

## Savings Working Group

---

**From:** william Hughes-Games [contact details withheld]  
**Sent:** Tuesday, 21 September 2010 4:46 p.m.  
**To:** Savings Working Group  
**Subject:** Compusory KiwiSaver Submission to Savings Working Group

### The case for Compulsory KiwiSaver

#### Background

One of the tasks of the *Tax Working Group* is to make recommendations on whether to make KiwiSaver compulsory and how to structure it. While there has been much publicity on why a compulsory pension/saving system would be beneficial to New Zealand, it is useful to have the benefits catalogued to refer to. At the end of this presentation is a list of the potential benefits. There is also a section on the Employer Contribution and a section on how to fix KiwiSaver.

#### Present Situation

Bill English has ruled out any further incentives for KiwiSaver. This is excellent. The present incentives should be scrapped. The incentives come from our taxes. They are our own money being given back to us. To give us this money, the government has three choices. It can:

- A. Increase taxes somewhere else,
- B. Reduce services or
- C. put us further into debt.

This government has done all three. I realize that the necessity to implement A, B and C are not all due to the KiwiSaver incentives but the incentives are part of the story. Removing the present incentives would leave a bit of fat in the system. In fact, according to Mr English, stopping subsidies would free up about 1b per year. It could well be we could achieve his required fiscal neutrality while fixing KiwiSaver.

The present KiwiSaver incentives makes you think you are getting something for nothing even though you pay for it under A, B and C. There is a name for schemes that purport to give you something for nothing.

#### What is Wrong with KiwiSaver as it Stands

The worse aspect of KiwiSaver from the point of view of the investor, is that contributions are after tax. The average Kiwi on a 33% marginal tax rate has to earn \$150 in order to have \$100 to invest. As I will show below, it takes a very long time to get back to the buying power of the money that you initially earned. In fact, it takes around 40 years under present conditions. A huge jump in the 'worthwhileness' of KiwiSaver would be made if we could contribute before taxes. Other countries have got it right. In Australia, taxes on contributions are 15% regardless of your marginal tax rate so all Ausis get to invest \$127.50 of every \$150 they earn. In Britain, the system is complex and convoluted but the end result is that they get to invest the whole 150 (pounds in their case).

The next problem with KiwiSaver, if it remains as-is, is that your dividends or interest are taxed at your marginal rate. To add insult to injury, you are not taxed on your real earnings but on your numerical earnings. Let me illustrate.

Lets look at a simple fixed interest deposit at 6% during a time when, inflation is 3%. (You can choose any scenario you think is relevant and work through the math). Personally, I would rather have a fixed interest investment than one that depends on capital gains. I have seen at least 5 crashes of capital in my life. All that distinguished the most recent crash is that it was the largest. As with the Chch Earthquake, I doubt if we have yet seen the big one yet.

So you invest \$100 at the beginning of the year. At the end of the year you have \$106 in the bank. Because

you are in the 33% tax bracket, \$2 of your \$6 earnings are taken for taxes leaving you with \$4. Because of inflation, you needed \$103 just to break-even, so your real earnings are \$1 (I haven't even taken this back to beginning-of-the-year equivalent. If I did so, your real earning would actually be \$0.97). Put in the Log conversion formula\*\* and you will find it will take over 40 years to get back to the buying power of the original \$150 that you earned in the first place. ( $\log 1.5 / \log 1.01$ )

We are asked to put our money into a saving scheme which will have [\*incredibly positive results for New Zealand\*](#). It is a significant proportion of our earnings and an even larger portion of our discretionary income (income after fixed expenses). Surely it isn't too much to ask that we get a fair return from our investment. Click on the above link to see a catalog of benefits to our country of a compulsory savings plan. Look below if you have a printed copy.

A great thing about a worthwhile KiwiSaver is that you would not have to make it compulsory. People would want to buy into it. If you have to make it compulsory so that people will join, this is clear evidence that it is not a fair or worthwhile system. The economy would benefit so much from a ready fund of money to invest in New Zealand with the earning staying in the country, that the tax take would hugely increase. In addition retired folk, who tend to spend their income, would be feeding all their savings into the economy. Win-win all around.

