THE TREASURY
Kaitohutohu Kaupapa Rawa

Better saved than sorry: The Treasury's position on New Zealand's saving performance

John Whitehead, Secretary to the Treasury

Chapman Tripp, Wellington

13 August 2007

[Slide 1: Title slide]

Hello everyone, and thank you for the opportunity to speak to you this evening.

When there is a broad range of economic issues that the Treasury could talk about, you may wonder why I've decided to focus exclusively on the topic of saving. Perhaps I can explain it to you this way. Imagine for a moment that instead of the Treasury being a team of analysts studying the economy, we were a team of zoologists studying an un-named animal. There would be one group of commentators looking at our work and proclaiming "Treasury says the animal has poison glands and is found in Australian waterways. It must be a jellyfish." Another bunch of pundits would state "Treasury data shows it's a furry brown marsupial that lives in a burrow, so it's probably a wombat". Then a third cohort of experts would say "Hold on, according to Treasury the animal has a bill, webbed feet and lays eggs, so it's clearly a duck". Of course, what we've really been looking at all along is a platypus.

We find ourselves in a similar situation with public perceptions of our work on saving. The different elements of our saving-related work are being viewed individually rather than considered collectively. As a result, too many people just aren't seeing the big picture.

Tonight I'd like to bring that big picture into clear focus. I'll tell you what the Treasury's position is on New Zealand's saving performance; why we have taken a position on saving, and how we arrived at our position. I'll also outline why we believe a pro-saving push is the right thing to do. Lastly, I'd like to give you a sense of what the Treasury's approach will be as we continue to examine saving-related issues.

What our position is

To get straight to the point, here is where the Treasury stands. Having considered recent data, evidence and analysis, on balance we think that further or stronger pro-saving action is now justified. We have therefore advised the Government to encourage more private saving.

Let me just say upfront that the Treasury is not calling for compulsory saving. We recognise that saving is not necessarily the right approach for all individuals at all stages of their life.

Our judgement for further or stronger action rests on a least-regrets approach in light of data uncertainties, macroeconomic imbalances, and the possibility that individuals are basing savings decisions on long-run expectations that could turn out to be mistaken.

Put concisely, our stance is "better saved than sorry". I'll touch on several reasons for this stance later, but for those of you interested in a more in-depth explanation, I've brought along hard copies of a Treasury Report that details the evidence and analysis underpinning our position on New Zealand's saving performance. You can also get the report from our website.

Why we have taken a position on savings

As Secretary to the Treasury I believe it is important that we have a well-considered and consistent view on saving, and to communicate that view widely. It really comes down to the basics of what we do as an organisation and why we do it.

The Treasury is the Government's lead advisor on economic and financial policy. It's important that we are able to articulate a clear position on saving and other matters of significance to the New Zealand economy, otherwise we would not be doing the job the Government, the public and I expect us to do. But more fundamentally, the Treasury is working for higher living standards for New Zealanders, and we aim to make a difference on the things that matter. There are three key outcomes that are driving our work:

- Economic Growth, which is vital to increasing New Zealanders' living standards;
- Macroeconomic Stability, which is an essential precondition to growth; and
- State Sector Performance, which is crucial for the effective delivery of public services and the management of the Crown's assets and liabilities.

Economic growth and macroeconomic stability are both strongly influenced by New Zealand's saving performance. For the Treasury to have a positive impact on these two outcomes, it's important that we have a firm grasp of saving-related issues and the confidence to act on them when required.

Another reason why we decided to articulate our position is that we are keen to present a view on saving across all aspects of data and evidence. The Treasury Report we released in May took into account the large amount of analysis we've done on many aspects of saving in recent years. Until our report came out, we had released only portions of our total body of work. An example that some of you here might be familiar with is the analysis by Grant Scobie and others of Statistics New Zealand's Survey of

Family, Income and Employment – or SOFIE for short – and its earlier Household Savings Survey. This research added to our body of knowledge about retirement income for a particular cohort of individuals. But it is only a part of the story the Treasury has on saving, not – as some would suggest – the whole story. We felt it was important for the totality of the Treasury's work to be in front of Ministers and the public.

I'm conscious that some people may feel the timing of the release of our saving position was just a little too convenient, given it came right after the Government's Budget announcements on KiwiSaver. But we make no apology for releasing the work when we did. I commissioned the Treasury Report on saving a couple of months before the Budget, and believe putting it out straight after the Budget was absolutely the right time to release it.

The timing has coincided with a peak in public and political focus on saving-related issues. Just consider the current environment. KiwiSaver has recently been launched, the member tax credit has started, and other significant enhancements are due to take effect from next year. Parliament's Finance and Expenditure Committee is currently considering submissions on the details of KiwiSaver. The same committee is also conducting an inquiry into our monetary policy framework. And from just about every quarter we hear arguments and counter-arguments on what needs to be done about interest rates and exchange rates.

By releasing the Treasury's position on New Zealand's savings performance, our aim has not been to join the fray of public debate, but to help inform and provide context to public debate.

