SUBMISSION

TELEPHONE 0800 327 646 | WEBSITE WWW.FEDFARM.ORG.NZ

To:	Savings Working Group C/o The Treasury PO Box 3724 WELLINGTON 6140
Email:	savingsworkinggroup@treasury.govt.nz
Submission on:	**Savings Working Group**
From:	**Federated Farmers of New Zealand**
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NICK CLARK
MANAGER GENERAL POLICY

Federated Farmers of New Zealand
PO Box 1992, Christchurch, New Zealand

P 03 357 9459
F 03 357 9451
✉ nclark@fedfarm.org.nz

www.fedfarm.org.nz

SUBMISSION TO THE SAVINGS WORKING GROUP

1. INTRODUCTION

1.1 Federated Farmers welcomes the opportunity to provide this submission to the Savings Working Group.

1.2 Federated Farmers takes a strong interest in economic policy and the need for New Zealand to lift its mediocre economic performance. The Federation's position on economic policy can be summarised in the introductory comment from its submission on the 2010 Budget Policy Statement:

If the New Zealand economy is to recover from the recession in a sustained and sustainable way it is absolutely critical for there to be a more export-friendly environment and a rebalancing of the economy in favour of the tradable sector. To achieve this rebalancing ***all*** *government policies must to be consistent with promoting competitiveness and productivity, and in terms of fiscal policy, the Government can best contribute by constraining its spending to enable core Crown expenditure to fall below 30% of GDP.*

1.3 The debate on savings – whether New Zealand has a problem with savings and if so what to do to encourage more savings – is a key economic policy issue and we welcome this debate taking place. We are aware that there is a wide range of views on both the scale of the problem and on the solutions.

1.4 The issue of savings has become prominent in the debate on overseas investment in farmland. This debate has become heated despite the amount of farmland actually moving into overseas ownership being relatively small. Putting aside the arguments for and against overseas ownership of farmland, the reality of overseas ownership in our economy is that as a country we do not save enough to fund all of our investment needs. With New Zealand last running a current account surplus in 1973, we have had to borrow or sell assets to finance the deficits. Up until recently most of this financing has taken place through borrowing but with the global financial crisis leading to a higher cost of debt, pressure will build to sell assets. This is as true on the farm as it is for the economy as a whole.

1.5 That said there are discrepancies in savings data and some commentators say that New Zealand does not have a savings problem. Rather they point to there being an investment problem (too much low quality or unproductive spending and investment) or a combination of a savings problem and an investment problem. We think it will be important for the Savings Working Group to define and determine the problem before jumping to conclusions.

1.6 Overall, Federated Farmers' view is that the concerns about a lack of savings are more a reflection of the long-term underperformance of the New Zealand economy, which since the late-1990s has been exacerbated by poor policies that have impeded productivity and competitiveness. With the exception of its own savings, we are not convinced that the level or form of saving is something a government should seek to determine. Instead, we consider that governments should focus on implementing policies that will improve the performance of the New Zealand economy. Part of this is aiming to minimise policy induced distortions that push New Zealanders into certain decisions about saving and spending.

1.7 The remainder of this submission is structured in the following sections:

- Section 2: Summary of recommendations;
- Section 3: Comment on Savings Working Group Terms of Reference;
- Section 4: Comment on Section A ('Saving Policy in Context') of the Treasury paper prepared for the Savings Working Group, *Saving in New Zealand: Issues and Options*;
- Section 5: Comment on Section B ('The Policy Options') of the Treasury paper;
- Section 6: Conclusion; and
- Section 7: About Federated Farmers.

2. SUMMARY OF RECOMMENDATIONS

2.1 Federated Farmers recommends that the Savings Working Group should:

(a) Feel able to discuss items outside the scope of its terms of reference, particularly New Zealand Superannuation and other welfare benefits/income support;

(b) Consider whether New Zealand has a savings problem or an investment problem (or both).

