The Treasury

Budget 2015 Information Release

Release Document July 2015

www.treasury.govt.nz/publications/informationreleases/budget/2015

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government

[2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial

[3] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.

[4] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[5] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[6] 9(2)(ba)(i) - to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied.

[6a] 9(2)(ba)(ii) - to protect information, where the making available of the information would be likely otherwise to damage the public interest

[7] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[8] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[8a] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting the collective and individual ministerial responsibility

[9] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[10] 9(2)(h) - to maintain legal professional privilege

[11] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[12] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[13] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[14] Not in scope

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [4] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: KiwiSaver: Evaluation reports and policy options

Date:	11 February 2015	**Report No:**	T2015/211
		File Number:	SH-11-4-3-8

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** the contents of this report. **Refer** the report to the Associate Ministers of Finance. **Refer** the report to the Ministers of Revenue and Commerce. **Agree** to meet with officials to discuss the possible options for changes to KiwiSaver to address leakage (difficult) and headline cost (more straightforward).	At your earliest convenience if changes for Budget 2015 are sought.

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Andreas Heuser	Senior Analyst, Financial Markets	04 917 6012 (wk)	[4]	✓
James Beard	Manager, Financial Markets and International	04 917 6161 (wk)		
David Law	Senior Analyst, Economic Research and Analysis	04 917 6929 (wk)		

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Refer the report to the Associate Ministers of Finance (if agreed)

Enclosure: No

Treasury Report: KiwiSaver: Evaluation reports and policy options

Executive Summary

The seven year Evaluation of KiwiSaver by Inland Revenue has concluded and the final reports will be published shortly. We understand that Inland Revenue is providing you with these reports and the proposed timeframe for publication.

The Evaluation broadly finds that the scheme has been an administrative success. However, the scheme has had poor value for money and a high degree of leakage and substitution has occurred with estimates from zero to one-third of KiwiSaver balances representing new household savings.

This report summarises the key points contained in the Evaluation's Synthesis Report and, in response to a request from your office, provides some options for changes to KiwiSaver to reduce headline costs to the Crown and to reduce the degree of leakage.

Recommended Action

We recommend that you:

a **note** the contents of this report

Noted.

b **refer** this report to the Associate Ministers of Finance

Refer/not referred.

c Refer this report to the Minister of Revenue and the Minister of Commerce

Refer/not referred.

d **agree** to a meeting with officials to discuss the possible options for changes to KiwiSaver to address leakage (difficult) and headline cost (more straightforward)

Agree/not agreed.

James Beard
Manager, Financial Markets and International

Hon Bill English
Minister of Finance

Treasury Report: KiwiSaver: Evaluation reports and policy options

Purpose of Report

1. The purpose of this report is to brief you on the KiwiSaver Evaluation outcome and provide you with options to address the headline cost to the Crown and the degree of leakage of the scheme.

Background

2. The seven year KiwiSaver Evaluation was approved by Ministers in 2006 and concluded in 2013. This programme aimed to support the implementation and delivery of KiwiSaver and report on how it had met its objectives. The focus of the evaluation was on the public policy outcomes of KiwiSaver, rather than investment outcomes from KiwiSaver schemes. No further evaluation of this kind is planned for KiwiSaver and indeed may not even be possible due to limitations on availability of household savings data. Treasury reported to you in June 2014 on the status of the Evaluation to address your specific concerns about cost and quality [T2014/1250 refers].

3. The Evaluation has been led by Inland Revenue, on behalf of the Evaluation steering group. The steering group was made up of representatives from Inland Revenue, Ministry of Business, Innovation and Employment, the Treasury, Statistics New Zealand, Ministry of Social Development, Financial Markets Authority, Victoria University, and the Commission for Financial Capability (formerly Commission for Financial Literacy and Retirement Income).

4. The Inland Revenue briefing to the Minister of Revenue dated 16 December 2014 on the KiwiSaver Evaluation (IR2014/594) contained a summary of the Evaluation, Synthesis Report, and other report findings. We understand this report was also provided to you.

5. Inland Revenue have advised us that they are reporting to you separately with copies of the full set of reports. We also understand that Inland Revenue are liaising with Ministers' offices regarding the publication date and communications issues relating to the Evaluation.