It was clear to me that better information and context was needed when I considered how the Treasury's savings work was being covered in the public arena. Frankly, I was concerned about how our work was at times being misunderstood and, perhaps because of this, misrepresented.

In particular, media coverage of Grant Scobie's work did not paint the full picture of the saving issue and the Treasury's collective view on it. Instead, we had a string of stories and opinion pieces insisting that the Treasury view was New Zealanders were saving adequately for retirement and there's no saving problem. This ignores the caveats in the original research. It ignores the distinction between saving at the big picture macroeconomic level and saving at the small picture retirement level. And it ignores other important questions such as "What constitutes 'adequate' retirement income?" and "Is there a problem when a significant minority are not saving adequately for retirement?".

It became apparent that we had to set the record straight and explain our position fully and publicly. If some people have been looking at our work through a keyhole, it's up to us to fling open the door.

How we arrived at our position

Arriving at a Treasury position on saving was not an overnight process, and it's true to say we have expressed different perspectives in the past. Some wag might suggest that the Treasury's opinion on pro-saving action sounds like a cricket batsman calling for a quick single with "No!... Wait!... Yes!" (and hopefully not followed by "Sorry!"). We think it's more accurate to say that as conditions change, there has been – and rightly should be – an evolution of our view. I'd now like to take a moment to explain some of the process, new information and analysis that has shaped this evolution.

It would be great if there was a clear and straight path to take on saving, but unfortunately the path looks more like an obstacle course. Despite interest in the topic, and new data and research, the policy analysis of saving is very difficult because no one set of data allows you to draw categorical conclusions.

In 2003, the data suggested to us that although the level of private saving was low in New Zealand, there were grounds to expect household saving would increase, so there was no strong case for active policy intervention. The thought was that the one-off boost to borrowing and consumption from economic restructuring and financial deregulation would have largely run its course, plus there was a growing number of baby boomers reaching their prime saving years.

What actually happened, however, was household saving by a number of measures continued to decline, while macroeconomic vulnerabilities such as the current account deficit continued to grow.

By 2005, the OECD and Reserve Bank were expressing concern about low national and household saving, the increase in household debt and external debt, and the implications for financial and macro stability and for future living standards. Our own views had moved on by then too. While the Treasury did not see a strong case for compulsory individual saving or significant direct government subsidy of private saving, we did recommend a suite of policies that err toward giving private saving some support. The policies we recommended in 2005 included facilitation of work-place saving, better financial education, and more focus on long-term fiscal planning and transparency. It's satisfying to see these policy recommendations are now in place.

In the intervening two years we have had a full work programme on saving and related issues. We have been addressing these issues from a medium and long-term perspective, and considering not just retirement saving, but also macroeconomic factors and financial system development. There's the SOFIE-based work that I touched on earlier, looking at micro patterns of individual and couple income, wealth and saving. You might also be familiar with the joint Treasury-Reserve Bank investigation of supplementary stabilisation instruments and our follow-up Macro Policy Forum – which aimed to see what other tools could be effective at helping monetary policy rein in inflation and tackling macro imbalances. Mentioning things such as "mortgage interest levy" and "ring-fencing residential property investment losses" might jog your memory. I should also mention that we have a substantial joint work programme with the Ministry of Economic Development on the interactions between saving, financial system development, investment and economic growth.

As the scope and depth of our work has given us a richer view of the saving issue, we came to realise that the Treasury position on saving needed to be revisited. Earlier this year we systematically set about bringing together work and new information from within and outside the Treasury to help form this position.

First up, we considered the basics of a saving framework, starting with benefits and costs. Saving benefits New Zealand in many ways. It improves the financial resilience and incomes of individuals, and indeed the country. It increases the diversification of household balance sheets over time. It can lead to reductions in New Zealand's current account deficit, external debt and cost of capital. And it fuels the growth and development of New Zealand's financial system. There are, of course, costs as well. These include the sacrifice of current consumption, a government financial cost, and efficiency costs of incentives and regulations that distort behaviour.

We also looked at what motivates people to save. There's life-cycle saving, where you choose how much to save or consume and how much to work over your lifetime. There's precautionary saving, where you save to protect yourself and your family from unexpected events such as job loss or health problems. And there's bequest saving, where you work hard to accumulate an estate for your children to squander on fast cars and expensive booze once you're gone.

Another factor we considered was saving by the household, business and government sectors, and also how these sectors influence each other. To understand household saving behaviour one needs also to take into account the saving being done by businesses and by the government. For example, some major government programmes, such as New Zealand Superannuation and the national health system, serve as partial substitutes for private saving and insurance. These programmes play an important role in people's lives and affect their long-term saving decisions.

Within a savings framework, we also factored in New Zealand's long-term fiscal position and took account of the pressures that will shape policy choices. These pressures include an aging population and the associated permanent shift in population structure, increasing Budget constraints, income and wealth inequality, and increasing financial complexity. There's also a question of how we build not just financial capital, but human capital. New Zealand has to compete to attract skilled workers from around the world. This environment makes setting policy for saving a tough challenge.

