendix III). They are more likely to change the form of saving. If tax concessions divert savings from activities that would yield

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18 Investment, Savings and Insurance Association of New Zealand (1999) 'Towards an Ideal Taxation Regime', Investment, Savings and Insurance Association of New Zealand, p 2.

a higher return from an overall community perspective, efficiency and growth are impaired.

- There are no sound grounds for treating savings for retirement differently from other forms of saving. People may save in many ways, such as by paying off their mortgages, investing in their education and training, and building up businesses. Moreover, from an economic perspective there is no reason to favour short-term over long-term savings.

7.3 The government's expert inquiry on tax, the Taxation Review 2001, was directed to focus on the taxation of savings (among other issues). It endorsed the following key conclusion noted in its preliminary report:

> We are not convinced that tax concessions would be likely to result in higher national savings or that, if they did, the benefits would outweigh the costs due to the distortionary effects of concessions on the quality of peoples' saving decisions. We therefore favour retention of the TTE regime for the taxation of savings.[19] [20]

7.4 The minister of finance has floated the idea that retirement savings should be taxed on a TET basis. Such treatment could not be applied to short-term savings (eg call deposits and bank bills) because it would impose a penal tax by taxing the initial investment twice and thus severely distorting interest rates and financial markets. This effect becomes less important relative to the deferral of tax on earnings until the savings are withdrawn as the term of the investment increases.

7.5 The TET proposal was rejected by the Taxation Review 2001, would be very costly to introduce for long-term savings because revenue is lost upfront, and would lead to unintended tax avoidance schemes designed to exploit inconsistencies between savings and investments taxed on TTE and a TET basis.

7.6 It is sometimes asserted that the deferral of taxation, such as the adoption of an ETT regime (which is an income tax) or EET (which is a consumption tax), can provide a long-term revenue advantage for the government. This is an

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19 Tax Review 2001 (2001a), *Issues Paper*, The Treasury, Wellington p 169.
20 Tax Review 2001 (2001b), *Final Report*, The Treasury, Wellington p 94.

incorrect analysis. To protect revenue the government goes to considerable lengths to counter tax arrangements that might have that effect. It has, for example, recently required companies to pay resident withholding tax on interest at the 33 percent or 39 percent rate rather than 19.5 percent to stop the claimed deferral of tax on interest within the tax year. There are no persuasive grounds to change the TTE basis on which savings and investment are taxed.

7.7 In the last year or two policy has focused on refining existing tax rules so that superannuation savings are, as far as practicable, taxed at the marginal effective rate of the saver. The announcement in the 2003 budget that specified superannuation contributing withholding tax at the rate of 21 percent rather than the present 33 percent will be able to be applied to payments to superannuation funds on behalf of employees earning up to $38,000 a year is an example. This approach is consistent with the 1997 PRG report and is supported. However, as the TOLIS exercise demonstrated, lower and more uniform rates of income tax provide the only satisfactory solution to the problem.

7.8 An income tax, unlike a consumption tax, discourages savings (future consumption) relative to current consumption. This is an inherent feature of an income tax. Because an income tax provides offsetting advantages, for instance an income tax base is usually broader than that of a consumption tax like GST, developed countries rely on income tax to raise most of their revenue. The best that can be done to mitigate the adverse impact on savings of income tax is to keep the level of income tax as low as possible and to adopt a lower and flatter rate structure as recommended by the Tax Review 2001.[21] Lower government spending over time and thus a lower tax burden is required. Minimising the cost of NZS, the largest single element of government spending, would facilitate this.

8 Conclusion

8.1 Our key conclusions are accordingly as follows:

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[21] Tax Review 2001 (2001b), p III.

- Retirement income policies must be built on a sound conceptual foundation. The 2003 PRG report should advance public understanding and debate by clearly articulating a sound direction for policies on income in retirement.

- The suggestion in the PRG's terms of reference that it will focus on private provision of income in retirement is inconsistent with the requirements of the Retirement Income Act 1993 and the multi-party basis of the PRG process. The PRG is required to report on current government policies, which includes NZS and the NZSF.

- The key focus of the PRG report should be, first, on the policies needed to increase economic growth on a sustainable basis and, second, the design of NZS.

- NZS should be reoriented as a needs-based safety net consistent with other income support. This requires the generosity of NZS to be reduced by lowering its level, extending the age of eligibility and reintroducing means testing. Existing superannuitants and people close to retirement should be protected from such changes, which should be phased in gradually.

- The NZSF should be wound up. As Appendix I explains, it is largely an accounting exercise with no direct impact on the retirement income problem. By contributing to a high tax burden it impedes growth and its risks discouraging private savings. The proceeds should be used to repay debt instead.

- There is no convincing evidence that New Zealand's savings record is poor. The PRG should examine ways to reduce policy-induced impediments to private savings, especially a high overall tax burden, high income taxes and excessive regulatory burdens.

- Tax incentives and compulsory savings proposals should be rejected as ineffective, distorting, inequitable and illiberal policies.

Appendix I

RETIREMENT INCOME POLICY AND THE NEW ZEALAND SUPERANNUATION FUND

1 Commentary

1.1 The part pre-funding of NZS is largely an accounting exercise with no direct economic impact on the retirement income problem. As implemented, the NZSF is essentially a tax-smoothing scheme. The key reasons for reaching this conclusion are presented below. The first round or direct impact of the NZSF is examined. There may well be second round effects that affect real activity but these are likely to be modest relative to the direct impacts identified.

- The cost of NZS depends on the level of benefits and eligibility criteria. They are set independently of the balance in the NZSF and its rate of return. This can easily be seen by asking whether NZS would be cut (increased) if the NZSF were insufficient (excessive) to meet future claims on an actuarial basis. The answer is no. The NZSF makes no necessary difference to the level of NZS in the future.

- The level of government spending and taxes will be unchanged. Taxes are not being raised or current spending explicitly cut to build up the NZSF. A genuine move to a fully or partly funded scheme requires the working population to pay twice through higher taxes or lower current spending while taxes are held constant. This is not proposed because "it would require a massive reallocation of government expenditure and would be unrealistic."[1]

  The annual transfer to the NZSF is being made 'below the line'. It depends on a formula which reflects the ratio of the cost of NZS to GDP over the long term. The level of the operating surplus has no direct impact on the level of the transfer to the NZSF, although the

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[1] Cullen, Michael (2000a), 'Pre-funding New Zealand Superannuation: Funding Arrangements', report to the cabinet policy committee, Office of the Hon Dr Michael Cullen, 6 September, p 1.

government may elect not to allocate the amount required by the formula.

- If operating surpluses are transferred to the NZSF, then Crown liabilities (other than the liabilities of the NZSF) will be higher and/or other assets will be lower than otherwise. The transfer of operating surpluses to the NZSF when the Crown holds debt is equivalent to borrowing to invest in the NZSF.

