Abstract

In an attempt to invigorate private savings for retirement, the New Zealand Government had introduced the KiwiSaver from July 2007. It is a work-based retirement scheme with the goal to lift the wealth of retiring New Zealanders with investments that will supplement the pre-existing New Zealand Superannuation income.

The uniqueness of the KiwiSaver lies in its combination of voluntary enrolment, coupled with various financial “sweeteners”, contribution holidays and exemptions for early withdrawals. Various tax credits are also given to both employees and employers. In the first year of implementation, the employer contribution matching is not compulsory. However, this will change from 2008 onwards whereby employers are required to contribute 1% of the employee’s salaries or wages. The rate will rise by 1% per annum every year to a maximum of 4% by 2011. The employers is expected to have increased compliance and business costs from the KiwiSaver but these will be partly offset by tax credits and the 3% reduction in the business income tax in 2008. Other employer incentives include exemption from the Specified
Superannuation Contribution Witholding Tax (SSCWT) of up to 4% of the employees' salaries, for contributions made by the employers.

The KiwiSaver scheme has many implications for key stakeholders such as employers, employees, taxpayers, Government and the investment providers. Increased business compliance costs and Government spending are some of the operating costs of KiwiSaver. Other implications include potential growth in the financial market, the encouragement of habitual savings, and decreasing of pensioners’ reliance on state support for retirement. The clear winners for the KiwiSaver scheme are the investment providers and employees. Other stakeholders will gain some benefits and incur some costs with the scheme. This paper will also examine the policy implications as the KiwiSaver will ultimately be funded from tax revenues.
INTRODUCTION

The New Zealand Labour led Government announced (in the 2005 Budget) its intention to implement a work based retirement scheme (the KiwiSaver). The objectives of the scheme are to invigorate private saving and to curb excessive domestic spending. The Government was concerned with the nation’s growing appetite for spending and therefore lack of financial preparation for retirement.

However, some economists do not share the Government’s concern for the nation’s lack of financial preparation for retirement. There has been much debate as to whether the nation as a whole has a savings problem. Research conducted by Treasury indicates that the nation is saving enough for retirement. This however contradicts the research conducted by the Reserve Bank and the Organisation for Economic Co-operation and Development (OECD).

Despite the on-going debate on savings, the Government took what could be described as a paternalistic stance towards retirement savings via the KiwiSaver scheme. The KiwiSaver is different from other saving schemes within the OECD countries in terms of enrolment option, contribution holidays and financial incentives for joining.

Beginning 1 July 2007, all new employees aged 18 to 65 will be automatically enrolled with the KiwiSaver, with an opt-out option undertaken within 2 and 8 weeks from the commencement of their work. Employees who join will receive many financial incentives. They include a $1,000 kick-start lump sum payment, $40 administration fee subsidy per annum, compulsory employer contributions from 2008 onwards, first home subsidy for low-income earners and up to $1,042.86 tax credit per year (Armstrong 2007). These monetary incentives aim to boost the saving funds that are to be invested with the private sector, and encourage entry into the scheme.

The KiwiSaver saving scheme is an individualised savings account managed by the private investment providers. The scheme is portable and is not dependent on where the employee works. Funds are locked in the scheme until the employee reaches 65 years of age. To overcome any inertia towards savings, the scheme incorporates
commitment devices and withdrawal hurdles. Early withdrawals are discouraged with the exception of special circumstances like emigration, severe ill health or the purchase of a first home. However, employees can apply for a “contribution holiday” – a suspension of regular payments – after one year to enable employees to have a break from saving. Contribution holidays have a maximum period of 5 years and there is a restriction on the number of contribution holidays which can be sought.

The KiwiSaver scheme is also available to non-employees. Children, beneficiaries and self-employed can contribute to the scheme but they do not get any employer contributions and are required to apply directly to the investment providers.

According to Eaton (2007), the KiwiSaver will cost taxpayers an estimated $3 billion over four years beginning 1 July 2007. The cost includes hiring of additional Inland Revenue Department (IRD) staff, and administration and financial incentives granted to employees and employers. Employers, IRD and the investment providers will absorb the increased administration costs.