In addition to exploring some of the theory around saving, we turned our attention to the reality of overseas evidence on incentives and compulsion.

Across the Tasman, Australia has compulsory employer superannuation contributions of 9%, relaxed taxation, and strict lock-in until 60. The impact is a tripling of superannuation assets in 20 years, which is one heck of a shot in the arm for their financial system development. It's also estimated that their household saving rate would have been lower by 1.5% of GDP by 2001/02 without compulsory super. While compulsion has contributed to higher saving rates, there's also evidence that compulsory saving has been partially offset by switching behaviour. While switching behaviour is difficult to estimate, the Reserve Bank of Australia found 35c to 50c of every dollar of compulsory saving is offset by reducing other saving or increased borrowing.

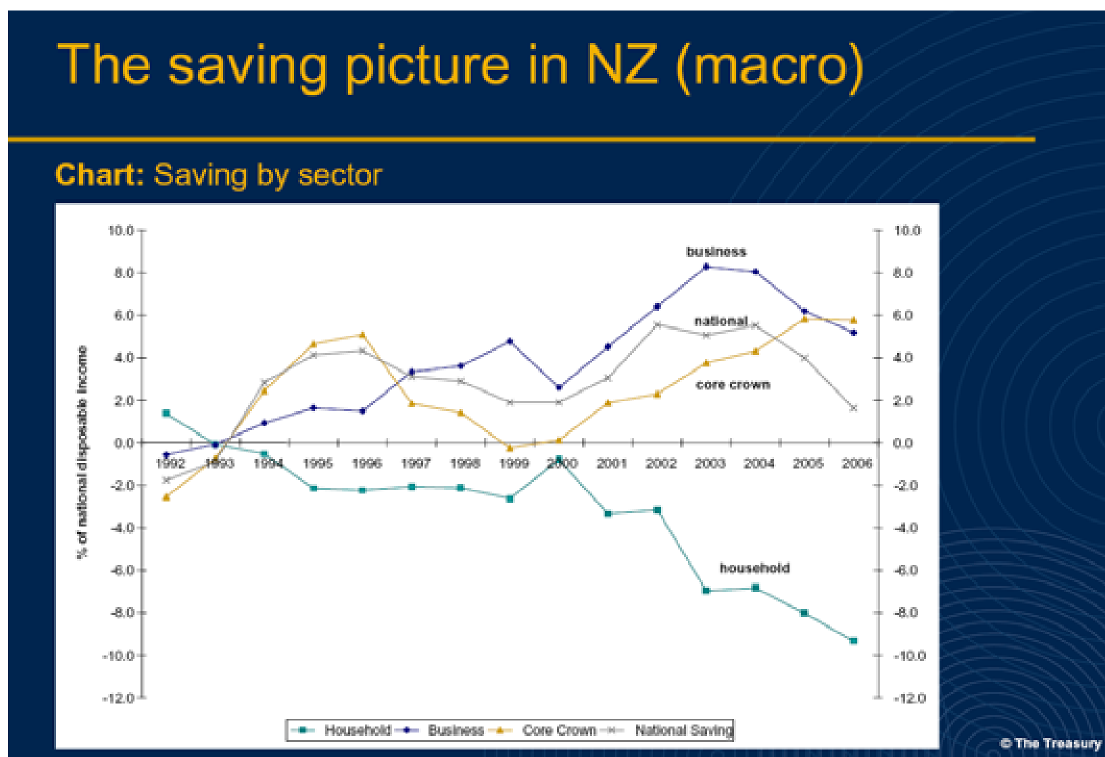
Over in the US there are a number of different schemes, including a tax-favoured programme with the not -so-inspiring title of 401k. When entry to a 401k programme was made the default for employees, understandably there was a substantial increase in participation.

Elsewhere in the Americas, the Chilean superannuation scheme involves compulsory contributions from both employers and employees. According to at least one study, there has been a significant impact on Chile's national saving, financial system development and GDP.

But what about the saving picture here at home? I'd liken it to one of those three-dimensional images, the ones with the seemingly disjointed pattern that you have to stare at and stare at for ages until some sort of comprehensible shape materialises – if you don't give up in frustration first. The secret is that you have to keep your eyes on the entire picture.

With saving, it is difficult to keep the big picture in your sights because there many different ways saving can be measured. There's the macro-level view versus the micro or household level view. You can measure the flow of saving, which is income not spent on current consumption. Or you can measure the stock of wealth, and estimate saving as the change in net worth between the beginning and end of a period. If all this sounds complicated, that's because it is, but I'll do my best to explain some of the measures that informed the Treasury's position on saving.

[Slide 2: The saving picture in NZ (macro)]



First of all, macro-level data indicates our national saving was around 4% of disposable income in 2005 and dropped to 1.6% last year. For the last decade we've been fluctuating in the 2% to 6% range. That puts us well below the OECD median. In international terms we've got a very big hole in the bottom of our pockets, and our national saving is dropping rather than rising.