(c) Consider New Zealand's net national saving and sectoral saving performance (including data measurement and methodologies) and whether there is a public policy problem;

(d) Consider the interaction of policies to facilitate rebalancing of the economy in favour of the tradable sector with policies to improve savings rates;

(e) Urges the Government to take concerted policy action to promote competitiveness and productivity;

(f) Urges the Government to commit to an early return to surpluses but to do so through reducing spending to below 30% of GDP rather than through increasing taxes;

(g) Work on reducing tax distortions with an emphasis on reducing and flattening personal tax rates;

(h) Consider how the impact of transfer payments impact upon people's propensity to save;

(i) Urge the Government to reduce or better target KiwiSaver subsidies, especially if there is to be a boost in automatic enrolment;

(j) Carefully consider the costs and benefits of compulsory superannuation and whether there should be a re-think of New Zealand's universal state-funded pension;

(k) Urge the Government to ensure that prudential regulation and monetary policy settings provide confidence to savers and support the tradable sector;

(l) Support better education on financial literacy and better information about investment options; and

(m) Seek to encourage better regulation of consumer credit but avoid over-regulation.

3. COMMENT ON SAVINGS WORKING GROUP TERMS OF REFERENCE

3.1 Federated Farmers supports the establishment of the Savings Working Group and we agree that it should consider fiscal policy, taxation, and KiwiSaver. However we do think the Working Group should have a broad remit and be able to consider items outside its scope. In particular we believe it should discuss New Zealand Superannuation and other welfare benefits and income support that impact upon people's propensity to save.

3.2 Recommendation: Federated Farmers recommends that the Savings Working Group should feel able to discuss items outside the scope of its terms of reference, particularly New Zealand Superannuation and other welfare benefits/income support.

4. COMMENT ON TREASURY PAPER: SECTION A – SAVINGS POLICY IN CONTEXT

4.1 Federated Farmers generally agrees with the sentiment of this section. We agree that lifting the level of national savings would help reduce imbalances and make more funds available for investment in growing the economy. The key though is to ensure that investments are high quality and we believe that over the years there has been a large amount low quality and unproductive investment and spending by households, businesses, and governments that may have been as much or even a bigger problem than any lack of saving. Government can directly influence only its own investment and spending decisions but it can and does have an indirect influence on the investment and spending decisions of households and businesses through its policies.

4.2 While government taxation and spending decisions are obvious examples, there is a wide range of regulatory and other policies that can have an impact on national savings. For example, landuse restrictions imposed by local authorities have been shown to dramatically increase the price of land, which has impacted on housing affordability, and has made New Zealand the second most unaffordable country behind Australia[1]. These restrictions must therefore be a factor behind the rapid accumulation of household debt and associated debt servicing costs over recent years.

4.3 Recommendation: Federated Farmers recommends that the Savings Working Group should consider whether New Zealand has a savings problem or an investment problem (or both).

[1] Refer to Demographia International Housing Affordability Surveys.

New Zealand's Savings Picture

4.4 Federated Farmers believes that an important role for the Savings Working Group will be to resolve whether New Zealand's net national saving is as perilously low as suggested. While the Treasury paper contends that net national saving is low and falling, there are (as the paper concedes) discrepancies over statistics and measurement which muddy the waters. Also, it has been suggested that New Zealand's low savings rates are actually not dissimilar to those of other Anglo-Saxon countries (although we accept that in terms of debt and net foreign asset position we are in less exalted company which makes New Zealand vulnerable to a change in investor sentiment).

4.5 The Federation also considers it important for the Savings Working Group to look into the link between government saving and private sector saving. The data of the past 15 years suggests that when the government has been saving (i.e., running fiscal surpluses) the private sector has been dis-saving and vice versa. Why is this? And what are the implications for private sector savings once the government returns to surpluses?

4.6 We tend to agree with the discussion on private sector saving, which shows a high proportion of household wealth tied to housing, low stocks of financial assets, and high debt relative to income. To some extent this is a reflection of the poor performance of the New Zealand economy which leads to New Zealanders having relatively low incomes compared to those in high income countries, like Australia. They have therefore borrowed against appreciating house prices to fund similar material standards of living as those in high income countries. More recently, as households became less comfortable with high debt levels, there has been a deleveraging but this will be a much slower process than the debt build up.

4.7 Booming rural land prices and changes in land use helped fuel a rapid build-up in agricultural debt from 2001 and 2008. With rural land prices down sharply since 2008 and with reasonably priced bank credit much harder to access, the sector's debt levels have stabilised with most farmers now intending to reduce debt[2]. With many farms struggling with low profitability, deleveraging of farm debt will be an even longer and harder process than it will be for households.

4.8 With regard to the government sector, Federated Farmers acknowledges that the government is running a large structural deficit caused by large increases in spending (since 2000) and tax cuts (since 2008). We agree that the deficit needs to be closed promptly but we think this should be achieved by reducing spending rather than by increasing taxes (see section 5 of this submission).