- The pre-funding of NZS does not raise the productivity of the labour force or increase the ratio of workers to retirees. There is, therefore, no reason to believe that consumption in the future will be increased. The material welfare of future retirees depends on the level of goods and services available for consumption during their retirement. Thus they are ultimately dependent on a productive economy generating the necessary flow of goods and services to meet their needs. People cannot eat dollar notes. As Michael Joseph Savage correctly observed, "It does not matter how much we try to manipulate the money system we cannot give the people any more than they are able to produce." [2]

- Aggregate savings will not increase. The government does not intend to increase its savings. This would require higher taxes and/or lower government spending on consumption goods and services, and higher surpluses. There is no reason why private households would increase their savings. On the contrary, to the extent that the government convinces people that pre-funding will ease the problem of funding NZS in the future, private savings could well fall. There is some tentative evidence that this may happen. A recent survey undertaken for Sovereign found that around the same proportion of New Zealanders are saving for their retirement as they were five years ago but the proportion of people who believe the government will provide an adequate retirement income has tripled over the past three years to 18 percent.[3]

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[2] Savage, Michael, debate on introduction of the Social Security Bill, 1938.
[3] Sovereign (2003), media release, 24 February.

- Investment in equities does not increase the risk-adjusted return on assets. The Crown will simply assume more financial risk than otherwise. Borrowing to invest in equities and other high-risk investments further accentuates the financial risk involved. If the government assumes more financial risk, other investors will carry less risk because the level of risk associated with the underlying real assets is unaffected by financing arrangements. Such arrangements merely redistribute the risk among different classes of investors.

- Investment in offshore equities is unlikely to increase the level of imports that can be sustained in the future. If there is an increase in capital outflows while the NZSF is being built up, there must (other things being equal) be an offsetting capital inflow or a change in the level of the current account balance (higher exports and/or lower imports). In these circumstances a change in the level of the current account is unlikely given that the fiscal position and private savings will not changed. Higher government borrowing than otherwise and changes in private sector capital flows will match the outflow of capital to acquire offshore investments. These processes will reverse as the NZSF is drawn down. This analysis assumes that the exchange rate does not change.

1.2 The NZSF also raises the following important issues:

- The NZSF will not achieve its stated public policy goal. The government's regulatory impact statement observed "The public policy objective of pre-funding is to address the future increase in NZS costs." [4] The scheme does not do this because it does not affect the cost of NZS.

- The government has acknowledged that the "economic implications of pre-funding are not as significant as the economic implications of the retirement income policies being financed – that is NZS rates and the tax policies accompanying them."[5]

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4 Cullen, Michael (2000b), 'Regulatory Impact Statement', report to cabinet policy committee, Office of the Hon Dr Michael Cullen, 6 September, p 1.

5 Cullen, Michael (2000a), p 4.

- Transfers to the NZSF are to be made until 2026. The NZSF is then to be dawn down. It is eventually to be reduced to a zero balance leaving present arrangements intact, despite a prediction that the ratio of NZS to GDP will still be around the peak level of 9 percent.

- Pre-funding of NZS does not alter the claim on resources that older people will make in future; the pre-funding scheme conveys the wrong message to young people; and it is equivalent to borrowing to buy shares.

2 Conclusion

2.1 The pre-funding of NZS is largely an accounting exercise with no direct economic impact on the retirement income problem. As implemented, it is essentially a tax-smoothing scheme.

2.2 Because the level and conditions of access to NZS remain unchanged, the long-term burden it imposes on the government's finances and the economy's capability to produce the goods and services needed by people in retirement remain unaltered.

2.3 From a financing point of view, the more logical approach would be to reduce debt further in the period ahead, cut taxes, or both – rather than establish a massive government-directed investment fund. Any benefits from pre-funding in terms of discipline on other elements of government spending could be largely achieved by publicly reporting future NZS liabilities and altering the long-term objective for government spending that the government is required to establish under the Fiscal Responsibility Act 1993.

2.4 The key requirement in any sound approach to retirement income is to reduce the generosity of NZS and make access to it more restrictive for the next generation of retirees, while protecting those currently in retirement.

Appendix II

COMPULSORY SUPERANNUATION

1 Introduction

1.1 This annex analyses the economic justification for compulsory superannuation.[1]

1.2 The paper addresses the role of the government in relation to retirement incomes (section 2) and scrutinises the grounds for compulsory superannuation (section 3). Other criticisms of compulsory superannuation are discussed in section 4. The conclusions are presented in section 5.

2 The Government's role in relation to the provision of income in retirement

2.1 The government's prime roles in advancing overall national welfare are to:

- Promote general economic and other policies that encourage the efficient use of resources, including price stability and full employment, and provide opportunities for all citizens. A wealthier country is better placed to support the elderly and other dependent groups, at least in absolute terms. Efficient labour, education and training markets assist people to support themselves during their working lives and to provide for their retirement.

- Encourage effort, innovation and risk taking by providing a predictable policy environment and by ensuring that such activities are not stifled by high taxes and welfare arrangements that undermine the acceptance of personal responsibility.

- Provide a safety net for people who are unable to support themselves and who are not supported through private means. This role applies to people of all ages – it is not confined to the elderly.

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[1] This appendix was prepared in advance of the release of the details of the Retirement Savings Scheme in 1997. It has been slightly edited only.

2.2 The living standards of people in retirement are largely determined by their ability to consume goods and services. Retirees cannot consume their savings directly. Their savings must be used to buy goods and services that are produced by New Zealand's working-age population or by workers of other countries (imports). The British economist, Nicholas Barr, expressed this point in these terms:

> Pensioners do not eat pound note 'butties' - they use the pound notes to purchase consumption, and it is consumption that matters.[2]

2.3 If retirees try to acquire more goods and services than workers are prepared to make available through their savings, pressure on the balance of payments will increase and/or inflation will be higher than otherwise. For this reason, policies that improve efficiency and thereby enable future output to be increased should be the focus of the government's policy on the provision of income in retirement. An emphasis on savings is misplaced.

2.4 An increasing elderly population can continue to be supported at current income levels only by:

- Constraining current consumption and investing overseas with a view to financing imports in the future.

- Constraining the consumption of the working-age population in future, for example through higher taxes, to make goods and services available to retirees.

- Boosting future output by increasing the working-age population relative to the dependent population (through immigration, by lowering the impact on work decisions of NZS and by addressing welfare dependency) and by raising productivity. NZS encourages people to withdraw from the labour force. There was a noticeable reduction in labour force participation by people over 60 years of age following the introduction of National Superannuation. Labour force participation by

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2 Barr, Nicholas (1979), 'Myths My Grandpa Taught Me', *Three Banks Review*, No 124, p 35.

people aged 60 to 65 years has increased since the policy of gradually raising the qualifying age for NZS was adopted.