Our national-level savings picture is thought to be pretty robust. However, when we break things down to a sector level, we run into problems. New Zealand does not have official saving data by sector – households, business, government and so on. This chart uses the still-experimental Household Income and Outlay Account or HIOA measure from Statistics New Zealand, and indicates household savings rates declining since the early 1990s and nose-diving since 2001. An alternative measure from the Reserve Bank shows a less dramatic but still declining trend into negative territory.

[Slide 3: International comparisons suggest NZ has low household saving]

International comparisons suggest NZ has low household saving

Table: Selected country household saving rates (period averages as a % of household disposable income)

	1970s	1980s	1990s	2000-2004	2005
Australia	14.2	11.1	5.4	-0.5	-2.6
United States	9.6	9.1	5.2	2.1	-0.4
Canada	12.0	15.3	9.1	3.4	-0.2
Germany	13.1	12.8	11.4	9.9	10.7
France	13.2	9.5	11.6	12.2	11.6
Netherlands	4.1	14.3	14.1	8.4	5.7
Japan	23.7	16.3	12.4	5.0	2.4
New Zealand	3.6	2.8	-1.6	-7.2	-14.8

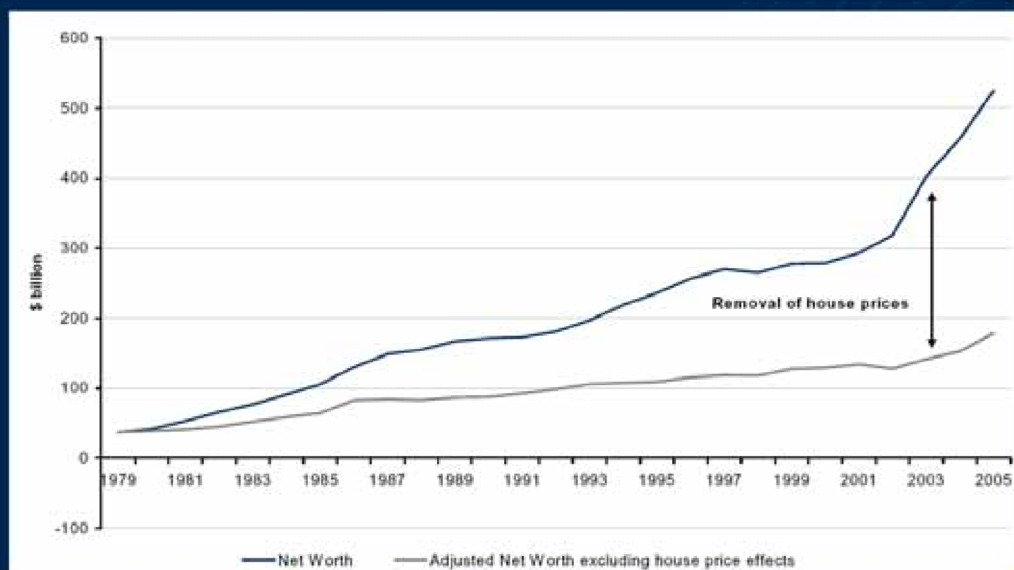
Data for Japan for 1970s are for period 1972-1979. Source: OECD

© The Treasury

We also have this data from the OECD which suggests New Zealand's household saving rate languishes well below those of other countries.

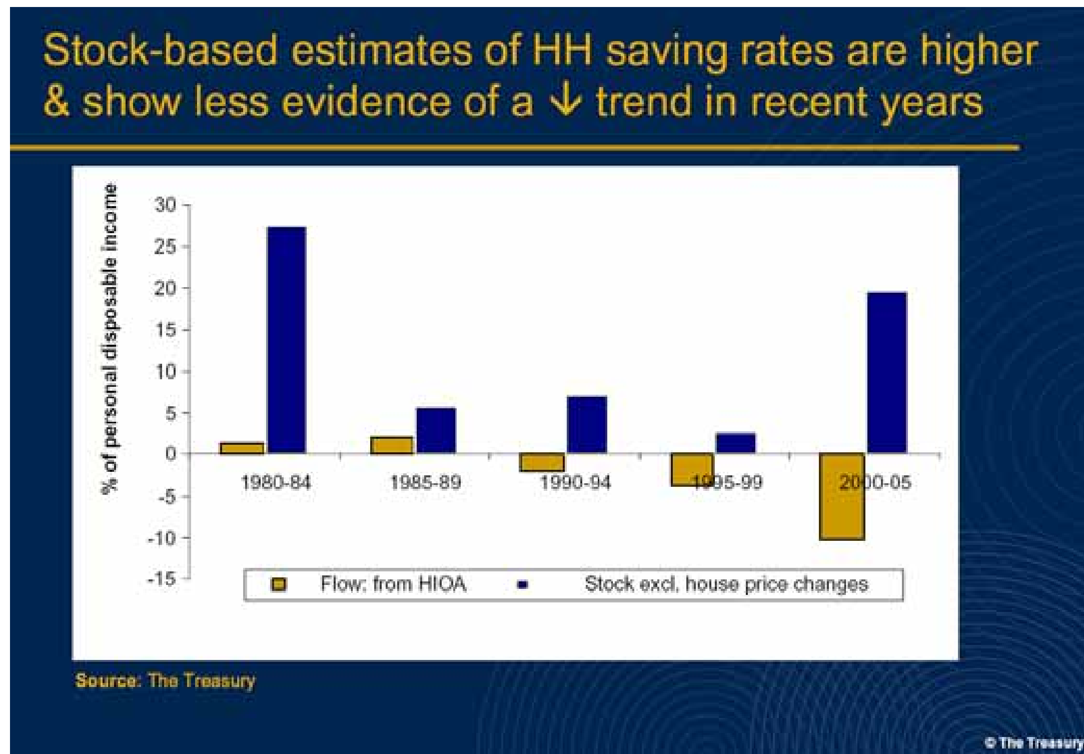
But here's where things start to get murky.