4.9 Recommendation: Federated Farmers recommends that the Savings Working Group should consider New Zealand's net national saving and sectoral saving performance (including data measurement and methodologies) and whether there is a public policy problem.

[2] Refer to Federated Farmers' July 2010 Farm Confidence Survey, http://www.fedfarm.org.nz/farmconfidencesurvey

Implications of Low Saving for the New Zealand Economy

4.10 The Treasury paper suggests that low net national savings has contributed to the following problems:

- Under-developed financial system.
- High interest rates and exchange rate.
- High current account deficits.

4.11 Federated Farmers agrees with the discussion on the problems set out in this section of the Treasury paper although we are not sure if there is necessarily a 'cause and effect' relationship between the savings rate and these problems. We see these problems caused more by the allocation of resources between the tradable and non-tradable sectors, which led to the tradable sector being in recession from 2004 while the non-tradable sector grew strongly, at least until 2008.

4.12 This allocation of resources was caused in large part by huge growth in government spending after 2000, which underpinned consumer spending. Meanwhile, from 1999-2008 the previous Government implemented a number of harmful policies, for example in tax, employment law, the emissions trading scheme, and it oversaw a growth in regulation. All have impeded productivity growth and eroded competitiveness.

4.13 It is absolutely critical for there to be a more export-friendly environment and a rebalancing of the economy in favour of the tradable sector. To achieve this rebalancing **all** government policies must to be consistent with promoting competitiveness and productivity. We have been encouraged to see some progress under the current government but the Federation believes that it must be bolder. The concerns about the possibility of a 'double-dip' recession show that policy-makers cannot afford to be complacent about the recovery.

4.14 Federated Farmers considers that concerted policy action across a broad front will reduce cost pressures, improve flexibility, and better facilitate the rebalancing in favour of the tradable sector. As this rebalancing occurs we expect it will also improve savings rates and enable more domestic-generated investment.

4.15 Recommendation: Federated Farmers recommends that the Savings Working Group consider the interaction of policies to facilitate rebalancing of the economy in favour of the tradable sector with policies to improve savings rates.

5. COMMENT ON TREASURY PAPER: SECTION B – THE POLICY OPTIONS

5.1 Federated Farmers comments on the following policies outlined in the Treasury paper.

Higher Saving Through Higher Growth

5.2 First and foremost, Federated Farmers considers that the Government should ensure that all its policies are consistent with promoting competitiveness and productivity and this should help facilitate rebalancing in favour of the tradable sector and raise national savings. Concerted policy action is required across the Government's six drivers (public sector; tax and welfare system; regulatory environment; infrastructure; skills; and science, innovation and trade policies) if this is to be successful.

5.3 Recommendation: Federated Farmers recommends that the Savings Working Group urges the Government to take concerted policy action to promote competitiveness and productivity.

Government as a Saver

5.4 The Government should seek an early return to surpluses but it should do so by reducing spending rather than by increasing taxes. Over the ten years to 2009 core Crown expenditure doubled in nominal terms and as a percentage of GDP it increased from 29% in 2005 to around 35% today. Reduced spending should also help monetary policy and take pressure off the exchange rate. We consider that there are many areas of spending that could be reduced and as we said in our submission on the 2010 Budget Policy Statement:

Federated Farmers and other advocates for smaller government are frequently asked for examples of spending that should be 'cut'. The biggest areas of current spending are health, education, superannuation and other welfare benefits. The Treasury's recent document Challenges and Choices, New Zealand's Long-Term Fiscal Statement *discusses a number of options for reducing government spending in these areas. Many of these options are politically difficult as they require improved public sector productivity and the restricting or removing of welfare entitlements to focus them on those in greatest need. Nevertheless they should be implemented.*

Federated Farmers has consistently expressed concern about big spending initiatives implemented in recent years, particularly 'Working for Families', interest free student loans, more generous New Zealand Superannuation, KiwiSaver subsidies, and 20 hours free childcare. These initiatives need to be reviewed as should all existing spending across all departments to ensure that the spending is affordable, provides strong value for money, and is appropriately targeted. Savings can either be reallocated to more productive, high priority areas, be used to reduce debt, or be returned to taxpayers.

5.5 Federated Farmers submits that the Government should set a target to reduce core Crown expenditure to below 30% of GDP by 2014 and even lower in the longer term. This would reduce the amount of debt that will need to be accumulated (as well as associated finance costs) and will help rebalance the economy in favour of the tradable sector.

