Policy Options to narrow NZ’s Saving – Investment Imbalance

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Our savings is insufficient to fund our investment
Why might we care?

Other forum papers have suggested that a narrower S – I gap would:
• Lower the real exchange rate

Why else might we care?
• Reduce macroeconomic vulnerabilities
• Raise trend growth
Outline

• Saving and Investment trends in NZ
• What stands out? How are we unique?
• Policy options
  – Government saving
  – Private saving
  – Tax
  – Housing
• How much additional saving could we get?
• Conclusion

Inter-linkages between these policy areas mean they need to be assessed jointly
NZ’s aggregate saving looks low by international standards
With no obvious trend since the 1980s
But public saving has trended up...
...and private saving has trended down
Investment: key messages

• Total investment rates have been similar to OECD average
• Composition of investment looks different from OECD:
  – Higher public investment
  – Lower business investment
• Too low to promote capital deepening and productivity catch-up
• Policy implications:
  – Narrowing of S – I gap needs to come from higher Saving not lower Investment
  – But policies may be able to improve the composition of Investment
Major policy areas that affect saving are interlinked

Evidence suggests that the nexus of policy settings chosen does impact on national saving.
How are our settings unique?

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3. We don’t offer tax-favoured saving vehicles of the scale available in other countries.

4. Our Government Saving has been unusually good.

- NZ Super
- Government saving
- Tax treatment of savings
- KiwiSaver
- Tier 3
## Tax treatment of Savings

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- TTE creates a disincentive for saving, relative to EET (or TEE)
- But EET makes it harder to achieve distributional goals
- Most other countries have resorted to some kind of compromise by shrinking the middle T. E.g. TtE
But... there are always tradeoffs

- Shrinking the middle T is expensive. Would need to be financed by something:
  - Capital gains tax?
  - Land tax?
  - Lower government spending?
- Shrinking the middle T has equity effects.
- Tax system coherence/ efficiency etc.
Non-neutralities between saving in different forms are large.

Real effective tax rates on different forms of saving

Marginal rate 17.5%
Inter-linkages are important
Other important strands of the literature

1. “Nudges” and other lessons from the behavioural economics literature
2. International lessons on designing efficient schemes
3. Leave private saving settings as they are and boost government saving instead
“Nudges” and behavioural economics

• Life cycle hypothesis traditionally forms the basis of saving behaviour analysis
• But concerns about “bounded rationality” and “self control” raise questions about its suitability
• Newer models allow for two types of savers: “active” and “passive”
Main implications

• Automatic saving default rates are very effective at raising saving rates
  – Especially for low-income employees
• Auto enrolment + matching contributions may be more effective than std tax relief
• Signalling and framing effects also important.
• Compulsory savings would go a step beyond what this literature suggests.
Other lessons from the literature

• The most “efficient plans” (OECD, 2007):
  – encourage high rates of participation and contributions from middle and low-income households.
  – Keep tax expenditures relatively low.
• KiwiSaver performs relatively well on these criteria... although room for improvement
How about the government just saves more?

- NZ Super
- Government saving
- KiwiSaver
- Tax treatment of savings
Public SAYGO

• Basically implies larger fiscal surpluses and building up assets on the government balance sheet.
• E.g. Via higher contributions to the NZSF.
• Would require higher taxes, or lower expenditures.
But episodes of strong government saving typically offset by weak private saving
High house price inflation associated with low household saving
How much additional saving could we get?

- Some exploratory work by Treasury suggests that some major parameter changes could generate significantly higher national saving flows.
- E.g. Changes to NZS settings could generate extra savings of around 0.5% to 1% of GDP per annum.
- Over time a single policy change could cumulate to a significantly higher stock of national savings (20% of GDP after 20 yrs; 40% of GDP after 50 yrs).
- More work is needed in this area.
Conclusions

• Policies to narrow NZ’s S – I imbalance could be good for the exchange rate, vulnerabilities and growth
• Focus should be on raising saving, not reducing investment.
• But focus on public savings alone is not sufficient
• Policy areas that affect private savings need to be considered jointly not independently:
  – KiwiSaver settings
  – NZS settings
  – Tax settings
• Significant increases to national saving possible