\*\* Since  $A = P(1 + i)^n$ , then  $n = \log A / P / \log(1 + i)$  where A = end amount, P = principle, i = interest expressed as a decimal and n is the number of years. You can use Log or ln. Both give the same answer. In our example n equals  $\log 1.5 / \log 1.01$ . (the compound interest formula)  
William

William Hughes-Games  
Waipara, N. Cant

---

## Benefits to the Country of Compulsory Pension Savings

*Investment in KiwiSaver would result in:*

- \* Increased business development in New Zealand as this newly available money is used for investment.
- \* Worthwhile jobs (as opposed to the present low paid, menial jobs) for Kiwi's from both the construction and running of these businesses.
- \* Lower inflation as a result of less money chasing consumer goods. If you are saving you have less to spend.
- \* A better exchange rate due to lower inflation leading to easier exports. Ideally, one wants a lower inflation rate than one's trading partners to take advantage of the lag factor. (economic hysteresis)
- \* Lower prices at the store for the average Kiwi due to competition. With less money chasing goods, competition between retailers increases. This results in lower prices for the consumer. This helps to make up for the fact that we will have less money to spend when some of our income goes into savings.

\* Less, or possibly, no need for the reserve bank to hike interest rates to keep inflation under control since saving lowers inflation automatically. In fact, when increased saving lowers inflation, the reserve bank should be able to reduce the base lending rate. Since interest is a business expense, lower interest rates further reduce inflation. Lower interest rates will also discourage the "carry trade" in which "mom and pop" from overseas speculate in our currency. The Carry Trade bubble also contributes to inflation and forces the reserve bank to raise the base interest rate. Discouraging the carry trade will still further reduce our inflation.

\* Stimulation rather than choking of business. The hiking of the base interest rate by the Reserve Bank chokes business by increasing this business expense. Saving/investment has the opposite effect powering business by providing less expensive credit.

Credit is less expensive due to a larger supply of money available for loaning. Simple supply and demand kicks in when lending institutions have an excess of liquidity. Money held in their vaults does them no good. They must reduce interest rates to get this money moving and working for them so all borrowers benefit.

\* More profitable businesses, especially export businesses, since, with lower interest rates, it costs them less to service their loans. More profit leads to higher wages and/or more investment back into their business, further strengthening our economy. A major factor in productivity is the amount invested in machinery and infrastructure per worker. More profitable businesses can afford to invest in their businesses.

#### *Note*

*We shouldn't be too hard on over-seas people who are investing in our economy. We aren't saving enough for the banks to have enough cash to lend us for our mortgages and business loans. Without this overseas investment we would be in a difficult situation. For some reason it is worthwhile for them to invest in our economy but not worthwhile for us to do so. This is probably due to the way the two groups (domestic and overseas investors) are taxed but I still find it a mystery. The result, though, is that the profit (interest) from our loans is flowing overseas rather than staying in New Zealand to power other enterprises. Hopefully, with some further improvements for the investor in KiwiSaver, it will become worthwhile for us to invest in our own economy and stop this financial hemorrhage. If we hypothesize a 10% leak from our economy, this means that every profit dollar that stays in New Zealand is exchanged 10 times, lubricating our business engine. Profits that go overseas are oil taken out of the motor. Reduce this leakage to 5% and every profit dollar goes around 20 times.*

#### **Further benefits**

\* A more stable and hence more attractive environment for business, possibly tipping the balance toward New Zealand for some businesses which are contemplating relocating overseas. Also the possibility of encouraging outside businesses to relocate to New Zealand. More businesses means lower unemployment and more competition between businesses for employees which translates into higher wages.

\* *Easier purchase of a house* (1) because of mortgages with lower-interest rates. This is caused by lending institutions having more money (supply and demand again) and because of competition between the lending institutions to lend this money. This will allow more people to purchase their own homes.

\* *Easier purchase of a house* (2) due to lower house prices. With a safe, worthwhile alternative investment through KiwiSaver, less people will be speculating on housing. Housing speculation is pricing houses out of reach for folk who want to buy a house to live in. High house prices are a bubble, just as the currency speculation is a bubble and is powered by perception rather than intrinsic worth. All bubbles contribute to general inflation. Surprisingly without the housing bubble, not only would houses be more affordable but so would bread and milk at the corner dairy.

\* *Easier purchase of a house* (3). With more money in peoples hands, from their KiwiSavings, when they go to buy a house they will have a larger down payment, still further easing the purchase of a home. (The government has suggested that it will be possible to access KiwiSaver funds to purchase the first house).

\* *Easier purchase of a house* (4) because of higher real wages. Investment in one's country increases per-capita productivity as money goes into the means of production. As long as wage increases do not exceed increases in per-capita productivity, they are not inflationary. With a higher real wage (as opposed to a higher nominal wage that inflation quickly neutralizes), it will be easier to buy a house.

\* More money in peoples hands at retirement with all the benefits this brings. Although this is the major reason given for KiwiSaver, it is actually a relatively minor benefit compared to all the other benefits which will come from all of us investing in our own economy. Note that retired people are not big on long term investments. They tend to spend their income. This means that the money going to retired people goes into consumption to the benefit of all businesses. Retired people who are often seen as a liability to the economy become an asset.