2.5 Immigration can help to modify demographic trends and assist in providing consumption in retirement for an aging population because:

- Immigrants with skills, ideas, a strong work ethic and capital help to foster competition, entrepreneurship, innovation and an outward-looking economy.

- Immigrants of working age help to reduce the ratio of dependents to workers. Many countries in Asia and elsewhere have much younger populations than most OECD countries.

2.6 In the short term an increase in savings can only be achieved by reducing current consumption.

3 Reasons advanced for compulsory superannuation

3.1 *National savings are inadequate*. It is argued that New Zealand has a shortfall of savings which constrains investment and hence the growth of output. This proposition does not justify a compulsory superannuation scheme because:

- There is no compelling evidence that aggregate savings are too low (see Appendix III). A large part of the differences among countries' savings ratios is a statistical illusion. Measurement problems are severe, and national accounting data need to be adjusted for factors such as the treatment of consumer durables, pensions, the actuarial surpluses or deficits of government welfare funds, and age structures.

  Provided sound fiscal and monetary policies are pursued, the level of savings will generally reflect people's preferences for current and future consumption (that is, their discount rates). The level of investment will reflect judgments by individuals and private firms on the amount of profitable investment opportunities in New Zealand relative to that of the rest of the world. The welfare of savers and investors would be

diminished if their preferences were interfered with other than for valid public policy reasons.

- It is more likely to alter the form of savings than the aggregate amount of savings. Many people would divert savings that would otherwise be made to the compulsory scheme without increasing their total savings. Australia's experience with a compulsory superannuation scheme supports this view. According to OECD data, its gross savings ratio did not increase during the 1990s. The ratio stood at 16.8 percent in 1994 and in each of the three years to 1994 was lower than at any time since at least 1977, raising the possibility that Australia's savings ratio has actually fallen. *The Economist* of 23 November 1996 summarised research which found that sound fiscal, capital market and other policies, and not its superannuation scheme, largely account for Chile's growth in savings.

- The government should focus on all savings rather than savings for a single purpose if it wishes to raise the aggregate level of savings. One efficient way of encouraging such savings would be to reduce income tax relative to GST. Unlike GST, income tax tends to discourage savings relative to current consumption. Lower government spending and hence lower taxes would help to promote savings. Excessive welfare programmes also discourage savings. The high saving rates recorded by some Asian countries may well be explained by low taxes, limited welfare support and high growth.

- There are no valid grounds to favour long-term savings relative to other savings. Financial markets enable savings of different durations to be matched with the lending terms desired by borrowers. This is illustrated by an investment in a company. Although the ownership of a share may change many times within a year, the company retains the capital initially subscribed. This allows long-term capital spending to be financed by short-term investors.

- Higher domestic savings do not automatically translate into increased output. Savings must be invested. Higher investment will only increase

output in the future if it yields an appropriate return. Some centrally planned countries like Albania, Russia and China recorded high savings rates for certain periods, essentially by constraining the supply of goods and services, and an abysmal growth in output. On the other hand, the United States and South Korea were countries that achieved high growth with relatively low savings. New Zealand has undertaken considerable investment but it has not always obtained commensurate increments to its output. Some of the most poorly directed investment arose from inefficient government policies and investment programmes. Moreover, higher levels of investment, if sustained, imply larger provisions for depreciation or the consumption of capital. They may lead to an increase in the level of output but not to an increase in the rate of growth.

- A compulsory superannuation scheme would, at most, be likely to have a modest impact on our gross savings ratio. Eight percent of household income (the contribution rate proposed for the 1997 scheme) amounted to about $4.5 billion in 1994/95. Household income is broadly defined to include compensation of employees, entrepreneurial income, property income other than imputed interest, ACC benefits, social welfare payments other than NZS and veterans' pensions, and other social assistance grants. If gross savings had increased by this amount, the savings ratio would have risen by about 5 percentage points. This calculation is based on extremely favourable and implausible assumptions, including no change in the behaviour of citizens, no substitution of other forms of savings, a very broad definition of income that includes interest, dividends and income support paid to the working-age population, and no change in economic activity in response to a large cut in disposable incomes. More realistic assumptions suggest that, at most, a small impact on savings might be obtained but at a high cost.

3.2 With a compulsory superannuation scheme:

- The return on related investments may be reduced for the following reasons:

  - The preferences of managers of institutional funds may differ from those of contributors. Institutions tend to invest in established enterprises such as companies with shares listed on the stock exchange. Small businesses and start-up ventures, which often struggle for funding because of the risk involved, tend to be financed in other ways. Business owners, farmers and other entrepreneurs may find it more difficult to obtain external funding and at the same time their savings would be diverted through compulsory superannuation to institutionally funded investments. Innovation and risk taking could be impaired. Large, established enterprises would be encouraged relative to small and new businesses.

  - The incentive to manage superannuation schemes efficiently and to be responsive to the wishers of savers would be diminished. While savers may be able to choose among registered schemes, fund managers would face less competition than at present. Moreover, the incentive for savers to monitor fund managers would be impaired with a mandatory scheme.

- Investment in human capital may decline. If compulsory superannuation, including government top-ups, provide people with a higher income in retirement than desired, they may invest less in education and training.

- People may become more dependent on the state. A compulsory superannuation scheme leads to moral hazard problems for the government. Moral hazard arises because the contributor may change his or her behaviour in unintended ways. Some contributors might be encouraged to save as little as possible in the expectation that the government will eventually top up their contributions.

3.3 Furthermore an alleged shortage of domestic savings does not make it necessary to raise interest rates to attract foreign investors as is sometimes suggested. In a closed economy, the interest rate is determined by the demand for investment and the supply of domestic savings. If the domestic rate of interest is above the risk-adjusted world rate of interest, because there are many profitable investment opportunities relative to available domestic savings, allowing foreign investment would reduce it. On the other hand, if the domestic rate of interest were below the world rate of interest in the closed economy case, it would rise not because inward foreign investment were allowed but because New Zealanders could increase their return by investing their savings abroad. Thus inward foreign investment does not raise New Zealand's interest rate but it could lower it if investment exceeds the amount of savings residents are prepared to supply at the risk-adjusted world interest rate.

3.4 *Foreign investment threatens the sovereignty of New Zealand*. It has been argued that compulsory superannuation is required to raise domestic savings and reduce our reliance on foreign investment. This ground for a compulsory scheme is not supported in the economic literature. It is based on a mistaken view of the role that foreign investment plays in a modern economy. Relevant arguments are as follows:

- New Zealanders will only sell land and other assets to foreigners if the latter offer a price at least as attractive as that offered by residents. Foreign investment therefore increases the wealth of New Zealanders by bidding up the price of assets.

- Foreign investors will only pay a higher price for assets than domestic buyers if they can put them to a more productive use than other bidders. This increases output and raises incomes.

