SAVINGS: POLICY ISSUES AND OPTIONS.

Discussion paper prepared by Peter Harris

6 June 2003.

A note on style.

The report is not intended to be an academic tome. It uses "plain English" when a more technically precise version would be cluttered with extended definitions, and endless qualifications and caveats.

It does not use cross-references to sources and studies for every assertion or observation made. The main sources used are listed in a brief summary of references in the appendix. A number of the observations come from conversations with stakeholders with an interest in the savings debate. They have not been identified because there is a need to avoid any pre-positioning of viewpoints in the lead-up to a workshop, forum or summit on savings.

TABLE OF CONTENTS.

Introduction		3
Savings policy: A summary		4
I.	Purpose of discussion paper	8
II.	Why do(n’t) people save?	10
III.	Should attempts be made to increase saving?	17
IV.	What needs to change to improve saving?	28
V	List of Questions	35
Appendix I. Core references		38
Appendix II. Statistical concepts and measures of saving		39
Appendix III. Tax incentives and disincentives		43

INTRODUCTION

Savings policy is complex. There is a summary of the issues at the beginning of the discussion document. We hope that you will read the fuller version but, if pressures of time prevent that, we would draw your attention to three sections that we do put in the **"must read"** category.

The first is the overview of what is actually happening with savings. That is on pages 10 to 14. The second is the section that looks at possible instruments that might be used to promote broader access to and take up of employment based superannuation. That is on pages 21 to 24. Finally, there is the discussion of the design of savings instruments that might help overcome some of the psychological barriers to savings. That is in pages 32 to 34.

"Savings policy" is not just about what the government ought to do by way of tax incentives for savings. Indeed, the thrust of this report is that that is probably one of the least cost-effective strategies for boosting private saving and increasing personal financial flexibility.

The design of a savings policy framework would ideally be helped if there were more information about "why" people save, and about some of the dynamics that are changing the financial status of the next generation(s) of savers. More work on that, to complement the very large strides made in recent years to improve information on "what" and "how" people save would be ideal.

In the meantime, it is possible to make progress. A robust savings framework is one in which all with a responsibility for a contribution to make to improving peoples' capacity to deal with their financial health in the future accept that responsibility and make the contribution. More importantly, it is one in which each part of the framework complements the others.

A comprehensive and complementary framework cannot be imposed. It has to emerge through discussion and compromise, and present as a consensus.

This paper is offered as a starting point in fleshing out the agenda for that discussion.

SAVINGS POLICY: A SUMMARY.

Saving: what New Zealanders do.

People save for many reasons: to buy a lumpy consumer durable like a car, to put something away for a rainy day, to provide for an income in retirement, or simply because they didn't need to spend all of their income at the time.

Saving:
- increases the financial flexibility people have, and
- (generally) increases the amount of money they have in the future.

Despite these apparent advantages, saving rates in New Zealand are low. At the personal level this means that most New Zealanders enter retirement substantially dependent on the state-provided New Zealand Superannuation for income, or to supplement what can be taken out of savings. 70 percent of the income of single New Zealanders over 65, and 60 percent of the income of couples, comes from New Zealand Superannuation.

At the national level, low savings rates mean that there is a limited pool available to finance investment in new plant and projects. In 2001, 73 percent of New Zealand's investment was financed by foreigners (either by equity or loans). While there is no apparent inability of New Zealand borrowers to access foreign savings, the dependence on them
- ensures that a portion of any increased economic output accrues to foreigners and is not available to enhance the living standards of New Zealanders;
- creates a possible source of volatility and instability.

Savings that do take place:
- build up over the life cycle, so that assets rise with age and income;
- are highly unequally distributed (in all age brackets over 35, there is a consistent pattern of the top 20 percent owning 60 percent of the assets of the group);
- are significantly impacted by inheritances;
- are heavily concentrated in owner-occupied housing (equity in the home accounts for 36 percent of the assets of New Zealanders);
- are increasingly less likely to be through employment based superannuation schemes (These schemes covered 22.6 percent of the employed workforce in 1990, but only 14.6 percent in 2001. They account for six percent of household assets compared with 15 percent in Canada and 11 percent in the USA);

This profile suggests that the net effect of a life of working, saving, borrowing and consuming is that New Zealanders enter retirement asset rich (owning a house) but income poor (with very low income flows from other assets).

The dynamic aspects of savings (and the related accumulation of debt) are not well known, but there is a real risk that a life history of beneficiary debt, student debt, more frequent periods outside paid employment and greater recourse to high-interest, short-term credit card debt will leave a substantial proportion of future retirees asset and income poor, or – even worse – indebted, asset poor and income poor.

Should saving be encouraged?

Decisions on whether to consume or save income, how much to put aside for future lifestyle needs, and where and how to save, are inherently personal decisions. Why then, should other agencies – the government, employers, unions, providers of financial products – intervene to influence the level and form of savings?

There are four main reasons.

- "Market failure". A number of studies have shown that there are information, confidence and psychological barriers that get in the way of converting what people objectively think they need and want to do, and what they actually do. Overcoming psychological barriers to savings can effect a change in the savings culture.
- Risk. The less consumers save to protect themselves from adverse circumstances, the more risk transfers onto the provider of last resort: taxpayers.
- Investment. A higher rate of domestic savings will ensure that more of the benefits from investment accrue in and to New Zealand(ers).
- Standards. There is a need to protect savers from poor standards, bad practice and inappropriate (often concealed) costs and fees.

A framework for savings policy.

A robust savings policy should not rely on a single vehicle through which saving is channelled. Nationally, saving can be done by the government, by businesses and by households. It can also take many forms, from temporary and liquid balances in bank deposits, to locked-in, workplace based and largely inaccessible retirement savings schemes.

If saving is seen as a means to an end (greater financial flexibility and protection from loss of regular income) a comprehensive savings policy has three core elements: the basic income protection provided by the government (especially in retirement, when income earning options are effectively closed); employment based, longer-term savings; and individual savings for targets that can vary in amount and timing. The policy would need to address incentives and disincentives to saving (including tax incentives and disincentives) especially for the second and third elements.

The elements are not entirely independent. Provisions in one area can impact on the incentive to save through other vehicles, and can create tensions when the ultimate beneficiary seeks to move savings to other uses (e.g. to access funds in a retirement scheme to pay off credit card debt or to put a deposit on a house)

It is clear that different interests can support enhanced savings for different reasons (e.g. an employer can support savings by individual employees as a recruitment device, or to assist with a retirement/ disengagement policy). The problem with this is that there are benefits to third parties (e.g. the government, if savings reduce the risk of extra demands on state support or if they increase investment and net national income), that may be higher than the benefits to the party bearing the cost (like an employer subsidising a superannuation scheme).

The workplace is a highly efficient and effective location and instrument to use in boosting savings, but there is very limited benefit to employers and unions in allocating time and money to boosting workplace based saving.

In this case, a number of policy options arise:

- Compulsion (in various forms, such as a requirement for employers above a certain size to offer access to a superannuation scheme).
- Incentives (to either the employee or the employer or both).
- Conscription (to find a way for unions to mobilise the collective interests of workers around a diversion of some part of salary into saving).
- Reward (kick-starting savings or augmenting savings with one-off boosters once certain milestones are passed).

The third element of a savings framework (individual savings in different and more flexible ways) is very difficult to "steer", because motivations and personal circumstances are so incredibly different. Policy here could well focus on the product on offer: fees, ethics, transfer values, and on education about the product range that savers have access to.

There is also a life stage, or mid-life milestone that might trigger a different attitude to and urgency about saving. It is not clear if this is simply something that changes motivation and behaviour, or whether policy or savings product can be designed to support and enhance savings that are stimulated by both need and capacity to save at certain life stages.

At present, there is no generally agreed approach to the elements that ought to go to make up a savings policy package, or about the weight that ought to attach to each of them. A "conversation" (workshop/forum/summit) between groups with an interest in developing a national consensus on savings policy can help progress initiatives that might boost savings.

Issues to discuss.

There are a large number of complex elements that need to be integrated into a comprehensive savings policy framework. It will not be possible to cover them all in an initial forum on savings policy. There are, though, four core elements have to be covered in the first round of policy development.

(i) The "first tier": New Zealand Superannuation.

Is it time to move on: to put NZS behind the debate on saving and to concentrate on promoting other forms of saving? There is a link between NZS and these other forms of savings: is it possible to explore the implications of that link without relitigating the issues of entitlements to and sustainability of NZS, and taking attention away from the need to improve performance in the other areas?

(ii) Expectations: defining the level of support that savers can reasonably expect?

What reasonable expectations can be placed on employers to offer superannuation as a condition of employment? What level of cost should the government meet in supporting workplace saving? What is likely to be a cost effective form of support: tax incentives, tax deferral, cost offset or rewards?

(iii) Quality of savings products and consumer protections.

Are consumer protection and disclosure requirements at the retail end of the savings industry adequate? If not, what additional interventions are necessary and justified?

(iv) Promotion: education and scheme design.

Where should the emphasis go in overcoming the psychological and information barriers to saving: education; design of default options around employment and saving; or restrictions on access to savings? What measures are likely to be counter-productive and build up resistance to saving?

A number of additional issues need to be worked through in the fullness of time. They refine and complement these core elements of a savings policy.

Supplementary issues for savings policy:

- Is there enough clarity around the links between domestic savings, investment, and national benefits from production, employment and income to create a basis for establishing what level of cost the government ought to bear in designing a package of measures to stimulate saving? If not, should the emphasis for policy design go on the personal benefits of savings with the wider macroeconomic benefits providing background comfort (that there will be a greater good as a by-product)?
- Where should the emphasis go in refining statistical and psychological understanding about trends in saving and the financial status of groups of New Zealanders?
- Do existing approaches to saving (by all parties) mean that "serious saving" is only being done by the top twenty percent of New Zealanders, and if so, where are the key interventions that will spread that practice?
- How serious is debt in its emerging forms, and does debt management have to be a part of a savings framework? If, so, what are the options?
- Is the dominance of the home in the asset plans of New Zealanders an issue that should – or can(!) be managed in both diversifying the asset base of households, and contributing more to supporting income and consumption in retirement?
- How far should the policy go in trying to establish good practice in employment relations, and who should take the lead in doing so?

