KiwiSaver and national saving

Introduction

KiwiSaver is attractive for employees. People who join KiwiSaver put at least 2% of their income into the scheme, and this is matched by a 2% contribution from their employers. Government makes an initial contribution of $1000 when a person joins the scheme. It also matches an employee's contributions, dollar for dollar, with a tax credit – up to a maximum of $1042 a year. Employer's contributions, provided that they are not higher than 2%, are not taxed.

Given that contributions from employers and government add to the saving being done by households, and that so many people have joined KiwiSaver since it was introduced, the scheme will have had a considerable impact on the level of household wealth. But assessing the impact of the scheme on household saving, and national saving, is not straightforward.

Not all household saving done through KiwiSaver is new or additional saving. Some of it is saving that would have been done in other ways, like making deposits in bank accounts. Some of this other saving will have now been transferred to KiwiSaver. The truly additional saving would be the amounts that were formerly being spent, but which are now going into KiwiSaver. This is an important point to note. For any sector, provided that the sector's income doesn't change, then an increase in saving means that spending declines, where this spending is on non-investment items. Also, a decline in spending means an increase in saving.

If we can determine the truly additional saving of the household sector – which is sometimes referred to as the 'additionality' of household saving – we then know the true impact of the household sector's KiwiSaver contributions on national saving.

However, this is not likely to be the full impact of the KiwiSaver scheme on national saving. Both government and employers are making contributions to the scheme. What would be the impact of, for example, government contributions to KiwiSaver on government saving and national saving?

It may be that government contributions simply result in a corresponding decline in government saving. Hence while the government contribution would lift the measure of household saving, this would be offset by a fall in the measure of government saving.

But is this likely? Would the level of government spending on other expenditure items – items other than KiwiSaver contributions – stay the same? If it did, then government saving would indeed decline by the same amount as government's contributions to KiwiSaver. But if government cut back its spending on other expenditure items in order to pay for its KiwiSaver contributions, then government saving would decline by less than the amount of its KiwiSaver contributions to the household sector. In other words, the impact of government KiwiSaver contributions on the measure of household saving would not be fully offset by a decline in government saving, resulting in a further positive contribution to national saving.

A similar argument can be made with respect to employers' contributions. Cuts to other areas of expenditure in order to pay KiwiSaver contributions would mean that the impact of KiwiSaver contributions on the measure of household saving are not fully offset by a decline in employers' saving. However such effects do not as yet appear to be well understood. Most of the research to date has been on the additionality of household saving. Nevertheless, we do calculate an alternative estimate of the impact on national saving which takes into account contributions from government and employers, as well as the additional saving by households.

The additionality of household saving

At least two studies have looked at this issue with respect to KiwiSaver:

- Gibson and Le (2008) undertook a postal study of New Zealand residents in December 2007 and January 2008; 604 completed responses were received. The survey had 99 respondents who were aged 18-64 and in KiwiSaver. The study looked at the respondents in KiwiSaver who were 'reshuffling' saving and those who were reducing spending. It seemed that around 48% of household sector contributions were in the 'reducing spending' category i.e. they were doing additional saving. However, the authors concluded that the actual percentage of additional saving was probably lower than this, since some of the respondents in the 'reducing spending' category were probably referring to reductions in mortgage debt repayments. Given that mortgage repayments are a form of saving, these respondents could therefore have been reporting, to some extent, lower saving, rather than additional saving. The authors created a number of scenarios where they assumed that various proportions of the 'reducing spending' category were actually reducing mortgage debt. The study concluded that each dollar of KiwiSaver balances appeared to represent $0.09 to $0.19 of additional saving. However, it should be noted that KiwiSaver balances included not only household contributions to KiwiSaver but also employers' contributions and government contributions. Also, the government contributions were very high since they included the KickStart contributions made by government in the first year of the scheme's operations.

- Scobie, Meehan and Law (2010) based their study on a survey of face-to-face interviews with 825 people aged 18-65 which was undertaken from January to March 2010 by Colmar Brunton. The 825 people surveyed consisted of 557 randomly selected members of the population and a booster sample of an additional 268 KiwiSaver members. Among other things, the survey asked the following question: how would the funds now being applied to KiwiSaver have been used if the respondent had not joined KiwiSaver? Six categories were provided for the answer. The authors use the results to show that, on average, KiwiSaver members would have applied 63% of the money they were now contributing to KiwiSaver to other forms of saving or debt reduction. In other words, the truly additional saving would be 37% of households' contributions to KiwiSaver.