With the KiwiSaver scheme, employers will face increased compliance and business wage costs associated with its implementation. To alleviate some of these costs, the Government has granted new tax relief and exemptions to employers. Effective from 2008, a further 3% reduction in the business tax rate helps to soften the impact of the KiwiSaver compliance costs for employers. These incentives can constitute substantial tax savings, particularly for larger companies.

The long-term survival of KiwiSaver is dependent on the Government, and the ability of the scheme to fulfil its objectives. Previous attempts to introduce a nation-wide retirement scheme since 1974 have all failed. The Labour and National parties, the two major political parties, could not agree on specific issues that caused this. Even with the present scheme, not all members of Parliament voted for it. There is a possibility that the KiwiSaver may not continue in the future if there is a change to a National-led Government. This is due to two reasons. Firstly, the present National party did not vote for the scheme and secondly, the National party has not favoured a compulsory or quasi-compulsory national retirement saving policy in the past.
The focus of this paper is to examine the rationale of the KiwiSaver scheme and its implications on the main stakeholders. The discussion involves several sections:

1. A brief discussion of the savings debate.

2. Discussion on the rationale and perceived advantages of the KiwiSaver

3. Implications of the scheme on key stakeholders.

4. A discussion on the limitations and conclusion for this paper.

DEBATES ON THE ADEQUACY OF NEW ZEALAND SAVINGS

From 1974 there has been no universal compulsory retirement saving scheme in New Zealand. Before the KiwiSaver Act was enacted in September 2006, the Government had followed a laissez-faire approach towards private retirement savings for its people. The two major political parties do not agree as a matter of policy on the importance of having to encourage private savings. In addition, more than 90% voted against the 1997 referendum for a nationwide retirement policy. Often there was skepticism about political suggestions for retirement savings, as they have been used as political footballs (St John 1999) during election campaigns. Furthermore, there is no agreement that New Zealand had a savings problem according to research done by the Treasury, Research Bank and the OECD. This is because different underlying assumptions were used in this research and therefore comparability of results was not possible.

Morgan (2006) and Treasury research conducted by Guest, Bryant and Scobie (2003), Scobie, Gibson and Le (2004), Le, Scobie and Gibson (2007), and Scobie, Le and Gibson (2007) indicated that there was no savings problem in New Zealand. Their findings confirmed the assessment of the Periodic Review Report (2003) and concluded that New Zealanders are saving adequately for their retirement.
However, research from the Reserve Bank by Hodgetts, Briggs and Smith (2006), OECD (2007) and Statistics New Zealand (2003) portrayed a contrary view indicating that New Zealanders were not saving enough. This conclusion was supported by the fact that New Zealand ranks the third highest among the OECD countries in terms of net foreign assets as a percentage of Gross Domestic Product (GDP) (Lane and Milesi-Ferretti 2006). The media also painted a grim picture of low savings levels and the escalating current account deficits over the last few years (Gaynor 2006).

Notwithstanding these conflicting findings, the Government chose to stimulate private savings via the KiwiSaver. The May 2007 Treasury report also suggests a interventionist approach towards savings. Unlike previous Treasury reports, this report encouraged the Government to intervene with the private savings using a suite of policies based on the “least regret” approach.

THE RATIONALE AND PERCEIVED ADVANTAGES OF THE KIWISAVER

The emergence of the KiwiSaver was a direct result of three problems faced by the Government. Firstly, there will be an increasing number of pensioners in 10 to 15 years time. Secondly there is ongoing consumer overspending. Thirdly there is a lack of domestic retirement savings. These problems imposed significant pressure on the state to fund the rising pension costs not met by existing arrangements.

