Formatted

Hon Dr Michael Cullen

Deputy Prime Minister, Minister of Finance, Minister of Revenue, Leader of the House

13 June 2003

Speech Notes

Embargoed until: 10am, Friday 13 June 2003

Retirement Commission Symposium: The Net Wealth of NZers.

Diana. This is the first opportunity I have had to thank you for taking on the important but testing role of Retirement Commissioner. I have absolutely no doubt that your energy and persistence will test the limits of the apathetic on the issue of the financial wellbeing of New Zealanders as they wander through life and end up retired.

This brings me to my second point.

You are here to explore new dimensions of the factors that contribute to the net wealth of New Zealanders. In many respects the net wealth of New Zealanders is not all that far removed from their fortunes with their Lotto tickets on a Saturday night.

Life is a lottery. Many years ago Aristotle Onassis was asked for the secret to his immense wealth. His response was “When I was a very young man, my father gave me some sound advice: here’s a million dollars – don’t lose it”. When Aristotle Onasis was a very young man, a million dollars was a very big, bold type, capital letters million dollars!

Net wealth is in many ways determined by the hands we are dealt during the stages of life. Family wealth and connections. Inheritances. Luck with entering and leaving housing and stock markets. Whether the companies we work for prosper or perish. If redundancy hits our industry and the town we live in and lays waste the value of the houses we have bought.

That, though, is only a part of it. We are, as ever, substantial architects of our own fortunes and misfortunes. We can save and invest, and influence a big part of the net assets we end up with. This brings me to saving; a topic that will take centre stage at this symposium.

“Saving” is a slippery concept. In its most simple form, it is that part of income that is not consumed. By deferring consumption, the individual (or group, or even nation) is able to consume different things in a later period. Savings change the scheduling of consumption. If savings are channelled through an instrument that earns income, more is consumed in the future time period.

Saving therefore not only shifts consumption through time, but it also increases the level of consumption in the later time period.

Saving increases the financial flexibility people have, and (generally) increases the amount of money they have in the future.

Assuming that people will not save if they can't afford to, savings are good for the individual.

Savers save for a host of reasons: to buy a lumpy consumer durable like a car, for the so-called rainy day (as an aside, I've never quite understood that saying – you tend to be trapped indoors on a rainy day and actually spend less), for an income in retirement, or simply because, like Jeanette Fitzsimons, they have more money than they need to spend at the time.

The question I have, then, is whether there is any need for a savings **policy.** Individuals will make personal choices about spacing consumption according to their needs and their expectations of future income and risk (adults making adult decisions). Investors will similarly make personal decisions about how much to offer to induce savers to lend them their money. Why should the government interfere?

In most instances, governments don't interfere to try and influence how people spend their own money. Certainly there are public goods like national defence, police, roads, health, education and welfare where the government does decide what people spend their money on, but it taxes them and has to go through an elaborate process to get agreement on the spending.

The government sets standards for markets. There are laws about truth in advertising (we long since gave up trying to legislate for truth in reporting), about fair trade practices, about safety standards and about the ages at which some people can buy certain products. Apart from standards, though, governments don't favour cars over horse-drawn carriages or try to shape what sort of leisure activity people spend their money on.

Why then, should a government either compel – say as per the Australian model – or incentivise with tax dollars, whether income should be spent or saved?

The answer, from the government's point of view, is ultimately risk.

There is an element of paternalism lurking in the background: people don't know what is in their own best interests but governments do! I don't want to write that off completely. There is a growing body of research that identifies barriers to savings: people lack confidence, or don't have adequate information, or put off activating what they rationally intend to do until it is too late. A savings policy can align intended action with what actually happens by clearing out those roadblocks to saving. At the end of the day, though, it is a question of risk. If people do not save enough, when they lose a job or stop working, the responsibility for their livelihood inevitably and unavoidably comes back to the government.

I have often said that the ability to retire in a degree of personal comfort, without worry and with dignity, is the least that citizens can expect in a modern, developed economy. I have also said that it is the most they can expect. They cannot expect the state to maintain in retirement the incomes the people became accustomed to during their working lives.

It is precisely because our tax funded superannuation scheme does not attempt any sort of income maintenance that it is relatively inexpensive, certainly by European standards. While it is relatively inexpensive, it also has the effect of leaving a gap – for most retirees – between what they had become used to and what they are reduced to. I repeat that New Zealand Superannuation is designed to be an adequate, not a generous, pension.

