

Savings Working Group Serves Up Strange Report

Highly critical comments are circulating about this month's Interim Report of the Savings Working Group.

One expert in the field emailed me saying, "I suggest Mr English disband the SWG right now. What value has it added?"

The report is indeed a strange one, both in style and substance.

Language like our "we've had the fun, the big spend-up, bought over-priced houses and farms, and a lot of bling" does not usually appear in a sober advisory group report.

The SWG is tasked with exploring the connections between national saving and fiscal policy, taxation and the future role of KiwiSaver. Yet its main focus seems to be on New Zealand's current account deficits and external debt, and it ranges over state sector management, productivity and other extraneous issues.

Without any analysis, the report asserts the conventional wisdom that New Zealanders are poor savers. This is hotly contested by numerous experts, including some in Treasury.

Simple intuition calls into question whether New Zealanders' aggregate savings decisions are likely to be very different from, say, citizens of other Anglo-Saxon countries.

Much empirical evidence seems to bear out this intuition.

A 2007 New Zealand Institute of Economic Research study concluded: "A review of the existing measures of household saving in New Zealand shows little evidence of a saving problem. Indeed the data that the proponents of saving policies have used poorly reflect the true household saving performance. Other data sources indicate that household saving is not only positive but has been rising strongly in recent years."

The 2001 McLeod tax review, Treasury working papers and a Motu study have reached similar conclusions. New Zealand's national savings rate (the sum of household, business and government saving), while below the OECD average, is above that of the United States and the United Kingdom.

The Motu study also cast doubt on the alleged "love affair with housing". It said, "an international comparison shows that New Zealanders hold a similar proportion of their net worth in property as do individuals in other OECD countries."

The Interim Report conflates the issue of saving with New Zealand's external deficits and debt. This is a serious error: even if all countries had the same savings rate, many would have external deficits because investment rates differ.

Moreover, the current account balance is the result of many influences, not just saving. A key one is the economy's international competitiveness. This deteriorated sharply under the previous government due to excessive government spending, cost-raising regulations and stalled economic reform.

Exporters' profitability was squeezed and external deficits increased. The obvious policy requirement is to shift resources from the domestic sector of the economy to internationally competing industries.

Simple arithmetic indicates that attempts to engineer higher saving could only marginally affect New Zealand's external indebtedness.

Suppose we could somehow grow national saving by, say, 20 percent from \$2 billion a year (the recent average) to \$2.4 billion. This would be a remarkable increase. Yet it would mean net foreign liabilities would fall from around \$162 billion by only \$4 billion over 10 years.

Moreover, this reduction is net of any fiscal cost of pro-savings policies.

However, some estimates suggest that KiwiSaver subsidies, which are running at over a billion dollars annually, and adding to the fiscal deficit and

hence government 'dissavings', are increasing household saving by only around \$200 million a year.

Reducing or eliminating these subsidies would appear to be 'low hanging fruit' for the SWG. It is right to urge the government to reduce its fiscal deficit faster. The main policy lever on national savings is the government's own savings performance.

The SWG toys with ideas on tax – a playground for amateurs – but none would have a material impact on savings.

Widely anticipated increases in GST over the medium term, as suggested by the SWG, are likely to discourage saving in the near term because the stock of savings held when GST is increased will buy fewer goods and services. Income tax cuts would not generally compensate for this effect.

No government is going to tax owner-occupied housing (and a better strategy to reduce this distortion is to keep cutting income tax rates). Complex tax indexation at low inflation rates is not worth the candle.

These ideas and many others in the report are largely diversions. It is not the SWG's fault that far bigger issues like superannuation and student loans are not on its agenda.

Nor does its brief extend to the range of policy responses to deal with New Zealand's external vulnerabilities, which are indeed very serious.

There are some well qualified experts on the SWG and in its secretariat. They need to do a far more rigorous job in their final report if it is to be taken seriously.

But they only have until the end of January to complete it.

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