In 1991 the Task Force predicted an increasing proportion of dependents (those that are 65 years of age and older) to peak in 2041 and remain at approximately the same level for the next 10 years (Task Force on Private Provision for Retirement 1991, 1992). The prediction is depicted in Figure 1 below. The dependency ratio will double between 2006 and 2041 implying substantial increases in age-related costs and superannuation payments.
There has been a growing concern with the significant increase in consumption and declining savings. The published current account deficits and high foreign debt attracted substantial attention. The high spending was a direct result of the favourable New Zealand dollar and the availability of large foreign capital, due to the high New Zealand interest rates. Cheaper imported goods have created consumer spending cravings. The ease with which borrowings can be obtained has further compounded the spending appetite. This high spending has resulted in a surge in both foreign debt and current account deficits as shown in Table 1 below.

Table 1: Comparative New Zealand’s debt, current account, assets and liabilities between 2003 and 2006

<table>
<thead>
<tr>
<th>Items</th>
<th>December 2006</th>
<th>% change</th>
<th>3 years ago (2003)</th>
</tr>
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<tbody>
<tr>
<td>GDP (nominal)</td>
<td>$157.9 billion</td>
<td>+18%</td>
<td>$134.1 billion</td>
</tr>
<tr>
<td>Household debt</td>
<td>$149.6 billion</td>
<td>+49%</td>
<td>$100.1 billion</td>
</tr>
<tr>
<td>New Zealand’s</td>
<td>$104.4 billion</td>
<td>+45%</td>
<td>$72 billion</td>
</tr>
</tbody>
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Table 1 indicates that both household debt and offshore loans have exceeded the increase in the GDP from 2003 to 2006. This has resulted in significant interest payments with adverse current account deficits in 2006.
The over-spending adversely affected the nation’s net imports. Net imports have increased by $2.6 billion between 2003 to 2006. This is further compounded by the rising investment payments resulting in an increase in the current account deficits of 144% (Gaynor 2006). All these statistics paint a grim picture of New Zealand’s net wealth, and indicate potential serious repercussions. Among these is the ongoing need to service the foreign debt, coupled with restrictions associated with borrowings. Furthermore, borrowers are susceptible to changing interest costs and any signs of default payment may result in more sales of domestic assets to foreign investors.

Since the Labour-led Government was elected in 1999, some indication of the need to increase financial provision for retirement began to emerge. This was met by a response from the Government. The first indication of the Government’s commitment towards retirement provision was the creation of the New Zealand Superannuation Fund in 2001. This was followed by the introduction of the 2004 State Sector Retirement Savings Scheme for public sector employees. In the 2005 Budget the KiwiSaver scheme was announced before it was passed into law in 2006. It was implemented nation-wide on 1 July 2007.

The Labour Government perceived many positive spin-offs when families and individuals save towards their retirement. These include:
- curbing spending;
- improving the nation’s wealth in the future;
- reducing the current account deficit;
- deepening the financial market; and
- promoting a more sustainable New Zealand economy (Cullen 2007).

Allocating a portion of one’s resources towards savings will not only curb spending but also help to build up wealth for future retirement. Supplementing the pension with private savings will improve the standard of living of retirees and help promote their financial independence.
In addition to individuals benefitting from savings, it may also be to the nation’s advantage. The larger pool of savings will build up national equity, enabling further investments locally and offshore. For example, Australia has accumulated almost $1 trillion in their superannuation funds since the introduction of the 1992 compulsory employee savings scheme (Bennett 2007). The large equity buildup from the superannuation fund enables the development of a more sophisticated Australian financial market thus attracting local and foreign investments.

Despite the many perceived advantages of a nation that saves, one needs to be aware of the associated costs with implementing a nation-wide retirement saving scheme such as the KiwiSaver. The implications of the scheme are wide ranging and taxpayers and employers will have to bear the financial burden with the KiwiSaver.

**IMPLICATIONS OF THE KIWISAVER SCHEME**

The operation of the KiwiSaver will affect many stakeholders in differing ways. The main stakeholders affected are employers, employees, Government agencies (such as the IRD in particular) and investment providers. The implications are many and varied as some stakeholders will financially gain from it but not the others. For example, employers will face increased compliance costs whereas employees who joined the scheme will benefit from it due to the financial “sweeteners”. This section will examine the impact of the scheme on the stakeholders in terms of compliance and incentives granted.