Evaluation reports

6. In the following we outline the main report to be published, the Synthesis Report, and list the four supporting reports that are to be published at the same time.

Synthesis Report

7. The principal Evaluation report to be published is the "*KiwiSaver Evaluation Synthesis Report*". It summarises the totality of reports over the seven year Evaluation period and broadly finds that KiwiSaver has been an administrative success but leakage and substitution have meant that this success has come at a high fiscal and economic cost. The focus of the Evaluation on the effectiveness of KiwiSaver policy on reaching its target group has helped to uncover these costs. Over the course of the seven year evaluation period the Government has acted to address these concerns by lowering or repealing subsidies (e.g. the halving of the annual member tax credit amount to $521 in Budget 2011).

8. The following provides some more detail on the Synthesis Report findings:

Administrative success of KiwiSaver

9. The Synthesis Report highlights the support for KiwiSaver from both employers and providers with respect to implementation, and minimal and decreasing compliance costs. The smooth administration of the scheme and IRD's role as a clearing house for contributions and scheme transfers has been a significant success.

10. Membership growth has outstripped initial forecasts. In recent years, a small majority of new members have 'opted in' rather than been automatically enrolled when changing jobs or starting in work.

Determining the impact of KiwiSaver on superannuation markets and the financial sector

11. A 2010 analysis found that KiwiSaver has provided a stimulus to the financial sector and is seen by fund managers as a medium to long-term growth opportunity. The impact on capital markets was found to be small. You should note that the Treasury will soon conclude a review of the efficiency of the KiwiSaver fund management sector and asset allocation trends (this work was foreshadowed in the Treasury Report T2014/1548 which also found that KiwiSaver was having a moderate positive effect on capital markets).

Determining the impact of KiwiSaver on individuals' saving habits and asset accumulation

12. KiwiSaver's effects on individuals' saving have been estimated in two main ways. Estimates based on 'flow' measures of saving (i.e. how much income is going to saving) have been derived from what people say they would have done with contributions to KiwiSaver in the absence of KiwiSaver (collected in two surveys conducted by Colmar Brunton in 2010 and 2014). Estimates based on 'stock' measures of saving (i.e. effects on individuals' stock of net wealth) have been derived by utilizing detailed asset and liability information for individuals over time from the Survey of Family, Income and Employment combined with administrative data on KiwiSaver membership from IRD.

13. The flow measures of saving suggest that contributions to KiwiSaver are increasingly being made at the expense of paying off mortgage or other debt. Additional savings, that is new savings rather than savings simply shifted from one product into KiwiSaver, have dropped from 36%[1] in 2010 to 31%[2] in 2014 (the drop is not statistically significant, and it is accurate to say around one third of savings is new savings). The stock measures of saving, however, suggest that KiwiSaver membership has had no significant effect on asset accumulation (Law and Scobie, 2014).[3]

Value for money

14. A report on the value for money of KiwiSaver will also be released with the synthesis and other Evaluation reports. This report highlights the high cost to the Crown of KiwiSaver.

15. In 2010 the KiwiSaver scheme appeared to be reaching about one third of the target population which is defined as "*individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement*". A costs and benefit analysis in

[1] Estimate first calculated in Law, D., Meehan, L. and Scobie, G. (2011) "KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving." Wellington, The Treasury, Treasury Working Paper 11/04.

[2] IRD (2015) "KiwiSaver Additionality and Substitution Research." Wellington, IRD.

[3] Law, D. and Scobie, G. (2014) "KiwiSaver and the Accumulation of Net Wealth." Wellington, The Treasury, Treasury Working Paper 14/22.

this value for money report used a value of leakage to the non-target group of 43% and suggested that for the period 2007/08 to 2012/13, the additional savings amongst the estimated target group for each $1 of government spending ranged from $0.20 to $0.38 as the level of government contributions dropped with fewer new enrolments and policy changes. These estimates of additional savings would be substantially lower, however, if either the preferred estimate of leakage in Law, Meehan and Scobie (2011) of 93% or the stock measure of additional saving due to KiwiSaver membership (of zero) estimated in Law and Scobie (2014) were applied to these calculations.

