THE UNIVERSITY OF AUCKLAND
BUSINESS SCHOOL
NEW ZEALAND

Retirement Policy and Research Centre

Submission on the KiwiSaver Bill

We request the opportunity to present at the Select Committee hearing in Auckland.

Co-directors

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1. Introduction

This submission on the KiwiSaver Bill (the Bill) is made by the recently established Retirement Policy & Research Centre (RPRC), University of Auckland's Business School.

The RPRC[1] is an academically focused centre specialising in the economic and income issues associated with demographic change. The RPRC's sphere of interest includes public provision of retirement income – New Zealand Superannuation (NZS) and the accumulation and decumulation phases of private provision for retirement.

We share the concern of other submitters, such as the Association of Superannuation Funds of New Zealand (ASFONZ), that the Bill will impose heavy-handed regulation on superannuation and saving schemes and, to a lesser extent, on employers. Existing workplace superannuation schemes could be put at risk.

We are also concerned that the opt-out provision might be later removed or significantly tightened in the interests of simplification and lower compliance costs. That may introduce compulsory private provision by the back door with no significant research or debate.

We are supportive of many of the issues raised by other submissions that we are aware of, such as from SuperLife, ASFONZ, and the New Zealand Business Roundtable. Rather than repeat the arguments raised in those submissions, we want to emphasise four particular issues that may not have received adequate attention:

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[1] RPRC's submission is made by **Susan St John** BSc, MA, PhD - Senior Lecturer Economics, Department of Economics, University of Auckland; Consultant OECD, private pensions 1990; Deputy Chair, Periodic Report Group 1997 and **Michael Littlewood** BA/LLB - Barrister & Solicitor: New Zealand and Western Pacific; Solicitor: England; Director Aventine Consultants, Auckland; Member, Prime Minister's Working Group on Superannuation 1990; Member, Task Force on Private Provision For Retirement 1991-92.

- The lack of clarity as to what might be the problem that is to be solved by KiwiSaver;
- The lack of attention to the decumulation, after a KiwiSaver member's "retirement", of the savings generated by KiwiSaver;
- The problem of small accounts;
- The taxation of investment income in a KiwiSaver scheme at the 19.5% rate for those earning less than $38,000 a year.

2. The real savings issue

We are concerned that the actual saving problem that New Zealand faces has not been properly identified. The Bill and its predecessor documents focus just on the 'saving for retirement of individual employees' issue.

The national saving problem is reflected in a nearly 9% Current Account Deficit (CAD) and a net international indebtedness that is large relative to other equivalent countries. KiwiSaver is unlikely to have a positive impact on the CAD, or on New Zealand's net debt, but the danger is that KiwiSaver may act as a substitute for paying future attention to this national issue. Before KiwiSaver becomes law, we need to understand whether this will actually help to address the issues that matter to the country.

While the government's original announcements referred to the need to enhance national saving, the Bill itself does not claim that KiwiSaver will help to improve the national saving deficit, nor that KiwiSaver is in any way dedicated to this objective. Therefore, one can assume that any extra saving through KiwiSaver is not actually expected to result in new saving for the nation. We think this is a subject that needs much greater understanding and a national debate. The timeframe and process that the Bill necessarily involves does not provide an opportunity for this important issue to be discussed.

There are, in fact, reasons to be concerned that KiwiSaver may detract from national saving. For example, there is a large risk that existing superannuation schemes will close, and that employers will play less of a role than now.

From an individual, in contrast to a national perspective, the low financial savings of most New Zealanders arise from an environment that:

(a) encourages too much investment in housing, while at the same time

(b) providing universal cover for retirement income through NZS .

KiwiSaver will not change either of those. Indeed, by confusing saving for retirement with saving for a house through the subsidised first home purchase scheme, the problem may be aggravated. We suggest that the government's work on the KiwiSaver framework has given insufficient attention to this issue.

If the Treasury's work on individual retirement saving is to be accepted, it appears that many, if not most people are saving sufficient to income-smooth over their lifecycles, once NZS is factored in (Scobie, Gibson, & Trinh, 2005). Even if the Treasury's assessment was overstated, and KiwiSaver in fact did help people to save who otherwise would not be saving enough for income smoothing, KiwiSaver has no mechanism for the orderly run down of the lump sums it will generate (see the next section 3 for more on this). Lump-sums that are spent early in retirement on large consumer items and lifestyle enhancements could well add to the dissaving that will reduce national saving.