**Employers**

Employers will face increased business costs resulting from administration and the contribution matching under the KiwiSaver scheme (Young 2007). This has been estimated to be approximately $600 million a year (Eaton 2007). The general obligations of employers with the KiwiSaver scheme are as follows:

- Decide whether they are an exempt employer by ensuring they meet certain qualifying criteria
Ensure that new employees (ages between 18 to 65) as at 1 July 2007 are given IRD information packs about the KiwiSaver

Obtaining relevant information from new employees and pass them on to the IRD

Provide employees with IRD information about the KiwiSaver scheme or any scheme that is chosen by the employer

Acting on any “opt out” options within weeks 2 and 8 timeframe and pass them on to the IRD

Ensure that any contribution holidays, ceasing of deduction, changes to the employee’s contribution rates are handled carefully and information provided to the IRD

Responding to existing employees request to join, verify their eligibility and notifying the IRD

Calculate and deducting the employees’ nominated contribution rate (4 or 8%) from all gross wages and salaries and paying those contributions via the PAYE. The definition of wages or salary under the KiwiSaver Act 2006, subsection 4(1) includes all taxable allowances and accommodation, overtime pay, bonuses and holiday pay.

Paying all employer specified superannuation contributions to KiwiSaver schemes via the IRD including employer monthly schedules

Make all compulsory contributions effective from 1 July 2008 onwards.

Sections 215 and 216 of the KiwiSaver Act provide for monetary penalties should employers failed to provide information to the employees or failed to make correct deductions. Any employees’ contributions deducted by the employers but which were not passed on to the IRD will be funded by the Government up to $20 per week per employee. The IRD will then seek the shortfall payment directly from the delinquent employers.

Legislation on compulsory employer contributions and the associated Government tax credit is currently before Parliament and the outcome will be known at a later stage. Once enacted, it will become effective from 1 April 2008. Employers will then be obliged to contribute 1% of the employee’s gross wages to the scheme. The contribution matching will not significantly increase business costs until 2010. This is
due to the tax credit granted by the Government to the employers, of up to $20 per week per employee. After 2010, employers will face increasing wage costs as the tax credit would be insufficient to meet the employers contribution of 3% of gross wages and salaries for the employees. This may prompt employers to reduce their costs by reducing wage payments or increase prices charged to customers.

However, the Government is granting three financial incentives to businesses to reduce compliance costs. First, tax tax credits of up to $20 per employee per week (maximum of $1,042.86 per annum) will be given for their contributions. Second, the employers’ contributions are exempted from the Specified Superannuation Contribution Withholding Tax of up to 4 per cent of the employee’s wages or salaries. Third, there will be a reduction of the business income tax rate from 33% to 30% for the 2008/2009 financial year onwards.

**Employees**

The Government is encouraging enrolment into the KiwiSaver by granting several financial incentives to employees. These incentives include

- a one-off tax-free lump sum kick-start of $1,000;
- a $40 per annum administration fee subsidy;
- a tax credit of up to a maximum of $20 per week (or $1,042.86 per annum);
- a housing subsidy for low income earners;
- employers’ contributions from 1 April 2008 onwards;
- a mortgage diversion facility (where allowable by the investment provider);
- and a contribution holiday facility.

The KiwiSaver employees account is an individualised investment portfolio managed by fund managers. It is portable and they can change between any Government approved investment providers but they can only belong to one scheme at any point in time.

The KiwiSaver scheme aims to develop long term habitual savings and therefore funds are locked-in until the employees reach 65 years. There are limited exceptions
for early withdrawals such as emigration, serious illness and the purchase of the first home. These permitted withdrawals will not attract the 5% withdrawal tax. In some instances of early withdrawal, the member’s tax credit will be forfeited to the Government. For example, on permanent emigration the employee can withdraw everything after one year of having been away from the country but the Government can claw-back the $20 per week tax credit contribution (Stock 2007).

