

Response to the Tax working group interim report

October 15th 2018

Comments on chpt7: Retirement savings

It is good to see that the Retirement income policy objectives are clearly focused on the individual and not on national saving:

The overall objective of retirement income policy is to minimise economic insecurity in old age. New Zealand achieves this objective through three main tools:

- *New Zealand Superannuation alleviates the risk of old age poverty by providing a universal benefit to all New Zealand citizens and residents 65 and over (subject to some residency restrictions).*
- *The KiwiSaver scheme supports private saving to maintain a standard of living in retirement over and above the level guaranteed by New Zealand Superannuation.*
- *Private decision-making on retirement saving is supported by measures to improve the financial literacy of New Zealanders. (TWG)*

National saving is a secondary consideration in pension design. It is unlikely funded schemes increase saving but even if they did, that is not the issue.

As (Barr, 2001) famously has said “an increase in saving does not necessarily increase output” For that to occur the following 3 links must apply:

- Saving must actually increase because of the funded scheme
- This is translated into more and better investment
- This investment leads to higher useful output

KiwiSaver is a very small part of overall wealth and a small, albeit growing, part of managed funds. It is dubious if growth in KiwiSaver is anything more than offsets to other forms of saving. Such offsets may be good to divert for example from overinvestment in housing but the main purpose of KiwiSaver is to provide a low cost mechanism for low/middle income earners to acquire a relative secure savings pot.

The TWG say “A greater pool of domestic savings could deepen domestic capital markets and enhance the ability of local firms to secure capital to grow.” My comment is this is what was said in 2005 and we have not seen the evidence of this so far—in fact the opposite.

The issue in NZ is not the lack of capital. There is a lack of mechanisms to allocate that capital to its highest use. Much of NZSF and KiwiSaver is invested

overseas and there is a problem of lack of NZ listings on the stock exchange. (See NZ Herald -Breaking the capital drought. October 5th 2018).

It is important for the TWG not to be diverted into arguments about national saving- it should not be the focus of retirement saving.

When the TWG say, for example, "Higher saving rates could, in principle, reduce the cost of capital and increase incentives to invest." It seems like pie in the sky. And this, "Higher national saving could also support export growth by reducing pressure on interest rates and exchange rates", while a theoretical possibility, in the real world, interest rates are driven by many other factors. Moreover it could equally be argued that more saving depresses the economy and reduces the confidence to invest. Saving does not cause investment.

When the TWG say "Savings policy may also affect the allocation of investment, for example by reducing distortions in the treatment of different asset classes." they are hinting at what follows which appears to be in the direction of making KiwiSaver more tax advantaged. The RPRC strongly disagree with this direction, preferring that distortions in housing are removed.

The Portfolio Investment Entity (PIE) regime

The RPRC is alarmed by suggesting that the PIE regime be made more generous. It is already very generous as the TWG point out. It would be much better for the top PIE rate to be raised to 33%. This would help moderate income inequality (one of the goals for TWG) and reduce avenues of tax avoidance.

The treatment of inflation

The RPRC agrees that the MTC compensates for tax on nominal interest income in KiwiSaver in times of inflation. But notes in a world where nominal interest in the bank is taxed and capital gains are vastly undertaxed, taxing nominal returns in KiwiSaver is consistent.

International comparisons

NZ should be proud of this:

"New Zealand has the lowest tax subsidy for retirement savings relative to its general system for taxing investment income" (TWG).

Other countries find it very difficult to reign in their expensive regressive tax breaks for retirement saving and look in admiration at what NZ did. Not being able to unwind tax breaks as NZ did in the late 1980s has meant countries like Ireland are struggling to bring in generic auto enrolment DC programmes (St John, 2016)¹.

¹ see also St John (2016) [Time for Ireland to bite the bullet](#), Irish Times 1 November 2016 and St John, S (2016) [We really don't know how lucky we are](#), New Zealand Herald, October 12th, 2016

RPRC agrees with the TWG when they say “a poorly-designed regime, which only slightly increases private saving and significantly reduces public saving, might actually have a net negative impact on national saving.” But national saving is NOT the important consideration here for pension design –it is surely **equity and the achievement of less inequality in retirement outcomes.**

The Group considered a range of options for encouraging greater saving through the KiwiSaver scheme and favours:

- The removal of ESCT for employees earning up to \$48,000 per annum.
- A five percentage point reduction for each of the lower PIE rates, applying to savings in KiwiSaver accounts. (The Government could also take the opportunity to simplify the PIE rate schedule, which is somewhat complex.)

The RPRC comments: The first option is of most benefit for those earning \$48,000 or more (assuming everyone has the ESC on the first \$48,000 removed- not clear from wording but if it is only for employees up to \$48,000 there are silly notch problems. Do you really want someone on \$49,000 to lose **all** the advantage of ESC tax free). This is a regressive step and women would view it unfavourably as yet another way their unpaid work is disadvantaged.

The reduction on PIE rates would apply to all PIE funds? This is again not the best way to help low income earners and does not fix the problem of the top PIE rate being less than the top income tax rate

The TWG did not consider the reinstatement of the \$1000 kick start for new KiwiSaver members over 18. This would be far more progressive than the first options considered as it does not depend on what is earned, it would be good for very low income earners and women.

Other ways to make policy more progressive need to be considered. Why have an employer contribution at all? Currently those who can't afford to be in KiwiSaver subsidise those who can. High income people who disguise their real income are likely to be able to take advantage of this lower PIE tax regime. A much better approach to levelling the playing field is to adopt the RFRM for net equity in real estate.

Women

The TWG say

“Saving patterns also differ by gender. Women’s adult lives often involve periods outside the paid workforce or in part time employment, which can result in lower government contributions to KiwiSaver and lower KiwiSaver balances than would otherwise be the case.[21]

It is a very unsatisfactory justification for the group to write:

“[21]The Group notes, however, that women also tend to receive New Zealand Superannuation for a longer period than men because of average life expectancy for women is higher.”

On average women no matter how long they live, begin retirement with lower savings and hence may have a reduced standard of living compared to men for all the years they actually live. Living longer suggests they need to be even more prepared than men instead of vastly less. But averages are distasteful- we distinguish longevity on the basis of gender because we can see gender. There is a huge overlap in the mortality curves suggesting that a true marker is probably some kind of longevity gene. Gender is a very second best characteristic.

The RPRC suggests that it is a pity that the TWG are making recommendations on retirement policy- this is supposed to be the role of the retirement Commissioner's three year annual report. Retirement policy issues are far broader than just tax.

Barr, N. (2001). *The welfare state as piggy bank. Information, risk uncertainty and the role of the state*. Oxford: Oxford University Press.

St John, S. (2016). *St John, S (2016) "New Zealand's Kiwi Saver Lessons for Ireland"*. .