

Saving New Zealand: Reducing Vulnerabilities and Barriers to Growth and Prosperity

Savings Working Group Final Report to the Minister of Finance

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Conclusions

- Over some decades, New Zealand has had inadequate saving relative to its investment needs. This poor saving performance has left it with a high level of NFL – a level similar to Ireland, Spain, Greece and Portugal. While our situation is not exactly the same as these economies, their financial difficulties are a clear warning to New Zealand.
- This high level of NFL puts New Zealand in a vulnerable position. The vulnerability is more acute because of a sharply deteriorating fiscal position, constrained economic growth prospects and a high dependence on increasingly cautious financial markets – with investors concerned about countries with weak balance sheets and large borrowing needs.
- The critical factor has been inadequate national saving and overdependence on foreign borrowing. New Zealand's growth has come at the cost of rapid growth in foreign debt – mainly private – and too much of this money has ended up in inflated house and farm prices.
- In addition, overdependence on foreign borrowing has resulted in high interest rates relative to other countries and (by many measures) an overvalued exchange rate. Consequently, the tradable sector – particularly exports – has underperformed relative to the non-tradable sector, which has grown much faster.

- Decisive steps are needed to increase national saving above the current gross level of 17% of GDP by some 2% to 3% of GDP, lift productivity in both the government and private sectors, and increase net exports. If New Zealand fails to act credibly and effectively it increases the risk that many of the required adjustments will be imposed by market forces, probably in an abrupt and damaging way.
- The first step should be to stabilise the NFL-to-GDP ratio at below 90% and then, over a decade or more, reduce it to a more manageable 70% and then 60%. These changes will both reduce vulnerability and – most importantly – improve economic growth prospects. They should be started immediately.
- The fastest way to stabilise the NFL-to-GDP ratio is to return the fiscal balance to surplus earlier than current projections.
- A sharp increase in government sector productivity and performance would have a major positive impact, including on the capacity of the sector to supply goods and services over future decades. Current long-term fiscal projections show that if successive governments keep debt to a sustainable level – as they should – then, if there are no substantial increases in taxes, their spending in real terms will decline each year for about the next 30 years. This is a seriously unattractive prospect. However, raising the public sector's performance and productivity growth rate, from 0.3% per annum to 2% per annum for five years and 1% per annum thereafter, would improve the situation. It would give the government options amongst (i) avoiding the decline in spending and services, (ii) allowing growth in spending and services, and (iii) an increase in national saving. Clearly, a highly performing public sector has many advantages.
- A "no change" approach to government policy is not viable. There is a serious need, for example, to look at New Zealand's poor economic performance: the low capital-to-labour ratio, falling productivity growth rate and weak trade performance. Overall, there needs to be a much more strategic approach to economic policy and policy generally and less orientation to short-term political objectives. The intent would be to get better policy coordination towards important objectives, and improve New Zealand's overall economic, social and environmental performance.
- A repetition of the unsustainable-boom problems of the recent past must be avoided. Many factors that have influenced New Zealand's poor saving performance have been considered in this report from a policy perspective. These include: asset-price inflation, interest rates, monetary policy, household debt, contractual saving, migration, subsidies, taxation, market failures, household incomes, disclosure and financial literacy.

- The recent housing boom highlighted the importance of asset-price inflation as an issue. The rise in house prices was accompanied by a large rise in debt. More than half of private-sector debt is now in housing loans. Furthermore, during the boom many households saw no need to save since their wealth was increasing through house price revaluations. Policies are required to prevent unsustainable booms and to prevent excessive asset price inflation. One of the options is to reduce borrowing or, in other words, restrict the supply of credit. Reducing borrowing is – to some extent – an alternative means of increasing saving and wealth.
- Substantial differences in effective tax rates, favouring housing and penalising simple savings products such as term deposits, have had a big impact on saving and investment behaviour. Some of the policies being recommended by the SWG address this issue.
- Migration is another issue that the government should investigate further. There are indications that high immigration rates have pushed up government spending, house prices and business borrowing, and prevented necessary adjustments to the economy.
- Although there is reasonable confidence in saving data for the total private sector, there are significant issues with the quality of data for the household and business sectors. These issues merit close attention.
- The SWG considered a large number of other issues in relation to private, household and retirement saving, including KiwiSaver. The level of retirement savings appears to be high enough – at least for people over 45 – to avoid an increase in elderly poverty rates. These rates are at reasonable levels by international standards.
- However, there is much room for improvement. Recommendations on KiwiSaver include:
 - Membership in KiwiSaver should be increased, but not made compulsory at this time since many of the gains from compulsion should be achievable by other means.
 - Changes in the application of the KiwiSaver subsidy could yield better results.
 - There is a need for better disclosure of KiwiSaver terms, fees and other charges and returns. Fees and costs are generally too high, and more efficient approaches would add value. Moving to a single default option with much lower costs and fees is important. An additional low-risk fund that holds only short-term government securities should also be set up.
- Annuities, or similar instruments, have an important role to play in the way older people manage their savings. The government should lead the development of an appropriate instrument or market, with any involvement on a full cost-recovery basis.
- More work on financial literacy would help facilitate changes to attitudes and approaches to saving and put New Zealand on a more sustainable path.

- The saving problem has developed over a long period and it is unreasonable to expect it to be solved overnight. But it is serious and requires urgent attention. While there may be some downside for New Zealanders in the short term – with consumption growing at lower rates than the economy overall – the long-term effects should be very positive. For example, higher saving in KiwiSaver or other accounts is likely to boost the development of the local capital market, including the sharemarket. The availability of more capital should also put downward pressure on interest rates and encourage investment. This in turn should mean a lower exchange rate and higher exports. In summary, in the long term, higher saving should lift economic growth and national disposable income on a sustainable basis.
 - The SWG recommendations offer a solution for low saving and the high NFL. They should also help to change attitudes and behaviours towards saving.
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