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An article from the Retirement Policy and Research Centre

On the relative values of KiwiSaver incentives

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This *PensionBriefing* looks at the case for a more generous tax treatment of KiwiSaver.

There have been comments recently about the tax position of the benefits a member gets from KiwiSaver – see here . Mercer New Zealand has seemingly shown that the government is better off in tax collected over the value of incentives paid. The conclusion is that the taxes on KiwiSaver savings should be lowered so that members, rather than the government, will be better off.

The analysis is superficially correct but is regrettably simplistic. Without access to the original numbers, we have constructed an alternative set to illustrate the flaw in this exercise. While it is acceptable for Mercer (a KiwiSaver provider) to argue for even more favourable tax treatment than now, the numbers must withstand analysis.

SuperLife KiwiSaver[1] has put together an analysis that produces a similar pattern of results to the Mercer numbers. Using a member who joins today at age 18 and contributes until age 65 (47 years), with a starting pay for simplicity of $45,000 a year and reasonable guesses about pay increases, tax and inflation, the table summarises the lifetime position in tomorrow's dollars – in other words, unadjusted for inflation:

KiwiSaver analysis – 47 year member		
	Tomorrow's dollars	**% of final benefit**
Member contributions (after-tax)	$209,449	11.7%
Employer contributions	$207,372	11.6%
Net investment income	$1,326,166	74.0%
Tax credits received	$49,880	2.7%
Closing KiwiSaver balance	$1,792,866	100.0%
Total tax collected	$374,047	20.9%
Total tax incentives paid (inc. no ESCT)	$152,018	8.5%

The Mercer analysis concluded that because, in our example, the government collects $222,029 more tax than the $152,018 that it pays over in incentives, the government should lower tax on the KiwiSaver investment income. Somehow, the government is profiting from KiwiSaver over the long term, despite its very large cost to taxpayers.

[1] Michael Littlewood is an external director of SuperLife Trustee Limited, the trustee of SuperLife KiwiSaver.

The Mercer fallacy can be illustrated by thinking of the economic counter-factual. Let's assume that our member needed to save for retirement and needed to have accumulated the $1,792,866 by age 65 reached in the example ($561,628 in today's money using a 2.5% inflation rate). In the absence of the tax-subsidised KiwiSaver environment, the annual contribution in year 1 would have been 9.2% of the member's after-tax pay rather than the 4%/4% employee/employer contribution (total 8%) The table shows what would have been the case in a tax neutral, TTE environment:

The counterfactual analysis – 47 year member in a TTE tax environment		
	Tomorrow's dollars	**% of final benefit**
Member contributions (after-tax)	$482,360	26.9%
Employer contributions	n.a.	-
Net investment income	$1,310,506	73.1%
Tax credits received	n.a.	-
Closing balance	$1,792,866	100.0%
Total tax collected through saving scheme	$369,631	20.6%
Total tax incentives paid (inc. no ESCT)	nil	n.a.

So, the counterfactual sees the saver having to put aside a total of $65,539 more than under the KiwiSaver example (counting the employer's contributions as belonging to the member as part of the member's overall remuneration). The two cases seem to show that the government collects less tax under the counterfactual case than under the alternative ($4,416).

However, the counterfactual analysis disguises a significant tax issue. Under KiwiSaver, the employer's contribution is tax-free – the counterfactual requires the member to find the equivalent of the employer's contribution from after-tax income. Over the 47 years, the government will have lost at least $102,000 in income tax that is not collected under the KiwiSaver environment but that would have been paid on the member's pay in the counterfactual case.

Under the counterfactual, the government would collect more tax in total ($97,584) than with KiwiSaver. The difference between the two is a direct loss to the government and means all New Zealanders' taxes need to be higher to compensate.

So Mercer seems to be suggesting that KiwiSaver isn't generous enough; that taxpayers should spend even more tax dollars on those who can afford to save for retirement and at the expense of those who can't save (perhaps because they are too poor) or who don't see the need.

The government will soon be spending between $2-3 billion a year on KiwiSaver. Increasing that to make KiwiSaver even more generous should not be on the agenda. Here are some things New Zealanders should really be talking about:

- Forced savings seem not to increase national saving – countries that have a compulsory scheme seem not to save more than countries that do not – see, for example, http://www.pensionreforms.com/Preview.aspx?75 .
- Tax incentives may actually reduce national saving – see, for example, http://www.pensionreforms.com/Preview.aspx?243 .

- More than two thirds of New Zealanders aged 45-64 were, before KiwiSaver, saving enough or more than enough for retirement (where 'enough' is defined as a 100% continuation of pre-retirement consumption after retirement without 'eating the family home'.) – see http://www.pensionreforms.com/Preview.aspx?121
- There is very little poverty in old age in New Zealand (see http://www.pensionreforms.com/Preview.aspx?89) – by contrast, Australia has one of the worst old-age poverty rates in the developed world. In other words, what we have had in New Zealand (pre-KiwiSaver) seemed to have been working.

Tax incentives for retirement saving are regressive, expensive, complex and distortionary. However, their worst sin is that, based on international evidence, they seem not to achieve their objective of raising saving. Increasing the tax advantages of KiwiSaver will probably make things worse.

Mercer's tax analysis of KiwiSaver asked the wrong question. We should not be surprised that the answer was less than helpful.

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