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**NEW ZEALANDERS' SAVINGS HABITS:  
ARE THEY REALLY POOR?**

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# **NEW ZEALANDERS'S SAVINGS HABITS: ARE THEY REALLY POOR?**

## **Introduction**

The American actor and writer Will Rogers once observed, "It's not what people don't know that's the problem, it's what they do know that's not true".

Because they have been told so often, New Zealanders 'know' that they are poor savers; that low saving means low economic growth; and that government action is needed to cure their bad habits. In particular, the government needs to 'do something' because New Zealanders are currently making inadequate provision for their retirement.

The purpose of this paper is to examine the validity of this familiar mantra.

## **Are savings low?**

For decades there have been concerns that savings have been too low, and not just in New Zealand. The Labour government of the late 1950s wanted to increase savings. So too did the Planning Council in the 1970s. Sir Frank Holmes told the Economic Summit in 1984 that New Zealand had been relying too heavily on foreign investment and should increase its domestic savings. Reserve Bank governor Don Brash recently said New Zealand's savings record "looks particularly poor". Many commentators have made similar comments about the apparent decline in measured household savings in the United States and other countries in the 1990s.

These claims have persisted despite the fact that they have been contested many times. The McLeod Tax Review commented last year that:

[W]hen looking at the impact of savings on the current and future well-being of New Zealanders, the most relevant measure is national savings; that is, the sum of private and government savings. On examining the available evidence and the reasons why people save, it was not clear to us that New Zealanders save too little.<sup>1</sup>

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<sup>1</sup> Tax Review 2001, Final Report, October 2001, p 93.

The Review added that a number of submissions disputed this conclusion but that "None, however, cited any supporting evidence other than a claimed consensus among relevant experts that there is a problem".

By far the most exhaustive recent attempt to assemble evidence on New Zealand's savings level and trends is a Treasury Working Paper by Iris Claus and Grant Scobie.<sup>2</sup> The paper highlights the problems with the measurement of saving and the difficulty of drawing clear implications for policy. It should be compulsory reading for anyone interested in the savings debate. Among the points it makes are that:

- saving is difficult to measure (in New Zealand and elsewhere) because of factors such as hidden economy activities, depreciation (which is an unobserved variable), and the difficult distinction between households and businesses;
- in New Zealand, national saving is calculated from two sources of data: (i) from the national income and outlay account as the difference between disposable income and total consumption expenditure, and (ii) from the flows of investment and net lending in the capital finance account. Definitional changes can have large effects, as illustrated by the revisions to national saving from SNA68 to SNA93;
- household saving is obtained from the income and outlay accounts only, and does not have the same degree of accuracy as the national saving rate;
- saving as measured in the national accounts does not correspond very closely to theoretical concepts of saving. This measure also counts as current consumption many items such as education, some health expenditures and consumer durables which are arguably investment goods. Adjusting for such treatment substantially raises the national savings rate;
- the flow measure also ignores changes in household wealth such as homes and financial assets. The alternative stock measure of household wealth is more relevant for assessing the adequacy of retirement saving, but little

information is available on the assets and liabilities of individual New Zealand households. The wealth survey being undertaken by the Office of the Retirement Commissioner will help fill this gap. (Estimates for the United States suggest that if realised and unrealised capital gains were included in saving, the savings rate would actually have increased during the 1990s);

- inflation also distorts the flow measure of private saving, as it transfers resources from lenders to borrowers;
- when adjustments for inflation are made, there has been no apparent downward trend in the level of private saving in New Zealand and, more importantly from an economic perspective, national savings rates could be much higher than suggested by the conventional measures.

A further point is that there is an inverse relationship between the household savings rate and the government savings rate (fiscal surpluses and deficits). Household savings rates fell in the early and mid-1990s as budget surpluses were achieved and rose in the late 1990s as the fiscal position deteriorated.

Having regard for other factors such as demographic trends that are relevant in making international comparisons, I am unaware of any convincing evidence that New Zealanders are poor savers.

This conforms with simple intuition. Saving is deferred consumption. We save in order to meet our expected consumption requirements in the future. Most people spend most of their income over their lifetimes. It would be surprising if the choices New Zealanders make between current and future consumption differ greatly from those of people in comparable countries. Certainly the split between private and government savings could vary depending on the roles undertaken by governments in areas such as education, health, housing, welfare and retirement income. However, it is a plausible hypothesis that New Zealand's overall national savings rate, properly measured, would not differ greatly from those in countries with similar income levels.

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<sup>2</sup>

Iris Claus and Grant Scobie, 'Saving in New Zealand: measurement and trends', Treasury Working

## **Savings and economic growth**

One of the main reasons why some people worry about saving is that they assume there is a close and causal relationship between national saving, investment and economic growth. Such beliefs are common among parties on the political left and central planners, but are not confined to them. The Soviet Union's economic policy was founded on 'primitive socialist accumulation' and 'capital fundamentalism' was an earlier feature of the development strategies of many developing countries. But as the experience of such countries and the contrasting experiences in the 1990s of the United States (which has one of the lowest savings rates as conventionally measured) and Japan (with a high measured savings rate) shows, savings and economic growth are not necessarily closely related in economies with open and well developed financial markets.