These lists are not exhaustive. They provide a basis that parties interested in pursuing the savings policy debate can add to or delete from. Further input will then allow a structured and reasonably comprehensive agenda to be developed for a subsequent workshop/forum/summit on this important and pressing dimension of public policy.

Comment is invited on the content of this discussion paper.

I. PURPOSE OF THIS DISCUSSION PAPER.

The Investment, Savings and Insurance Association (ISI) has instigated a process that will bring a variety of stakeholders and interested organisations together to discuss the components of a new framework within which personal savings are encouraged and facilitated.

A robust savings policy should not rely on a single vehicle through which saving is channelled. Nationally, saving can be done by the government, by businesses and by households. It can also take many forms, from temporary and liquid balances in bank deposits, to locked-in, workplace based and largely inaccessible retirement savings schemes.

If saving is seen as a means to an end (greater financial flexibility and protection from loss of regular income) a comprehensive savings policy has three core elements (or "tiers"): the basic income protection provided by the government (especially in retirement, when income earning options are effectively closed); employment based, longer-term savings; and individual savings for targets that can vary in amount and timing.

These elements are not entirely independent. Provisions in one area can impact on the incentive to save through other vehicles, and can create tensions when the ultimate beneficiary seeks to move savings to other uses (e.g. to access funds in a retirement scheme to pay off credit card debt or to put a deposit on a house)

Much of the debate on savings policy has focussed on the first element or tier, and while no element is independent of any other, the biggest gap, in terms of a settled policy on savings is around tiers two and three.

The intention of the process that the ISI has initiated is to work collaboratively to structure an environment that will enable New Zealanders to accumulate personal savings in order to give them more financial freedom. There is a need to take a lifetime perspective, recognising that there are milestones against which individuals can plan their finances. Although the framework envisages an integrated approach to the various forms that savings may take, there will be special emphasis on the workplace as an instrument that can leverage savings levels.

Any discussions that may take place will be more constructive and productive if:
- the issues that concern participants are outlined in advance;
- there is a comprehensive agenda that both identifies the issues and elaborates on them;
- background information explains the context in which the issue arise.

This report is not a conclusive outline of that comprehensive agenda. It is an initial attempt to sketch out the conceptual and practical issues that have arisen around the savings policy debate. Potential participants are invited to use the report as one perspective on savings policy, and to see if there are major areas and issues that have not been covered.

Responses will allow a revised draft to be presented to a workshop/forum/summit as a background document that can be used as the agenda in forming a consensus on savings policy.

This initial report:
- Sets out some of the "national interest" perspectives that would provide the common cause around which a partnership on savings might form.

- Defines the core interests and concerns of a number of interest groups.
- Provides a preliminary list and definition of the issues that would need to be explored in developing the framework.

II. WHY DO(N'T) PEOPLE SAVE?

What are "savings"?

"Saving" is a slippery concept. In its most simple form, it is that part of income that is not consumed. By deferring consumption, the individual (or group, or even nation) is able to consume different things in a later period. Savings changes the scheduling of consumption (its "inter-temporal dimension" in the jargon). If savings are channelled through an instrument that earns income, more is consumed in the future time period.

Saving therefore not only shifts consumption through time, but it also increases the level of consumption in the later time period. In this sense, "saving" is inextricably linked to "investment".

Saving:

- increases the financial flexibility people have, and
- (generally) increases the amount of money they have in the future.

How do we measure savings?

Savings may well be a slippery **concept,** but when it comes to measuring who saves, and how much they save, statistics can prove just about anything! It all depends on what is being measured and who is doing the measuring.

Unfortunately, different series not only show radically different **patterns** of savings, but different **trends** in savings behaviour.

What can be said from the array of measures is that:

- at the personal level, savings rates are low, and it is only a small percentage of the total population that will accumulate sufficient savings to sustain living standards at a reasonable level when earned income stops (usually through retirement):
- from the point of view of the national economy, saving is insufficient to finance total investment, so there is a reliance on the saving of foreigners (as evidenced in a persistent deficit in the current account of the balance of payments).

An aspect of the low level of national saving that might be relevant for developing a policy framework on saving is that while government and business saving is generally positive, household saving is extremely low, and on some measures negative.

Some of the (confusing) technical detail about measures of savings is recorded in appendix II. The appendix also lists the questions that need to be addressed if it is felt that developing a policy on savings needs to work off a more consistent and more relevant information base.

What can we say about savings?

Three qualifications.

[National savings has three components: saving by the government, saving by businesses and savings by individuals – "households". All are important. Business saving – through retained

earnings – tends to be most directly connected with new investment. It is also linked to household savings. To the extent that New Zealanders own businesses, their savings go up pro rata with their share in the business. In this section, no attempt has been made to isolate the special features that might impact on business saving. The data record the **effects** of business savings, not their cause. If private households own farms, businesses or commercial property, or have interests in family trusts, the value of those interests are shown as household assets. There is no information available on which to judge whether those asset values are a result of conscious savings decisions by businesses or simply a matter of luck (windfall capital gains or losses)]

(It is useful to distinguish between **flows** of saving (set amounts of current income that are not consumed) and **stocks** (the accumulated effects of past income, consumption, borrowing and saving). The stock of saving can be influenced by "outside events" – how profitable trading conditions have been, whether interest rates have been rising or falling, and how capital values have been moving. In this section – unless it is clear from the text, references are to the stock of savings)

{Except where it is clear from the text, data in this section come from the Household Savings Survey. The HSS defines "assets" widely. They include conventional definitions of assets such as bank deposits, shares, farms, property and the like. They also include some things that might be regarded as consumer durables like motor cars and collectables. "Other" assets cover any asset with a value of more than $1,000 and include home computers, and sporting or hobby equipment. They do not cover furniture, household appliances and clothing}

Qualifications aside, a general picture of private savings in New Zealand shows:

Assets accumulated through net savings are quite low.

On average, individuals have $97,900 in net assets, and couples $322,300. The average is misleading. It is boosted by small numbers with large assets. The median value of assets (the middle of the range) is only $10,300 for individuals and $172,900 for couples. By comparison, the average wage is a little under $39,000 per annum.

As expected, net assets rise with age, as people accumulate savings over the life cycle.

The Household Savings Survey data show that savings tend to rise in rather regular steps with age and income. This could simply reflect the dominance of the house in the asset portfolio of New Zealanders. As people grow older, their equity in their homes rises. Given that 36 percent of all assets held are in the house that is being lived in, this factor would smooth any observed variation in the composition of asset ownership by age group.

The effect is that in the age group approaching retirement (55 – 64), a higher percentage of the population have a reasonable stock of assets. The absolute values, though, are not particularly high. Only 35 percent of individuals in this age bracket, and 60 percent of couples, have net assets of $200,000 or more: and that includes the house.

There may be a "milestone" effect on savings, so that as people reach "mid-life" (somewhere around 45), there is a more determined effort to accumulated savings that are earmarked for retirement.

In 1998, Lynne Middleton wrote a Masters thesis that built on the USA work of L C Hayes. Hayes isolated the factors that enabled women to do well in retirement. The factors were a strong

and independent identity, a healthy lifestyle, secondary employment skills and financial security. Significantly, all were developed during middle age, which reinforces the prospect of retirement savings developing a distinct identity at some cut-off or turning point in life stages.

Middleton carried out in-depth interviews with six women in order to gain some insights into women's attitude towards and actions around retirement income. The sample was somewhat biased: all six were middle-aged, they had good incomes and had a degree of knowledge about the issues. There was, though, a mix of lifestyles (single, partnered, divorced) and asset status (own home, no home, high credit-card debt).

All of them wanted to save for their retirement as a distinct objective related to a post-work lifestyle change. (Reducing hours, doing unpaid work). They probably had false expectations about ease of access to lower-paid alternative work, but all wanted to face a change in their work patterns with some confidence about being able to live to an acceptable degree of personal comfort.

They faced different savings imperatives (pressure to freehold the family home, need to get on top of out-of-control card debt), but saw retirement savings as something that was distinct from more general asset and debt management. Interestingly, the home was not seen as an assessable asset for retirement income/consumption. In one case, freeholding the house was seen as a pre-condition for starting or increasing retirement savings. In another, the fact of not owning a house was countered by the individual's expectation that she would inherit the house from her parents. (In this case, the expectation was from one generation that the older generation would not/should not see the house as a consumable asset).

Despite the fact that HSS data do not show an observable shift in savings at a set point in the life cycle, those data could be dominated by the accumulation of equity in the house. If data on the value of managed funds and of financial assets are examined separately, there does appear to be a quantum step up for groups over 45 years of age.

There is a high degree of inequality in the distribution of assets: much more so than the distribution of incomes.

Few assets and high debts mean that savings patterns for the young are difficult to interpret. However, for all age groups over 35 there is a fairly consistent pattern of the top 20 percent of the age bracket owning 60 percent of the assets.

This figure probably understates the concentration of asset ownership. Assets build up over the life cycle. Those in the older age groups have larger absolute (as opposed to relative) net assets, so for the population as a whole, the top of the scale owns an even greater percentage of the whole. The top ten percent own nearly half (48 percent) of all assets and the top twenty percent hold 67 percent).

One measure of equality is the "Gini coefficient". The closer a coefficient is to one, the less equal is the distribution. The coefficient for the distribution of wealth is 0.689, while the coefficient for the distribution of income is only 0.322.

Pakeha have more assets than Maori.

In each age group, Pakeha have more assets that Maori, and the margin is very wide: Pakeha have at least three times as much as Maori in net assets.

As expected, net worth rises with educational qualification, occupational status and income level, all which are related.

Inheritances play a large part in determining net worth.

Especially before retirement, single people who have inherited assets have median net assets more than twice the value of single people as a whole. The gap narrows a little in the immediate pre-retirement age band (55-64) as people accumulate assets and the proportionate influence of the inheritance declines. In this bracket net assets of those who inherit are "only" 80 percent higher than for the population as a whole. In absolute terms the differences remain the same at around $100,000.

Similar patterns are shown for couples, although the relative differences are not quite as large. This probably reflects the fact that couples accumulate more assets between them during the life cycle, so the asset base is larger relative to the inheritance. In absolute terms, inherited assets boost wealth by a little more than for single people, probably because there is a greater chance that both partners will inherit something.

