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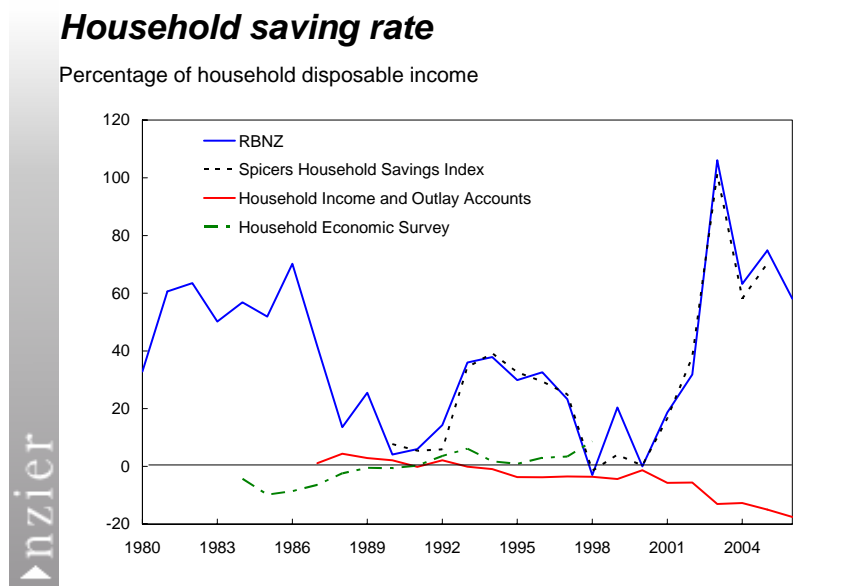
To the Chief Reporter

NZIER public discussion document - media release

Does New Zealand have a household saving crisis?

Data from the Household Income and Outlay Accounts (HIOA) show that the ratio of household saving to disposable income has been negative since the early 1990s and has declined steeply since 2000. This evidence has led many people to believe that New Zealand has a household saving crisis which has hampered investment and growth and which will result in inadequate retirement incomes in due course. These concerns have been addressed by several policies, notably the New Zealand Superannuation Fund (2003), State Sector Retirement Savings Scheme (2004) and KiwiSaver (2007).

NZIER's review of all existing measures of household saving in New Zealand finds 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 also been rising considerably in recent years.



Problem with the data

There are many reasons to believe the frequently-cited HIOA saving data inadequately capture true household saving. Firstly, being based on the national accounts statistics framework, HIOA overlooks hidden economic activity. Because tax evasion is an important motivation for this activity, it tends to be greater on the income side than the consumption side. Since saving in HIOA is the difference between income and consumption, omitting the informal economy understates saving. The size of the informal economy tends to rise with the effective tax rate so the increase in the top personal tax rate (from 33% to 39%) in 2000 is likely to have caused an accelerating understatement of household saving.

Secondly, HIOA takes no account of income from assets that New Zealanders hold directly in other countries. Given the lack of a full capital gains tax, no exchange controls, the very small local equity market, large inflows of migrants, and the global focus of many New Zealanders, the wealth held directly overseas is potentially large. Therefore, omitting this source of income understates saving.

Thirdly, the sharp drop in the household saving rate from 2000 seems a sensible response to a fiscal policy change. In 2000, the top personal tax rate was raised by 18% from 33% to 39%. This shifts saving from households to the government by raising government revenue at the expense of household disposable income. Moreover, the fiscal surplus has expanded and households may have interpreted this as the government saving on their behalf, reducing their need to save.

The increase in the top tax rate applies to personal income but not to corporate and trust income and this has induced a change in the form of household saving. The income earned from trusts has grown steeply since 2000. Unincorporated businesses have been incorporated to reduce the tax burden. Shareholders in closely held companies have restricted their drawings to reduce their liability for personal income tax at the higher rate. In New Zealand, it is very cheap to set up and operate a company; thus cost and inconvenience do not much constrain incorporation and retaining savings to avoid the highest personal tax rate.

It is noteworthy that while household saving as recorded in the national accounts has fallen sharply since 2000, government and business saving have risen just as markedly so that aggregate saving as a percentage of GDP has been reasonably stable.

Are pro-saving policies a safe bet?

It is not true that in light of data uncertainties, using policies like KiwiSaver to promote saving is the 'least-regrets' approach. If saving is already high, more saving will depress consumption and weaken growth. If saving is low, external borrowing can be used to fill the shortfall. Saving is also costly since it reduces current consumption.

Whether investment is financed by borrowing or saving does not matter. The crucial question is still how wisely invested the funds are. As long as the loans are used in profitable investments, indebtedness is not a problem. If New Zealand has difficulty sustaining foreign debt, it is because it has a growth problem, not a saving shortage.

Moreover, pro-saving policies like KiwiSaver are inefficient and inequitable. These policies entail subsidies, which will result in higher taxes (or lower government saving). The collection of tax to finance the subsidies creates a deadweight loss equivalent to the administrative resources involved in the money-go-round. Much of the saving is unlikely to be new saving but merely the reallocation of saving from other forms to the tax-favoured vehicle. The subsidies will also induce some people to borrow or delay loan repayment to fund their 'saving' contributions.

Overall, the reasons that have been used to justify pro-saving policies lack economic underpinnings. If there is a policy that New Zealand needs, it must be one that promotes growth. Pro-saving policies are more likely to be regrettable than not.

The paper is available from the NZIER website www.nzier.org.nz, under Publications/Reports and working papers 2007

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