



## Media Statement

1 February, 2011

Charts attached

# SAVING NEW ZEALAND: REDUCING VULNERABILITIES & BARRIERS TO GROWTH & PROSPERITY

The Savings Working Group (SWG) has reported to Government. Important conclusions include:

### **New Zealand's level of debt is too high.**

It has borrowed too much overseas. Net Foreign Liabilities (NFL), mainly debt, are 85% of gross domestic product (GDP), which is a similar level to the troubled countries of Europe. Australia is at 58% NFL.

### **This liability makes the New Zealand economy vulnerable.**

Sudden events over which we have no control could cause a dramatic and damaging fall to the economy. In the absence of that we simply face a continuing deterioration in the economy and living standards.

### **Increasing saving is essential to reduce vulnerability.**

Saving, the difference between what we earn and what we spend, must be increased – especially in the government and household sectors. This would reduce New Zealand's vulnerability and establish the basis for sustainable economic growth. Continued foreign borrowing is not a viable option.

### **Urgent action is recommended.**

SWG recommends an urgent increase in national saving of 2% - 3% of GDP, amounting to some \$3 billion to \$5 billion annually. The focus should be first on the government sector and shifting it from deficit to fiscal surplus earlier than the projected date of 2016.

## Commentary on Recommendations

### ***National Saving Issues***

- In future, economic policy must be on a much more integrated and strategic basis; more focused on national benefit and less on short-term political gain.
- National saving must increase first to stabilise NFL at below 90% of GDP and then reduce the level to 70% and then towards 60%. Each step will progressively reduce New Zealand's vulnerability. The process will also reduce New Zealand's interest rate and cost of capital, encouraging investment; and lower the exchange rate, encouraging exports. This will put the economy's growth platform on a more sustainable basis.
- Higher productivity and performance in the state sector is an immediate priority and could make a substantial difference.
- Tax changes are essential, to remove serious distortions that favour housing and penalise interest income from basic savings products. We recommend a number of changes, including indexation. We also recommend a further shift away from income tax and towards expenditure tax (GST), with full

compensation for people on low incomes, in order to further reduce the bias in the present taxation system against saving.

- Part of the savings and debt problems may be due to high and variable rates of immigration and this needs further close assessment.
- Steps must be taken to prevent a repeat of the unsustainable and damaging boom of the last decade, which resulted in a large increase in New Zealand's debt, much of which went into housing and a "bubble" in house prices. The SWG estimates that the tax system bias in favour of housing caused about half of the increase in house prices, with serious implications for affordability. Moreover, the boom boosted investment in housing rather than investment in more productive assets that would have lifted productivity and potentially lifted exports.

### ***Household Saving and KiwiSaver***

- The SWG does not recommend compulsory KiwiSaver at this time, partly because there is considerable scope for improvement without taking that step. Amongst a number of other recommendations: extended automatic enrolment is proposed for all employees; lowering the starting age of full membership to 16; various changes to the default regime, including a single low-cost scheme with an ultra-low risk option; and measures to significantly improve disclosure and the return to savers from lower fees and costs.
- Better availability of annuities is encouraged and consideration of contributions to the New Zealand Superannuation Fund, in the context of a shift towards a "save as you go" approach. Financial literacy is important and a greater effort is advocated. Also, there are some difficult data issues with saving and wealth which need to be addressed.

### ***Business Saving***

- The role of business profitability is vital for the economy, and New Zealand's policy strategy should be much more consistent with it.

## **Commentary**

The reality is that New Zealand's economy has been performing poorly for some decades, with no effective policy response.

Now, it has simply reached a point where, unless there are serious changes, we risk a major economic disruption, a "sudden stop," likely to leave practically all New Zealanders worse off. It's as if we are standing on top of a cliff that may collapse dramatically, or crumble slowly. Either way, it will be a bad fall. We need to move back from the brink, and fast, particularly as the global financial crisis has made international lenders and investors much more wary of the problems of high debt economies. Sentiment can become negative very quickly.

Unfortunately, low national saving is not New Zealand's only problem. Growth in productivity, exports, incomes and living standards has been poor – the productivity growth rate actually halved over the last

decade. The vital tradables sector – producing exports and import substitutes, plateaued in the mid-2000s and then declined in both output and employment, while non-tradables – such as property, retail and government services – continued to grow strongly. The whole position was and still is unsatisfactory and unsustainable.

Reflecting these problems, between 1987 and 2007 the market incomes of New Zealand households in the lower-income half of the population, after adjusting for inflation, actually declined. And their final incomes, what they actually received in the hand, only increased because of the tax system and transfer payments – which is pretty shocking really.

Without higher productivity New Zealanders' incomes will be increasingly set by our lower cost, more competitive trading partners. There is a lot to be done and increasing saving is a vital early step.

Increasing benefits or other government spending is not a solution. Current base case, long-term fiscal projections already show that with government debt kept to a sustainable level, as it must be, and without substantial tax increases, total government spending will have to decline each year in real (inflation-adjusted) terms for about the next 30 years.

The critical issues are national saving, productivity – which needs more investment in productive capital – competitiveness and growing the tradables sector on a sustainable basis.

### **The Way Ahead**

It's going to be challenging. We have enjoyed the easy, soft-option policies – papering over the cracks of an unsustainable, poorly performing economy with sharply rising (up about 50%) government spending and excessive foreign borrowing. Now it's time to face reality, and to appreciate that short-term palliatives almost certainly mean more pain later.

With astute policies and economic management there is a good path forward. Other countries have done it – and others are now moving forward on the same journey. It would be damaging indeed if New Zealand's mettle was tested – and found wanting.

**The Savings Working Group report is available online:**

[www.treasury.govt.nz/publications/reviews-consultation/savingsworkinggroup](http://www.treasury.govt.nz/publications/reviews-consultation/savingsworkinggroup)

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