The house people live in dominates their asset portfolio.

The home accounts for 36 percent of the total value of the assets of New Zealanders. If other properties are added, the total rises to 45 percent.

Together, farms, businesses and family trust make up the next largest category at 24 percent. These will be much more important in the portfolios of particular categories of New Zealanders (the self-employed and professionals) than the overall average suggests.

Assets in superannuation schemes account for a very small six percent of total assets. Life insurance policies add another two percent to that total. This compares with 15 percent in Canada and 11 percent in the USA.

A surprisingly high six percent of assets are held in bank deposits. The same amount is held in bank deposits as is held in superannuation schemes.

Interests in shares and managed funds also make up six percent of the asset stock, but intuitively it seems possible that in this case the average masks quite wide variations between distinct groups in the population. Managed funds are particularly significant for those over 65.
A very small percentage of the population (four percent) owned family trusts, but the median value in trusts was relatively high (at $216,000).

The coverage of employment related superannuation schemes is declining rapidly.

In 1990, there were 333 employment based registered superannuation schemes covering 22.6 percent of the employed workforce. By 2001, the number of schemes had fallen to 263. In itself that may not be too alarming: a number of stand-alone schemes have folded into master trusts. The alarming thing is that coverage of the employed workforce has declined from 22.6 percent to 14.6 percent: the penetration of super has fallen by more than a third in only a decade.

There is no clear evidence about where employment based super may bottom out.

What is not clear from the available data is where coverage "bottoms out" under current policy settings. A number of schemes have closed to new members, and have not been replaced with alternatives. As pre-closure members retire, the coverage will gradually decline. There is no estimate of the percentage of new entrants to the workforce or of those starting new and different jobs who have access to a super scheme. There is therefore no good benchmark available to estimate what a "steady state" may look like under the current policy regime.

The "current regime" is not just the tax regime. It is also influenced by employer practice, (emphasis on total remuneration packages, outsourcing of trustee functions) by employment patterns (more labour market churn) and by employee attitudes (a desire to make personal decisions on levels and forms that saving will take).

The Insurance and Superannuation Unit of the Ministry of Economic Development has a database that could generate some insights on how many "new members" joined schemes in any year. There are difficulties with definitions (for example when members leave a stand alone scheme and join a master trust the form of transfer may classify them as "new members" of schemes), but it is possible to get a better feel for the way employment based super is evolving.
There is also very little information available about changes that have been made to the details in these schemes: for example about ease of access to past savings.

The decline in employment based super has been matched by a rise in retail superannuation savings, but a lot of that may have simply been superannuation surcharge avoidance.

The decline in employer sponsored schemes has been offset by an increase in the numbers in retail superannuation schemes. Membership of private sector employer and NPF schemes fell from 273,065 active members in 1990 to 218,284 in 2001. However, this fall was more than offset by a strong rise in the membership of retail superannuation schemes: up from 234,590 active members to 434,583. Balances in the retail schemes rose from a little under $1.5 billion in 1990 to nearly $8 billion in 2001.

Anecdote suggests that a lot of this growth was driven by a desire to avoid the NZS surcharge during the 1990s. However, the surcharge has gone, and there does not appear to be a wholesale withdrawal of money from the schemes. Contributions in 2001 almost matched benefit payments. This may reflect scheme rules (designed to comply with surcharge avoidance), and more analysis is needed before any conclusions can be made about what appears – at least superficially – to be an avenue of savings that has attracted large numbers of savers and considerable savings balances.

The general patterns revealed in this snap-shot of saving practices raise a number of issues that need to be explored in any debate on savings policy.

How serious is the decline in employment based savings?

Is the rise in retail superannuation schemes cause for some comfort, or is it likely to be transient?

Does the current policy mix mean that only the top twenty percent of the population are likely to be "serious savers"?

What is the role of home ownership in the pattern of savings, and does this in effect constitute saving on behalf of the next generation (the heirs)? If so, does this have any implications for savings policy?

Is the relatively low level of assets of Maori a factor that can or should be taken into account in developing a savings policy, or is this a reflection of the problems associated with age, income and occupational status in general?

Is it possible to structure savings policies, programmes and instruments around the "mid-life" milestone?

Debt: how does it finance asset accumulation or erode savings?

Consumption can be postponed – that is the essence of saving. It can also be brought forward – by borrowing. Borrowing is not simply an erosion of saving: the interaction is more complex than that. Borrowing to buy a house may well improve the overall pace at which assets accumulate.

What, then, can be said about debt?

In a home owning democracy, the debt of choice is a mortgage!

Mortgages overwhelm the debt profile of New Zealanders. 80 percent of debts are by way of mortgage. Next is bank overdrafts and the like at 10 percent, student loans at five percent and credit card debt at three. There is almost nothing else, with hire purchase debt having retreated to obscurity.

A perhaps surprising feature of mortgage debt is that it is fairly common right up until retirement: fifty percent have a mortgage in the 45 – 54 age bracket and even in the 55-64 bracket mortgages are still held by 30 percent. Obviously the **level** of debt reduces with age. By age thirty-five, the average level of owners' equity in the house has passed fifty percent. The fact remains that large numbers of New Zealanders do not "pay off the mortgage" early!

Credit card debt is very common and rising rapidly.

There is concrete evidence of a rapid build up of credit card debt, probably associated with easier access to cards, ready increases in credit limits and more aggressive promotion of card use (such as by loyalty programme points for card use).

The Household Savings Survey identified credit card debt as the most common form of personal debt (with about half of those surveyed having such debt), but contributing a modest amount to total debt (3 percent of the total, compared with mortgage debt at 80 percent).

This may understate the importance of credit card debt. The Reserve Bank estimates outstanding credit card balances at $3.6 billion at February 2003, compared with the HSS estimate of $1.9 billion. Some of the difference will be the outstanding balances on business credit cards and some will reflect the growth of debt since the HSS survey.

However, the impact of card debt at the margin – on savings outside of the purchase of a family home – may be more significant than its overall share of total debt, and there is no doubt that it is an area of rapid debt growth.

Outstanding advances on credit cards increased by 9.6 percent in the year to February 2003, by 13.9 percent in the year before that and by 22.2 percent in the year to February 2001. Anecdotal reports suggest that a more than fifty percent increase in card debt in only three years is impacting on household financial management, and all other things being equal, (i.e. if all savings are treated in the same way) the risk is that some household balance sheet management would see long-term savings reduced to take some pressure off short term debt repayment problems.

This does not suggest that regulating a "lock-in" of retirement savings is needed, but it does at least suggest that retirement savings need special attention: if only in the form of education and advice to limit unmanageable credit card debt exposure in preference to liquidating retirement savings.

"Beneficiary debt" may be locking a significant sub-set of the population out of any prospect of serious savings, and locking them into long-term financial inflexibility (living hand to mouth).

Organisations that work with financially distressed families report that debt traps are a major constraint on any capacity for them to get on top of their finances. It is not quite clear if this is simply a life-stage impact, or whether beneficiary debt has the potential to create a group that enters retirement not just asset and income poor, but indebted as well.

Beneficiary debt compounds for a number of reasons. Many if not most beneficiaries will at some stage need a special benefit which is often in the form of a loan. Low incomes mean that they have difficulty making lumpy payments like registering a car. This in turn means that they get fined for not having a current registration and so end up in debt to the Courts. If they are not in work they have less access to both conventional (bank) and informal (workmates) lines of credit and are forced into the high-interest "street front" lenders.

Beneficiaries therefore end up with layers of debt, as one debt mitigation tactic simply adds another layer.

The interface between saving, debt and asset accumulation means that debt cannot be left out of a framework for thinking about savings policy. Issues that arise include:

Are there any measures that can be taken to integrate policies on student debt and credit card debt with a wider programme of improved financial planning and financial management by New Zealanders?

Are New Zealanders likely to attain their asset goals with current recourse to debt, and if not, are there any policy implications arising?

Are there measures that can be taken to manage beneficiary debt and increase the financial flexibility that beneficiaries have as they move off benefit and back to an active role in the economy?

III. SHOULD ATTEMPTS BE MADE TO INCREASE SAVINGS?

Assuming that people will not save if doing so puts them under excessive financial stress (i.e. that they will save what they can "afford" to save), savings are "good" for the individual. The question that arises is whether they also generate additional public benefits. (This becomes crucial if other parties are to make a contribution – in whatever form – to promoting personal saving).

Savings in a simple economy.

In a "Robinson Crusoe economy" (no trade, one unit of labour, and a natural endowment of resources) savings and investment are the same thing. Crusoe (ignore Friday) stops fishing for a day to build a net. Consumption is deferred so that more fish can be caught in the future. Saving is a necessary precondition for investment. But it is not a sufficient condition: Crusoe could simply have had a day off. By channelling the saving (no fishing) into investment, Crusoe increases his capital stock: he has produced the means of production (the net).

Decoupling savings and investment.

In a complex economy, savings and investment are decoupled.

The people who save are (mostly) not the people who invest. Not only that, but the **reason** they save has absolutely nothing to do with the reason investors invest.

Savers save for a host of reasons: to buy a lumpy consumer durable like a car, to guard against adversity (the rainy day), to build up assets to consume when they no longer have the will or capacity to work (retirement income), or simply because they had more money than they needed to spend at that time (a residual).

Investors invest because they see a profit opportunity and need to spend money to create the asset that can take advantage of the opportunity. They can either save the necessary money themselves (such as a company retaining earnings to plough back into new projects), or more likely borrow it from the savers (by issuing them shares, or by paying interest to them for the use of their money).

In this specification, the question arises as to whether there is any need for a savings **policy.** Individuals will make personal choices about spacing consumption according to their needs and their expectations of future income and risk (adults making adult decisions). Investors will similarly make personal decisions about opportunity, risk, and how much to offer to induce savers to lend them their money. Why should the government interfere?

It doesn't interfere in a whole host of decisions about what consumers buy and what traders offer for sale, so why is this product – the price on offer for the use of money – any different?

Reasons to have a savings policy.

There are four reasons to develop a savings policy.