16. The costs to the Crown are reducing over time as membership growth slows. The reduction to the member's tax credit in Budget 2011 will have, at least partially, caused this. However, there is the potential for the HomeStart deposit subsidy policy to reverse this trend should that significantly increase uptake.

Other reports to be released

17. In addition to the Synthesis Report, the following reports which form part of the Evaluation will be published: "*Who is enrolling in KiwiSaver?*"; "*KiwiSaver Qualitative Research*"; "*KiwiSaver Additionality and Substitution Research*"; and "*Government Retirement Savings Incentives in New Zealand: do they provide value for money?".*

Value for Money and Leakage in KiwiSaver

18. Officials were requested to outline some options to improve the value for money of KiwiSaver given the results of the Evaluation. In the following we outline some of the factors to take into account:

Difficulties in defining the target population for KiwiSaver

19. The value for money of KiwiSaver policy is a measure of how much it costs the Government to prompt an additional dollar of savings from the target population. Value for money is related to the degree of leakage from payment of the Crown subsidies to individuals outside of the target population.

20. Assessing value for money is difficult due to the imprecision inherent in the wording of the purpose in section 3 of the KiwiSaver Act. That purpose refers to boosting savings among

> "*individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement*".

21. Because of this definition, it is not possible to identify the target population for KiwiSaver with reference to income bands or employment status (or other measures commonly used to define eligibility for Government support). In order to overcome this problem, the value for money analysis in the Evaluation is based on the self-reporting by respondents to surveys conducted by Colmar Brunton in 2010 and 2014 and is also based on the methodology in Law, Meehan, Scobie (2011).

Difficulties in addressing leakage

22. As discussed above, the Evaluation finds that KiwiSaver has been poor at boosting savings among the target population (as defined in the Act) and a significant degree of leakage has occurred. Designing options specifically to reduce leakage associated with KiwiSaver, assuming that the programme is to continue largely in its present form, would be extremely difficult. To better understand this it is helpful to consider the

elements which contribute to the estimated leakage to the non-target group of 93% in Law, Meehan and Scobie (2011).

23. In order for a member of KiwiSaver to be considered part of the target group by the authors, two conditions had to be satisfied (which were the best proxies available for the stated purpose of section 3 of the KiwiSaver Act).

24. First, the individual in question had to have reported an expected retirement income shortfall, measured as the difference between the annual income they said they expected to have in retirement (the median was $35,000) and that which they said they would need to meet their basic needs (the median was $33,000). Only 20% of KiwiSaver members had an expected retirement income shortfall. The proportion of non KiwiSaver members who reported an expected retirement income shortfall was similarly low, at 24%.

25. The second necessary condition in order for an individual to be considered part of the target group of KiwiSaver was that, conditional on having a retirement income shortfall, upon joining KiwiSaver that individual had to substantially increase their savings as a result. In particular more than 30% of an individual's contributions to KiwiSaver had to represent additional savings. Only a third of individuals who reported a retirement income shortfall met this additional condition.

26. Only 7% of KiwiSaver members met these two conditions and therefore belonged to the programmes target group.[4] 93% of KiwiSaver members did not meet one or both conditions so are described as contributing to leakage from the scheme.

27. The figure for leakage of 43% which Inland Revenue have used in their Value for Money report (but sourced from Law, Meehan and Scobie (2011)) requires only something similar to the first of these two conditions to be met. In particular, rather than calculating expected retirement income shortfalls based on the annual income individuals said they would need to **meet their basic needs**, the calculation uses the higher level of income individuals said they would need **to be comfortable** (the median was $45,000).

28. Regardless of definition much of the following logic applies: For a policy change to improve leakage, at least one of three things would be required.

    a. First, more people could be somehow caused to have an expected retirement income shortfall. However, this is obviously not desirable.

    b. Second, the extent to which KiwiSaver generates additional saving would need to increase. It is not at all clear how this could be achieved and indeed recent evidence (Law and Scobie (2014)) suggests KiwiSaver may not be delivering any additional savings amongst members on average.

    c. This leaves reducing membership of KiwiSaver amongst the 93% of individuals who either do not report an expected retirement income shortfall (80% of members) or who do not save substantially more upon joining KiwiSaver. To achieve this would require being able to easily identify these people. However, this would be extremely difficult given the aforementioned inability to define the target population for KiwiSaver using conventional socio-economic metrics or identifiers (such as income).

