

**Address to the "Saving New Zealand Forum."
By Hon Dr Michael Cullen**

23 July 2003 Speech Notes

Embargoed until: 9am Wednesday 23 July 2003 Opening of the Saving New Zealand Forum.

Thank you for the opportunity to make a few observations about the context in which you are discussing savings policy at this forum. First of all, let me congratulate the Insurance and Savings Industry Association for taking the initiative to pull this event together.

Savings is an area where we can talk forever, and analyse endlessly and draw up long lists of pros and cons of different options and do absolutely nothing. It is an area that I have found very frustrating in my term as Minister of Finance. When I was given this portfolio, I identified savings as a key area for economic policy, but it has been an elusive target.

There are probably three key reasons for this. The first one is cost. Mere housekeeping - tidying up some of the anomalies that exist in the tax treatment of saving - tends to cost tens of millions of dollars. Substantial new initiatives generate revenue impacts that run into the hundreds of millions of dollars.

This is the tyranny of large numbers. There are nearly two million New Zealanders in employment. On simple arithmetic, even very modest incentives like \$100 a year can generate massive fiscal risks.

The second is so-called fungibility. Things change shape and substitute for each other. There is a big risk that boosting savings in one form is simply offset by declines in savings that were held in a different form. This certainly applies at the national level: increasing private savings can easily be accompanied by reductions in government savings. It can also apply at the individual level, and I will be very interested to hear evidence from the Australian experience on how much of an offset there has been in other savings alongside very strenuous efforts to push compulsory employment based savings.

The third is split responsibility. The government cannot boost private savings on its own. Individuals have to decide to save. Often, employers need to co-operate and contribute if a savings structure is to be effective. Finally, the industry has to offer a relevant product on competitive terms if we are going to bolster confidence in the benefits that savings can generate. There has to be a combined effort if we are to make a difference. The effect is that each party waits for another to take the lead and nothing gets done.

This reinforces my welcome of the ISI initiative: this forum is an opportunity for all of the key stakeholders to get together and to start a process that can identify who needs to do what next, and what conditions have to apply before they will do it.

I do detect a change of attitude. The 1990s were a high watermark for individualism. A part of that was the rise of the idea of the total remuneration package. Employers recruited on a set fee for service and the worker did what he or she decided they wanted to with the wage. While this is fine in theory, there is a growing body of research that suggests that the hands-off approach works against some of that total remuneration going into long term saving. We know the reasons. People take the line of least resistance, and if the status quo is not to divert wages into savings, that will dominate behaviour. They may lack confidence in, or knowledge about how or where to save. Savings deducted at source are out of sight and out of mind. It is harder to part with ready cash. And so the list goes on.

This suggests that completely devolving all decisions on saving to the individual may actually result in them saving less than they would want to save if they were making an objective and informed decision. I also think, though, that during the 1990s the limits of individualism were exposed: while we still want to encourage free choice and individual liberty, there is an ideological retreat from pure liberalism. Collective responsibility and collegial action have to find their proper place in social and economic arrangements. This also applies to savings.

This forum is about the search for the balance that avoids patronising people and telling them what is good for them, but that recognises where barriers to good decision making exist.

Before we move on from the philosophy of the nineties, though, we should not forget the experiences of the late seventies and early eighties. In many ways the extremes of the nineties were a reaction to the distortions created by the regulatory era that preceded them. I am not sure that any country had the foresight to develop a seamless and painless response to the traumas and instability of the seventies, and to the stagflation that resulted from them. We need to remember that high and persistent inflation created havoc with savings that were locked into dollar denominated forms.

The debate on savings takes place against a backdrop assumption that the macroeconomic environment is stable: that inflation is under control, that property rights are secure, that taxes are predictable and that there is reasonable security of employment. If any of these were at risk, a very different savings response would be optimal. Hedging against risks of persistent high inflation would imply more savings in real assets. A less secure employment environment suggests more liquid forms of saving.

It is important that we can plan within a stable macroeconomic environment, but we should never take one for granted. That is the least we can learn from the seventies. It is often said that a nation's psyche is shaped by the traumatic experiences of its history. The strong inflation aversion of the Germans is said to be conditioned by the devastating experiences of the hyper-inflation of the 1920s. Our own aversion to unemployment is a product of the soul destroying experiences of the 1930s Depression. If this is true, there is a need to be wary about complacency on the savings and retirement income fronts. By and large, our experiences in this regard have been rather benign.

Throughout our settled history we have had a relatively young population. We were

ahead of most other countries in introducing universal pensions. The OECD and IMF constantly complain that the state pension is too generous: to my way of thinking that is a testimonial that it is probably adequate. All of this tells me that a "she'll be right" attitude might dwell amongst us. Vigilance, not complacency, is therefore needed.

I don't want to pre-empt, and I certainly don't want to foreclose on the discussions that you will have today. I do think, though, that I should make a few comments about New Zealand Superannuation. This is because one of the frustrations with the debate on savings has always been the shadow cast by NZS. Do we scare and panic New Zealanders into saving by highlighting its unsustainability, or lull them into a false sense of security by promoting its virtues? Will the threat of its demise stimulate savings or create despair? Will increased confidence in its future provide a more stable platform on which additional savings can be built, or will it encourage savers to either live for the moment or chase higher risk investment outlets in the safe knowledge that the government is effectively insuring against investment loss? These debates go round and round and seldom get anywhere.

The truth is that the only way to find out which is right is to conduct a forty year social experiment, and nobody is going to do that. If I could borrow one of the PM's favourite phrases, its time to move on.

The view that I have often stated is that confidence about basic income security in retirement is the least that the citizens can expect in a modern developed economy. Democratic arithmetic tells me that it is an expectation that will be delivered on. It is also the most that citizens can expect. They cannot expect the state to replicate in retirement the incomes they enjoyed during working life. Not only would that be very expensive, it would also be inequitable. We would be using taxpayer resources to sustain the income inequalities that the market generated in the first place.

If that view informs policy we can say that New Zealand Superannuation is a relatively cheap way to provide universal retirement income. The Superannuation Fund does offer a way of cushioning the fiscal costs of the transition to an older population structure. I am confident that the fund is close to passing the point of no return: no future government can really afford to dismantle it, because it offers that extra degree of confidence about income security in retirement. By the same token no government can give cast iron guarantees about anything, especially looking forty or fifty years ahead. New Zealand Superannuation and the Fund are there. Individuals will make their own assessments about how adequate the income that they offer is and how sustainable they will prove to be.

It is time to move on, but I have to say that there are uncertainties with the global savings environment that do complicate things in the immediate future. For the first time in over sixty years, talk about the risk of deflation is becoming almost as common as talk about inflation. It is not a good idea to promote savings in an environment of falling asset values. Even if we don't buy into the prospect of deflation - and I have to say that I can't see any evidence of deflationary pressures - there is still the recent experiences of a long bear run that may have made people a bit more cautious about traditional savings vehicles.

Timing is everything. Under these circumstances, I think that the emphasis should not

go on devising the right savings plan for individuals, but on devising a better savings policy structure. Individual choice can then be exercised within a savings friendly framework. For my part, let me simply say that I have no intention of revisiting the decision to set up a diversified investment fund to partially pre-fund New Zealand Superannuation. There are still virtues in saving that are not diminished by periodic downturns in global markets.

I wish you all the best for your deliberations today. I am going to stay here for as long as my diary commitments allow, but I look forward to catching up on the discussions that I will miss. Thank you for coming, and thank you in anticipation for your contributions. Most importantly, though, I hope that this forum continues rather than concludes the savings policy development process.

Thank you.