We use this estimate of additionality in the analysis which follows, where we look at various options for KiwiSaver. However, the proportion of additional saving could be a little higher than 37% if KiwiSaver was made compulsory. Compulsion may result in a larger proportion of

people who are 'liquidity constrained' being in the scheme. These people will not have other forms of saving or assets and hence will not be able to redirect these other savings into KiwiSaver. Therefore most of their saving is likely to be additional saving.

KiwiSaver options

Spreadsheet models have been derived to look at five KiwiSaver options and to calculate the impact they might have on national saving. For simplicity, we have focused on the employed population. This includes the self employed. However, we do not cover children or others who outside the workforce. Also, we look only at regular contributions to KiwiSaver and ignore the Kickstart contributions made by government when people join the scheme.

The key variables regarding these options are: the proportion of the workforce that is contributing to KiwiSaver (the membership rate), and the contribution rates for employees, employers and government. As noted above, an additionality rate of 37% was used in all of the options. Government contributions are capped at $1042 per person per year in each option.

The five options are:

1. *Membership rate of 60%, with contributions set at 2% of members' income for employees, employers and government.* The average membership rate for the year ended June 2010 was around 37%. The membership rate of 60% in this option may, or may not, be a reasonable maximum rate for a voluntary saving scheme.

2. *Membership rate of 100%, with contributions of 2% of members' income for employees, employers and government.* With a membership rate of 100%, this option can be seen as being a compulsory scheme.

3. *Membership rate of 100%, with 4% contributions from employees, 2% from employers, and 2% from government.* In this option, employees contributions are in effect still being matched, but the matching is being shared by employers and government.

4. Same as option 3 except that the tax concession for employers' contributions is ended, with tax being levied on these contributions at a rate of 30%.

5. Same as for option 4, but with no contributions from government.

Table 1 summarises the results. Further details are in the appendix.

Table 1 KiwiSaver options

	Options				
	1	**2**	**3**	**4**	**5**
Description of scenarios:					
Proportion of workforce in Kiwisaver	60%	100%	100%	100%	100%
Employees' contribution rate	2%	2%	4%	4%	4%
Employers' contribution rate	2%	2%	2%	2%	2%
Government contribution rate	2%	2%	2%	2%	0%
Tax rate on employers' contributions	0%	0%	0%	30%	30%
Results:					
Total contributions to Kiwisaver, % of GDP	1.7	2.8	3.9	3.6	2.8
Additional saving by households, % of GDP	0.2	0.4	0.8	0.8	0.8
Contribution to NIIP after 10 years, % of GDP	2.4	3.9	7.9	7.9	7.9
Alternative estimate of additional saving, % of GDP	0.6	1.0	1.4	1.3	1.0
Cost of Kiwisaver to government, % of GDP	0.7	1.2	1.2	0.9	0.0

Note that:

1. ‘Additional saving by households’ is the line of the table to focus on, since it also reflects the impact of additional saving by households on the measure of national saving.

2. ‘Contribution to NIIP after 10 years’ shows the estimated impact of additional saving by households on the net international investment position i.e. the level of net foreign assets. Contributions to national saving will affect the current account balance by the same amount. And changes in the current account balance will be reflected in changes in net foreign assets. Hence accumulated changes in saving over a ten year period will reflect the change in net foreign assets over the period. Since the figures are positive, they will reduce net foreign liabilities.

3. ‘Alternative estimate of additional saving’ includes not only the additional saving by households but also one third of employers’ contributions and one third of government contributions. It is an alternative estimate of the impact of KiwiSaver on national saving. However, this estimate is only indicative; we currently don’t have good information on how the KiwiSaver contributions from these sectors would affect national saving.

Some comments on the results:

- Option 1, the voluntary option makes a contribution of only 0.2% to national saving. This is not surprising given that it is a ‘bare bones’ option with employees’ contributions being only 2%. It does not, for example, account for the voluntary contributions that are currently being made. Over the last year many employees have kept their contributions at 4%, despite the minimum now being only 2%. A weighted average of current

contribution rates is around 3.3%.[1] This is surprisingly high. It suggests that if the rate was to be raised again to 4% the impact on employees may not be too onerous. On the other hand, nearly all of the people who have joined over the last year have opted for the minimum rate of 2%.