- *Standards.* Governments are not indifferent about what traders offer consumers and what consumers buy. There are hosts of regulations on product standards, truth in advertising and so on. Savings policy needs to identify the appropriate range and form of standards if savers are to be given the same protection from exploitation that consumers of other products expect.
- *Transfer of risk.* The less consumers save to protect themselves from adverse circumstances, the more risk transfers onto the provider of last resort: taxpayers. The standard view is that low savings creates pressure to maintain a relatively generous state pension. Because those who do save resent state pensions being paid to those who don't, the irresistible political pressure is to make that state pension universal. In practice, this "income support" when consumers have not saved can have a much wider catchment: the state paying more for tertiary education, health care, and even unemployment benefits (compared with, for example, the USA).
- *"Market failure".* A number of studies have shown that there are information, confidence and psychological barriers that get in the way of converting what people objectively think they need and want to do, and what they actually do. Overcoming psychological barriers to savings, providing more effective access to relevant information and improving confidence about savings decisions can effect a change in the savings culture.
- *Promoting investment.* If (and it is a big if) higher savings leads to more investment, there are multiple benefits to be had from increased saving: more production, more employment, higher incomes, a larger tax base, more protection from adverse economic circumstances and so on.

This list suggests that there are some benefits to the government in managing its fiscal risks if individuals are encouraged to save more. There are also benefits that the government can capture "on behalf of" savers because only the government has the capacity to capture those benefits. These benefits are those associated with consumer protection standards, and overcoming the information and confidence aspects that contribute to "market failure".

Sitting in behind these immediate and tangible advantages in encouraging saving is a bigger picture question: how much all stakeholders in the economy - the government, employers and unions – should promote savings in order to reap a much wider economic dividend.

Savings: what economics tells(?) us.

Savings equals investment.

Economic theory reduces the relationship between savings and investment to one that equates them: savings *equals* investment.

(Simplifying), no-one can produce something that some-one else will not buy. (They can, but it is not economic production). Hence the level of production will be set by the level of overall spending. In a simple economy, spending can either be on consumed items, or through investment (spending on new plant or equipment, or building up stocks for later sale). That spending creates incomes for those engaged in production. But income can only be spent or saved.

Elegantly

- Income equals expenditure.
- Income can be consumed or saved.
- Expenditure can be on consumption or investment.
- Consumption is common to both income and expenditure.
- Therefore the residuals – savings and investment – must be equal.

If savings are **not** equal to investment (remember that savers and investors are separate groups and their motivations are entirely different, so it would be an extraordinary coincidence if the plans of savers matched the intentions of investors), production (and hence income) adjusts until they are.

If savers save more than investors want to invest, total production cannot be sold, and hence firms cut back, reducing incomes (and savings) until saving again aligns with investment.

Savings do not cause investment.

The point behind this very brief foray into the economics of savings and investment is to illustrate that because the **definitions** of economic theory assert that savings *equal* investment it does not follow that savings *cause* investment.

Savings policy cannot rest on an assumption that raising savings raises investment. Investment is driven by the availability of profitable investment opportunities. Savings can *facilitate* investment because if savings levels are below investment intentions, competition for the scarce savings drives up interest rates and makes some investment options uneconomic.

There is another way in which savings link to investment: they influence the benefits that accrue to New Zealanders from the investments that are undertaken.

Benefits from higher domestic savings.

In an actual world, no economy is a sealed unit. Investors can access the savings of foreigners if local savings are insufficient to fund their investment plans. There is still the expansion of activity, and the growth of jobs and incomes associated with it, but some part of the economic activity that flows from the investment accrues to foreigners in the form of the interest and dividends paid to them for the use of their money.

It is estimated that in the year to March 2002, 5.5 percent of total economic production in New Zealand accrued to foreigners who had financed past investment. (This was slightly lower than recent ratios which have been in the six to seven percent range). This is a not insignificant "leakage" of potential national income. However, it is not then correct to say that if New Zealanders did not use the foreign capital, New Zealanders would be 5.5 percent better off. There is no way of knowing what level of investment would have taken place in a sealed economy, what interest rates would have been needed to persuade locals to forgo consumption, and what investments would have been burned off at those higher interest rates.

In the limit case, savings are crucial to investment: this is where foreigners perceive the risks of lending as too high and in that case an absence of domestic savings does limit the level of investment that can be undertaken. It is not clear when that limit is reached, and certainly at this

stage there is no apparent inability of New Zealand borrowers to access foreign savings (although they may do so at the extra cost that any "country risk premium" adds to interest rates.)

Classifying savings and investment.

While economic theory can put saving and investment into neat conceptual boxes, those boxes are not particularly helpful when it comes to forming policy on savings. Specific activities can "migrate" between saving, investment and consumption, depending on who is doing the classifying. Take the example of buying a house. Is the buyer "saving" (by building up an asset that can be sold at a later time to finance consumption), "investing" (in the asset, which will generate future income by the owner not having to pay rent), "consuming" (shelter) or bits of all or all three at the same time?

There are major conceptual difficulties about what constitutes an "asset" as far as investment is concerned. Is education an investment, or is it a consumption good because education allows people greater enjoyment of life? If it is an asset because it increases capacity to produce goods, how is it valued: on the cost to the state or the total cost to the state and the individual, or on the extra productive value that the human capital can create? Is it an asset if it can leave for Australia tomorrow?

A final difficulty is that when attempts are made to link savings that are designed to improve personal financial flexibility and to protect against adversity, the link to economic concepts breaks down completely. The individual simply wants to "save" by "investing" in assets that align with their preferences for return and risk. This can be a bank deposit, a company share, a residential property, a unit trust, a work of art or any such instrument. Very few are "investments" in the conceptual economic sense. In economic terms, investments add to the stock of capital and improve productive capacity.

Buying a Telecom share, or an existing house, or a work of art does not add any productive capacity: it merely transfers the ownership of existing assets from the seller to the buyer.

This raises a contentious question around whether a policy framework built around saving could or should attempt to "channel" savings into some areas that are deemed to be more beneficial from the national interest perspective. There have been a number of reports from the OECD, IMF and even from the NZ Treasury that suggest that the current tax regime is inefficient in directing investments into areas of low net benefit (or at least of not being neutral as to where they are directed). Rental housing and forestry are two such.

The economics of savings: some conclusions.

Conceptually, there is economic "good" associated with higher savings.

They can lubricate local investment, capture more of the benefits that flow from investment for New Zealanders, and act as a hedge against a risk that foreigners desert New Zealand for greener or less risky pastures abroad.

That said, macroeconomic objectives should not be the primary guide to the **structure** of savings policy. The benefits are too difficult to quantify, and it is too hard to establish a link between steps that may be taken to boost savings and an eventual lift in investment, production, employment and incomes. These objectives can provide a comforting backdrop to a framework within which positive measures are taken to boost private saving, but not a lot more than that.

This is perhaps a surprising and heretical conclusion.

The issue that arises is whether that is a shared view among the participants in the discussion on savings policy.

If it is not a shared view, are there ways of clarifying the links between savings and enhanced economic performance?

Is it possible to shape policy on savings to steer saving away from areas that have less direct and tangible beneficial economic impacts?

Can any economic benefits be quantified so that it is possible to establish a ballpark level of cost that can justifiably be spent to promote saving?

Is it realistic to attempt to identify the beneficiaries of any increase in savings so that costs can be apportioned in line with benefit received (the government, the savings industry, business, workers)?

Should employers try to encourage savings?

A robust savings policy should not rely on a single vehicle through which saving is channelled. Nationally, saving can be done by the government, by businesses and by households. It can also take many forms, from temporary and liquid balances in bank deposits, to locked-in, workplace based and largely inaccessible retirement savings schemes.

If saving is seen as a means to an end (greater financial flexibility and protection from loss of regular income) a comprehensive savings policy has three core elements (or "tiers"): the basic income protection provided by the government (especially in retirement, when income earning options are effectively closed); employment based, longer-term savings; and individual savings for targets that can vary in amount and timing.

These elements are not entirely independent. Provisions in one area can impact on the incentive to save through other vehicles, and can create tensions when the ultimate beneficiary seeks to move savings to other uses (e.g. to access funds in a retirement scheme to pay off credit card debt or to put a deposit on a house)

The centrality of the "second tier" to a lot of thinking about saving is that it is almost the entire focus of the terms of reference for the 2003 Periodic Review Group on retirement income policies.

This begs the question, though: why should employment be the focus, and why is there an expectation that employers should bear costs in facilitating savings by employees?

There are three main reasons to focus on the workplace.

- Paid employment is still by far the most common way that individuals earn income from active labour market participation. Employers and the self-employed are significant and should not be ignored, but just over eighty percent of the economically active are on a

payroll. A robust employment based savings regime captures four-fifths of the population that are at that stage of the life cycle when stronger savings might be expected.
- Saving via the workplace is efficient. It is easier to communicate with groups of potential savers who gather on a regular and predictable basis at central point. Deducting contributions to savings schemes before residual income is handed over is cheap and reliable. "Bulk buying" a savings product reduces the overhead (commissions) of selling savings product one by one, house to house.
- Workplace saving is likely to be more effective. Surveys show that employees tend to place more store by information received from the employer about savings, because the employer is not seen as having a vested interest or ulterior motive (as opposed to the savings and insurance industry, and politicians, who are). Schemes can be designed to get around the psychological barriers associated with starting savings (putting it off until later, lack of confidence about personal knowledge of savings options, and taking the line of least resistance – see above).
- This form of saving is likely to lift the level of saving compared with attempts to encourage saving out of income that has already been received. Because workplace scheme deductions are at source, the perception is that the "net" pay is what is available for spending (or saving through the third tier). Contributions are out of sight, and out of mind.
- There is a greater likelihood that these savings will be "new" savings rather than a result of shifting saving from one form or vehicle to another, which is a more likely result if an individual is encouraged to join a "retail" savings scheme.`

None of this addresses the question of **why** employers should bother. Even if the workplace is an efficient and effective focus of savings campaigns, making a scheme available, explaining it, and administering it costs money. If a workplace based scheme is accompanied by an expectation that employers will subsidise or match employee contributions, a scheme can add to labour cost.