However, employees must be aware of certain restrictions and limitations of the KiwiSaver despite the many financial sweeteners granted. As the saving funds are invested with the private providers in a trust account, the Government does not guarantee the security of the funds. Employees should make the decisions to join with the scheme within 8 weeks of their new employment. If they do not opt out within that time frame, they will be required to contribute towards the KiwiSaver for at least 12 months. This may restrict the financial freedom for some employees due to unanticipated financial obligations.

Inland Revenue Department (IRD)

Among all the Government agencies, the IRD is the central place for all administrative tasks for the KiwiSaver scheme. The IRD has been given wide powers to act as an intermediary for the collection of contributions and then pass them on to the investment providers. They can also impose fines and penalties on employers who have not fulfilled their KiwiSaver obligations. Any delinquent employers who do not surrender the employees contributions will be followed up by the IRD. Other responsibilities of the IRD include

- receiving member’s contributions;
- providing KiwiSaver information packs;
- allocating members to default KiwiSaver schemes;
- administering opt-out and contribution holiday requests;
- passing the contributions to the KiwiSaver providers;
- verifying employers’ contributions;
- collecting any short payments from the employers;
• paying tax credits for employer contributions; and
• paying tax credits, lump sum and administration fee subsidies to the
  KiwiSaver providers for employees’ individual accounts.

The administration of the members’ contributions is processed via the PAYE tax
system to minimise business compliance costs. This additional work caused by the
KiwiSaver will require additional 300 to 400 IRD staff to administer and monitor the
scheme (National Press Releases 2006). As KiwiSaver is an individual retirement
savings account, the administrative load on the Government, on employers and on the
providers, can be substantial.

Investment providers

Due to the larger pool of voluntary savings from the KiwiSaver, it is inevitable that
the New Zealand financial market will benefit from it. Prior to the KiwiSaver, there
had been no tax incentives to save for retirement. The largest form of savings is in the
form of housing stocks (Hodgetts, Briggs and Smith 2006) due to the tax incentives
for housing investments and the sentiments associated with tangible brick and mortar
housing asset (Goh, 2005). Consequently, the New Zealand financial market is
relatively “thin” compared to other assets held by the nation.

The KiwiSaver aims to boost the financial market with the larger pool of savings
funds. Investment providers and fund managers are expected to have an increase in
financial business. Much can be learnt from our Tasman counterpart, Australia, who
currently enjoys superannuation fund of up to AS1 trillion since the implementation of
their 1992 compulsory employee savings. The high liquidity created by KiwiSaver
should stimulate the financial market and provide more opportunities for local and
foreign investments.

Employees who joined the KiwiSaver scheme are given choices on the Government-
approved investment providers. If they do not nominate a preferred investment
provider, the IRD will nominate on their behalf from the six default providers on a
rotational basis. These default providers have been carefully selected by the Government and they are required to accept all members who wish to join. The default providers are

1. ASB Group Investments Limited;

2. AMP Services (NZ) Limited;

3. ING (NZ) Limited;


5. National Mutual Corporate Superannuation Services Limited (trading as AXA New Zealand); and

6. Tower Employee Benefits Limited

The Government has categorised these providers as default based on these criteria

- security and organisational credibility;
- organisational capability;
- proposed design of the scheme;
- administration capability;
- competitive fee levels; and

Employees who are not familiar with investments would tend to join the default providers or select the employer’s preferred provider. However, it must be noted that the majority of the default options will be conservative investment portfolios consisting mainly of short-term, high quality, fixed-interest securities with low risk. It is therefore expected that the default investment options will generate relatively low returns (Woodbury 2006). Stock (2006) also highlighted the poor investment performances for AMP, ASB and AXA over the last five years ending October 2006.
This section described the impact of the KiwiSaver on certain stakeholders. Not every stakeholder will benefit from the scheme and it is clear that the KiwiSaver will incur considerable start-up costs, and not inconsiderable on-going administrative costs. The KiwiSaver scheme will cost taxpayers an estimated $3 billion over four years and an additional $1.2 billion a year after the implementation period (Eaton, 2007). Employers are expected to incur $600 million annually to comply and administrate the scheme (Eaton, 2007).