- Option 2, the first of the compulsory options, makes a contribution to national saving of 0.4%, which is still not particularly high. As noted earlier though, compulsion could lift additionality, and hence the contribution may be a little understated.

- Option 3 lifts the rate of household contributions, which is a critical variable in determining the impact of the scheme on national saving, to 4%. Not surprisingly, the contribution to national saving is twice that of Option 2, being 0.8%. This would push down the deficit in the net international position by nearly 8% of GDP over a 10 year period, and by nearly 16% over 20 years.

- Option 4 taxes employers' contributions at a rate of 30%. While this rate is the same as the business rate, employees' marginal tax rates could be used instead. In the current situation, with no tax being applied, the nominal amount that high income earners gain as a result of this tax concession is significantly higher than that of low income earners. Applying employees' marginal tax rates to the employers' contributions would end the bias towards higher incomes arising from this concession. Applying tax to these contributions will lower household saving a bit but could leave the contribution to national saving unchanged; if government saved the additional revenue from the tax, rather than spending it, the resulting rise in government saving would offset the decline in household saving.

- One of the reasons behind having government make contributions to KiwiSaver was to make the voluntary saving scheme attractive to employees and to get them to join up. With compulsion, this reason disappears. Option 5 shows a scheme with no contributions from government. The impact of household contributions on national saving, via additional saving, stays the same. However, total contributions to KiwiSaver, and the measure of household saving, will be lower.

- If Option 5 were implemented government would be free to use the money that is currently being used for KiwiSaver contributions for other purposes. However, if it spent the money on consumption goods and services this could be seen as being counterproductive since this would lower saving and would undercut the effects of KiwiSaver. Government could ensure that the money was saved by using it for investment purposes. One possible investment vehicle would be the NZ Super Fund. However, in effect this would be no different than leaving the money in KiwiSaver. Perhaps government should continue putting money into KiwiSaver, unless it is clear that there is an urgent need for the money elsewhere.

[1] See IRD (2010), Table 3.3, for the distribution of current member contribution rates.

- Option 5 may seem unattractive to employees, especially those who have been conscripted into the scheme. While employees pay 4% of their income into the scheme, the only other contributions are those coming from employers; on an after-tax basis, these are equal to 1.4% of income (2% times 0.7). While these contributions arelower than current contributions, they would still amount to 35% of employees' contributions. It could be argued that this is high relative to initial returns on most other forms of investment.

- If government contributions were ended for employees, presumably they would also end for people who are not employed.

- Kickstart contributions, which provide grants of $1000 to each new member, could be a problem if compulsion was implemented. The cost to government would be very high as a large number of new members suddenly came into the scheme. 'Soft compulsion', where all those outside the scheme are automatically enrolled but have a right to subsequently opt out, could also result in a surge in costs from Kickstart. Perhaps Kickstart contributions could be paid out as 5 annual contributions of $200.

- A positive attribute of KiwiSaver is that it takes contributions from each sector and locks it up in a savings vehicle for a long time. And even if it is difficult to quantify the effects of the scheme, it seems likely that over time KiwiSaver will have a significant impact on the level of national saving and the net international investment position. Given that the scheme locks up savings in household sector accounts, it would seem appropriate that contributions from this sector should be larger than those from other sectors. Consideration could be given to lifting the household contribution rate to 4%.

Compulsory saving: arguments for and against

Implementing compulsory membership of KiwiSaver would clearly not be a step that could be taken lightly. In the end, the decision rests with government. Some of the arguments for and against compulsory saving are outlined below.

For:

- Some people probably feel that they don't know how much they should be saving for retirement and tend to put off the decision to start saving. They may put off the decision to save until it is too late, and hence never get started. Furthermore, some people probably have trouble in knowing what type of investments they should be making. Some will in fact put their money into unsuitable types of investment. Some form of compulsion may be helpful in cases like this.

- Making the scheme compulsory would have a scale effect: the impact on national saving, the current account balance, and the international investment position would be larger than they would be under a voluntary scheme. Also, the results would probably be noticeable at an earlier stage.

- A compulsory scheme could be made less expensive to government than a voluntary scheme since some of government's financial inputs to the scheme could be scaled back. However, some of the benefits of the scheme with respect to national saving might be diminished.

Against:

- Some people will be unwilling participants, and possibly litigious.[2]

- It would be relatively unusual for a country to have both a universal pension that is not means-tested and a compulsory funded scheme. People could feel that they are being forced to pay twice.