Michael Littlewood identifies three main potential benefits to employers.
- To remain competitive with other employers, and to retain valuable workers. This can be enhanced if access to a scheme is by invitation, and if there are vesting rules that link access to an employer contribution to length of service. Even without these restrictive provisions, the availability of a scheme can make some employers "good" to work for. They attract a larger number of applicants for vacancies, allow the employer to be more selective in hiring, and to retain those who are selected.
- It reduces problems of retiring workers when age is starting to impact on performance. This might be particularly advantageous in a era where age discrimination is illegal. Under that regime, employers are tempted to introduce competency tests, which can be damaging to workplace morale, cause tension and unpleasantness and open up scope for litigation around unfair dismissal. Moving into retirement in the knowledge that there is additional income available has a subtle effect on changing expectation and of easing the process of exit from the labour market.
- Saving may be a good way of identifying good workers. If an employer has a savings scheme, it tends to attract workers with a positive attitude to savings, and some studies have found that "savers" tend to be more diligent and effective workers than "non –savers".

Apart from the financial advantages of providing a scheme, employers may do so for two other less tangible and quantifiable reasons.

One is simply to be a "good employer". Workplaces are part of a wider social order, and employers have rights that are matched with responsibilities. They can expect to have access to a

supply of skilled workers (largely trained at the cost of the rest of society), who have access to health services, (not paid for by the employer) and who are bound by certain standards of performance (attendance at work etc). These rights are matched with some responsibility to ensure that there is some asset to fall back on when the worker terminates employment.

The other reason that employers may provide schemes is simply that other employers do! There is very little solid evidence available on why employers offer schemes, and those that do give reasons have difficulty in establishing the extent to which the schemes actually achieve their purpose. Doing what others do may be linked to the recruitment and retention factor, but there are other retention strategies available (higher wages, for example!). It is fully possible that norms and conventions are a strong influence on practice.

The general conclusion here is that:
- the workplace has the potential to be an effective platform on which to construct better savings practice; but
- it is by no means clear that the private benefits to employers match their private costs in providing a scheme.

If there is a divergence between public benefit and private benefit, a limited number of options suggest themselves.

Compulsion (in one form or another).

Compulsion can either be compulsory contributions (say on the Australian model) or a requirement to have a scheme available (like the Irish model). It is highly unlikely that the circumstances under which compulsory employer contributions came into being in Australia will ever exist here, and if they did whether the scheme would not come under subsequent pressure from workers to access their savings.

Compulsory access would normally be for employers of a particular size, but compliance of constant change in the regulatory environment employers face would be factors that influenced the timing of any move to compulsory access.

Incentive (through some form of subsidy)

Tax incentives are notoriously expensive because they reward the “intra-marginal” saver: the saver who would have saved anyway. Tax advantages are also expensive simply because of the weight of numbers. There are nearly two million employed New Zealanders. If only half of them took advantage of a subsidy, and the subsidy was as small as $100 per annum, this would cost $100 million per annum. It is unlikely to be a strong pull on saving, particularly if access to the subsidy meant that access to savings was restricted.

Government advisors are adamant that tax incentives will not increase national savings: they are made at the expense of reduced government savings, and some of the private savings that attract subsidies are simply a shift in the form of saving (to the tax advantaged vehicles).

None of this applies to tax **dis**incentives when either employer contributions or earnings in funds are taxed at a higher marginal tax rate than the worker can obtain through other products. If employment based savings is both efficient and effective, overtaxing savings through that vehicle must be bad policy. There are a number of anomalies in the tax treatment of different types of saving. Details are contained in Appendix III.

It is less clear if the same conclusions apply to tax **deferral.** The present tax regime taxes savings at the front-end and exempts withdrawals from tax. Exempting savings from tax at some other stage of the saving cycle (on contributions to qualifying schemes, or on earnings) but taxing the saving when the income is drawn out does "cost" taxpayers through the time use of money. However, if the net effect is to increase income, the tax loss might be low (or negative).

It is also necessary to evaluate whether tax **distortions** (where there are different rules for passive and actively managed funds, or on cross-border investments) have less than optimal national benefits.

Other forms of incentives may be more effective. Examples would be state subsidised "kick-starts" for approved schemes, or "rewards" when certain savings milestones were reached. The advantage of this latter form of subsidy is that it is not speculative (the saving has to have taken place to get the subsidy). Because it is one-off, the recurring nature of an annual tax break is avoided. From a psychological point of view it could leverage the apparent appetite of New Zealanders for reward schemes in their different guises!

Transfer of cost (so that if there is a public benefit to be gained, the cost of obtaining it is met from the public purse).

Relieving employer compliance cost could take many forms: direct grants, provision of bureau services, the establishment and marketing of an "omnibus" savings framework that the employer plug in to at no cost and so on.

An advantage of cost relief is that the government is better placed to influence scheme design and default options (being in unless the employee opts out, default rates of contribution, restrictions on access to savings and so on)

There is probably little point in debating whether the workplace is an efficient and effective focus for promoting saving. It is.

The issues for a wider debate on savings policy relate more to roles, rights, obligations and costs.

What reasonable expectations can be placed on employers to offer workplace savings schemes?

How far can those expectations go in terms of promotion of schemes and absorption of administration costs?

Is it realistic to set targets for coverage of employment related scheme in terms of percentage of the workforce with access to one, and dates by which coverage targets are to be met? (e.g. 50 percent of workers employed by employers with 50 or more workers having access to a scheme by 2010)

What is a reasonable level of cost to expect the government to meet in promoting workplace based saving?

Are there serious practical complications standing in the way of (at least) a neutral tax treatment of employment based savings?

How is any subsidy to saving best designed?

What review and reform processes should be in place to monitor the cost effectiveness of any programme from all perspectives?

Should any workplace savings programme be limited to longer-term (ten years minimum, retirement etc) milestones or should it not discriminate in this way?

If a workplace programme is built around all forms of saving, (as opposed to being locked-in until retirement and inaccessible) should it expect the same level of government financial and regulatory support?

Are special additional measures needed to promote savings by the self-employed?

Will the unions help?

Like employers, unions have a conceptual interest in promoting savings, but it is not core business. In philosophical terms, they would see the union as interested in lifetime security, articulated and negotiated collectively. To the extent that saving contributes to that, saving is "union business". In addition, unions sometimes see superannuation as an additional service that the union offers, increasing the value of belonging to the union.

Like for employers, attention to promoting savings is not costless. For unions, the direct costs are the allocation of organising time, research resources and negotiating capacity. There are, however, indirect costs.

There are very few workplace based superannuation schemes that have access restricted to union members. This means that the union could devote considerable resources to negotiating and promoting a scheme, but access is not a union-member related benefit and hence the "service" dimension is somewhat tenuous.

There is also an inherent suspicion among union members that any employer contribution to a scheme could potentially have been used to finance wage increases: i.e. that all payments into a scheme are, at the end of the day, salary diversion. With that perception, the union is seen to be determining how members "spend" their wages – a perception that can set up a tension between those union members who did not want to save and the union. This tension is particularly acute where contributions to a scheme are voluntary but attract and employer contribution when made. In this case, the benefits of a potential wage increase do not go to all workers, and the union is under some pressure to spread the obtainable remuneration increase across the membership as a whole.

Finally, to the extent that the union is associated with a scheme (and especially if there are union trustees) the union can attract displeasure when scheme returns are lower than expected and in years when losses are made. The union does not get offsetting kudos when good returns are made: there is an asymmetrical response with displeasure at losses greater than pleasure from equivalent gains.

Unions have therefore tended to be somewhat nervous about being seen to be advocating superannuation too strongly. There can also be some capacity problems: familiarity with and competence in investment planning is not a common union competency.

The results of all of these factors are:
- workplace savings have a low profile in union business; and
- there is a significant variation in that profile between different unions and within particular unions over time as key personnel are recruited or leave the union staff (or join or leave the job in some cases).

In terms of profile, superannuation may not always be at the back of queue of union demands, but it is seldom near the front. This does vary over time, but after a decade of concession bargaining, most unions are concentrating on claims around wages, hours of work, leave, job security and the like.

There is the (unknown) extent to which members have made private arrangements during the 1990s when access to work-based savings was closed to many employees, and an apparent appetite for purchasing houses rather than putting limited money into superannuation schemes (especially for younger workers who seek to divert as much discretionary income as possible into servicing or reducing a mortgage).

The dominance of home purchase over other forms of saving is reflected in statistical measures of saving, and as far as the preference for house purchase over traditional employment based superannuation may well have been conditioned by the steady and inexorable (and non-taxable!) increase in house prices during the last decade.

A final consideration contributing to the low profile is that collective bargaining is (with few exceptions) incredibly disaggregated. This disaggregation exposes the key personnel limitations of unions in an area where some expertise is essential.

The uneven union interest in superannuation can be put down to historical and cultural factors, which can change.

As a generalisation, union involvement in superannuation has been limited to three broad areas:
- Where there is a long-standing arrangement and superannuation is seen to be an integral part of the vocational or industrial career structure (meat, waterfront, airline pilots etc);
- In the state sector;
- Where an industry provider makes an arrangement with a union and effectively covers the cost of an organiser to undertake the specific tasks associated with the promotion of a scheme (e.g. IRIS)

In each of these areas, involvement is decreasing. With increased labour market “churn”, the career structure and the traditions of employment within it are eroding. In the state sector the GSF is closed, and robust replacements have only been developed in a few areas where superannuation is strongly attached to the occupation (police, universities, doctors). Low wages and demands for access to funds have meant that “sponsored” or “badged” schemes are making slow – if any – progress.

Union **activity** on superannuation is (in general) low key. That might change if union **policies** were more focussed and that focus raised the profile and the priority of saving. The requirement

to develop submissions to the Periodic Review Group will put some urgency into formalising a policy position, but it is not clear if this will raise either profile or priority.

In the meantime, unions tend to:
- Continue to place emphasis on the importance of protecting the adequacy of "Tier one" (NZS) entitlements (on the basis that women earn less, retire with fewer assets and live longer, and that lower paid workers do not have the capacity to make adequate personal provision);

- Advocate the introduction of savings incentives (without having a firm view on what form those incentives should take);

- Support industry and employer moves to reduce some barriers to employment based superannuation (prospectus requirements and over taxation);

- Seek larger employer contributions (while remaining ambivalent about whether those will, ultimately, be at the cost of smaller wage increases);

- Believe that one part of the problem is an information and competency gap (which can be reduced by a more comprehensive programme explaining why savings matters and how to save).

