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### **Last Rites for the Cullen Fund?**

Commentators have suggested that the government's decision to suspend automatic contributions to the New Zealand Superannuation Fund (the so-called Cullen Fund) may spell its eventual demise.

Should we mourn that outcome? Would it have any implications for future superannuation benefits, as some have suggested?

The answer to both questions is no.

The justification for establishing the Fund was always weak.

Some thought that, as minister of finance, Dr Cullen's underlying motive was to salt away budget surpluses rather than allow his colleagues to spend them, given that he had raised taxes and couldn't bring himself to cut them when the surpluses mushroomed.

If that was the strategy it didn't work: in the five years to 2009, spending increased by a massive 50% and the public accounts are now in structural deficit.

The ostensible reason for the Fund, however, was to partially pre-fund New Zealand Superannuation (NZS) in preparation for the growing fiscal burden of an aging population.

This rationale always made little sense.

As the Business Roundtable pointed out at the time, pre-funding was largely an accounting exercise, with no direct economic impact on the retirement income problem. Unless the terms of NZS change, the real cost remains unaltered.

At most the Fund amounted to a tax-smoothing scheme which was estimated at its inception to cover only 14% of NZS, with the balance coming from current taxation.

With the suspension of contributions for a decade, the Treasury estimates that only 8% of costs will be covered.

Moreover, there was never any chance that the Guardians of the Fund would remain free from political interference in their job of maximising its returns (for a given level of risk). Predictably, in a few short years we have seen political parties variously proposing to bias the Fund's investments towards infrastructure, green projects, venture capital and investment in New Zealand.

The Business Roundtable argued that instead of putting money into a 'jam jar', a more prudent policy to provide for the future would be to continue to repay debt and focus on boosting productivity and growth.

The merit of the debt-reduction argument is confirmed by the losses of \$3 billion borne by the Fund in the past year and its meagre 3.26% annualised return since it was established.

Some commentators have still not learned the lesson. Rod Oram has criticised the decision to suspend contributions, saying "borrowing to grow the Super Fund is a sound investment strategy."

But returns above risk-free rates can only be achieved by taking on more risk. Sharemarkets could easily fall by 30-50% again when the Fund is at its peak. If it made sense to fund future pensions by risky investments it would make sense to do the same for future health costs and other government programmes.

The Business Roundtable has consistently argued for the Cullen Fund to be wound up on the grounds that, by contributing to a high tax burden in the build-up period, it impedes economic growth and risks discouraging private savings. Other commentators have now joined in this call.

An additional reason for taking this step is to 'deleverage' the Crown balance sheet. Finance minister Bill English has argued that assets should be managed as actively as liabilities. Facing growing debt, a household or a company looks to realise assets to reduce its exposure, and the same principle applies to the Crown.

The budget decision should be taken as an opportunity to refocus the superannuation debate.

What matters most for future retirees is growth in the economy to deliver the goods and services they need. So the first imperative is to reverse the slump in productivity growth of recent years with effective pro-growth policies.

We should also confront directly the problem of the growing superannuation burden, as other countries are doing, and reduce disincentives to private savings.

In its recent report on New Zealand, the OECD recommended that policy action to contain future superannuation spending should be decided “fairly rapidly” to allow people time to plan.

The report said: “To make significant long-term savings, the universal benefit should be indexed to the CPI rather than wages, a step that has already been taken by many OECD countries.”

It also advocated raising the eligibility age to 67 and indexing it to life expectancy.

The United States and Britain have adopted eligibility ages of 67 and 68 respectively and the Australian government announced a move to 67 in its recent budget. Although controversial as a surprise move, polls have indicated significant (40% plus) public support.

Can we really afford more expensive arrangements than much wealthier countries?

Such moves, coupled with measures such as reforms to other welfare policies and lower taxes, would do more to encourage private savings than attempts to offset savings disincentives with subsidies like KiwiSaver – a lesson we should have learned with the failed attempts to offset import protection with subsidies to agriculture.

Ironically, Dr Cullen’s savings legacy has been to reduce government savings (by turning surpluses into deficits), reduce business savings

(through recession-induced falls in company profits) and possibly reduce household savings (if calls by the Reserve Bank and others to spend rather than save during the recession are heeded).

If they are not, the negative movements in the first two components of total national savings will likely outweigh the third.

And by presiding over the slump in productivity growth, Dr Cullen has made NZS, and the welfare state of the future in general, less affordable.

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