3. The use of capital sums from KiwiSaver

The point of saving for retirement for the individual must be to enjoy ***income*** that is additional to the state pension (NZS). From the point of view of society as a whole, the extra income may provide a source of funding for healthcare, vision, hearing, disability aids, and long-term care that otherwise might burden the working age population (through state-provided care and higher taxes).

In other developed countries, tax breaks for saving are justified by requiring that the eventual savings purchase an annuity. In New Zealand, we do not have that possibility because retirement savings are not tax-favoured. We in no way suggest that New Zealand should even think about restoring tax privileges for retirement saving just for the purpose of encouraging the purchase of annuities. That does not, however, make the issues associated with the decumulation phase of savings disappear.

Without a requirement to annuitise, without a sensible annuities market, and without a clear signal of the types of social provision that people should be prepared to pay for themselves, both the individual and society are exposed to risks that could be reduced with appropriate government intervention. The Bill pays no attention to these issues.

For the individual, there is a risk that the extra savings provided by KiwiSaver are dissipated too soon. There is no present way that an individual can buy competitive protection against excess longevity risk (there is only one life insurance company currently offering annuities). The only practical protection that most middle-income individuals outside the privileged few private, defined benefit pension plans can obtain, is that provided by NZS itself.

For society, there is the risk that those who live a long time will outlive their KiwiSaver supplement. When extra costs arise they may need to fall back on support from the working age population through tax-funded provision or rely on direct provision from their children

We suggest that a provision needs to be inserted in the Bill to the effect that policies around the decumulation of KiwiSaver are being developed. We appreciate that this suggestion will require study, debate and considered responses to implement. However, a "statement of principle" would give a signal on the significance of this issue to the future financial well-being of KiwiSaver retirees.

4. Proliferation of small accounts

Based on the rules set out in the Bill, most New Zealanders should join and contribute 4% of pay for at least 12 months (to qualify for the initial $1,000 paid under clause 193 of the Bill to the member's KiwiSaver account). An employee on the national average wage would contribute $1,631. Together with the government's $1,000, that means the total contributions in the 12 months will be $2,631.

Having contributed for 12 months, most employees (certainly all employees with any debt) should stop contributing for the following reasons:

(a) reducing debt (repaying the mortgage, credit card or other personal debt) gives a higher, "guaranteed" after-tax return than saving in KiwiSaver[2];

(b) KiwiSaver contributions will be locked up until age 65 so reducing the saver's flexibility – alternative saving vehicles can avoid the KiwiSaver scheme's restrictions;

(c) the employee might simply have a better, immediate use for the money or more profitable investment opportunities (like building a business).

If this scenario is correct, there could be literally hundreds of thousands of relatively small accounts in KiwiSaver schemes where no current contributions are being made. In fact, it is quite possible that no further contributions will ever be made to these accounts.

Many KiwiSaver members will, in fact, earn less than the national average wage so that even smaller amounts than in our example will be accumulated in the early years

Managed funds are not really suitable vehicles for small amounts of saving. We suggest that consideration should be given to allowing cash to accumulate in a low risk, fixed interest account, such as may be supplied by any of the

[2] Now that student loans are interest-free they are an exception to this general rule. They should be kept owing for as long as is practicable by the payment of the minimum required amounts.

major registered retail banks, until a sum of may be $10,000 or $20,000 is available. At that point, the member could consider transferring the savings to a KiwiSaver scheme with more investment options.

We suggest that there be no need for such a low risk bank account to be part of a "registered superannuation scheme" as contemplated by the Bill though the other suggested KiwiSaver constraints could still apply (such as limited access, contribution rules, transfer out requirements, communication requirements). This might make a savings bank an obvious vehicle as it already focuses on small account holders.

The risk is too high that low income people will see investment losses not gains on small amounts and that the costs of administration that, in these cases, will be borne largely by taxpayers through the "capped annual fee subsidy" will be relatively high. For example, if the subsidy were, say, $50 a year, that represents as much as 1.9% of our sample saver's contribution in year 1 ($50 on $2,631).

5. The tax on investment income

The latest tax announcements on "qualifying collective investment vehicles" (QCIVs) are supposed to offer low income contributors to superannuation schemes tax at their marginal tax rate, which is claimed to be 19.5% for investment income earned in the scheme. The Inland Revenue Department might explain who actually faces such a tax rate.

The problem is that superannuation scheme members, whose taxable income is less than $38,000 a year, claim the low income rebate on their earned income, but the abatement of the low income rebate is against ALL income including investment income.