Sitting behind this is an ongoing reservation about access to savings. On the one hand, better incentives can be justified as the *quid pro quo* for locking savings in, but on the other there is a recognition that workers are reluctant to lose access to savings in special circumstances. Savings vehicles will need to have a mix of "untouchable" and "withdrawable" elements, but why and how much is in each category is as yet undefined.

Unions do not control core levers in the savings environment (making source deductions, offering incentives) and will always be somewhat limited to playing a support role in promoting savings. That support role should not be underestimated: historically it has been crucial in building up traditions of savings and a "super culture" in particular industries.

The issue for the debate is how to leverage the support that unions can offer in building up workplace acceptance of the virtues of salary diversion.

Is it realistic to enhance union promotion of workplace savings by customising savings products as being available to union members only?

Will it be cost effective for unions to be given assistance with education and promotional programmes targeted at members?

Should key unions and selected employers (e.g. the government as employer and certain state unions) take the lead in setting standards in scheme provision to set an example?

Where should such partnerships be targeted?

Is it possible to establish "good practice" examples in the private sector?

IV. WHAT NEEDS TO CHANGE TO IMPROVE SAVINGS?

The discussion in the previous section on whether different groups ought to promote savings inevitably led to comment on what might need to change in order to allow them to do that. Questions arising under the "should they" banner are also relevant under a consideration of "how can they" and what needs to change to encourage and assist them to do so. Those "what" questions are not repeated in this section, but it should be noted that they are also relevant in the context of this section of the discussion paper.

An integrated savings framework needs to be built on some of the motivations, practices, understandings and fears of those who save, and systematically target the barriers that stand in the way of more efficient and effective savings.

The starting point in following this up is to examine why and how people save.

Influences on saving.

There is a tendency to assume that people will make rational savings decisions over the life cycle.

Perfect rationality means that over the life-cycle, people will trade off their preferences for current income versus future consumption and/or retirement income, adjusting as they go around personal milestones: saving to buy a car, then for a deposit on a house, putting money aside for children's education, and finally for retirement.

The last one is tricky. Standard advice is that saving for retirement is more effective the earlier it starts, so saving here can well be rational even if it takes place alongside other forms of saving and while the individual has personal debt (credit card debt, a mortgage and a super scheme). This is particularly true if saving attracts a subsidy from the employer (or even the government). In these cases, if the individual does not save, the subsidy is lost, and there can be no later "catch-up".

In a perfectly rational model, savings patterns will alter with changes in the external environment (such as if the state pension rises or falls, is income tested or not, and if returns on past savings are higher or lower than expected). This is the so-called "multi-period optimization" of savings.

A critical question for savings policy is whether this multi-period optimisation actually drives saving behaviours.

While there is a large and growing amount of information available in New Zealand about **what** people do in managing their finances, there is almost nothing available about **why** they do it.

The small savings of small savers.

For insights into motivations around saving, it is necessary (at least for now), to draw on information gathered in other countries.

Elaine Kempson of the Personal Finance Research Centre at the University of Bristol has carried out research into the motives of low and middle income savers in Britain, and on the basis of survey responses categorises four distinct types of saving:
- Putting money aside for bills and household expenses;

- Short-term savings for particular items such as a car;
- Long-term savings for "old age" or "the future";
- Putting money into savings for no particular purpose.

This work does imply that there are conceptual differences that motivate savings, even if the conceptual differences might not appear relevant in determining overall levels of saving. A less encouraging finding of later research was that very few in the survey (six percent) were saving long term.

The largest group of savers (41 percent) simply "put money in" to savings accounts for no specific purpose.

The studies indicate that two-thirds of low and middle income people do save, and from their perspectives there are quite distinct reasons for doing so. The act of saving was not found to correlate much with income level, but more strongly with age, and with when individuals started saving (developing a saving habit).

Income level was significant in how regularly people saved, rather than if they saved at all. Although savers simply put money into savings accounts without a clear idea of what they were intended for, most (89 percent) regularly drew money out again. Only 11 percent put money in and left it to accrue.

Milestones: the attraction of short-term savings targets.

This implies that to the extent that people save around personal life-cycle milestones, they save around short to medium term ones. It is the longer term (retirement) savings that are problematic, yet that is the stage of the greatest life cycle need (because the opportunity to earn is over).

In New Zealand, a lot of the debate has focussed on the influence of a universal, non-means tested and "generous" state pension in giving people sufficient comfort to dull any motivation to save ("The government is saving for my retirement"). This issue will be looked at later, but it is clear that even without New Zealand superannuation, problems with retirement saving have been encountered in other countries.

Overseas studies have identified a number of psychological barriers to saving.

<u>Will-power.</u>

Even if people think they should save, they simply lack the will-power to do so. This does depend a little on what appears to be differences in savings cultures as between countries (e.g. Japan and New Zealand), but intuitively it seems reasonable to draw conclusion about the will-power effects in New Zealand from USA studies, which probably has a similar savings culture.

There, the baby boomers were saving only one-third of the amount needed to maintain their consumption in retirement. Of course it is possible that they "rationally" only wanted one-third of income in retirement compared to current income, but a more plausible explanation is that they lacked the will-power to save.

Most US households reach retirement age with very few liquid assets and do virtually no long-term discretionary saving. The implication is that the assets they do have at retirement are not

liquid: they have been locked into pension plans that are out of temptation's way. These earmarked savings plans are decidedly "different".

Too awful to contemplate.

One study found that some people find the prospect that at some time in the future, their earning power will diminish or end, too hard to contemplate. Saving for retirement makes them confront this uncomfortable inevitability, so to avoid having to face the reality they simply put off the retirement savings decision.

This factor suggests that there is a bias against retirement savings, and again implies special attention to get over the barrier if there is to be "neutral" treatment of savings destined for different end uses.

Habit and rules of thumb.

Totally rational "multi-period optimization" implies access to a vast amount of complex information, an ability to understand and analyse it, and a full range of options through which the rational savings portfolio can be managed. In practice, most people work off limited information, have either an inability or a lack of confidence in understanding the information they do have, and confront a restricted range of savings options. They save by habit or by using simple rules of thumb.

As a general rule, decisions on "retirement savings" are inherently more complex than saving for near term consumption (put the money in a term deposit) or for specific purposes like home ownership (where there are well promoted and publicised and largely standardised products on the market, such as mortgages).

Creating a fully informed retirement savings environment requires special treatment of this type of saving.

Asset accumulation and savings multipliers (compound interest).

Accepted theory is that utility postponed is utility reduced. Consumption today, all other things being equal, is assumed to be valued more highly than consumption at some time in the future. If this is a standard human sentiment, then there is a need to reward the saver for having voluntarily given up immediate access to potential consumption (i.e. pay a positive rate of interest on savings).

Savings are not "neutral". They compound (by the "rule of seven": a dollar earning interest doubles in ten years if it earns seven percent interest and in seven if it earns ten percent). This compounding has very profound effects on the end value of savings, especially those left untouched over reasonably long periods of time. If promoting retirement income is the goal, it is important to secure the highest level of retention and reinvestment possible.

Some forms of savings are more prone to having earnings accessed and used for current consumption (i.e the capital value is maintained but the potential of compound interest is dissipated). In this sense all forms of savings are not equal: some are more likely to be used as a base for further consumption and others as a base for further saving.

A large number of studies, across different countries and covering different time periods point to one overwhelming conclusion: all savings vehicles are not the same as far as the likelihood of earnings being retained and reinvested.

Moreover, contrary to the "rational" savings model expectations, when capital gains were made, far from this being a stimulus to reduce other savings, other savings actually increased.

Capital gains in the stock market had virtually no impact on extra spending by the stock owners. However, when take-overs generated cash, nearly sixty percent of the cash was spent. (This compares with over eighty percent for extra disposable income)

Home-owners tended to save more in other vehicles than non home-owners when the expectation would be that those who do not save via buying a house would save in other forms.

The studies also indicate that the elderly do not tend to consume housing wealth. This is particularly relevant in New Zealand where so much of the saving is in the form of home ownership: if all savings are regarded as the same, but housing is not consumed, the ***de facto*** level of savings available to use as retirement income is substantially reduced.

An issue for the design of savings policy is whether more information is needed on why New Zealanders save, and the extent to which they regularly draw down savings.

Will restricted access to savings preserve savings and lead to higher rates of accumulation, or simply mean that less is put into long-term saving?

How effective is education in overcoming some of the psychological barriers to saving?

New Zealand Superannuation: how does it complicate the savings policy equation?

The debate on saving in New Zealand never strays far from the effects of New Zealand Superannuation on private savings. The financial fundamentals are stark. The accumulated assets of all registered superannuation schemes are a little over $18 billion. The government pays out a little under $6 billion in NZS benefits in **just one year.**

There are two views on NZS. One is that by providing a pension, NZS takes the pressure off people to save. The other is that by providing a degree of comfort and certainty, NZS creates a platform on which other "tiers" can be built. Unless there is a forty year social experiment, it will never be possible to determine absolutely which view is right.

There are, though, two aspects of NZS that are worth exploring. NZS is itself not "generous". 65 percent of the average wage for a couple is one third of the average wage per person. (Nearer 40 percent for a single superannuitant). The report *Living Standards of Older New Zealanders* established that that level of pension was adequate if:

- Those in retirement has a reasonable stock of assets (and especially a house), and
- They had not experienced a life-cycle "shock" (redundancy, marital break-up, illness) in the ten years before retirement.

More education could clarify that more comfort in retirement, and more flexibility to respond to pre-retirement shocks comes from more adequate saving. In addition, there is very little information about the dynamics of social change, and whether future generations of retirees will

enter retirement with a far less robust asset base which may in itself make reliance on NZS unwise.

There is evidence that the distribution of income in New Zealand has become less equal (Gini coefficients rising over time). There is also evidence that the distribution of wealth is more unequal than the distribution of income. Hence, in future, some will enter retirement in a more comfortable position and NZS will continue to be adequate.

But for another sector of society - size unknown – entering retirement “asset rich/income poor” may not be the expectation. A mix of paying off student debt, more regular periods out of employment using up savings, lifestyle changes that use short-term credit more widely, and less access to employment based superannuation could all contribute to precarious retirement.

This (possible) growing dependency on NZS will come at a time when future governments will not be in a position to increase its **level.** The demographic equation is against it. Some pre-funding will **ease** the transition to a population structure that has more retired and fewer economically active, but it cannot **avoid** the transition.