- Foreign investment promotes competition and innovation, facilitates the introduction of new skills and ideas, and generally strengthens international linkages. It may, for example, provide access to research and development and to export markets. In these ways foreign investment reduces costs and raises productivity. There is

overwhelming evidence that open goods and capital markets improve efficiency.

- An increase in savings would not necessarily reduce inward foreign investment. It could be reflected in higher investment in New Zealand, offshore investment and/or higher overseas reserves. These outcomes are derived from the national income accounting framework which requires that the following identities hold at all times:

  (1) investment - savings = imports - exports

  (2) imports - exports = capital inflows - capital outflows + the change in overseas reserves

  (3) investment - savings = capital inflows – capital outflows + the change in overseas reserves

  Equation 1 shows that an increase in savings must be accompanied by higher investment and/or a reduction in net imports (that is, imports less exports or the current account deficit). If the adjustment is entirely through higher investment, there would be no change in the current or the capital accounts and foreign investment would not be reduced (equations 1 and 2). If net imports adjust, then inward foreign investment (capital inflows), capital outflows (outward foreign investment) and/or reserves must change by an equivalent amount (equation 2). If the full adjustment were reflected through capital outflows or overseas reserves, there would be no change in foreign investment in New Zealand.

- Foreign institutions will only lend to private enterprises that are deemed to be creditworthy. If they make a mistake they bear the cost. However, in the case of overseas borrowing by the government, the merits of the particular project to be financed are of little importance to the lender because his or her key security is the government's power to impose taxes.

- The view that foreign investors will act against the interests of New Zealanders is mistaken. Adam Smith's observation on the motivation of domestic producers applies equally to foreign owned enterprises:

> It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.[3]

3.5 *Myopia.* It is argued that people make inadequate provision for retirement because their time horizon is too short. The myopia argument is unsustainable for the following reasons:

- Adults of sound mind can generally be assumed to act rationally in the sense that they do not systematically make the same mistakes. They learn from experience. The presumption that people usually act in their best interests is at the heart of economic analysis. The abandonment of the assumption of rationality does not overcome the perceived problem. How could a government that reflects the interests of voters be assumed to act rationally if most voters are deemed to behave irrationally?

- Retirement is a predictable event. Risk is an everyday occurrence which people begin to learn to live with from a young age. Research has shown that people generally act rationally in respect of well-known risks that have a relatively high probability of occurring. The probability of reaching retirement for a person of working age is much higher than the risk that a person's home will burn down during his or her working life, yet 97.5 percent of homes in New Zealand are insured against loss from fire. This is despite the availability of safety net assistance (such as income support or the accommodation supplement).

- People may prefer to consume now rather than in the future. The view that people are saving too little assumes that there is an optimal balance between current and future consumption which is known. But people have different preferences and face varied circumstances, and they may

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3 Smith, Adam (1937), *An Inquiry into the Nature and Causes of the Wealth of Nations*, Random House, New York, p 14 (first published in 1776).

make a variety of arrangements to provide income in retirement. They may accumulate savings, build up human capital and physical assets, extend their working life and help younger family members to gain educational qualifications in return for support in their retirement.

Any compulsory superannuation scheme is likely to require people to save sufficient income to provide a pension broadly equal to NZS. This would imply a doubling in retirement income for some people, if NZS were retained on a universal basis, and would require up to 16 percent of pre-tax income to be committed to the funding of NZS and the top-up scheme. It is highly unlikely that such arrangements would reflect the preferences of people on low to modest incomes, including beneficiaries, who have little discretionary income. Some people would retire on higher incomes than they earned when working and bearing the costs of raising a family.

- Most people previously provided for their retirement privately. The establishment of large-scale public pension arrangements is a development of the twentieth century. Public assistance was previously limited and most people provided for themselves by continuing to work until they were prevented from doing so by ill health, drawing on savings or property, or by relying on help from family, neighbours or charitable organisations. Untargeted public assistance was modest by current standards before National Superannuation came into effect in February 1977, and the capacity of most people to provide for themselves in retirement is much greater today than it was in earlier generations.

3.6 *Capital market failure.* It has been argued that capital markets limit private savings by failing to provide the scope for investors to hold a diversified range of assets. Secondly, unanticipated inflation can inhibit saving for retirement. Thirdly, insurance markets are said to be unable to provide appropriate cover against events such as an unanticipated shortening of one's working life.

3.7 These arguments are implausible because:

- Financial institutions in New Zealand and elsewhere provide a vast range of products that enable small investors to diversify their risks. There has been substantial growth in such products in New Zealand over recent years, partly in response to the establishment of a more neutral environment for savings and competition within financial markets.

- Some assets, such as property and inflation-indexed bonds, provide a hedge against inflation. Unanticipated inflation is, nevertheless, a concern. The best response lies in the retention of a sound monetary policy directed at maintaining price stability and appropriate institutional arrangements for its implementation.

- Insurance markets provide cover for most people. While moral hazard and adverse selection problems lead to some constraints on the types of policies and coverage offered, the government is unlikely to be better placed to address them. Moral hazard is a significant problem that affects the welfare system. While compulsory schemes can limit adverse selection problems, they do so by cross-subsidising people in different risk categories and limiting competition with the result that the economy operates less efficiently. They do not resolve moral hazard concerns. Contributors may, for example, be encouraged to invest in very risky investments if the government is committed to topping up their savings on retirement. Such a strategy would offer the prospect of high returns while the risk of a highly unfavourable outcome would be reduced at the expense of the taxpayer.

3.8 *People generally earn insufficient income during their working lives to provide for their retirement or, alternatively, people won't save for their retirement – the so-called free rider argument.* These arguments cannot justify a compulsory scheme because:

- Such a scheme cannot increase total income, other factors being equal. It requires people to reduce current consumption or other savings to contribute. If the scheme is actuarially fair, the annuity (or pension) must reflect the contributor's savings and the net income of the scheme (i.e. compensation for forgone consumption net of administration costs).

Higher pensions can only be provided to retirees if they are subsidised by future claimants on the scheme (an example of a chain IOU) or by current workers, for example by way of a subsidy out of current taxation. Both involve inter-generational transfers. The first is equivalent to borrowing to buy the groceries.

- It makes no sense to increase benefit levels to enable people who face a temporary drop in income to contribute to a superannuation scheme. Such people may recover from their misfortune. For example, there is limited unemployment among over 25-year olds. The groups most likely to be unable to save for their retirement are people who suffer from enduring health problems or permanent disabilities, full-time care givers, the long-term unemployed, and people who otherwise have a patchy work record. Many of these groups may be supported in other ways, such as by family members or insurance. A compulsory savings scheme will not solve the problem of these people not providing for their retirement income and becoming dependent on the state. The community will still expect the government to provide a safety net for people who cannot support themselves and who are not supported in other ways. This can best be done through income support during their retirement when their circumstances can be assessed with greater certainty.

