Brent Sheather's
RESEARCH

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TAX INCENTIVES FOR RETIREMENT SAVING: MOVING THE DIAL OR SUBSIDIZING THE FINANCE SECTOR? – Part 1

Although the public typically perceives the financial world as being highly volatile there are some consistent trends that can be relied upon to occur again and again. Markets surprise but market players are much more predictable. A great example is that, no matter the state of personal or government finances, leading institutions will warn retail investors that they are not saving enough and predict an impending "retirement crisis" for all but those on the Rich List. To encourage a sense of urgency they will hint that there are doubts as to the Government's ability to fund National Superannuation in the medium term. But, they advise, salvation is at hand – there is an easy solution to all of these illusory crises: It is of course to make KiwiSaver compulsory, at higher levels of contribution, and simultaneously introduce generous tax incentives for retirement saving.

As with much of the behaviour of financial experts an understanding of this casuistry can be informed by "following the money". Compulsory KiwiSaver with higher contribution levels, lubricated by generous tax incentives, has huge advantages for just about everyone in the financial sector including fund managers, financial advisors and accountants. What's not so clear is whether "the solutions" will deliver value for individuals and NZ as a country.

There are numerous instances of the finance sector putting its hand on its heart and citing its social responsibility to lobby for compulsory KiwiSaver with tax incentives. Just recently FirstCape Chief Executive, Malcolm Jackson, was quoted in NBR as saying that KiwiSaver was more than 15 years behind Australia and with the current setting, the country was going to drift further behind. Average KiwiSaver balances were about $30,000 compared to more than $120,000 in Australia. Jackson said this was in part due to KiwiSaver not being compulsory and the lower comparative contribution rates. Asked about his confidence in effecting that change Jackson said "You miss 100% of the shots you don't take. It's part of our responsibility as an organisation and our social responsibility to at least try".

Good stuff from Mr Jackson but there is not a great deal of original thought here – for many years now local fund managers have rehearsed these same arguments. Typically they wring their hands, look earnestly at the camera, and tell us that "we are not saving enough for our retirement". They point to the fact that Australians have accumulated $2.7 trillion as if it has happened in isolation, implying that these monies would have otherwise been wasted on lattes, smashed avocado and holidays. Unfortunately the reality is that that huge sum has not just materialsed due to some miracle of financial engineering – it has meant lower wages for Australians and thus, less ability to pay off mortgage debt. Other recent notable lobbying on the topic include the ANZ Bank's submission to the Tax Working Group which also, predictably, advocated for taxation incentives for savings and compulsory

KiwiSaver. Milford also made a submission stating that "saving only 6% of our income to Kiwisaver is not enough to fund a comfortable retirement" and suggested that contributions to KiwiSaver should be excluded from taxation and capped at a reasonable amount per year citing the UK's £40,000 limit. It also suggested that the "retirement problem" would be alleviated if investment profits within KiwiSaver attracted lower tax rates, adding that "tax incentives tilting behaviour towards saving as opposed to spending will increase people's ability to fund their own retirement therefore relying less on NZ Super. This is a long-term win – win outcome for both the government and the individual".

So that is the local finance sector's prescription for savings and tax reform but we need to be aware that this solution could possibly just reflect that sector's overarching objective of maximising funds under management and profitability and further that the Australian pension nirvana might be a figment of the local finance industry's imagination. A number of unconflicted organisations and experts, both in Australia and the US, have a different perception of the costs and benefits of their superannuation schemes. A few years back, the Economics Editor of The Australian newspaper argued that, despite tax concessions that reduce Australia's tax base by tens of billions of dollars a year, compulsory super has only marginally reduced the reliance on the Age Pension. The story also noted that the cost of superannuation tax concessions far outweighs the reduction in Age Pension outlays. The article went on to say that if compulsory super was abolished this would allow the Australian government to cut income taxes dramatically and competition within the superannuation industry would "increase dramatically because those who choose to keep putting their own money into super would pay more attention to their funds' fees and performance". It noted giving people the choice of saving for their retirement, paying off their house or investing in their own business is consistent with a liberal government and economic policy and that a move to make Super voluntary "would destroy the myth that the company's contributions come on top of their wages".

Our own Bill English made the same points in a speech at a Centre for Independent Studies conference saying that "Australia's compulsory saving scheme had caused a massive diversion of capital without improving saving" and "if you look at Australian households the growth in their super accounts is directly paralleled by their growth in debt and one reason Australia has one of the highest household debt ratios in the world is because it has compulsory super". This is, of course, an ideal situation for the finance sector: firstly it expands the size of household balance sheets in that increased savings are to some extent financed by higher debt levels and secondly, the banksters clip the ticket on both the assets and the liabilities.

The Retirement Income Review, which I covered back in December (https://www.nbr.co.nz/investment/the-australian-retirement-income-review-unpacked/), also highlighted some of these key problems with the Australian superannuation "nirvana":

- The RIR concludes that the quid pro quo of employee contributions are lower wages. Whilst this is pretty much common sense many individuals, and a few journalists, believe that because employers must match KiwiSaver contributions up to a maximum of 3% that KiwiSaver represents free money. The report reads "the weight of evidence suggests the majority of contributions to superannuation are paid for through lower growth in wages".

- Commenting on the RIR the Grattan Institute made the point that higher super contributions cost the government more than it saves: "Treasury modelling shows that lifting compulsory super from 9.5% to 12%

would cost taxpayers more in super tax breaks than it would save in reduced Aged Pension spending until 2055."

- The other important finding of the RIR is that most Australian retirees have more than enough money. Peter Martin of the Australian National University, noted that most Australian retirees are reluctant to eat into their super and die with most of what they had when they retired intact. The Review sees this as a betrayal of the purpose of government supported super saying "superannuation savings are supported by tax concessions for the purpose of retirement income and not purely for wealth accumulation". Similarly a recent Grattan Institute study found that many Australian retirees shift to the next life with more savings than they began their retirement with.

That is enough for today – -in two weeks time we will look at a recent US paper which argues that the provision of substantial tax incentives for retirement saving in the US should be scrapped and the resultant tax savings used to address the large forecast deficit in the Social Security (SS) program. SS is similar to NZ's National Superannuation.