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THE UNIVERSITY OF AUCKLAND BUSINESS SCHOOL

A briefing paper from the retirement policy and research centre

Does the economic rationale for KiwiSaver stack up?

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This briefing paper briefly assesses the case for KiwiSaver that saving for retirement will improve New Zealand's current account deficit.

In his post-budget speech to the Wellington Chamber of Commerce, the Minister of Finance, Michael Cullen, outlined the economic rationale for the extensions to KiwiSaver announced in the 2007 budget.

The "enhancements to KiwiSaver", dubbed KiwiSaver 2, are designed to "help Kiwis save more", and shift "the mix of growth away from domestic demand and towards saving and investment". Dr Cullen cited a Treasury report, released the next day, as saying "a higher structural level of national saving, over the longer term, would see a reduced current account deficit…"[1] In a later speech, Dr Cullen stated that the increase in savings "would build the pool of assets needed for business investment", implying a direct link between savings, productive investment and economic growth.[2] Interestingly, almost identical reasons were given for introducing compulsory superannuation in Australia in 1992.[3]

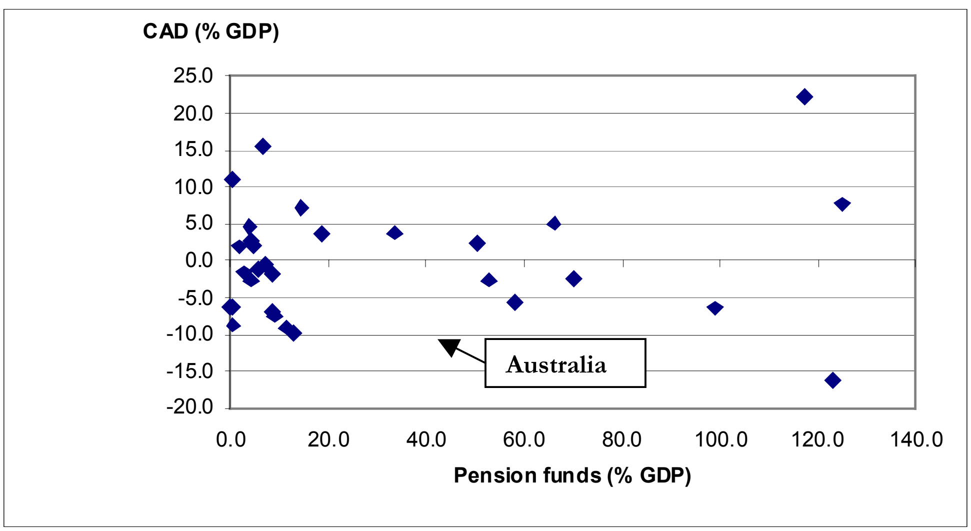
On the face of the numbers, it appears New Zealand has a savings problem. New Zealand's current account deficit is about 8% of GDP[4] and total overseas debt is $198 billion, or 119% of GDP.[5] By definition this suggests national investment exceeds national saving however, it is not certain that the deficit is the fault of negative household saving. Figures from the Reserve Bank show gains in household net worth coming from increased property values. However, a Treasury study found that "from 1980 to 2005 the annual average rate of household saving based on these estimates from household balance sheets was 12.4% of personal disposable income, after removing the effect of changes in house price."[6] They based their argument on data from the Household Economic Survey and an analysis of housing taken from the households' aggregate balance sheets from the Reserve Bank. This, they argued, was a preferable measure of household saving to that based on national income accounts. In other words, while New Zealand's overseas debt position looks grim, the evidence that New Zealand households are not saving is mixed at best.

Nevertheless New Zealanders, it seems, like to like to borrow and spend. Credit card billings have risen by about 10% per annum since 1999 (except for a period in 2000 when they increased by about 30%). Arguably, the country's growth over the last seven years reflects debt-fuelled consumption on the back of rising property prices – that is, on rising nominal values for non-productive assets. House price inflation in recent years has allowed households to borrow on the equity in their houses. The Treasury study cited above found that for every dollar rise in housing net equity there was 10 cents of apparent equity withdrawal.[7] However, householders are perhaps responding rationally to policy settings that favour investment in housing[8] above other, more productive investments that might assist in reducing our net overseas debt. Adding to this, many of the billions of dollars going offshore are dividends to overseas investors. New Zealand's overseas investments are insufficient to offset this outflow, although again there are measurement issues that may be overstating this difference.

However, it is not clear that KiwiSaver will achieve what it purportedly sets out to do. While it may provide an incentive to some individuals to save more, evidence from overseas suggests that, on a macroeconomic level, it may not have much effect on overall rates of debt or economic growth.

Figure 1 shows the pension funds in an economy, as a percentage of GDP, against that economy's current account balance (also as a percent of GDP) for OECD countries. The correlation of 0.1 is not statistically significant. Indeed, Iceland has one of the highest pension fund pools as a percentage of GDP, and a current account deficit that skyrocketed up to 26% in 2006. Australia, the country often cited as a model New Zealand should follow, has a current account deficit that is 5.9% of GDP despite having pension funds worth 58% of GDP. Australia has a household savings rate of –0.4% of disposable household income.[9] This suggests that not only are Australians spending all their disposable income, they are borrowing against their accumulated superannuation savings.[10]