[Slide 4: Stock measures suggest that wealth has increased even after allowing for house price increases]



When we look at stock measures of household wealth, it suggests that wealth has increased even after allowing for house price growth.

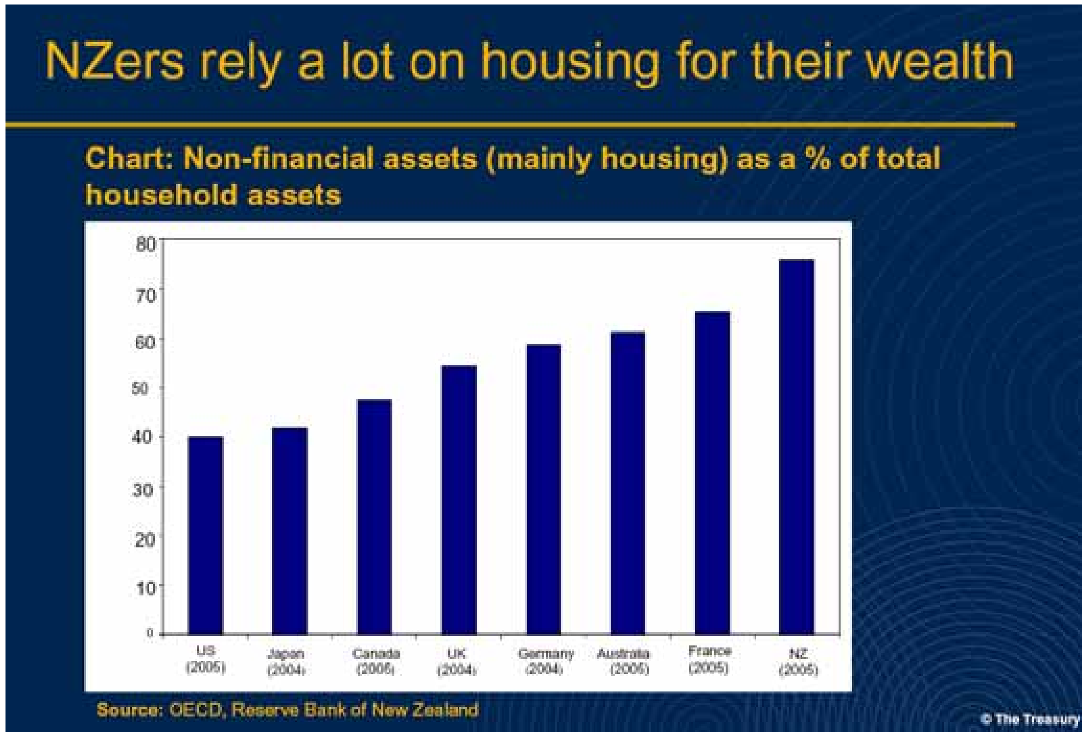
[Slide 5: Stock-based estimates of HH saving rates are higher and show less evidence of a ↓ trend in recent years]



Compared here with the HIOA measure, we see a diverging story. The stock-based estimates of household saving rates are higher and show less evidence of a downward trend in recent years.