- It is rational not to save voluntarily for retirement if the government provides a level of income that is judged by working age people to be adequate. The problem here is an excessive level of state provision rather than irrational behaviour.

- The vast majority of people act prudently. The need for income in retirement is widely discussed within the community. This explains why it is an important political issue. There are no grounds to compel people to save if the numbers that are likely to be improvident are small. There is little reason for believing that they would be large, provided that the state safety net is set at a basic level.

4 Other criticisms of compulsory superannuation

4.1 A number of other arguments can be advanced for opposing compulsory superannuation. They include the following:

- Compulsory superannuation involves a substantial intrusion of the state into the lives of individuals. Personal choices are constrained for doubtful reasons. It is hard to think of an intervention which would have a greater impact on the ways in which individuals are able to arrange their lifetime affairs. The grounds for government intervention in retirement income provision, other than by way of a basic safety net and, possibly, the provision of information, are substantially weaker than for health or disaster insurance.

- It is illogical to raise superannuation benefits and taxes, via enhancements to NZS and the introduction of a compulsory superannuation scheme, to adjust for an aging population. A far better approach is to reduce the generosity of NZS relative to average weekly earnings for future cohorts of retirees and to target it more closely on the elderly who would otherwise face hardship.

- Increasing the income of retirees is not a high social priority. Few of the elderly are among the poorest members of our society. Bob Stephens of Victoria University found that none were living in poverty in 1990/91 when the poverty line was set at 50 percent of mean income. Over 60 percent of the elderly were found to spend less than their income. Households with children on low market incomes and beneficiaries with dependent children should be accorded a higher priority because they face relatively greater hardship.

- A compulsory superannuation scheme would do nothing to reduce the numbers of people in a range of categories from being dependent on the state for support in their later years, and do nothing to help them. They include the following:

  – people who are born with severe mental or physical disabilities;

  - widows with dependent children and with few assets;
  - people who suffer major injuries or illnesses before reaching retirement and who are not supported through private insurance or ACC;
  - full-time care givers who are unsupported by their former spouses or partners;
  - recent refugees who have had little opportunity to re-establish their lives;
  - middle and older age immigrants with limited assets;
  - people who, for a variety of other reasons, have little attachment to the work force and a poor work ethic;
  - other people who earn very low market income during their lives such as people with few skills, voluntary workers and certain members of religious communities; and
  - people who have spent much of their lives in prison.

- NZS could be regarded as a government-provided compulsory scheme that is funded from taxation on a PAYG basis and is actuarially unfair. Some elements of the proposed scheme are also likely to be actuarially unfair. Examples include provisions relating to single and married (or equivalent) annuitants and the gender of contributors. There are no efficiency grounds for departing from an actuarially fair scheme on grounds of marital status, gender, race or other factors. The international record is that not one government insurance/savings scheme has remained actuarially fair for long.

- A compulsory superannuation scheme would bias contributors' preferences. Consumption and savings are unlikely to represent a constant proportion of each person's income. They can be expected to fluctuate depending on circumstances. People on low to moderate incomes will face substantial difficulty in saving to buy a house and

service an unsubsidised mortgage if, say, 8 percent of their gross income is committed to compulsory superannuation. The inability of contributors to draw on personal savings should an adverse event occur during their working lives, such as serious illness, accident or marriage break-up, would reduce their welfare and expose the government to additional fiscal risks. What will happen when a person appears on television to plead for access to superannuation savings or government assistance to help fund a life-saving operation for his or her young child that is only available overseas?

- A compulsory scheme would reduce incentives to work, save and invest, and would adversely affect a host of other choices. It is equivalent to a tax increase for all citizens who would not otherwise save at the prescribed level. A contribution level of 8 percent on top of the present tax scale could increase the marginal tax rate for a person with an annual income between $9,500 and $38,000 from 21 percent to 29 percent, an increase of 38 percent. It would constitute one of the largest increases in income tax ever imposed in New Zealand, if not the largest. While it might be argued that the rate of tax is lower than that applied in the past, such an argument is not valid because the tax base is now much broader than previously. Very high effective marginal tax rates may apply where government assistance, such as family and income support and the accommodation supplement, is abated or where student loans are being repaid. A compulsory superannuation scheme could be expected to impose substantial deadweight costs on the community and reduce the growth potential of the economy.

- There would be pressure on wages as people reduce their willingness to work in response to a higher effective tax. Increased wages unmatched by productivity gains would lead to higher unemployment, especially among those with little attachment to the work force such as those with few skills or without a strong work ethic.

- The implementation of a compulsory superannuation scheme would require significant regulation that would impair the efficiency of capital markets:

  - registered institutions would be favoured. Competition would be reduced thereby impeding innovation and raising costs. Registered providers would benefit from an implicit government guarantee that would reduce their incentive to be efficient and expose the government to fiscal risk if they failed. The DFC case demonstrates how difficult it is for the government to adopt a hands-off stance when government backing is assumed. Prudential supervision of registered banks illustrates the problem of implicit government guarantees that arises when the government registers firms. Similar problems would arise if individuals are forced to save with institutions that are authorised by the government;

  - the form of the scheme's investments would need to be constrained. Otherwise contributors could borrow back their savings and defeat the purpose of the scheme. In practice it would be difficult to prevent people from undermining the intent of the scheme in this way. This difficulty would increase the more liberal are the rules for investments and qualifying schemes.

- Government schemes are open to interference on political grounds. Contributors usually have few opportunities to enforce their rights. With a lawful contract changes can only be made by mutual agreement between the parties. Equivalent property rights are not normally conferred on contributors to government schemes. The government usually reserves the right to modify contributions and entitlements through the political process. The ACC scheme illustrates these points.

  Australian experience also suggests that, over time, governments are likely to interfere with the decisions of superannuation funds for political reasons, with harmful consequences for the allocation of

capital. The Keating government, for example, put pressure on institutions to invest in venture capital projects and in infrastructure, and to direct funds to Australian rather than offshore investments, regardless of the possibility of lower returns and higher risk. A government led by a politician such as Sir Robert Muldoon could be expected to act in similar ways. Any legislative safeguards that are put in place could be repealed.

- Government schemes encourage litigation. The courts could be expected to add to the costs of the scheme by broadening entitlements that appear to be paid to a distressed litigant by a faceless government with the apparent capacity to pay. Court decisions have contributed to the creeping cost of ACC.

- There would be a large incentive to avoid compulsory contributions. Incomes earned through trusts and companies, and as fringe benefits rather than as wages, are obvious examples.

- Substantial administration and compliance costs would be imposed on the community. Government schemes often involve continual fine tuning in addition to major changes from time to time. Australia has made over 2,000 changes to its superannuation arrangements since the early 1980s. Enforcing compliance has been a longstanding problem with Chile's scheme. Forty-five percent of contributors to the Chilean scheme are reported to be in default of their obligations. Twenty percent are more than a year behind.