This suggests that long-term financial planning by individuals should factor in some savings as a safeguard against unforeseen changes in age of entitlement to NZS or other long-term changes in the eligibility criteria and/or level of the pension.

The issue for a debate on savings policy is whether the NZS argument should be left to one side because constantly revisiting it merely draws attention away from the importance of boosting other forms of private saving (tiers two and three).

Sound planning for the second and third tier requires certainty in the rules that surround tier one. Can a debate on a savings framework improve certainty, or allow for timely responses to changes in those rules?

A second issue is whether more emphasis should go on clarifying where NZS is inadequate.

Is there a need for a more detailed evaluation of the dynamics of asset accumulation, and what level of tier two provision is sensible as a means of ensuring income adequacy in retirement?

The product: does the practice of employer provision of the “second tier”, and product the industry offers for the “third tier” contribute to low savings?

Research done here and overseas establishes that:

- There are strong psychological barriers to savings.
- There is a reluctance to sacrifice access to savings.
- When there is access to savings they are more likely to be used for immediate purposes (paying off credit card debt, buying a consumer durable).
- There are major information and confidence problems around “how to” save.

The question, then, is whether current practice in the savings “market” works against those human traits or is designed to overcome them.

The product the market offers can promote or discourage saving at both the second and third tiers.

In the USA workers typically have access to company based savings plans (the so-called 401(k) plans). If they have to elect to contribute, participation rates are low. Companies that reverse the election (i.e. workers are automatically enrolled unless they elect to withdraw) report markedly higher participation rates.

Moreover, those who are in plans overwhelmingly elect the "default" contribution rates and investment plans. Because these default rates are typically set conservatively (low contribution rate, cautious investment plan) they tend to generate slow retirement savings growth. Surveys suggest that it may not just be myopia (don't save more than you have to), or the influence of the status quo, but that with limited knowledge about or confidence in financial matters, workers actually see the default options as a type of *de facto* financial planning advice from the company.

Another experiment sought to allow the status quo to work to increase savings rates over time. In this experiment, workers were offered two options: one to increase savings rates by five percent, the other to increase savings by three percent, but only at the time of the next pay increase. (The savings rate hike did not require separate confirmation. Workers could elect to leave the "escalator" at any time). Within a very short period of time the escalator savings surpassed those of the conscious decision to raise savings, and even when workers stopped the automatic increase they seldom went back to a level that was lower than the five percent option.

It is, though, not all one-way traffic. Protecting savings may require lack of access to them. At the same time, there has been a general trend towards seeing reward from employment as a total remuneration package. Access to saving is often seen as being a necessary condition for putting the money into a scheme in the first place ("its my money"). There is a delicate balancing act required here.

The quality of the savings product on offer from the industry at the third tier (private voluntary saving) is also coming under scrutiny. It was a focus of comment by the Superannuation Task Force, and draws regular comment from media commentators and from organisations like Consumers' Institute.

Issues that need to be addressed are:

- Fees.
- Distribution of fees ("front-end loading" fees make withdrawal benefits low or negative for a considerable period of time).
- Transfer values.
- Rights to suspend contributions.
- "Double dipping" (financial advisors charging fees and then recommending savings vehicles that pay them a commission as well).

Susan St John has recently raised the issue of the role of annuities in the savings product mix: an issue that has not had much attention in the past. She sees this as essential if there is to be a predictable augmentation of NZ Superannuation, and suggests that making it mandatory to take an annuity from (at least part of) superannuation scheme assets will overcome the tendency to live frugally and die asset rich.

However, she lays down some very stringent product standards before annuities can become part of the way savings are drawn down. These include improving value for money, providing a hedge

against inflation, making provision for insurance against catastrophic care costs, providing a degree of insurance against growth in living standards and – controversially – making use of the equity in owner-occupied housing.

The key issue for savings policy is the extent to which product design and product standards (other than requirements for full disclosure and protection from misleading information) is the responsibility of any agency other than the industry itself. Will commercial reality not force providers to meet the needs of the users?

The discussion needs to identify whether savings products should be subject to minimum consumer protection standards only, or whether it is legitimate to expect wider stakeholder influence in the design of savings programmes.

Should design features be by consensus or is it legitimate to extend regulatory intervention beyond consumer protection (e.g. to require annuities).

What criteria ought to guide decisions on where to drawn the boundaries of regulatory intervention?

What is the role of education on product quality, and what protections from litigation should be provided to those who seek to inform savers of the strengths and weaknesses of different products?

V. LIST OF QUESTIONS

How serious is the decline in employment based savings?

Is the rise in retail superannuation schemes cause for some comfort, or is it likely to be transient?

Does the current policy mix mean that only the top twenty percent of the population are likely to be "serious savers"?

What is the role of home ownership in the pattern of savings, and does this in effect constitute saving on behalf of the next generation (the heirs)? If so, does this have any implications for savings policy?

Is the relatively low level of assets of Maori a factor that can or should be taken into account in developing a savings policy, or is this a reflection of the problems associated with age, income and occupational status in general?

Is it possible to structure savings policies, programmes and instruments around the "mid-life" milestone?

Are there any measures that can be taken to integrate policies on student debt and credit card debt with a wider programme of improved financial planning and financial management by New Zealanders?

Are New Zealanders likely to attain their asset goals with current recourse to debt, and if not, are there any policy implications arising?

Are there measures that can be taken to manage beneficiary debt and increase the financial flexibility that beneficiaries have as they move off benefit and back to an active role in the economy?

The issue that arises is whether that is a shared view among the participants in the discussion on savings policy.

If it is not a shared view, are there ways of clarifying the links between savings and enhanced economic performance?

Is it possible to shape policy on savings to steer saving away from areas that have less direct and tangible beneficial economic impacts?

Can any economic benefits be quantified so that it is possible to establish a ballpark level of cost that can justifiably be spent to promote saving?

Is it realistic to attempt to identify the beneficiaries of any increase in savings so that costs can be apportioned in line with benefit received (the government, the savings industry, business, workers)?

What reasonable expectations can be placed on employers to offer workplace savings schemes?

How far can those expectations go in terms of promotion of schemes and absorption of administration costs?

Is it realistic to set targets for coverage of employment related scheme in terms of percentage of the workforce with access to one, and dates by which coverage targets are to be met? (e.g. 50 percent of workers employed by employers with 50 or more workers having access to a scheme by 2010)

What is a reasonable level of cost to expect the government to meet in promoting workplace based saving?

Are there serious practical complications standing in the way of (at least) a neutral tax treatment of employment based savings?

How is any subsidy to saving best designed?

What review and reform processes should be in place to monitor the cost effectiveness of any programme from all perspectives?

Should any workplace savings programme be limited to longer-term (ten years minimum, retirement etc) milestones or should it not discriminate in this way?

If a workplace programme is built around all forms of saving, (as opposed to being locked-in until retirement and inaccessible) should it expect the same level of government financial and regulatory support?

Are special additional measures needed to promote savings by the self-employed?

Is it realistic to enhance union promotion of workplace savings by customising savings products as being available to union members only?

Will it be cost effective for unions to be given assistance with education and promotional programmes targeted at members?

Should key unions and selected employers (e.g. the government as employer and certain state unions) take the lead in setting standards in scheme provision to set an example?

Where should such partnerships be targeted?

Is it possible to establish "good practice" examples in the private sector?

An issue for the design of savings policy is whether more information is needed on why New Zealanders save, and the extent to which they regularly draw down savings.

Will restricted access to savings preserve savings and lead to higher rates of accumulation, or simply mean that less is put into long-term saving?

How effective is education in overcoming some of the psychological barriers to saving?

The issue for a debate on savings policy is whether the NZS argument should be left to one side because constantly revisiting it merely draws attention away from the importance of boosting other forms of private saving (tiers two and three).

Sound planning for the second and third tier requires certainty in the rules that surround tier one. Can a debate on a savings framework improve certainty, or allow for timely responses to changes in those rules?

A second issue is whether more emphasis should go on clarifying where NZS is inadequate.

Is there a need for a more detailed evaluation of the dynamics of asset accumulation, and what level of tier two provision is sensible as a means of ensuring income adequacy in retirement?

The discussion needs to identify whether savings products should be subject to minimum consumer protection standards only, or whether it is legitimate to expect wider stakeholder influence in the design of savings programmes.

Should design features be by consensus or is it legitimate to extend regulatory intervention beyond consumer protection (e.g. to require annuities).

What criteria ought to guide decisions on where to drawn the boundaries of regulatory intervention?

What is the role of education on product quality, and what protections from litigation should be provided to those who seek to inform savers of the strengths and weaknesses of different products?

The debate on savings policy would be better informed by extending the information obtained from surveys like the HSS and Living Standards survey and tracking changes in the savings habits and asset values of a sample of savers through time.

If this conclusion is not shared by participants in the policy debate, the issue arises as to where the emphasis goes in refining understanding on trends.

Should the emphasis focus on the stock of savings, since these are the ultimate determinant of the financial flexibility that individuals have?

APPENDIX I

CORE REFERENCES.

Some basic documents were used in preparing this report and they were augmented with a number of interviews and conversations with individuals with an interest in and knowledge of the savings policy debate in New Zealand.

Collection of papers presented to the *Savings and Fund Management* conference organised by Conferenz. 29 and 30 April 2003, Wellington.

"Savings Rates and Portfolio Allocation in New Zealand", Joint Working group of Government Officials and ISI, Treasury Working Paper 99/9, Treasury, Wellington, 1999

"The Net Worth of New Zealanders: a report on their assets and debts", Retirement Commission and Statistics New Zealand.

Ingrid Claus and Grant Scobie, "Saving in New Zealand: measurement and trends", NZ Treasury Working Paper 02/02.

Report of the Government Actuary for the year ended 30 June 2002.

Elaine Kempson and Claire Whyley:"Understanding Small Savers" and "Understanding Small Savers II", January and September 2000, Pearl Assurance.

"Case Study One: Saving for Retirement", Peter A Gorringe, NZ Treasury, Wellington (2001)}

Three studies produced by the (US) National Bureau of Economic Research between May 2000 and December 2001. The research team was Brigitte Madrian, Dennis Shea, James Choi, David Laibson and Andrew Metrick. The NBER working paper numbers are 7682, 8651, and 8655.