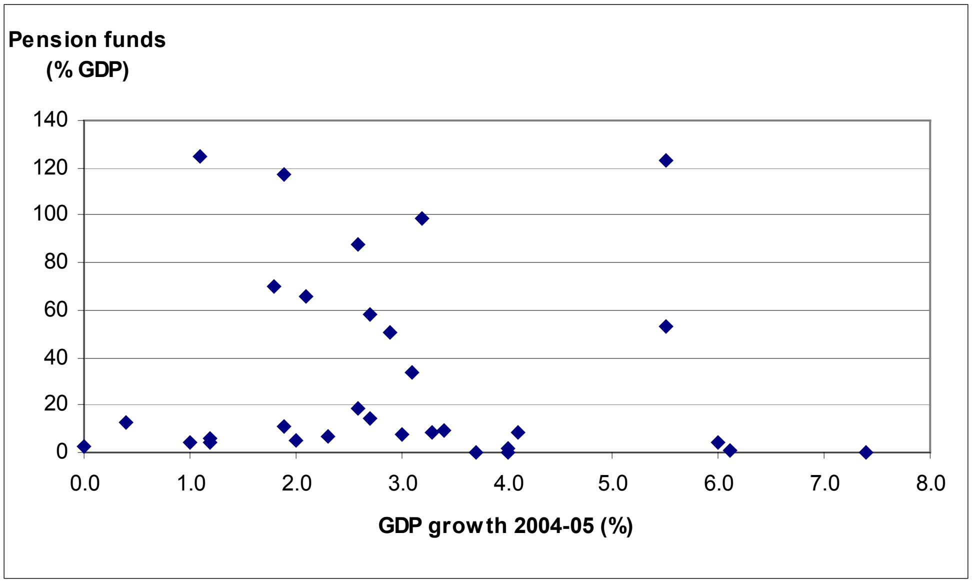
Figure 1: Pension funds (%GDP) vs current account balance (% GDP) for OECD countries, 2005. Correlation = 0.1



Source: OECD

Nor is there any clear evidence of a relationship between economic growth and pension funds. Figure 2 shows rates of growth in 2004-05 against pension funds in the OECD. While GDP growth rates fluctuate, overall growth in the OECD was 2.7% in 2005.[11] If there was a positive relationship between savings, investment and growth, we would expect to see a relationship between pension funds and economic growth, notwithstanding year-to-year variations. Yet no such pattern is evident. Other factors operate to affect GDP growth rates, and these appear to overwhelm any effect that pension funds may have.

Figure 2: Growth 2004-05 vs pension funds (% GDP) for OECD countries. Correlation = 0.08



Source: OECD

The economic reasoning used to sell KiwiSaver is flimsy at best. Countries with compulsory superannuation saving (which includes many OECD countries)[12] exhibit a range of overseas indebtedness, investment and growth, and net foreign direct investment. Any effect pension funds have is subsumed by other variables including government policies, domestic interest rates, trade policy, or as in New Zealand, the national propensity to borrow and consume.

All this makes KiwiSaver's stated aim of "building a stronger economy and a fairer society"[13] seem far-fetched. Other criticisms of KiwiSaver could be ignored if there was a real prospect that these laudable aims could be achieved, but this is unlikely. While it is tempting to look at the millions in Australian capital flooding into New Zealand and dream that New Zealand may be in a position to turn the tables, in a world where trillions of dollars[14] in pension funds are prowling the globe looking for profitable assets, additional cash will simply push up the price of those assets. No New Zealand fund would ever be large enough to compete with their Australian, Canadian and U.S. counterparts, especially as they will be fragmented among dozens of investment vehicles.

* RPRC acknowledges the work of Donna Wynd, researcher in compiling this briefing.

[1] Michael Cullen, Speech to Wellington Chamber of Commerce, 18 May 2007, http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=29420

[2] Michael Cullen, Speech to New Zealand Herald Mood of the Boardroom Breakfast, 29 May 2007, http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=29559

[3] See Drew, M and Jon Stanford (2003), A review of Australia's compulsory superannuation scheme after a decade. Available online at: http://www.uq.edu.au/economics/abstract/322.pdf

[4] June, 2007. Reserve Bank of New Zealand, http://www.rbnz.govt.nz/statistics/extfin/e3/data.html

[5] It has been suggested there are some issues around measurement of this, as well as the raw numbers. See New Zealand Institute of economic Research (2007), *Does New Zealand have a household savings crisis?*, NZIER working paper 2007/01, available at http://www.nzier.org.nz/Site/Publications/NZIER_reports_working_papers.aspx

[6] van Zijll de Jong, Mark & Grant Scobie (2006), *Housing: An Analysis of Ownership and Investment Based on the Household Savings Survey*, Treasury working paper 06/07, available at http://www.treasury.govt.nz/publications/research-policy/wp/2006/06-07.

[7] Ibid.

[8] See Child Poverty Action Group (2007), *Submission to Select Committee Inquiry into housing affordability*. Available at: http://www.cpag.org.nz/resources/submissions/res1182163595.pdf

[9] OECD, http://ocde.p4.siteinternet.com/publications/doifiles/122007021P1T103.xls

[10] Stanford, J (2004), *Long term issues in superannuation: An overview* The Australian Economic Review, vol 37, no 2, pp180-183.

[11] Ranging from a high of 7.4% (Turkey) to 0.2% (Italy).

[12] OECD (2007), Pensions at a glance, http://www.oecd.org/els/social/ageing/PAG

[13] Supra, note 2.

[14] US$29.3 trillion in 2006 – OECD (2007), Pension Markets in Focus, http://www.oecd.org/dataoecd/46/57/39509002.pdf