There is a tendency to focus on the "65 at 65", and see 65 per cent of the average wage as comfortable. Remember that that is for two people. Each person in a couple retires on closer to one third of the average wage. A single superannuitant is on about 40 per cent of the average wage.

A maintenance of standards of living in retirement therefore does depend on some personal income to replace at least a part – and often a substantial part – of the earnings that are lost by retiring.

The first task is to do a stocktake and see if this is happening. If people are making adequate provisions for their retirement, there is no need to do anything. We should not have a savings policy just for the sake of having one.

I have to say that New Zealand would be very unusual if there was no problem in this regard.

A 1993 study in the USA found that the baby-boomers were saving enough to replace about one-third of their current incomes when they entered retirement. There are all sorts of qualifications that need to be applied to that raw conclusion. Firstly, there should not be a presumption that retirement income needs to equate with income levels during working life. In 1993, the boomers would have been in their mid forties and could well have been earning a lot to finance the tertiary education of their children. There should not be a presumption that spending at those levels has to be maintained to sustain a comfortable lifestyle later on. Secondly, there is some evidence of a "wake up call" that comes with an eventual acceptance of the inevitability of ageing. Savings tend to accelerate from the mid forties as time for saving starts to run out. Qualifications aside, there is still a big gap between what they were doing and what we might objectively have expected them to have been doing.

Later today, Grant Scobie will be presenting data that shed more light on the replacement rates that New Zealand savers seem to be achieving. That will be an interesting exercise.

A difficulty with any of these exercises is that there is an impicit assumption that the assets that have been built up are available to finance consumption in

retirement. In theory they all are, but in practice they may not be. This is particularly true of owner-occupied housing which, on average, accounts for 36 per cent of the net wealth of New Zealanders. There are strong cultural and social practice pressures to see the family home as the asset of the heirs, not of the owners. The owners have rights of occupancy – in their minds if not in law – and may well limit how well they live to protect the inheritance. It is true that the owned home provides shelter at less cost than would rented accommodation and is a real asset contributing in a material way to wellbeing in retirement. The issue is, though, whether continuing to own rather than liquidate the asset through some form of reverse mortgage, means that New Zealanders over-consume housing during retirement. If they do, actual replacement rates from savings may be lower than they appear to be.

This may all come out in the wash: the house is consumed, but just with a lag of one generation. The Household Savings Survey showed that especially before retirement, single people who have inherited assets have median net assets more than twice the value of single people as a whole. The gap narrows a little in the immediate pre-retirement age band (55-64) as people accumulate assets and the proportionate influence of the inheritance declines. In this bracket net assets of those who inherit are "only" 80 per cent higher than for the population as a whole. In absolute terms the differences remain the same at around $100,000.

Similar patterns are shown for couples, although the relative differences are not quite as large. This probably reflects the fact that couples accumulate more assets between them during the life cycle, so the asset base is larger relative to the inheritance. In absolute terms, inherited assets boost wealth by a little more than for single people, probably because there is a greater chance that both partners will inherit something.

I will be interested to see how inheritances are factored into calculations of replacement rates. This is a difficult area for policy because policy cannot rely on averages: I suspect that like with Aristole Onasis, the averages mask big differences between those who inherit a lot of wealth and those who inherit moderate amounts.

The symposium is also looking at the Australian experience. This relates to the earlier matter I raised of whether compulsion in some form enters the policy mix.

We do have a form of compulsory superannuation here: it is called New Zealand Superannuation. It is just that the compulsion is inter-generational. I don't want to be seen to be foreclosing on the issue of compulsion before discussion of it begins at this symposium, but I will offer some insights.

There is a huge philosophical step associated with compulsory savings. It is one thing to educate people about savings and to encourage them to save. It is another to give them incentives to save. It is altogether different to require them to save in certain forms, rather that spend that money on paying off a student loan, buying a house, educating their children or even having a holiday.

Any compulsory system inevitably runs into enormous problems around exceptions and exemptions. Emigration, matrimonial property settlements and financial hardship are only three that spring to mind.

At the end of the day, though, I detect one common thread running through all compulsory retirement savings schemes: they are designed not so much to replace the loss of earnings once people are retired, but to replace the amount that the government has to pay to maintain income adequacy in retirement.