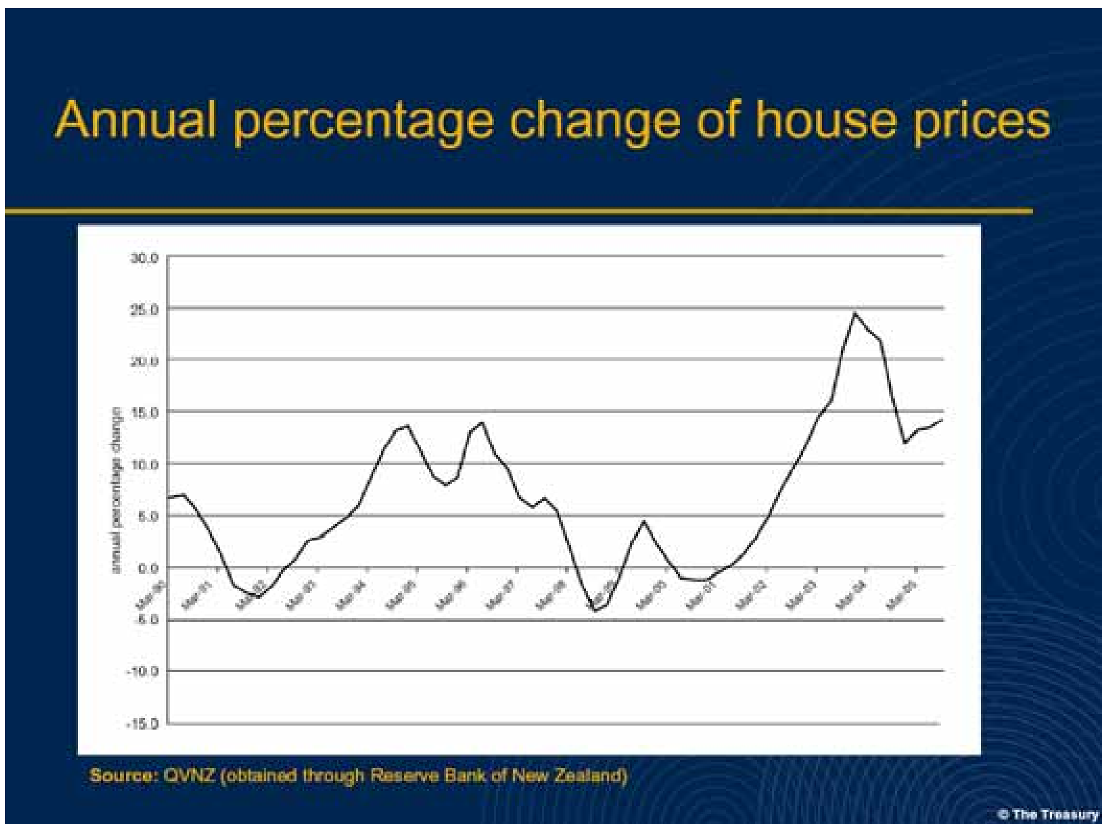
The bottom line for the Treasury is that the available data do not give us a clear picture on household saving, so there is little that can be confidently concluded. In an effort to get better macro data, Statistics New Zealand with support from the Treasury and the Reserve Bank have a project underway to develop a full set of institutional accounts.

[Slide 6: NZers rely a lot on housing for their wealth]



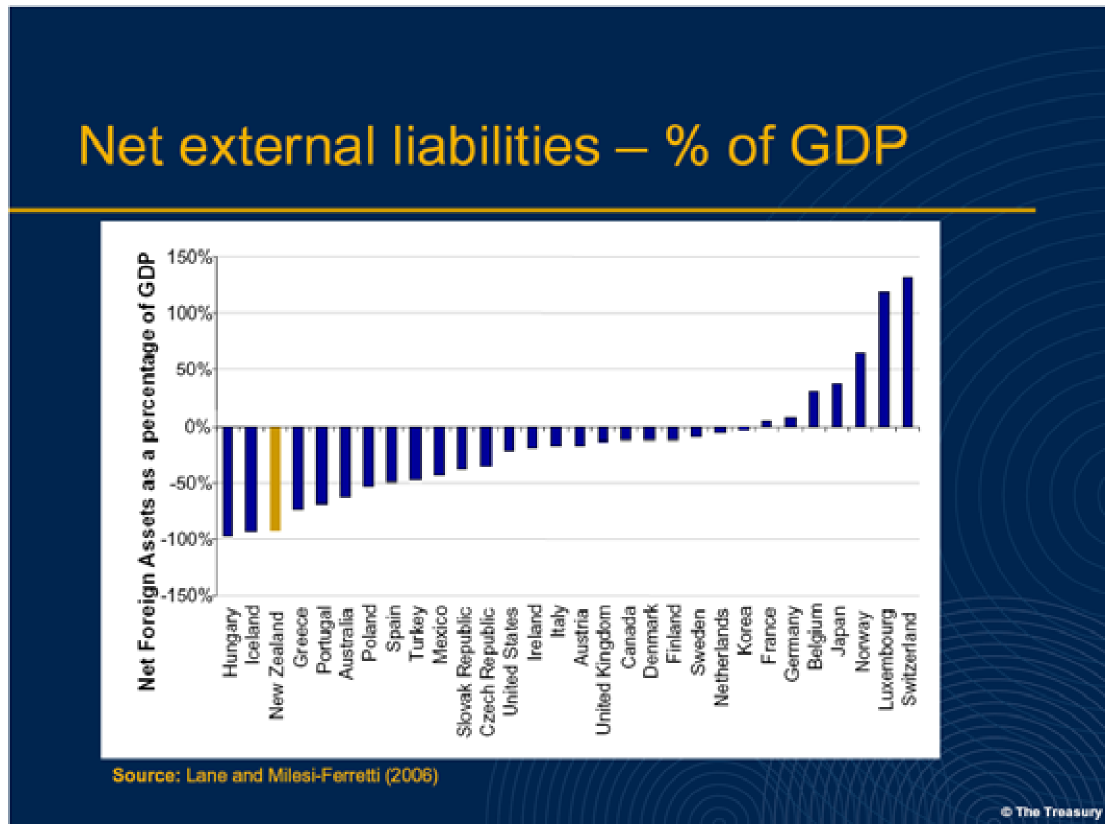
One thing not in question is that New Zealanders rely a lot on housing for their wealth. This chart of non-financial assets as a percentage of total household assets is a good indicator of how much we have locked up in housing. In our love affair with housing, we even manage to out-passion the French.