The main beneficiaries of the scheme are those employees who join and the investment providers. However, due to the infancy of the scheme, one is unable to fully realise the full effects of the scheme until later. The perceived advantages of the KiwiSaver may not be in evidence until the scheme has been fully operational for several years. At this stage, one is unable to determine fully the viability of the scheme and therefore an acknowledgement of the limitations is important in determining the scope of the paper.

LIMITATIONS OF THE STUDY

The scope of this paper is limited to discussing the rationale of the KiwiSaver scheme and its initial impact on the main stakeholders. An evaluation of the viability and sustainability of the KiwiSaver scheme is best carried out a few years after its operation. It is imperative that initial teething problem will arise due to the newness of the scheme. But that in itself does not negate the benefits of having a retirement savings scheme. Further research and critical evaluations of the KiwiSaver in achieving its goals is therefore necessary post-implementation of the scheme.

It is also not the intention of this paper to discuss the issues surrounding the adequacy of savings in New Zealand and to determine whether an interventionist retirement savings policy by the Government is appropriate or not. This debate is best carried out before the KiwiSaver is implemented nationwide. Future research should concentrate on identifying the most efficient and effective way in managing the scheme which will generate an overall positive return to the society ie. the cost of having the scheme
is less than the benefit derived from it. Other future research should include examining the views of the stakeholders involved with the KiwiSaver.

CONCLUSION

There are many reasons for a nation-wide retirement saving policy to be in place, but the most important reason for the implementation of the New Zealand KiwiSaver is to develop a savings culture to improve current account deficits and create wealth for retirement. Unlike other national savings schemes within the OECD countries, the KiwiSaver is unique in terms of enrolment options, incentives granted, and contribution holidays. There are flexibilities within the scheme to encourage participation but also withdrawal hurdles to facilitate long term habitual savings.

Associated with the KiwiSaver are the many implications on key stakeholders. Some stakeholders welcome the scheme as they can benefit financially from it, whereas others may not be as enthusiastic as the scheme will cost them time and money. Employees and investment providers are expected to gain financially from the scheme, whereas employers and taxpayers are expected to pay for it.

Employees are encouraged to save with the KiwiSaver due to the many financial sweeteners and tax credits granted. It is also expected that these financial sweeteners may encourage existing savers to divert their savings towards the KiwiSaver. To limit its effect, the incentives cap of the KiwiSaver will help address this issue. The overriding aim of the KiwiSaver is to encourage the citizens to save.

Increased savings will boost financial business, thus enabling fund managers more investment opportunities. The long term flow-on effects will enlarge and strengthen the New Zealand financial market. This may bring a more balanced mix of the asset portfolio by redirecting savings to the financial market and away from the traditional housing asset.
The contribution matching required of employers from 2008 may force some employers to lower their net wages paid to employees and/or charge higher prices. Thus, one needs to be aware that the KiwiSaver scheme has significant costs and is funded by taxpayers and businesses. It is important that the nation should not be myopic about the associated costs when assessing the viability of the KiwiSaver scheme.

The long-term survival of the KiwiSaver scheme is dependent on future election outcomes and the success of the scheme in achieving its objectives. History has shown the abandonment of previously legislated retirement saving schemes with the change in Government in the 1970s. As the present KiwiSaver did not receive unanimous support from all members of the parliament, a future change in the Government can possibly lead to its demise. As the scheme is very much at its infancy, it is difficult to assess the likely sustainability of the KiwiSaver as only time will tell. An evaluation should be undertaken post-implementation of the scheme to include views from all stakeholders. Their accounts will contribute towards assessing the suitability of KiwiSaver to New Zealanders and the need for a nationwide retirement savings scheme that is not only costly to administer but also disadvantage businesses in terms of compliance and administrative costs.
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