"Self-control and Saving for Retirement" David Laibson, Andrea Repetto and Jeremy Tobacman, Brookings Papers on Economic Activity, 1:1998.

APPENDIX II.

STATISTICAL CONCEPTS AND MEASURES OF SAVINGS

There are a number of measures of saving that are produced on a regular basis, and that track savings over time. There are also periodic special surveys that produce "snap-shots" of assets, debts and indicators of well –being. The two important recent studies in this latter category are the *Living Standards of Older New Zealanders* study commissioned by the Super 2000 Task Force and completed by the Ministry of Social Policy, and the *Net Worth of New Zealanders* report carried out by Statistics New Zealand on behalf of the Retirement Commission.

There are six regular statistical series that allow savings data to be extracted:

- The System of National Accounts, which contain measures of savings in three categories: household, government and business saving.
- The Household Economic Survey (HES), which tracks income and spending from a survey of a sample of New Zealand households.
- The Household Income and Outlay Account (HIOA), which is a sub-set of the SNA.
- A Reserve Bank Household Net Wealth survey.
- The Westpac Household Savings Indicators, which adjust the results from the Reserve Bank surveys.
- The Annual Enterprise Survey (which includes a measure of business net wealth)

Unfortunately, different series not only show radically different **patterns** of savings, but different **trends** in savings behaviour.

The National Accounts show household savings as negative since 1994. The HES shows household savings as negative 4.3 percent of disposable income in 1984, but gradually improving to positive 4.9 percent by 2001. HIOA shows savings as positive 1.7 percent in 1984, falling to negative 3.7 percent in 2001.

The reasons behind the differences reflect differences in survey coverage.

By way of example, because the National Accounts are comprehensive, they will count as household income, payments made by the government to meet some private consumption like part of the doctors' fees for children. The HES is limited to cash flows. The HIOA imputes as income the rent that is associated with owner-occupied dwellings, the pension scheme payments made by employers to the individual's account, and the interest earned on super scheme balances

Not only will different surveys of savings produce different results, but different concepts of saving will also show up very large variations in the estimates of how much saving takes place.

The "economic" versus "accounting" definitions of saving.

Under standard accounting rules, a number of items of spending are regarded as consumption, but in economic terms they could be seen as saving (i.e. deferred consumption). Buying a car, for example, may be seen as "saving" from an economic point of view because it allows for transport to be consumed in future time periods.

Claus and Scobie reclassified a number of items that are treated as consumption in the standard accounting framework and estimate that from an **economic** point of view, gross national savings in the 2001 financial year were 37 percent of GDP, not 15.7 percent as revealed in the formal accounts. (Net savings – after depreciation – were 12.9 percent not 2.1)

Saving in the "underground" economy.

Most consumption is captured in official statistics because the need to claim GST refunds means that very little consumption is not recorded or reported. However, a lot of income is generated "under the counter" in the grey, or informal, or even illegal parts of the economy. Estimates of this underground activity suggest that it may be anywhere between seven and eleven percent of GDP.

A full assessment of actual income, including this element, would give a measure of saving that is twice as high as the official measure.

Household savings and investment.

If domestic savings are insufficient to finance investment, investors borrow from foreigners. The shortfall is therefore not simply the rate at which savings are changing, but the rate at which investment is changing. Because the relevant measure is total saving, government saving can conceal the extent to which household saving is failing to match investment.

In 1981, 55 percent of total investment was matched by domestic savings: the other 45 percent was sourced offshore. Over the next twenty years, investment levels quadrupled (in dollar terms) while savings only rose two and a half times. The result was that in 2001, 73 percent of New Zealand's investment was financed by foreigners.

More alarming is the fact that in 1981, 23 percent of investment was financed by the savings of private New Zealand households. Twenty years later, the government was making 82 percent of all domestic savings.

[Care needs to be taken here. These are highly aggregated economic concepts. The government is deemed to be "saving" even if it is simply paying off debt. It is not directly "investing", but in a conceptual sense the economics of government saving is that the total flows from abroad to finance investment are reduced: hence government saving "finances" investment!]

Not only had foreign savings met 73 percent of the investment need, but the government was the main contributor to the bulk of the remainder. In 2001, household saving equated to a **negative** 32 percent of total investment.

Stocks and flows.

It is usual to regard savings as a “flow”: the amount of income not spent in a given week, month or year. However, past savings add up, just as a drawing down of them depletes the “stock” of savings. Another important influence is how earnings and asset price shocks change the value of the savings stock. It is the stock of savings that determine the net wealth of households: the ultimate aim of increasing saving.

Strong increases in house prices can increase net wealth, just as recent stock market reversals will decrease net wealth. The impacts will have very uneven effects on classes of savers, depending on the vehicles they have used for saving.

Measures of household wealth.

The Reserve Bank and Westpac HIS surveys are likely to understate the net wealth of New Zealanders. These measures value assets and subtract debts like mortgages. The assets that are valued are selective (consumer durables are not counted), forms of investment are not comprehensive (some investments in farms or forestry ventures are not captured in the surveys) and debts are likely to be overstated (some mortgages are in effect loans to small businesses operated by the house owner).

Savings by age group

A common observation is that savings rates increase with age, and that this holds even in retirement: the retired do not run down their savings, and die asset rich. Intuitively this appeals. The young have low incomes and high initial debt (student loans, need to take out a mortgage on a first home, costs of getting established with car, furniture and household appliances). The capacity to save remains constrained until around 45, as family incomes are reduced with periods out of the workforce raising children and as the costs of raising and educating children increase with age of child.

Statistically, the expectation holds, but only for individually owned assets: house and financial assets. If the concept of “savings” changes, a radically – not marginally – different picture emerges. It is possible to see the pay-as-you-go New Zealand superannuation scheme, and the public health system, as forms of “saving” and “consumption”. The taxes that earners pay to fund NZS and the health system can be seen as a form of collective saving. When NZS is received, pensioners “decumulate” the taxes they paid in during working life. That is actually not far off the perception of many New Zealanders and a strong political driver behind the move to abolish any income or asset testing of NZS (“we paid in all our lives”).

There is less of a perception of a link between taxes paid in and health care consumed, but conceptually there is no difference and financially there is a vast difference: those over 75 consume a very large proportion of total health spending and “decumulate” large amounts of lifetime tax contributions.

This way of measuring savings blurs the distinction between savings made by paying taxes and using public services later (NZS and health), and savings being only in the form of personally owned assets. It does two things. It shows a higher level of savings by New Zealand households (even if some of it is compulsory saving via taxes). It also shows a more even level of savings by

different age groups up to the point of retirement, when (collectively) there is a heavy draw-down of past savings.

A summary of the impact is shown in the table.

Adjusted saving rates by age group in 1998 (percent of disposable income)

Age group	Unadjusted savings rate	Savings rate adjusted for NZS and health contribution and receipts.
19 – 24	7.6	17.6
25 – 29	7.9	17.9
30 – 39	8.3	18.3
40 – 49	12.7	22.7
50 – 59	19.4	29.4
60 – 64	12.6	12.6
65 – 74	15.3	-85.0
75+	28.8	-117.0

Source: Claus and Scobie: p32.

Measures of saving: implications for the development of savings policy.

The issue that arises is if this confused and confusing array of statistical measures of savings, giving vastly different levels, different distributions of savings and even different directions of savings trends is relevant to the debate on savings policy.

The data can reinforce the rationale behind efforts to promote savings (as indicated by the increase in the dependence on foreign saving for investment) and clarify the role of inter-generational saving via taxes and universal benefits and services.

Apart increasing awareness that the context in which savings take place is more subtle, there does not appear to be a great deal to be gained by digging deeper into these data sources and trying to reconcile different concepts and survey results.

The debate on savings policy would be better informed by extending the information obtained from surveys like the HSS and Living Standards survey and tracking changes in the savings habits and asset values of a sample of savers through time.

If this conclusion is not shared by participants in the policy debate, the issue arises as to where the emphasis goes in refining understanding on trends.

Should the emphasis focus on the stock of savings, since these are the ultimate determinant of the financial flexibility that individuals have?

APPENDIX III.

TAX INCENTIVES AND DISINCENTIVES

Issues

- Alignment of investment and personal tax rates.
- Tax treatment of capital gains.
- Tax treatment of international investment.

Assumptions

- Most investments in NZ are made from tax paid income.
- All traders should declare and pay tax on capital gains.
- There is no case law definition of a trader.

Taxation Anomaly # 1

Alignment of Investment and Personal Tax Rates

Marginal Tax Rate	Direct	Coy	Unit Trust	Insurance Bond	GIF A	GIF[1] B	Super
> 33c	Y	N	N	N	N	Y	N
@ 33c	Y	Y	Y	Y	Y	Y	Y
< 33c	Y	N	N	N	N	Y	N[2]
Offsets		Imp Credit	Imp Credit				SSCWT

[1]NZ Cash and Fixed Interest Only
[2]Is due to change following 2003 budget.

Taxation Anomaly # 2

Tax Treatment of Capital Gains

	Direct[1]	Coy	Unit Trust	Insurance Bond	GIF A	GIF B	Super
Income Tax	Y	Y	Y	Y	Y	N	Y
Captial Gains Tax	N	Y	Y	Y	Y	N	Y

[1]Equities, Commercial and residential property, Fixed income, Art, Antiques, Cars

Taxation Anomaly # 3
Tax Treatment of International Investment

	FIF[1]	**Grey List[2] (Direct)**	**Grey List[2] (Vehicle)**
Income	Y	Y	Y
Realised Capital Gains	Y	N	Y
Unrealised Capital Gains	Y	N	N

[1]Four methods of valuation.
[2]Australia, Canada, Germany, Japan, Norway, Britain, USA.

Implications of Tax Headwinds

Playing field is upward sloping for our profession
Industry responses:

- Move to custodial wraps.
- Move to passive investment management using IRD exemption.
- Move to non-distributing overseas vehicles.

Misallocation of Capital.

Solutions

- Align top personal with company tax rate.
- Align the tax on earnings in collective investment vehicles with marginal tax rates.
- Reduce the dispersion of personal tax rates.
- Reform our implicit capital gains tax regime - RFRM?
- Move further from income to consumption taxes.

Note:
I have made no comment on effective tax rates.