Kiwiscammer:

Helping (some) New Zealanders retire richer

From the 1st July 2007 all New Zealand residents up to the age of 65 will be able to join Kiwisaver, the government's great leap backward in retirement policy. Individuals can contribute 4 to 8% of their pre-tax income, and the scheme will lock their savings in until they turn 65. As a sweetener, the government will provide an upfront contribution of $1,000. Anyone starting a new job after 1 July will be automatically enrolled, and has eight weeks to opt out.

At present all New Zealanders are entitled to government superannuation when they turn 65. NZ super is universal – available to all regardless of income or work history. The universal nature of NZ super is one reason there is so little poverty among the elderly. Individuals also had the option of saving for their retirement privately. A simple, fair system that worked!

Why Kiwisaver?

What changed? As a country we spend way more than we earn. According to the Minister of Finance, Michael Cullen, we need to be saved from ourselves and encouraged to save more. Saving will make us "less dependent on foreign capital", reduce our overseas debt, and "improve living standards for the retired". Somewhat bizarrely, we also need to save more because "increasing saving encourages more personal responsibility". Eh? How does that work? "Gosh, I have a Kiwisaver account. Better not run that orange light."

There are a few problems with Dr Cullen's argument. For a start, it's not clear we're not saving enough for our retirement. In 2004, Treasury "tentatively" concluded "there is no apparent gross under-saving for retirement…"

If export-led economic growth is what is wanted, then how about getting rid of the tax breaks enjoyed by property investors? As it is, there is little incentive to invest in export-oriented industries that receive less favourable tax treatment and face high exchange rates. The main reason we have so much overseas debt is because many New Zealanders borrow to speculate in housing. We don't have a saving problem, we have a property speculation problem.

There is no established link between saving, investment and what the government vaguely refers to as "economic transformation", and it's not even clear Kiwisaver will increase our national savings.

First, a bit of economics. (Carry on reading, it will be good for you.) National saving is made up of private household saving and public, or government, saving. The government has a budget surplus because it gets more money in than it spends. Unspent income is saving, so the government's surplus is part of national saving.

If 50% of workers join Kiwisaver, it will cost $965 million in 2008/09, rising to $1.63 billion in 2016/17. This will reduce the surplus. Observe we are just transferring money from the public sector into private savings accounts. Saving will only increase if people save 4% of their incomes in addition to what they are already saving. More likely is people will shift their savings into tax-preferred super schemes. Part of the cost is government subsidies to employer and employee contributions – up to a maximum of $40 per week. So up to an income of $500 per week, the more you earn the more you get.

Lastly, there is the current account deficit. This measures how much we owe the rest of the world. And we owe billions. By encouraging everyone to save, it is hoped we won't have to borrow so much from overseas and that this will reduce our debt. Australia is usually cited as evidence of this, but what is happening there?

New Zealand households are especially fond of borrowing against housing equity and spending it. But Australia has a similar problem. They, too, love to borrow and spend, but guess what they're borrowing against? Their super savings, of course. So they're not saving more. They are saving with one hand and borrowing with the other. It's a big, fat, money-go-round. They also have a high current account deficit, as well as higher rates of poverty among the elderly.

Where does your money go?

Where will your savings go? Into a privately managed fund, which will hopefully mean your nest egg grows. Managed funds make money by trawling the globe trying to get the edge on the competition, usually by buying and selling shares and bonds. It's been called the global casino, and is about as risky.

Having a slice of sharemarket action looks attractive at present. Sharemarkets around the world are – mostly – doing very nicely. But they can lose a lot of money very quickly, and your nest egg bears all the risk. Kiwisaver accounts have no government backing or insurance. So check your fund's risk assessment, and remember there is a trade-off between risk and reward.

Under pressure from fund managers, and contrary to Treasury advice, the government has made employer contributions tax-exempt. Contributions of up to 4% of earnings can be made to Kiwisaver accounts. To level the playing field, this tax exemption has been extended to other registered superannuation schemes. These tax exemptions offer rich rewards for those on high incomes. 4% of $100,000 is worth a lot more than 4% of the minimum wage. This scheme – like similar schemes overseas – favours the rich. The more you earn the more you can get. Think of it as redistribution up the income ladder.

There is now pressure to make employee contributions tax-exempt and for retirement saving to be compulsory (another reason not to vote for Winston Peters, if you needed one). If this happens, kiss your universal NZ super goodbye. It will be back to the bad old days when the rich retired well and the rest of us – particularly women and the low-paid – scraped by in moth-eaten boarding houses or worse.

Will you be better off with Kiwisaver? If you don't need the money now to pay off debt or feed the family, and you don't think you'll need it till you're 65, and you are happy with the level of risk involved then you should probably go for it. You get $1,000 up front and tax breaks.

The government giveth, the government may taketh away

There is another, less well publicised, angle to this. The Social Security Amendment Bill has been reported back to parliament with only a few minor changes. One of the clauses in the Bill reads: "where appropriate [benefit applicants] should use the resources available to them before seeking financial support under this Act". So how locked in is Kiwsaver? Will you have to use it all up before you can apply for a benefit? If so, how long is it supposed to last? Will it apply to all savings and super schemes? And if people know they have to use up their assets, why bother saving if they only get hammered in the event they are made redundant, fall ill or have an accident? The Minister of Social Development has gone on record assuring people their Kiwisavings will be safe, but frankly it's hard to take that assurance seriously.

All these changes are regressive, and have occurred under a government that has refused to extend the In Work Payment to our poorest children. If we really do need investment and so-called economic transformation, then we should be spending the Kiwisaver millions on at-risk children in low-income households, not subsidising the retirement savings of the better-off. Feed our kids properly, educate them and make sure they're healthy. That is the best investment we can make in our future.

* *All quotes are from the budget speech, available online at www.beehive.govt.nz.*

To find out more about Kiwisaver go to http://www.kiwisaver.govt.nz. To see if it's right for you go to the Retirement Commissioner's website at http://www.sorted.org.nz/.

On 21st March the Public Policy group from the University of Auckland had a symposium on the proposed changes to the welfare system. If you have just been made redundant or think you might be, those changes will affect you. Find out what is behind the changes and what they mean by going to http://www.auckland.ac.nz/publicpolicygroup. Go to "Proceedings" at the bottom of the page.