A successful effort to raise national savings and investment rates might have little effect on economic growth. A basic growth model suggests there would be a one-off increase in per capita income but no permanent effect on the rate of growth. More sophisticated models produce similar results. Consumption per head – which is what we are seeking to maximise – could actually fall because of the greater burden of capital depreciation.

Several other relevant points emerge from the economic literature about the relationship between savings, investment and growth:

- the magnitude of net saving in advanced economies is only a tiny fraction of the value of the existing capital stock. Policy initiatives that improve the use of the entire capital stock can have a much larger effect on national output;
- in open economies investment is not constrained by domestic savings. Financial sector liberalisation means that firms can access vast global capital markets – profitable investments are unlikely to go begging for lack of funds;

- the causal connection between savings and growth may not run in the direction that is commonly supposed. Some researchers have concluded that growth drives savings rather than the other way round, and that savings typically rise with per capita income; and
- modern accounts of growth, including the so-called 'new growth' theories, place primary emphasis on the importance of policies and institutions that are conducive to high levels of economic freedom as the key determinants of productivity and innovation.

A second recent Treasury paper confirms these general findings.<sup>3</sup> It notes that New Zealand's average investment rate at around 22 percent of gross domestic product (GDP) ranks in the middle of OECD rates, and finds that "there is no obvious link between domestic saving, investment, the current account and real output growth." It also finds that the supply of venture capital does not appear to be a significantly constraining factor for New Zealand, thus implicitly questioning the government's recent incursion into this field. The authors conclude that "policies to promote domestic saving are unlikely to enhance economic growth. Such policies would need to be justified on other grounds."

### **Should governments seek to influence savings?**

Savings are not an end in themselves – rather they are a means to future consumption opportunities. It is hard to see why governments should attempt to dictate the choices people make between present and future consumption. Consider two scenarios.

First, Michael Novak tells the story of two professional women who opt for very different lifestyles. One lives frugally but saves significant sums every year and ends up with a million dollars in mutual funds and a pension. The other enjoys the good life, food and travel, and ends her career with just enough to make ends meet in retirement. Do these sisters envy each other? On the contrary. They feel sorry for

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<sup>3</sup> Iris Claus, David Haugh, Grant Scobie and Jonas Törnquist, 'Saving and growth in an open economy', Treasury Working Paper 01/32.

one another. Each thinks the other is crazy. Why should a government interfere with their choices?

Second, suppose that governments could somehow force people to save more and that higher savings led to higher growth. Would that be a good thing? Governments could also legislate for a 60-hour week which would boost GDP, but most people would regard themselves as worse off. Income and wealth are at best very imperfect measures of welfare – forgone consumption and forgone leisure in the respective cases would offset the income gains for most people.

In fact, there is little evidence to suggest that governments can materially influence national savings levels other than through their own decisions on government savings (budget surpluses) or dissavings (deficits). Study after study has shown that compulsory savings schemes and tax incentives for savings alter and distort savings patterns but have little or no effect on aggregate savings. The Tax Review concluded:

[E]ven if it were considered desirable for New Zealanders to save more, there is little evidence that changes to the tax system will induce higher saving, other than by redistributing income from those who are less likely to save (typically, poorer households) to those who are more likely to save (typically, wealthier households).<sup>4</sup>

This is consistent with OECD advice that "the theoretical and empirical evidence provides hardly any firm ground for relying on tax policy to affect private savings levels on a significant and permanent basis."<sup>5</sup>

Why then, despite the evidence, do governments have a perennial urge to interfere in savings decisions? One answer is that some politicians simply want to run other people's lives. Another is that they can buy votes by bribing taxpayers with their own money. Also there is constant lobbying from vested interests for government intervention. To its credit, the Investment, Savings and Insurance Association stated in 1999:

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<sup>4</sup> *Op cit*, p 93.

<sup>5</sup> *OECD Economic Surveys: New Zealand*, December 2000, p 127.

The ISI is not looking for favoured tax treatment for the products its member companies sell. New Zealand does not need more inequities in its tax system.<sup>6</sup>

The government has also recently rejected a return to tax incentives, although it created one with its increase in the top personal tax rate to 39 percent by introducing a gap between the tax on fund earnings and the tax rate of many investors. However, vested interests have a habit of coming back, and the National Party has mooted the idea of reintroducing tax incentives. This should be opposed as having no basis in professional analysis.

Does all this mean that there is no reason for concern about savings patterns and levels in New Zealand? To the contrary. It is true that the environment for savings was improved with lower inflation, deregulation of the financial system, the introduction of GST and an end to public sector dissavings. However, there have subsequently been backward moves, including higher levels of government spending and hence the overall tax burden, and a widening of the tax scale which has accentuated distortions such as the treatment of housing and increased administration and compliance costs. In addition, the government's extensive role in health, education, housing, welfare and retirement incomes reduces the need for self-provision – why save if the government does the job for you?