4 It is likely that a similarly low proportion of people who were not members of KiwiSaver at the time of the study would be part of the programme's target group as defined.

Targeting measures to improve leakage is difficult

29. Indeed, Law, Meehan and Scobie (2011) undertook regression analysis to try and identify factors associated with the levels of individuals' expected retirement income shortfalls (or excesses). The key result in the current context (other than that KiwiSaver membership was found to have no effect) was that only two factors were associated with a reduced likelihood of reporting an expected retirement income shortfall. These were having higher income, or being a non salary / wage earner (i.e. being self employed, unemployed or not in the labour force). In both cases, however, the relationship is **weak**. These two factors are far from being perfect predictors of whether or not a KiwiSaver member belongs to the target group. So, even if KiwiSaver membership were restricted to those on relatively low incomes or only salary and wage earners, **we would not expect to see a substantial improvement in leakage**.

Options for Reducing Fiscal Cost and Value for Money of KiwiSaver

30. Using forecast information provided by Inland Revenue, Table 1 (below) provides estimates for annual fiscal savings that would result for each of a number of possible changes to KiwiSaver. These illustrative options relate either to reducing annual member tax credits, kick start payments, or a combination of both. While we have estimated fiscal savings for 2015/16 onwards, Inland Revenue advises that administrative constraints mean changes could not be implemented for the fiscal year 2015/16.

31. Option (1) halves the maximum annual member tax credit from $521.42 to $260.71. This is estimated to generate annual fiscal savings of approximately $270m in 2015/16 rising to $394m in 2021/22. These estimates take account of the current distribution of annual member tax credits and include a behavioural response from those people with no salary or wage income such as the self employed. However, no reduction in contributions to the scheme (which would include a reduction in contributions, increases in members taking contribution holidays or a reduction in enrolment) by salary and wage earners is assumed as a result of this option. This is because annual member tax credits for most people in this group will be substantially smaller than the compulsory 3% employer contribution to KiwiSaver which will continue to provide a substantial incentive to both join and contribute to KiwiSaver.

32. Because non salary and wage earners make up only a relatively small portion of the total membership of KiwiSaver, even assuming membership amongst this group were to fall substantially by 50% (as we have done), does not substantially affect estimates of fiscal cost savings. For example, if we instead assumed no behavioural response amongst this group upon halving the maximum annual member tax credit the estimated fiscal savings in 2015/16 would instead be $255m, $15m lower.

33. Removing the annual member tax credit entirely is estimated to generate annual fiscal savings of approximately $690m in 2015/16 rising to $912m in 2021/22. This is the option (2) presented in Table 1 and also provides an estimate of the costs of annual member tax credits in future years if KiwiSaver remains in its present form.

Table 1 – Annual estimated fiscal savings from KiwiSaver options ($ million)[5]

Option	2015/16[6]	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Annual Member Tax Credit							
(1) Halved	270	294	315	335	355	374	394
(2) Removed	690	729	766	803	838	875	912
Kick Start							
(3) Halved	59	52	52	53	53	54	54
(4) Removed	117	103	104	105	106	107	108
(5) Removed (for under 18's only)	25	13	12	12	11	10	10
Combination							
Option (1) + (3)	329	346	367	388	408	428	448

34. Option (3) is to reduce the kick start from $1,000 to $500 and this generates estimated annual fiscal savings of $59m in 2015/16 falling to $54m in 2021/22 assuming no resulting reduction in KiwiSaver membership. Option (4) removes the kick-start entirely and is estimated to generate annual fiscal savings of approximately $117m in 2015/16 falling to $108m in 2021/22. This option also provides an estimate of the costs of kick start payments in future years if KiwiSaver remains in its present form.

35. The final option (5) would remove the kick start entirely for those under 18 years of age. Assuming that this simply delays the point at which people join (i.e. someone who would have joined in 2015 when aged 16 will now join in 2017 when they turn 18) this option generates estimated annual fiscal savings of $25m in 2015/16 falling to $10m in 2021/22.

