



**BUSINESS SCHOOL**

**Retirement Policy and Research Centre**

## **Response to the Tax Working Group interim report**

**October 15<sup>th</sup> 2018**

### **Comments on Chpt7: Retirement savings**

It is good to see that the Retirement income policy objectives set out are clearly focused on the individual and not on national saving:

*The overall objective of retirement income policy is to minimise economic insecurity in old age. New Zealand achieves this objective through three main tools:*

- *New Zealand Superannuation alleviates the risk of old age poverty by providing a universal benefit to all New Zealand citizens and residents 65 and over (subject to some residency restrictions).*
- *The KiwiSaver scheme supports private saving to maintain a standard of living in retirement over and above the level guaranteed by New Zealand Superannuation.*
- *Private decision-making on retirement saving is supported by measures to improve the financial literacy of New Zealanders. (TWG)*

National saving is a secondary consideration in pension design. It is unlikely funded schemes increase saving but even if they did, that is not the issue. If an increase in National saving is to have desirable effects on the economy, there must be links between the scheme and increased saving, and between more saving and more investment. There are no necessary links. Moreover, more investment does not of itself mean more quality and sustainable growth.

“ an increase in saving does not necessarily increase output” (Barr, 2001).

Many pension experts believe that pensions policy should primarily have equity objectives: ensuring equitable shares of future output between working age cohorts and pensioners.

KiwiSaver is a very small part of overall wealth and a small, albeit growing, part of total managed funds. It is dubious if growth in KiwiSaver is anything more than offsets to other forms of saving. Such offsets may be good to divert for example from overinvestment in housing but the main purpose of KiwiSaver is to provide a low-cost mechanism for low/middle income earners to acquire a relatively secure savings pot.

The TWG say “A greater pool of domestic savings could deepen domestic capital markets and enhance the ability of local firms to secure capital to grow.” This

was an argument for KiwiSaver in 2005 but we have not seen the evidence of this so far—in fact the opposite.

The issue in NZ is not the lack of capital. There is a lack of mechanisms to allocate capital to its highest use. There is a problem of lack of NZ listings on the stock and much of NZSF and KiwiSaver is invested overseas and exchange ([See for example NZ Herald -Breaking the capital drought. October 5<sup>th</sup> 2018](#)).

It is important for the TWG not to be diverted into arguments about national saving- it should not be the focus of retirement saving. The achievement of less inequality in retirement outcomes should be paramount.

The TWG say, “Higher saving rates could, in principle, reduce the cost of capital and increase incentives to invest.” and “Higher national saving could also support export growth by reducing pressure on interest rates and exchange rates”. While these maybe theoretical possibilities, in the real world, interest rates are driven by many other factors. Moreover it could equally be argued that more saving depresses the economy and reduces the confidence to invest. Saving does not cause investment.

When the TWG say “Savings policy may also affect the allocation of investment, for example by reducing distortions in the treatment of different asset classes.’ they hint at what follows which appears to be in the direction of making KiwiSaver more tax-advantaged to level the playing field. The RPRC strongly disagrees with this direction, preferring that distortions in housing are removed.

### **The Portfolio Investment Entity (PIE) regime**

The RPRC is alarmed by the suggestion that the PIE regime should be made more generous. It is already very generous as the TWG point out. It would be much better for the top PIE rate to be raised to 33%. This would help moderate income inequality (one of the goals for TWG) and reduce avenues of tax avoidance.

A much better approach to levelling the playing field is to adopt the RFRM for net equity in real estate.

### **The treatment of inflation**

The RPRC agrees that the MTC can be viewed as compensation for tax on nominal interest income in KiwiSaver in times of inflation. But notes in a world where nominal interest in the bank is taxed and capital gains are vastly undertaxed, taxing nominal returns in KiwiSaver is at least consistent.

### **International comparisons**

NZ should be proud of this:

*“New Zealand has the lowest tax subsidy for retirement savings relative to its general system for taxing investment income” (TWG).*

Other countries find it very difficult to reign in their expensive, regressive tax breaks for retirement saving. Not being able to unwind tax breaks as NZ did in

the late 1980s has meant countries like Ireland are struggling to bring in generic auto enrolment DC programmes (St John, 2016)<sup>1</sup>.

RPRC agrees with the TWG when they say “a poorly-designed regime, which only slightly increases private saving and significantly reduces public saving, might actually have a net negative impact on national saving.”

### **Incentives to save**

The Group considered a range of options for encouraging greater saving through the KiwiSaver scheme and favours:

- The removal of ESCT for employees earning up to \$48,000 per annum.
- A five percentage point reduction for each of the lower PIE rates, applying to savings in KiwiSaver accounts. (The Government could also take the opportunity to simplify the PIE rate schedule, which is somewhat complex.)

The RPRC comments: If everyone has the ESCT on the first \$48,000 removed it is of most benefit for those earning \$48,000 or more and is expensive without helping those on low incomes much. However, if it is only for employees earning up to \$48,000 as appears to be the case, there are troublesome notch problems. Would someone on \$49,000 to lose **all** the advantage of the removal of ESCT?. How will either of these options work for people with two or more employers? How will the self-employed be treated?

Would the reduction on PIE rates apply to all PIE funds? This is again not the best way to help low income earners and does not fix the problem of the top PIE rate being less than the top income tax rate. High income people who disguise their real income are likely to be able to take advantage of this lower PIE tax regime.

Other ways to make policy more progressive and to actually deliver more to low income people need to be considered. For example, the reinstatement of the \$1000 kick start for new KiwiSaver members over 18. This would be far more progressive than the options TWG favour as it does not depend on what is earned, it would be good for very low income earners, and women, many of whom may not start KiwiSaver until later in life. The kickstart offers protection for small savers in the initial phases who otherwise may see their balances become negative after fees and poor returns.

### **Women**

The TWG say

“Saving patterns also differ by gender. Women’s adult lives often involve periods outside the paid workforce or in part time employment, which can result in lower

---

<sup>1</sup> see also St John (2016) [Time for Ireland to bite the bullet](#), Irish Times 1 November 2016 and St John, S (2016) [We really don't know how lucky we are](#), New Zealand Herald, October 12th, 2016

government contributions to KiwiSaver and lower KiwiSaver balances than would otherwise be the case.[21]

The TWG appear to justify this in the footnote:

“[21]The Group notes, however, that women also tend to receive New Zealand Superannuation for a longer period than men because of average life expectancy for women is higher.”

This justification is inappropriate. On average women no matter how long they live, begin retirement with lower savings and hence may have a reduced standard of living compared to men for all the years they actually live. Living longer suggests they need to be even more prepared than men instead of vastly less. But averages are distasteful- we distinguish longevity on the basis of gender because we can see gender. There is a huge overlap in the mortality curves suggesting that a true marker is probably some kind of longevity gene. Gender is a very second-best characteristic for longevity projections.

Retirement policy issues are far broader than just tax. The RPRC would to see any recommendations on tax as part of the Retirement Commissioner’s three-year annual report in 2019.

Barr, N. (2001). *The welfare state as piggy bank. Information, risk uncertainty and the role of the state*. Oxford: Oxford University Press.

St John, S. (2016). *St John, S (2016) "New Zealand's Kiwi Saver Lessons for Ireland"*.