Entitlement to the low income rebate (which used to be called the low income earner's rebate) is determined by earned income alone (except, as an accident of history, for those on NZS). The income of superannuation contributors, including investment income, between $9,500 and $38,000 a year is required to be taxed at the effective marginal rate of 21%, as working out one's tax online will demonstrate.

The 19.5% is the incorrect rate for everyone who has earned income or NZS of more than $9,500 per annum. It is correct only for someone whose total taxable income is exactly $38,000. So why is 19.5% being chosen for the tax in the QCIVs?

We appreciate that this is more a tax than a KiwiSaver issue but we note that default KiwiSaver schemes will have to be QCIV compliant. Also, clause 74 of the Bill uses the 19.5% rate in the calculation of the net interest to be credited under clause 72 of the Bill (interest on money held in the holding account).

The current policy of separating superannuitants out in the tax form benefits only those with tax losses from self-employment which was never the intent of the original legislation. While superannuitants (and for that matter others) are not necessarily pursued for the extra 1.5% (21% less 19.5%), anyone with interest income over $200 per annum is required to request a personal tax summary so that 19.5% is not a final tax .

The Bill may provide an opportunity to abolish the low income rebate and to have four statutory rates of income tax 15%, 21%, 33%, and 39% which is largely the case now for most. We also note the substantial fall in the real value of the low income rebate over time as the threshold of $9,500 has not been changed since 1986 and the middle effective rate has fallen from 28% to 21%. The case for abolition is strong. The only justification for retaining the low income rebate is to make sure that minors are taxed at 19.5% rather than 15% when their trust income is under $9,500. This issue could be dealt with in other ways.

6. Survey of Family Income and Employment (SoFIE)

In 2002, the government started to gather information on the economic circumstances of families, described as follows

> Since October 2002, the Survey of Family, Income and Employment (SoFIE) has been collecting information on New Zealander's (sic) circumstances and

> lifestyles, and the factors that influence these aspects of people's lives. Nationwide, survey respondents have answered questions about their work, family and household circumstances, income, net worth and health.
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> SoFIE is a 'longitudinal' survey that runs for eight years, meaning respondents are revisited yearly to build a picture of how their circumstances change during this time. SoFIE is now in its fourth wave (or interview cycle), and over time, a dynamic picture similar to a video of a person's life is created.
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> The information gathered by SoFIE will be used to answer questions such as:
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> - How does education affect a person's chance of employment?
> - How do changes in the make-up of a family affect people's standard of living?
> - What are the patterns of family income over time?
> - Are people able to save for their retirement over time?
>
> (Statistics New Zealand, 2006)

SoFIE will track an initial 15,000 New Zealand "economic units" over the eight-year period. The government is congratulated for financing what will be the best New Zealand survey of its kind. SoFIE can reasonably be expected to provide a wealth of data on which to better assess the extent of any savings problem and, in particular, any retirement saving problem.

As we suggested in section 2 above, a much clearer identification of the problem that KiwiSaver is suppose to solve is needed. From a public policy perspective, KiwiSaver must be evaluated in terms of clear goals. We recommend that the expensive evaluation process implied by the Bill be guided by a principled approach to these issues that draws on the new information from SoFIE. This could be signalled in the Bill.

7. Economic growth

Much public policy concern with New Zealand's ageing population highlights the higher future costs of health and superannuation that will fall on a relatively smaller working-age population.

We suggest that KiwiSaver will not necessarily help to prepare New Zealand for the changing demands on tomorrow's economy.

Economic growth is the only practical way forward in this regard. Even if financial savings increase through KiwiSaver (see section 2), there is no necessary link to increased or better investment that will increase New Zealand's growth rate[3]. Savings may, in fact, be sent overseas to help other countries grow. Superannuation schemes in New Zealand typically invest about 40% of their assets overseas.[4]

KiwiSaver will undoubtedly change the financial scene in New Zealand but it may not help to address the thing that really matters – improved performance of our economy. Again, this reflects our concern that there has been no clear identification of the problem that KiwiSaver is intended to address.

References

Scobie, G., Gibson, J., & Trinh, L. (2005). *Household Wealth in New Zealand.* Wellington: Institute of Policy Studies, School of Government, Victoria University of Wellington.

Statistics New Zealand. (2006). *Survey of Family Income and Employment*, from http://www.stats.govt.nz/additional-information/survey-of-family-incomeemployment/default.htm

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[3] The economic literature is divided on the connection between increased financial savings and growth and on increased national saving and growth

[4] According to Reserve Bank statistics 38.8% of managed funds are invested overseas (*Money, credit and financial statistics, Table C15 at http://www.rbnz.govt.nz/statistics/monfin/index.html*