[Slide 7: Annual percentage change of house prices]



The growth in house prices in the last few years has had the effect of making homeowners wealthier. This wealth effect tends to make people willing to consume more through, for example, borrowing more against their assets. Perhaps a look at the three dips in the graph over the last 15 years might be a sobering reminder that house prices don't always go up; they sometimes go down. In fact the national median house price has dropped for the last two months. In some other countries house prices have gone significantly negative at times.

[Slide 8: Net external liabilities - % of GDP]



If we need more sobering up, there's always the current account deficit and its impact on our net external liabilities to consider. A lot of our assets are either foreign-owned or financed by loans from foreigners, and the income that those overseas investors earn from New Zealand-based assets outweighs the income that we earn from offshore assets. This is a big component of our current account deficit.

I don't want to get into too much detail here, but I should say that New Zealand's current account deficit and net external liabilities partly reflect savings trends. Both are at levels that are around the highest in the OECD, and in the case of the current account deficit, the current level is unsustainable. If it continues, our very high ratio of net external liabilities to GDP will grow even larger.

When we shift from macroeconomic data to microeconomic data, we still find the view on saving pretty foggy.

Unfortunately there are no surveys in New Zealand that are specifically designed to measure the flow of saving at individual household level. While the SOFIE data I mentioned earlier will eventually assist in some respects, at the moment we have to rely on the Household Economic Survey, which has too many shortcomings to provide the basis of firm conclusions.

[Slide 9: The savings picture in NZ (micro)]

The saving picture in NZ (micro)

Table: Holdings of super schemes - by types of schemes

	Percent of population who hold a scheme (%)	Mean value of scheme ($)	Median value of scheme ($)
Workplace superannuation scheme	8.2	72,800	26,200
Personal superannuation scheme	12.0	40,500	15,600
Any superannuation scheme	19.3	56,200	20,000

Source: Treasury's calculations based on 2001 Household Savings Survey data for individuals aged 18-64

Table: Holdings of any super scheme - by income quintile

Quintiles of income	Any superannuation scheme		
	Percent of population who hold a scheme (%)	Mean value of scheme ($)	Median value of scheme ($)
1	1	67,400	24,400
2	2	43,300	14,500
3	4	40,200	15,200
4	6	51,500	22,800
5	7	71,700	25,000
Total	19	56,200	20,000

Source: Treasury's calculations based on 2001 Household Savings Survey data for individuals aged 18-64

© The Treasury

Thankfully we have better information on New Zealanders' net worth from the Household Savings survey. In general terms what this data tells us is that New Zealanders appear to invest relatively little in superannuation assets, and what's not shown here is that the total assets we invest in superannuation lags behind other countries such as the US and Canada. Something we have to bear in mind of course is that KiwiSaver could give these figures a pretty big shake-up.

[Slide 10: The saving picture in NZ: ages 45-64]

The saving picture in NZ: ages 45–64

Table: Proportions of the population who may be saving inadequately for retirement

	Baseline (%)	Adjusted (%)	Low-middle Incomes, adjusted (%)
Non-partnered individuals			
Ages 45-54	34	19	14
Ages 55-64	28	9	10
Couples			
Ages 45-54	37	30	34
Ages 55-64	37	14	23

Notes: The adjusted scenario assumes a decline in retirement consumption with age and introduces a cap on retirement consumption, which results in lower prescribed saving rates. "Low to middle incomes" is the group of people earning between $15,000 and $50,000 per annum.

Source: Le, et al. (2007) and The Treasury

© The Treasury

The final piece of the micro picture I need to mention is the use of SOFIE data to examine what proportion of the population aged 45 to 64 may be saving inadequately for retirement. This is the area of the Treasury's saving-related work that has attracted the most attention in the public arena –it seems at the exclusion of all else.

The work estimated the savings rates that would be required for this specific cohort of people to enjoy a level of consumption in retirement similar to what they had before retirement. As with much empirical analysis, the work also needed to make a number of simplifying assumptions that have a bearing on the results. It's a truism of empirical research that a minor change in assumptions at the beginning can yield a major change in conclusions at the end.

What the analysis showed was that while a majority of people aged 45 to 64 may be saving adequately for retirement according to the assumptions used, a significant minority are not. The reasons why people are deemed to be saving adequately in this research are also important. Of course, some have already saved enough by accumulating sufficient wealth to maintain their current consumption in retirement. Other people may be saving adequately at the moment, but will have to maintain their saving rate even if they leave the workforce prior to turning 65, as a significant number of people do. And another large group has such low current incomes that it makes no sense to save for retirement, given that New Zealand Superannuation alone is enough to maintain or indeed increase their level of consumption once they retire.