- The tax simplification programme has significantly reduced the number of people required to file tax returns. The introduction of a compulsory savings scheme, which would require contributions to be assessed and monitored and entitlements to be recorded, would require this aspect of the simplification exercise to be unwound.

- The possible establishment of a public scheme, as an investment option, would lead to the well known problems of performance associated with government ownership of private activities, including financial

institutions. Poor incentives would lead to inefficiencies, for example mispricing which would drive out competitors. Lobbying by government enterprises leads to regulatory provisions that favour them. Such inefficiencies may not be apparent for some years because an evaluation of the viability of long-term insurance arrangements is difficult as it is affected by many assumptions about future earnings and mortality rates. ACC provides an example of the type of problems that would emerge over time. The union that covers the relevant part of the Chilean financial services sector agrees that the Chilean superannuation scheme employs four times more sales staff than are required.

- The introduction of a compulsory superannuation scheme would lead to new uncertainty for savers, firms and financial institutions. Policy uncertainty would diminish the progress which has been made in encouraging people to save on a voluntary basis.

- The design of a feasible compulsory superannuation scheme would pose many problems. They would include the following:

  - the specification of who is required to contribute to compulsory superannuation. Difficult issues would arise in respect of people who are due to retire shortly and who could expect a negligible annuity if they are required to contribute, short-term visitors (such as staff on secondment from overseas) and New Zealand residents temporarily working abroad. Would people whose compulsory savings are likely to generate little income relative to the scheme's administration costs, perhaps because they only occasionally undertake paid work, be exempt?;

  - the establishment of rules relating to withdrawal from the scheme. At what point would the obligations to contribute cease in respect of residents who emigrate? Would they be able to withdraw their savings with income accrued? Would annuities be paid to retirees who emigrate or people who are overseas on a temporarily basis? Would people of working age who are

suffering from a terminal illness be permitted to withdraw their savings?;

- the definition of income that is subject to the compulsory levy. If income were to be defined as wages and salaries and benefit income (that is, a payroll approach similar to ACC), there would be incentives to convert income into other forms (such as bonuses, fringe benefits, interest and dividends). This problem is reduced with ACC because income subject to the levy is capped. There would also be incentives to trap income in companies and trusts. The self-employed would have greater scope to do this than salary and wage earners. If a broad definition of income were adopted, income from businesses and profits may need to be defined. Would income earned offshore be liable? The definitions of income used for tax purposes are subject to ongoing litigation;

- the determination of restrictions on the amount of annuities, if any. There have been initial suggestions that partners would be preferred relative to single people in the event of death during retirement. This raises controversial issues relating to the definition of a partner. Would, for example, gay and lesbian partners be treated on the same basis as married people? More broadly, the application of the principles underlying the Human Rights Act 1993 would need to be addressed.

  If annuities were not computed on an actuarially fair basis, adverse selection problems would begin to loom large. They arise where the scheme is attractive to a particular class of contributors. For example, if the rules favoured married people relative to single people and if contribution rates were fixed, a scheme provider would seek to discourage excessive enrolment by married couples or people who are likely to marry. A provider might seek to do this through its advertising and the location of its business.

On retirement a contributor's accumulated savings may be required to be used to buy an annuity for life. Some people believe that lump sum withdrawals should be permitted. There would also be pressure to allow surviving spouses and children to benefit in the event of the early death of contributors.

Financial institutions would be unable to offer fully inflation-proofed annuities unless the government issues inflation-indexed bonds (or equivalent investments) in vast quantities. This is unlikely to be an efficient way to finance government assets. Thus retirees are likely to face greater inflation risks and lower returns because of the uncertainty involved in pricing annuities than if their accumulated savings were invested in other ways.

- The establishment of the contributors' rights, if any, to pledge their accumulated savings as security for loans or to assign or transfer their annuities. Would contributions or annuities be available to unsecured creditors in the event of bankruptcy? Would contributions be confiscated by the Crown where illegal activity such as dealing in drugs is involved? In the event of the insolvency of an employer, what status would be accorded contributions that have been deducted from tax or are due but had not been paid to the fund?

- The criteria for registering and deregistering providers. Would the government be prepared to register any scheme provider? If not, what prudential and other requirements would be proposed? Could overseas providers be registered? If not, competition would be reduced and the average risk status of providers would be increased. The administration of registration arrangements would require the establishment of a new government agency or unit.

- The rules, if any, relating to changes in providers. Would contributors be able to change providers at will? Would existing

savings be transferred or would only new savings be affected? Each year about 20 percent of contributors to Chile's scheme change providers despite rules aimed at achieving a narrow dispersion of earnings among schemes.

– Would providers be free to set fees? If not, what controls would be placed on them?

5 Conclusion

5.1 Compulsory superannuation is undesirable for the following reasons:

- A key feature of retirement income policy should be the promotion of economic growth which alone can deliver the real goods and services needed by a growing number of elderly. Interventionist policies reduce economic growth.
- The provision of income in retirement should be a private responsibility for the vast majority of New Zealanders, as in many other countries.
- The government should provide a safety net. Policy on NZS has been heading in the right direction (gradual increases in the age of eligibility, reductions in the generosity of support and, until recently, a commitment to targeting).
- Compulsory superannuation involves an unjustified intrusion into people's lives. The welfare of savers would be reduced.
- Concerns about savings deficits and risks to national sovereignty from foreign investment are misplaced. They do not justify compulsory superannuation.
- With a compulsory savings scheme government assistance would still be required for people on low incomes and non-earners who are not supported in other ways, such as people with little attachment to the work force and care givers, and for those whose savings were lost following the failure of a financial institution.

- Compulsory superannuation is equivalent to a tax increase for all citizens who would not otherwise save at the prescribed level. A large rise in the effective rate of tax would be imposed on many citizens. A government that is committed to increasing its spending cannot cut taxes to offset superannuation contributions and maintain a prudent fiscal policy. Incentives to work, save and invest and a host of other choices would be adversely affected.

- The introduction of a compulsory scheme would be a massive and vastly expensive undertaking. Substantial resources would be committed to the design and operation of the scheme. Ongoing regulation and litigation can confidently be expected. Its implementation would require detailed attention by the government and involve ongoing political controversy as changing circumstances forced amendments to it over time.

Appendix III

SAVINGS

1 Are savings low?

1.1 For decades there have been concerns that savings have been too low, and not just in New Zealand.[1] The Labour government of the late 1950s wanted to increase savings. So too did the Planning Council in the 1970s. Sir Frank Holmes told the Economic Summit in 1984 that New Zealand had been relying too heavily on foreign investment and should increase its domestic savings. The then Reserve Bank governor Don Brash said New Zealand's savings record "looks particularly poor". Many commentators have made similar comments about the apparent decline in measured household savings in the United States and other countries in the 1990s.