- A compulsory scheme could have an adverse impact on people in lower deciles who are already struggling to cope, even before losing another 2% or 4% of their income.

- A compulsory scheme could have a similar impact on young people. Their first priorities with respect to saving are likely to be paying off student loans and saving for a home and family.

- Sticking with a voluntary approach right now does not preclude making the scheme compulsory at some time in the future. Enrolments are still increasing steadily, and the peak enrolment rate may be higher than the 55% used in Option 1 earlier. On the other hand, if household contributions were lifted to 4% and the tax concession on employers' contributions was removed, this could lower the number of new enrolments.

References

Gibson, John and Trinh Le (2008), *How much new saving will KiwiSaver produce?*, Working paper in economics 03/08, Department of Economics, University of Waikato.

IRD (2010) *KiwiSaver evaluation: annual report July 2009-June 2010*, available from: http://www.ird.govt.nz/aboutir/reports/research/report-ks/

Scobie, Grant, Lisa Meehan and David Law (2010) *KiwiSaver evaluation: analysis of a survey of individuals; some preliminary results*, a note prepared by New Zealand Treasury for the Savings Working Group.

[2] There may also be a few issues that need clarification e.g. does compulsion means that participants have to make contributions or would contribution holidays still be allowed?

Appendix

Model (based on 2010) [Figures are $m unless stated otherwise]							
			Options				
Description of scenarios:	**2010**		**1**	**2**	**3**	**4**	**5**
Proportion of workforce in Kiwisaver	37%		60%	100%	100%	100%	100%
Employees' contribution rate	2%		2%	2%	4%	4%	4%
Employers' contribution rate	2%		2%	2%	2%	2%	2%
Government contribution rate	2%		2%	2%	2%	2%	0%
Tax rate on employers' contributions	0%		0%	0%	0%	30%	30%
Proportion of household saving that is additional	37%		37%	37%	37%	37%	37%
Factor to adjust govt contribution (due to threshold of $1042)	83%		83%	83%	83%	83%	83%
Base year data:							
GDP, expenditure measure, June year	189,295		189,295	189,295	189,295	189,295	189,295
Compensation of employees (CoE) June year (est)	85,384		85,384	85,384	85,384	85,384	85,384
Employer contributions	626		626	626	626	626	626
Other income (other super, fringe benefits, etc) (assumption)	200		200	200	200	200	200
CoE less employer contributions and other income	84,558		84,558	84,558	84,558	84,558	84,558
Self-employed income (estimated using NZ Income Survey)	16,066		16,066	16,066	16,066	16,066	16,066
Calculation of contributions:							
Income of employees in Kiwisaver	31,287		50,735	84,558	84,558	84,558	84,558
Employee contributions (including those of the self-employed)	745		1,207	2,012	4,025	4,025	4,025
Employer contributions (gross)	626		1,015	1,691	1,691	1,691	1,691
Government contributions	618		1,002	1,670	1,670	1,670	0
Tax on employer contributions	0		0	0	0	507	507
Total contributions to Kiwisaver (net)	1,988		3,224	5,374	7,386	6,879	5,209
Total contributions to Kiwisaver (net), % of GDP	1.1		1.7	2.8	3.9	3.6	2.8
Calculation of additional saving:							
Additional saving by households	276		447	745	1,489	1,489	1,489
Additional saving by households, % of GDP	0.15		0.24	0.39	0.79	0.79	0.79
Contribution to NIIP over 10 years, % of GDP	1.5		2.4	3.9	7.9	7.9	7.9
Contribution to NIIP over 20 years, % of GDP	2.9		4.7	7.9	15.7	15.7	15.7
Alternative estimate of additional saving	686		1,112	1,854	2,599	2,431	1,880
Alternative estimate of additional saving, % of GDP	0.36		0.6	1.0	1.4	1.3	1.0
Cost of Kiwisaver to government:							
Government contributions	618		1,002	1,670	1,670	1,670	0
Tax concession on employer contributions	188		304	507	507	0	0
Total cost	806		1,307	2,178	2,178	1,670	0
Government contributions, % of GDP	0.3		0.5	0.9	0.9	0.9	0.0
Tax concession on employer contributions, % of GDP	0.1		0.2	0.3	0.3	0.0	0.0
Total cost, % of GDP	0.4		0.7	1.2	1.2	0.9	0.0