5.6 Recommendation: Federated Farmers recommends that the Savings Working Group urges the Government to commit to an early return to surpluses but to do so through reducing spending to below 30% of GDP rather than through increasing taxes.

Getting the Saving Environment Right

5.7 Federated Farmers considers that tax distortions that influence saving and spending decisions should be removed. We also think that government spending (e.g., New Zealand Superannuation and welfare benefits/income support) should not distort savings decisions. Both are discussed below.

Reducing Tax Distortions

5.8 Federated Farmers agrees that tax distortions should be removed. Budget 2010 made a step in the right direction by reducing tax rates on income and saving while increasing GST. However, as the Treasury paper notes, different types of saving are taxed in different ways and savings held for long periods may face higher taxes.

5.9 The Federation strongly supports lower and flatter personal tax rates as its preferred option for reducing distortions. We have also supported inflation indexation of tax rates, but this was when the previous government was showing no interest in reducing tax rates. We are supportive of lower tax rates for interest income and open-minded about the partial exclusion of interest income but we are cautious about any move away from a 'broad-base low rate' system.

5.10 However, we would not support a dual ('Nordic') income tax system due to the complexity of separating labour and capital income, which could be a particular problem for farmers and other self-employed people. Both the 2009 Tax Working Group and the 2001 McLeod Tax Review examined the dual tax system and neither review considered it to have merit in New Zealand. Nor would the Federation support a capital gains tax and we note that the Government has already decided not to implement a capital gains tax (or a land tax).

5.11 Recommendation: Federated Farmers recommends that the Savings Working Group should work on reducing tax distortions with an emphasis on reducing and flattening personal tax rates.

Effect of Government Spending

5.12 Federated Farmers considers that government provision of transfer payments is important for those in genuine need. However, they also impact on well-off people's saving choices by reducing the need for lifecycle saving and reducing the need for precautionary saving or insurance. The Treasury paper explicitly discusses student loans and New Zealand Superannuation. These are examples of transfers that reduce the need for lifecycle saving. Other areas of income support such as Working for Families, ACC and the main welfare benefits (e.g., unemployment, sickness, and domestic purposes) impact more on precautionary saving or insurance.

5.13 Federated Farmers' view is that the generosity of these transfer payments has a significant impact on the propensity to save by people who should able to save. As mentioned above we have previously expressed concern about big spending initiatives implemented in recent years, particularly 'Working for Families', interest free student loans, more generous New Zealand Superannuation, KiwiSaver subsidies, and 20 hours free childcare. Although our concern has been about the fiscal cost of such transfers, we are equally concerned about their impact on people's behaviour.

5.14 Although the parameters of New Zealand Superannuation are outside the scope of the Savings Working Group, we believe it should consider whether the age of eligibility of 65 should be increased (as it has been or will soon be in many other western countries). It should consider whether the level of New

Zealand Superannuation should be adjusted by indexing increases to inflation instead of wage increases. And although this is controversial in New Zealand it should also consider whether New Zealand Superannuation should be subject to some form of means testing, as is the case in Australia.

5.15 Although the welfare system is also outside the Savings Working Group's scope (due to it being separately considered by the Welfare Working Group) we think the impact of the welfare benefits and income support on people's savings decisions is too important to be neglected by this group.

5.16 Recommendation: Federated Farmers recommends that the Savings Working Group should consider how the impact of transfer payments impact upon people's propensity to save.

Options to Subsidise or Compel Saving

5.17 Federated Farmers considers it timely for the Savings Working Group to look closely into KiwiSaver and review its experience. KiwiSaver has proven to be popular, but has it resulted in more people saving or have people been diverted from other saving options? Has KiwiSaver resulted in a higher rate of national savings or has it simply changed the composition of savings? Have KiwiSaver's substantial subsidies (which cost around $1 billion per annum) encouraged more private sector savings than the fiscal cost? Should large subsidies remain in place when the Government is no longer saving?

5.18 Consistent with its wider view on transfer payments, the Federation believes that any incentives for KiwiSaver (whether they are the 'kick-start' or ongoing government contributions) should be targeted to those on moderate to lower incomes. It is these people who are most likely to be in need of help to increase their saving, whereas wealthier people are more likely to be saving anyway and KiwiSaver will be diverting funds from other forms of saving.