1.2 These claims have persisted despite the fact that they have been contested many times. The McLeod Tax Review commented last year that:

> [W]hen looking at the impact of savings on the current and future well-being of New Zealanders, the most relevant measure is national savings; that is, the sum of private and government savings. On examining the available evidence and the reasons why people save, it was not clear to us that New Zealanders save too little.[2]

The Review added that a number of submissions disputed this conclusion but that "None, however, cited any supporting evidence other than a claimed consensus among relevant experts that there is a problem".

1.3 By far the most exhaustive recent attempt to assemble evidence on New Zealand's savings level and trends is a Treasury Working Paper by Iris Claus and Grant Scobie.[3] The paper highlights the problems with the measurement of saving and the difficulty of drawing clear implications for policy. It should be

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1 This appendix is a slightly edited version of an address, 'New Zealand's Saving Habits: Are They Really Poor?' by Roger Kerr to the IIR Funds Management and Superannuation Funds Conference, 7 March 2002.

2 Tax Review 2001 (2001b), p 93.

3 Claus, Iris and Scobie, Grant (2002) 'Saving in New Zealand: Measurement and Trends', Treasury Working Paper 02/02, The Treasury, Wellington.

compulsory reading for anyone interested in the savings debate. Among the points it makes are that:

- Saving is difficult to measure (in New Zealand and elsewhere) because of factors such as hidden economy activities, depreciation (which is an unobserved variable), and the difficult distinction between households and businesses.

- In New Zealand, national saving is calculated from two sources of data: (i) from the national income and outlay account as the difference between disposable income and total consumption expenditure, and (ii) from the flows of investment and net lending in the capital finance account. Definitional changes can have large effects, as illustrated by the revisions to national saving from SNA68 to SNA93.

- Household saving is obtained from the income and outlay accounts only, and does not have the same degree of accuracy as the national saving rate.

- Saving as measured in the national accounts does not correspond very closely to theoretical concepts of saving. This measure also counts as current consumption many items such as education, some health expenditures and consumer durables which are arguably investment goods. Adjusting for such treatment substantially raises the national savings rate.

- The flow measure also ignores changes in household wealth such as homes and financial assets. The alternative stock measure of household wealth is more relevant for assessing the adequacy of retirement saving, but little information is available on the assets and liabilities of individual New Zealand households. (Estimates for the United States suggest that if realised and unrealised capital gains were included in saving, the savings rate would actually have increased during the 1990s.)

- Inflation also distorts the flow measure of private saving, as it transfers resources from lenders to borrowers.

- When adjustments for inflation are made, there has been no apparent downward trend in the level of private saving in New Zealand and, more importantly from an economic perspective, national savings rates could be much higher than suggested by the conventional measures.

1.4 A further point is that there is an inverse relationship between the household savings rate and the government savings rate (fiscal surpluses and deficits). Household savings rates fell in the early and mid-1990s as budget surpluses were achieved and rose in the late 1990s as the fiscal position deteriorated.

1.5 Having regard for other factors such as demographic trends that are relevant in making international comparisons, we unaware of any convincing evidence that New Zealanders are poor savers.

1.6 This conforms with simple intuition. Saving is deferred consumption. We save in order to meet our expected consumption requirements in the future. Most people spend most of their income over their lifetimes. It would be surprising if the choices New Zealanders make between current and future consumption differ greatly from those of people in comparable countries. Certainly the split between private and government savings could vary depending on the roles undertaken by governments in areas such as education, health, housing, welfare and retirement income. However, it is a plausible hypothesis that New Zealand's overall national savings rate, properly measured, would not differ greatly from those in countries with similar income levels.

2 Savings and economic growth

2.1 One of the main reasons why some people worry about saving is that they assume there is a close and causal relationship between national saving, investment and economic growth. Such beliefs are common among parties on the political left and central planners, but are not confined to them. The Soviet Union's economic policy was founded on 'primitive socialist accumulation' and 'capital fundamentalism' was an earlier feature of the development strategies of many developing countries. But as the experience of such countries and the contrasting experiences in the 1990s of the United States (which has one of the lowest savings rates as conventionally measured) and Japan (with a high

measured savings rate) shows, savings and economic growth are not necessarily closely related in economies with open and well developed financial markets.

2.2 A successful effort to raise national savings and investment rates might have little effect on economic growth. A basic growth model suggests there would be a one-off increase in per capita income but no permanent effect on the rate of growth. More sophisticated models produce similar results. Consumption per head – which is what we are seeking to maximise – could actually fall because of the greater burden of capital depreciation.

2.3 Several other relevant points emerge from the economic literature about the relationship between savings, investment and growth:

- The magnitude of net saving in advanced economies is only a tiny fraction of the value of the existing capital stock. Policy initiatives that improve the use of the entire capital stock can have a much larger effect on national output.

- In open economies investment is not constrained by domestic savings. Financial sector liberalisation means that firms can access vast global capital markets – profitable investments are unlikely to go begging for lack of funds.

- The causal connection between savings and growth may not run in the direction that is commonly supposed. Some researchers have concluded that growth drives savings rather than the other way round, and that savings typically rise with per capita income.

- Modern accounts of growth, including the so-called 'new growth' theories, place primary emphasis on the importance of policies and institutions that are conducive to high levels of economic freedom as the key determinants of productivity and innovation.

2.4 A second recent Treasury paper confirms these general findings.[4] It notes that New Zealand's average investment rate at around 22 percent of gross domestic product (GDP) ranks in the middle of OECD rates, and finds that "there is no obvious link between domestic saving, investment, the current account and real output growth." It also finds that the supply of venture capital does not appear to be a significantly constraining factor for New Zealand, thus implicitly questioning the government's recent incursion into this field. The authors conclude "policies to promote domestic saving are unlikely to enhance economic growth. Such policies would need to be justified on other grounds."

3 Should governments seek to influence savings?

3.1 Savings are not an end in themselves – rather they are a means to future consumption opportunities. It is hard to see why governments should attempt to dictate the choices people make between present and future consumption. Consider two scenarios.

3.2 First, Michael Novak tells the story of two professional women who opt for very different lifestyles. One lives frugally but saves significant sums every year and ends up with a million dollars in mutual funds and a pension. The other enjoys the good life, food and travel, and ends her career with just enough to make ends meet in retirement. Do these sisters envy each other? On the contrary. They feel sorry for one another. Each thinks the other is crazy. Why should a government interfere with their choices?

3.3 Second, suppose that governments could somehow force people to save more and that higher savings led to higher growth. Would that be a good thing? Governments could also legislate for a 60-hour week which would boost GDP, but most people would regard themselves as worse off. Income and wealth are at best very imperfect measures of welfare – forgone consumption and forgone leisure in the respective cases would offset the income gains for most people.