It is on this issue that compulsory savings schemes have hit a wall of public opposition in New Zealand. There is a perception that people are not so much saving for themselves, but are saving on behalf of the government. Compulsory regimes tend to be built either on a very low base rate of universal entitlement, or on some abatement regime under which the amount of state pension paid reduces when individuals receive incomes from personal accounts.

Under these regimes, there is resentment by those who save that those who don't get the tax funded payment. There is also gaming: people try and withdraw balances before they start to count against the state entitlement, or they convert them into capital assets or other forms that do not count in the abatement calculation.

I would also caution against trying to import a regime that developed in a particular time, place and circumstance into a completely different place, at a different time, and under very different circumstances. The Australian model could be introduced because they had a highly centralised wage fixing system, a very specific electoral accord between the Australian Labor Party and the Australian Council of Trade Unions, and faced a balance of payments crisis that made sense of converting a wage increase that was due into individual savings account balances.

If they were starting again, and didn't have the wisdom of hindsight, I doubt very much that the Australian model could be introduced even in Australia at this time.

Since this is a symposium, where the aim is to explore ideas, and not a policy negotiation forum, let me throw one idea into the ring. When we talk about the net assets of New Zealanders we tend to talk about the financial assets under their personal control: assets they can sell. If we are talking more generally about the net wealth of New Zealanders – and specifically how this impacts on retirement – how do we value the asset of citizenship?

Citizenship carries with it entitlements: entitlements to any state funded pension that is available, and entitlements to health care. It is probable that the net wealth associated with rights of citizenship vastly exceeds the net financial assets under personal control for the vast majority of New Zealanders, especially in retirement and increasingly so as they get older and need more health care.

At present, the amounts paid out on New Zealand Superannuation each year are almost one-third of the total value of balances in registered superannuation

schemes. Making some rule of thumb assumptions about interest earned on fund balances during retirement, these magnitudes imply that in an intergenerational sense, collectively we are only funding maybe four or five years of retirement income out of personal superannuation plans.

Looked at another way, between 60 and 70 per cent of the incomes of the retired currently come from New Zealand Superannuation . Those different approaches to the same equation tend to reconcile. The broad brush conclusion is that collectively – and there are vast differences between individuals within that collectivity - a third of our income in retirement comes from personal saving and two-thirds by consuming the asset associated with rights of citizenship.

That is income. There is a part of consumption that is not funded out of income and that is the health care provided free or at below cost. The best estimate available is that health care provided to those over 65 costs an additional 60 per cent on top of the cost of New Zealand Superannuation. NZS is not the tip of the iceberg as far as the value of the asset of citizenship is concerned, but it is probably only two-thirds of that value. This is not a criticism or complaint: it is just a fact of life that as people age their health care needs increase.

In this wider context, it is fair to say that over three-quarters of consumption during retirement is financed by drawing on that asset called citizenship.

Here is the dilemma for policy. If the state is providing over three quarters of the consumption needs of the retired, is the urgency of private provision reduced? On the other hand, if there is such a high level of dependency on state support in retirement, what risk strategies should people take around the continuation of that level of support as both the numbers in retirement and their proportion of the total population rise dramatically? Simply, is the dominance of public provision of support in retirement a good thing or a bad thing?

Governments can, and in my view should, try to reduce the risk that state supports become unsustainable. This government has done its best to do that by setting up the New Zealand Superannuation Fund. That has required substantial fiscal discipline: we are putting a bit less than 2 per cent of GDP, or 4.2 per cent of government revenue, into the fund.

The fact remains that governments can't bind future governments, and they cannot anticipate what other fiscal pressures will emerge in the longer term. Increased security will never mean total certainty.

I hope these comments create enough confusion as a basis on which you can start your deliberations today. There is a new vigour in the debate around savings and retirement income. This symposium is an example, but we have the Insurance and Savings Industry Association summit next month, and the report of the Periodic Review Group to look forward to at the end of the year.

All in all, savings is coming out of the "too hard" tray, and I am confident that the analysis and debate will lead to significant advances in understanding the

requirements of sound policies on savings and retirement incomes. I congratulate the Retirement Commission on its initiative in convening this symposium and wish you well for your deliberations.