36. Any option presented to reduce annual member tax credits can be combined with any of the options to reduce kick start payments. As an example we have combined options (1) and (3).

37. All options presented will improve value for money measures as calculated by Inland Revenue in the Evaluation as these measures are simply ratios of additional individual savings to Crown contributions; where Crown contributions to KiwiSaver under each option are reduced. We would expect options (1) and (2) in Table 1 to reduce membership amongst non salary and wage earners such as the self employed and therefore these options may make a marginal improvement to leakage. It is not clear that any of the options presented would be likely to affect (positively or negatively) the extent to which KiwiSaver increases individual savings.

Other Issues – National Savings; Auto-Enrolment; HomeStart Policy

38. Our analysis has focussed on fiscal savings from changes to KiwiSaver. We have not undertaken a comprehensive analysis of the effects of these policy changes on other policy issues which have been discussed in the context of KiwiSaver changes in the past.

---

5 These estimates assume an announcement with Budget 2015 and are subject to further detailed analysis by officials and advice from Inland Revenue on the timing of implementation.

6 As outlined below, Inland Revenue require a 12 month lead time to implement changes to the annual member tax credit and kick start payment and therefore fiscal savings in 2015/16 are unlikely to be achieved.

39. The 2011 Budget changes to KiwiSaver removed the tax-free status of employer contributions to KiwiSaver, halved the annual member tax credit and increased the compulsory employer and employee contribution rates to 3%. A future one-off enrolment exercise was also announced, subject to a fiscal surplus. The Treasury's advice in advance of those changes analysed the effect of policy options on national savings (and the NIIP). Our current advice has not analysed those matters, however, we note that if the same logic were applied, a reduction in KiwiSaver subsidies would positively affect national savings based on available evidence. We also understand Ministers still intend to conduct the one-off enrolment exercise when fiscal conditions allow.

40. If you wish to pursue changes to KiwiSaver subsidies for fiscal strategy reasons, we recommend a discussion of the effects of these on national saving and on the efficacy of the one-off enrolment exercise.

41. Finally, the Government's HomeStart policy allows KiwiSaver members to use the kick start and annual member tax credit payments towards a first home deposit under that scheme. We have not considered the extent to which a reduction in the generosity of the kick start and annual member tax credits will affect the future success (or otherwise) of the HomeStart policy.

Time Frames for Changes

42. Following an analysis in the limited time available, Inland Revenue advises that, based on their previous experience of implementing an annual member tax credit rate change, Inland Revenue would require about **12 months lead in time** to implement the change. The implementation timeframe should consider alignment with the KiwiSaver annual member tax credit cycle (July/August each year) in which providers claim the bulk of annual member tax credit payments on behalf of members. The expected timeframe for implementing any changes to the kick-start payment is not currently known but it is envisaged that it could be easily accommodated within a 12 month period and it does not need to be aligned to any particular cycle.

43. Any targeted changes to **eligibility** for the annual member tax credit and/or kick-start based on income or employment status are more complex and would likely require system changes outside the existing configuration pattern of the FIRST system as well as changes in the SAP system. With the current work underway to facilitate Business Transformation it is important that the functionality of the FIRST system is not significantly affected.

44. Inland Revenue advises that they would need time to do more detailed analysis to fully understand the impacts, costs and timeline for implementing any changes. Changes to the timeframes may affect the estimated fiscal savings in this report.

Next Steps

45. This advice has been provided in response to a request for prompt advice. In the first instance, we would welcome a meeting with you to discuss your level of ambition for any proposed changes. Following that discussion, we could carry out a fuller analysis together with Inland Revenue colleagues.

Data Sources and References

Law, D., Meehan, L. and Scobie, G. (2011) “KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving.” Wellington, The Treasury, Treasury Working Paper 11/04.

Law, D. and Scobie, G. (2014) “KiwiSaver and the Accumulation of Net Wealth.” Wellington, The Treasury, Treasury Working Paper 14/22.

Inland Revenue Department (2014) “Government Retirement Savings Incentives in New Zealand: do they provide value for money?”, Wellington.

Inland Revenue Department (2015) “KiwiSaver Additionality and Substitution Research.” Wellington.

Inland Revenue Department (2015) “KiwiSaver Evaluation Synthesis Report”, Wellington.