\* Less need for investment from overseas since we have our own increased source of investment. Overseas investment results in profit being sent overseas where it is lost to the New Zealand economy. Profit earned and spent in New Zealand supports our home grown businesses at many levels.

\* Less debt owed by Kiwi's. Instead of buying something on credit, incurring interest and paying it back over time, people will save, get interest and then buy. High debt is going to land a lot of us in trouble. This depends on easier access to our KiwiSaver funds, something that the government is against at this juncture and so we may not see this benefit. It also depends on KiwiSaver being a worthwhile system of investment so people will invest in it. Certain purchases such as an electric car, house insulation, solar panels etc are, in effect, a pension which starts at the date of purchase, not at age 65. Such investments, which are in effect a pension, could be financed through KiwiSaver to the benefit of all. All of the above also make a population more resilient to eco-quakes (both *economic* and *ecological*)

\* Avoidance of the 'crunch' which is coming due to us regularly spending 10% more than we earn. If this continues, it will eventually lead to a precipitous fall in our exchange rate as outside investors loose faith in the worth of our currency. Such economic earthquakes are as bad for everyone as is our present over-inflated currency. The longer this excess spending goes on, the greater will be the size of the inevitable correction. Our objective should be to induce overseas investors to gradually get out of our currency as we fill the gap rather than to have them suddenly pull the plug.

Up to this point the tacit assumption has been that all the money collected under the umbrella of KiwiSaver will be invested in New Zealand businesses. This is of course unrealistic. However, investing overseas is not all bad. True, we are investing in the businesses of our competitors but on the other hand, we are bringing their profits into New Zealand where they can help with our balance of payments.

## **The Employer Contribution**

The employer contribution is the most cynical part of kiwisaver as it stands and like all con tricks it depends on the 'mark' thinking he is getting something for nothing. The employee looks at the system and believes he will be getting an increase in salary of 4%. Sure, he doesn't get to spend it but it will be waiting for him when he retires. Nonsense!

It is true that for the first year or two the employee will be getting a real benefit. He is on a negotiated salary and the employer will be adding money for KiwiSaver. Incidentally, most of this money is coming out of the tax payer's pocket anyway through taxes since the government is subsidizing the employer so that he can pay this extra. Even worse, it is coming out of the pockets of all tax payers and is going into the pockets of people who join KiwiSaver. However, these first couple of years are irrelevant. What do you think will happen as inflation continues on its 3% per year course. What will happen when a worker change jobs.

In both these instances, the employer will calculate what he can afford for the great priveledge of having

you work for him. He will then deduct what he has to pay for KiwiSaver and offer what is left as your salary. If you stay in your present job, your salary will not increase as much as you would otherwise expect and if you change jobs, you won't be offered as much as you would have expected given the level of inflation and your past expectations.

You, on the other hand will unwittingly be complicit in this fiction. You will look at your salary and say, OK it isn't what I was expecting but on the other hand, my employer is putting in X amount into KiwiSaver which will benefit me when I retire. Wake up. He is not putting in anything. He has simply offered you a reduced salary so that he can afford to put his contribution into your pension and if government services are to remain the same, the government will have to raise your taxes to make up for the money they are "giving" you.

Actually, there is one small benefit you do get. As the regulations stand at present, the portion the employer puts in is before taxes so you do get a part of what is really your own salary put in without deduction. (that is if the employer passes this benefit along to you). The matching portion *you* put in is fully taxed before investment.

## **Fixing KiwiSaver**

KiwiSaver as it stands is a very poor investment. One indication of this is that the government has had to bribe people with the various incentives to get them to enter the system. Whenever someone is giving you something for nothing, suspect a con trick. KiwiSaver is a case in point. So what is wrong with KiwiSaver as it stands.

There are two problems with KiwiSaver. First, if you are a middle income earner on a marginal income tax bracket of 33%, you have to earn \$150 in order to invest \$100. Secondly, when you earn a dividend or interest of \$100 through KiwiSaver, you only get to keep \$66. If you work through a calculation assuming you can get a 6% investment through KiwiSaver and that inflation over your life time is 3%, you will find that it takes just over 40 years before the first money you invested at, say, age 20 is back to the buying power of what you originally earned. You are already close to retirement. Money invested later in life never does get back up to its original buying power. Its not as if no other country has got it right. Australia, the UK and the USA all have systems that allow the investor to invest before taxes (in the case of Australia you are taxed 15% on investment and dividends regardless of your tax bracket) and to keep what he earns through his pension plan investment. The whole problem with KiwiSaver is the tax regime imposed on it by the government and the bribes they provide us are a sure indication that they realize what a poor investment it is. When people wake up to what a poor investment KiwiSaver is, they will be opting-out and the huge benefits to New Zealand listed at the beginning of this blog will not occur.