5.19 Boosting automatic enrolment by automatically enrolling all current non-members into KiwiSaver (but giving them the option to 'opt-out') would substantially increase the numbers of people in KiwiSaver but in our view the fiscal cost would require the Government to make substantial changes to KiwiSaver subsidies if the scheme is to be affordable to the taxpayer. A policy-induced surge in enrolments would also increase the contributions employers must make. This could be harmful for farms and other businesses during the current difficult economic climate and reduce the ability of employers to provide pay rises to employees.

5.20: Recommendation: Federated Farmers recommends that the Savings Working Group should urge the Government to reduce or better target KiwiSaver subsidies, especially if there is to be a boost in automatic enrolment.

5.21 With regard to compulsory superannuation, Federated Farmers is sceptical on whether the benefits would exceed the costs. While Australia's experience with compulsion has been held up as a reason for that country's economic success, there are other important factors behind its better economic performance. For example, under successive governments Australia experienced a much longer period of coherent economic reform (which helped increase its productivity and competitiveness relative to New Zealand where reforms first stalled and then went backwards from the late 1990s).

Australia has also shown a greater willingness to make use of its mineral resources.

5.22 There are also costs to compulsory superannuation. As the Treasury paper acknowledges ‘compulsory saving raises difficult wellbeing and fairness issues’. The paper also notes that while compulsion increases household savings, it does not increase savings by the full amount of compulsory contributions as households reduce other forms of saving. For many people (and businesses) compulsory superannuation would effectively amount to a tax increase.

5.23 New Zealand is unusual in having a universal state-funded pension with no means testing. In our view it would only make sense to make KiwiSaver compulsory if the government was to abandon the pension’s universality – otherwise the fiscal costs would be too high.

5.24 Recommendation: Federated Farmers recommends that the Savings Working Group should carefully consider the costs and benefits of compulsory superannuation and whether there should be a re-think of New Zealand’s universal state-funded pension.

Macroeconomic Prudential and Monetary Policy Settings:

5.25 High quality prudential regulation is very important for giving savers confidence in financial institutions, while monetary policy settings are equally important for protecting savings against the impact of inflation. Through their impact on the cost and availability of credit and their impact on the general price level and the exchange rate, both are also very important for the competitiveness of the tradable sector.

5.26 Recommendation: Federated Farmers recommends that the Savings Working Group should urge the Government to ensure that prudential regulation and monetary policy settings provide confidence to savers and support the tradable sector.

Investment Options and Financial Literacy

5.27 With regard to investment options and financial literacy, Federated Farmers agrees that the wider population is generally unsophisticated and there needs to be better education to improve financial literacy and better information about investment options. There is a case for better regulation of household debt, particularly clamping down on dubious and oppressive lending practices, but we consider it important to retain individual responsibility and regulations should seek to avoid moral hazard. It would be unfortunate if over-regulation of consumer credit was to result in households taking on more debt.

5.28 Recommendation: Federated Farmers recommends that the Savings Working Group should support better education on financial literacy and better information about investment options.

5.29 Recommendation: Federated Farmers recommends that the Savings Working Group should seek to encourage better regulation of consumer credit but avoid over-regulation.

6. CONCLUSION

6.1 Federated Farmers welcomes the work of the Savings Working Group and we consider its work to be very important in the context of wider economic policy.

6.2 However, while we want an economy that can generate more savings for investment in our own assets, we think it important for the Savings Working Group to get a good understanding of the savings picture in New Zealand and whether we have a savings problem or an investment problem.

6.3 The Federation's view is that the concerns about a lack of savings are more a reflection of the long-term underperformance of the New Zealand economy, which during the period 1999-2008 was exacerbated by poor policies that have impeded productivity and competitiveness, particularly for the tradable sector.

6.4 With the exception of its own savings, we are not convinced that the level or form of saving is something a government should seek to determine. Instead, we consider that the Government should focus on implementing policies that will improve the performance of the New Zealand economy. Part of this is aiming to minimise policy induced distortions that push New Zealanders into certain decisions about saving and spending.

6.5 Federated Farmers believes that policies to facilitate the rebalancing of the economy in favour of the tradable sector will also help to improve savings rates and we suggest this to be a good place for the Savings Working Group to start.

7. ABOUT FEDERATED FARMERS

7.1 Federated Farmers of New Zealand is a member-based organisation representing farming and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand farmers.

7.2 The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of the rural community; and
- Our members adopt responsible management and environmental practices.