It follows that the environment for saving could still be materially improved. The income tax at its present level discourages savings: the earlier strategy of reducing the government spending ratio in the economy and moving to a lower and flatter tax

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<sup>6</sup> Investment, Savings and Insurance Association of New Zealand, *Towards an Ideal Taxation Regime*, August 1999, p 2.

scale has not been carried through. The reintroduction of tax incentives as proposed by National would be a further retrograde step: at an annual cost of around \$145 - 170 million, it would limit the scope for cutting the top rate by about 2 percentage points, or a third of the Labour-Alliance government's increase. Political parties that are serious about returning New Zealand to the top half of the OECD income ladder simply must commit themselves to lower levels of spending and taxation.

Given lower tax rates and higher disposable incomes, there is extensive scope for many middle and upper income earners to rely less on government-provided social services, which are often of inferior quality, and assume greater personal responsibility. Such changes would not necessarily increase aggregate national savings but, by conforming more closely with standard efficiency and equity criteria, they would lead to better economic and social performance.

Finally, on the specific issue of retirement incomes, the McLeod Review noted that:

... there is little evidence that most New Zealanders are currently making inadequate provision for their retirement. New Zealand's system of universal superannuation cannot be ignored in this context; it seems reasonable to conclude that virtually all current recipients of New Zealand Superannuation who have a mortgage-free home and relatively modest savings consider themselves to have at least a medium standard of living... We therefore take the view that, against the backdrop of universal provision of New Zealand Superannuation, most New Zealanders would not be well served by being induced or compelled to make additional retirement provision at the expense of living standards during their working lives.<sup>7</sup>

The residual question, of course, is whether current government retirement policies are optimal. Regrettably, this is still not the case. Despite some moves to improve the environment for savings and modify the government scheme, there have been backward steps, such as the move to universality and the increase in the benefit rate. The new Superannuation Fund is another diversion which will do nothing to solve the long-term problem. The key point to keep in mind is that rather than having a narrow focus on savings, the focus of retirement income policies should be on economic growth. As one study put it:

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<sup>7</sup> *Op cit*, p 94.

The key to providing high incomes in retirement is the pursuit of policies promoting high economic growth. Policies to this end are rarely focused just on retirement and superannuation issues but cover taxation, government spending, government regulations, labour market arrangements, and the incentive and reward structures facing individuals, private business enterprises and governments. With an expanding economy, most people should be able to self-provide for their retirement income, and should face incentives to save and to consume which are level and fair across their lifetime: the basic role of a government pension is to provide a bottom safety net against the problem of aged poverty.<sup>8</sup>

Federal Reserve chairman Alan Greenspan recently made a similar point about growth when he told a National Summit on Retirement Savings:

Retirees may have accumulated a large stock of retirement savings, but the goods and services needed to redeem those savings must be produced by an active workforce assisted by a stock of plant and equipment sufficiently productive to meet the needs both of retirees and of a workforce expecting an ever-increasing standard of living.

Though from the point of view of an individual household, saving reflects financial claims adequate to meet future needs, the focus for the economy as a whole, of necessity, must be on producing the real resources needed to redeem the financial assets.<sup>9</sup>

## **Conclusion**

As I read the economics literature, saving is not a controversial issue – the general conclusions of this paper have been well established. Most of what we think we know just ain't so. In particular:

- The measurement issues with savings are well known, and there has long been scepticism that, given appropriate adjustments, savings rates across countries vary as widely as is often assumed.
- There is no convincing evidence that New Zealand's savings record is poor.
- Theory and evidence indicate that domestic saving and investment is but one source of economic growth, of less importance in advanced countries than

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<sup>8</sup> Anstie, R, Freebairn, J and Porter, M, 'Superannuation and government aged pension schemes for a dynamic economy', Centre of Policy Studies, Melbourne, May 1989.

productivity-enhancing factors. A legitimate concern for New Zealand's inadequate growth performance should focus systematically on growth issues.

- There are no clear grounds for government efforts to alter people's consumption and savings choices, given a policy environment in which choices are distorted as little as possible.
- Tax incentives and compulsory savings proposals in particular should be rejected as ineffective, distorting, inequitable and illiberal policies. As one researcher has put it: "[S]aving-inducing tax plans are attacking a problem that does not exist with a mechanism that will not work in order to achieve a goal that would harm the economy."<sup>10</sup>

Rather, the debate in New Zealand should move on from concerns about macroeconomic savings aggregates to issues such as levels of spending and taxation and the boundaries between state and private responsibility for the provision and funding of social services, including retirement incomes. The purpose of this debate should not be to engineer particular levels and forms of savings but to improve economic incentives, encourage more efficient savings and investment decisions, and enhance overall economic and social performance.

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<sup>9</sup> Alan Greenspan, 'Saving for Retirement', National Summit on Retirement Savings, Department of Labor, Washington DC, February 28, 2002.

<sup>10</sup> Neil Buchanan, *Journal of Economic Issues*, vol 33 No 1, March 1999, pp 59-76.