3.4 In fact, there is little evidence to suggest that governments can materially influence national savings levels other than through their own decisions on

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4 Claus, Iris Haugh, David Scobie, Grant and Törnquist, Jonas (2001) 'Saving and Growth in an Open Economy', Treasury Working Paper 01/32, The Treasury, Wellington.

government savings (budget surpluses) or dissavings (deficits). Study after study has shown that compulsory savings schemes and tax incentives for savings alter and distort savings patterns but have little or no effect on aggregate savings. The Tax Review concluded:

> [E]ven if it were considered desirable for New Zealanders to save more, there is little evidence that changes to the tax system will induce higher saving, other than by redistributing income from those who are less likely to save (typically, poorer households) to those who are more likely to save (typically, wealthier households).[5]

3.5 This is consistent with OECD advice that "the theoretical and empirical evidence provides hardly any firm ground for relying on tax policy to affect private savings levels on a significant and permanent basis."[6]

3.6 Why then, despite the evidence, do governments have a perennial urge to interfere in savings decisions? One answer is that some politicians simply want to run other people's lives. Another is that they can buy votes by bribing taxpayers with their own money. Also there is constant lobbying from vested interests for government intervention. To its credit, the Investment, Savings and Insurance Association stated in 1999:

> The ISI is not looking for favoured tax treatment for the products its member companies sell. New Zealand does not need more inequities in its tax system.[7]

3.7 Does all this mean that there is no reason for concern about savings patterns and levels in New Zealand? To the contrary. It is true that the environment for savings was improved with lower inflation, deregulation of the financial system, the introduction of GST and an end to public sector dissavings. However, there have subsequently been backward moves, including higher levels of government spending and hence the overall tax burden, and a widening of the tax scale which has accentuated distortions such as the treatment of housing and increased administration and compliance costs. In addition, the government's extensive role in health, education, housing, welfare

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5 Tax Review 2001 (2001b), p 93.

6 OECD (2000), *Economic Surveys: New Zealand*, OECD, Paris, p 127.

7 Investment, Savings and Insurance Association of New Zealand (1999) 'Towards an Ideal Taxation Regime', Investment, Savings and Insurance Association of New Zealand, p 2.

and retirement incomes reduces the need for self-provision – why save if the government does the job for you?

3.8 It follows that the environment for saving could still be materially improved. The income tax at its present level discourages savings: the earlier strategy of reducing the government spending ratio in the economy and moving to a lower and flatter tax scale has not been carried through. Political parties that are serious about returning New Zealand to the top half of the OECD income ladder simply must commit themselves to lower levels of spending and taxation.

3.9 Given lower tax rates and higher disposable incomes, there is extensive scope for many middle and upper income earners to rely less on government-provided social services, which are often of inferior quality, and assume greater personal responsibility. Such changes would not necessarily increase aggregate national savings but, by conforming more closely with standard efficiency and equity criteria, they would lead to better economic and social performance.

3.10 Finally, on the specific issue of retirement incomes, the McLeod Review noted that:

> [T]here is little evidence that most New Zealanders are currently making inadequate provision for their retirement. New Zealand's system of universal superannuation cannot be ignored in this context; it seems reasonable to conclude that virtually all current recipients of New Zealand Superannuation who have a mortgage-free home and relatively modest savings consider themselves to have at least a medium standard of living… We therefore take the view that, against the backdrop of universal provision of New Zealand Superannuation, most New Zealanders would not be well served by being induced or compelled to make additional retirement provision at the expense of living standards during their working lives.[8]

3.11 The residual question, of course, is whether current government retirement policies are optimal. Regrettably, this is still not the case. Despite some moves to improve the environment for savings and modify the government scheme, there have been backward steps, such as the move to universality and the increase in the benefit rate. The new Superannuation Fund is another diversion

8 Tax Review 2001 (2001b), p 94.

which will do nothing to solve the long-term problem. The key point to keep in mind is that rather than having a narrow focus on savings, the focus of retirement income policies should be on economic growth. As one study put it:

> The key to providing high incomes in retirement is the pursuit of policies promoting high economic growth. Policies to this end are rarely focused just on retirement and superannuation issues but cover taxation, government spending, government regulations, labour market arrangements, and the incentive and reward structures facing individuals, private business enterprises and governments. With an expanding economy, most people should be able to self-provide for their retirement income, and should face incentives to save and to consume which are level and fair across their lifetime: the basic role of a government pension is to provide a bottom safety net against the problem of aged poverty. [9]

3.12 Federal Reserve chairman Alan Greenspan recently made a similar point about growth when he told a National Summit on Retirement Savings:

> Retirees may have accumulated a large stock of retirement savings, but the goods and services needed to redeem those savings must be produced by an active workforce assisted by a stock of plant and equipment sufficiently productive to meet the needs both of retirees and of a workforce expecting an ever-increasing standard of living.
>
> Though from the point of view of an individual household, saving reflects financial claims adequate to meet future needs, the focus for the economy as a whole, of necessity, must be on producing the real resources needed to redeem the financial assets.[10]

4 Conclusion

4.1 Saving is not a controversial issue in the economic literature – the general conclusions of this paper have been well established. Most of what we think we know about it is not true. In particular:

- The measurement issues with savings are well known, and there has long been scepticism that, given appropriate adjustments, savings rates across countries vary as widely as is often assumed.

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9 Anstie, R, Freebairn, J and Porter, M (1989), 'Superannuation and Government Aged Pension Schemes for a Dynamic Economy', Centre of Policy Studies, Melbourne.

10 Greenspan, Alan (2002), 'Saving for Retirement', National Summit on Retirement Savings, Department of Labor, Washington DC, February 28.

- There is no convincing evidence that New Zealand's savings record is poor.

- Theory and evidence indicate that domestic saving and investment is but one source of economic growth, of less importance in advanced countries than productivity-enhancing factors. A legitimate concern for New Zealand's inadequate growth performance should focus systematically on growth issues.

- There are no clear grounds for government efforts to alter people's consumption and savings choices, given a policy environment in which choices are distorted as little as possible.

- Tax incentives and compulsory savings proposals in particular should be rejected as ineffective, distorting, inequitable and illiberal policies. As one researcher has put it: "[S]aving-inducing tax plans are attacking a problem that does not exist with a mechanism that will not work in order to achieve a goal that would harm the economy."[11]

4.2 Rather, the debate in New Zealand should move on from concerns about macroeconomic savings aggregates to issues such as levels of government spending and taxation and the boundaries between state and private responsibility for the provision and funding of social services, including retirement incomes. The purpose of this debate should not be to engineer particular levels and forms of savings but to improve economic incentives, encourage more efficient savings and investment decisions, and enhance overall economic and social performance.

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[11] Buchanan, Neil (1999), 'Taxes, Saving, and Macroeconomics', *Journal of Economic Issues*, vol 33, No 1, pp 59-76.