The analysis also shows that inadequate retirement saving affects a higher proportion of people on low to middle incomes. What should also be noted is that whether or not people are saving adequately for retirement, it may be wise for them to save for other purposes, for example in case they cannot earn as much in later years, for future health care, in case they live longer than expected in retirement, or for bequests. Although this cohort analysis is valuable and interesting, it should be used cautiously, and it is also only one part of the picture.

Allow me to reiterate the Treasury position. Having considered recent data, evidence and analysis, on balance we think that further or stronger pro-saving action is now justified. Our judgement for further or stronger action rests on a least-regrets approach in light of data uncertainties, macroeconomic imbalances, and the possibility that individuals are basing savings decisions on long-run expectations that could turn out to be mistaken.

Why pro-saving action is justified

In such circumstances, some might argue that perhaps New Zealand shouldn't be too hasty; maybe we should sit tight for a bit longer and wait to see what happens. But as I explained earlier, the Treasury has come to a different conclusion through looking at matters from a medium and long-term perspective, and considering not just retirement savings but also macroeconomics and financial system development. In the words of noted economic luminary Jim Morrison from The Doors, the time to hesitate is through. We are convinced that stronger pro-saving action is desirable for precautionary reasons, growth reasons and effectiveness reasons.

Let me run through a few of the precautionary reasons.

First, increased savings can have an impact on the persistent macroeconomic imbalances New Zealand is facing – the unsustainably high current account deficit and net external liabilities. If we save

more of our own money, New Zealanders can own more of our own assets (or more of others' assets) and borrow less from the savings of the oft-mentioned Belgian dentists and Japanese housewives.

Second, New Zealand faces the strains of an ageing population. Just as it makes sense to prepare for some of this via the New Zealand Superannuation Fund, it also makes sense to encourage people to take action on their own personal saving.

Third, our household saving appears on some measures to be very low and undiversified. Some people aren't putting enough money away for retirement, and are instead putting all their nest-eggs into the single basket of housing that can drop in value as well as increase.

Fourth, there are saving data uncertainties at a micro and a macro level. When the data doesn't provide a clear picture, it's better to take precautions now than to be sorry later. That's why there's seatbelts in cars, life-jackets on boats, and an insurance industry.

There are also a number of growth reasons why pro-saving action makes sense.

Higher saving creates higher income for New Zealand and New Zealanders. It makes more money available for investment in productive assets, and therefore increases our wealth over time.

We have also seen in Australia and Chile that there is a likely positive impact of higher household holding of financial assets on financial system development. In turn, there is robust evidence of a causal effect of financial system development stimulating economic growth.

Saving that directs more money into financial assets rather than housing will benefit economic growth. Our economy is better off growing the stock market than it is feeding the house market.

Another plus for growth is the positive impact that increased saving could have on the current account deficit and exchange rate. A lower exchange rate would help the tradeable sector – those businesses that earn New Zealand a living in the world.

Some other reasons for pro-saving action are based on evidence that well-designed intervention can be effective in raising saving without triggering too much additional government spending. This includes international evidence on compulsion and savings incentives. As you've heard, Australia's compulsory superannuation and relaxed taxation has helped make their saving rate 1.5% of GDP higher than it otherwise could have been. There's also evidence on the power of default settings, in other words automatic enrolment. Participation in the American 401k programmes increased substantially when people had to opt out rather than opt in. And lastly, well-designed interventions to encourage private saving can leave scope for the government to maintain its own saving and limit the potential inflation impact.

So if pro-saving action is good in theory, what should it look like in practice? The Government's flagship initiative for increased saving is KiwiSaver, and you probably want to know what the Treasury thinks about it.

I'm not here this evening to play the role of Kiwi Saviour or a Kiwi Slagger – I'll leave that debate to other people. But what I can talk about is the Treasury's guiding principles for the design of a saving scheme, which we've based on evidence of effectiveness in other countries and New Zealand's current position.

Our guiding principles are that a saving scheme should:

- Avoid generous tax benefits to high-income earners [did I hear moans of disappointment from the crowd?]
- Have automatic enrolment
- Lock savings in
- Avoid a decline in government saving
- Avoid the inflexibility of full compulsion
- Reduce rather than stimulate property demand
- Hold savings in well-managed privately-owned funds, with a good range of choice
- Be supported with a sound and robust regulatory system and financial education.

I'll leave it to you to work out for yourself how KiwiSaver and its proposed enhancements appear to stack up against those principles.

Where to from here?

I'd like to close by letting you know what you can expect next from the Treasury on saving issues. Establishing our position on saving doesn't mean our work is done in this area – far from it. We have a full work programme that will continue to improve our knowledge and inform our thinking. We will keep looking at new evidence and asking questions. We will keep testing how pro-saving actions are working, and investigating whether the results we expect are in fact coming about. The Treasury is working in a dynamic space, where uncertainty is part of the landscape and being 100% definitive is rarely possible. In this environment, the Treasury will do its best to ensure that New Zealand's saving performance reflects the words of Frank Sinatra: "Regrets, I've had a few, but then again, too few to mention".

Thank you.