Kiwi Saver: is it good public policy?

by Keith Rankin, 16 April 2008

For a variety of reasons, there has been a call in recent years for New Zealand households to save more of their disposable incomes. Kiwi Saver is the government's answer to this call. Benefits are supposed to accrue to the New Zealand economy as a whole (through higher economic growth), and to individuals who, it is hoped, will be able to look increasingly to their own private means to sustain them in retirement.

The case that low rates of household savings is a constraint on growth, let alone the most important constraint, has never been made. Saving is supposed to facilitate business investment. Bank lending has been relatively unconstrained, however, despite allegedly low savings. But banks increasingly lent to households rather than to businesses.

It is true that investment (spending on capital goods) growth may be inadequate to yield the all of the productivity gains we might require to achieve a high and sustainable rate of economic growth. But a lack of savings is not the problem; rather it's a lack of investment opportunities given a variety of monetary and fiscal policy settings that are focussed more on slowing New Zealand's economy down rather than speeding it up.

Another New Zealand argument for increased savings is that our long-standing current account deficits represent our dissaving as a nation. But, if the current account of the balance of payments was truly a measure of saving, then, in the world economy as a whole there could never be any saving. By definition, the current account deficits and surpluses of all the world's countries cancel each other out; the combined deficits of some are exactly equal to the combined surpluses of the others.

There are individual benefits (and costs) that arise from increased individual savings. By saving an increased part of its income, a household gives up a claim on current (this year's) GDP, in favour of a claim on future GDP.

Savings are claims on wealth; not wealth itself. If future GDP is large then today's savings will purchase a large quantity of goods and services. If future GDP is small then today's savings will purchase just a small quantity of goods and services.

By saving, individuals ensure themselves a larger *share* of the future economic cake (ie of future GDP). So, the benefit of increased saving to individuals is to be able to claim a greater share of future wealth than they would otherwise be able to claim.

In this important sense, saving is a zero-sum game (otherwise known as a 'positional good'). If Household A, by saving more today, is able to claim a bigger share of future wealth, then by definition Household B's claim on future wealth is a smaller share than it would have been had A not increased its savings. Thus, there is competitive pressure on Household B to match Household A's increased savings, just to maintain its former parity with Household A. At no stage do we know how many goods and services A or B will be able to purchase from their savings. All we know is that if A saves more than B, then A will have a bigger claim on goods and services in the future than B does.

Saving only ceases to be a zero-sum game in an environment where increased aggregate saving has a measurable and positive impact on the per capita rate of economic growth.

During a recession or depression, increased saving (while still conferring individual benefits compared to no increase in saving) actually has a clear negative impact on the rate of economic growth. A recession typically is a result of too little spending. And saving is just another name for 'non-spending'. Actually having a policy (ie Kiwi Saver) to increase saving at a time when economic growth is contracting (and 2008 appears to be such a time) is folly in the short-run. It may do even more damage in the long run.

The act of increased saving is simultaneously deflationary (for the present) and inflationary (for the future).

Every year, an economy produces a 'cake' of consumable goods and services known as GDP. (This year's GDP is also known as 'present wealth'. 'Wealth' also is used in another way, to indicate the total amount of outstanding claims, including money held in wallets and bank accounts.) As new goods and services are produced, new claims of equal total value are also created. These new claims are called income.

There are other claims on present wealth. Savings from the past represent claims that may be relinquished in return for a share of present wealth. So do past capital gains on property, shares, etc. Further, financial intermediaries such as banks, by making loans, create additional sets of claims. Spending is the process in which claims are 'exercised' or 'relinquished'.

In a normal growing economy, a growth of about 3% per year in the number of claims spent is matched by a growth in the production of consumable goods and services by 3%. Conditions are deflationary if the growth of spending (ie the exercising of claims) is less than about 2% (and very deflationary if spending actually falls). Conditions are inflationary if the annual growth of spending exceeds say 5%.

What then is the present impact of Kiwi Saver if it achieves what it is meant to do; namely a reduction in spending (ie a reduction in the rate in which present claims are exercised)?

The impact will be either deflationary (if spending growth would otherwise have been at or below 3%), or counter-inflationary (if annual spending growth in the absence of Kiwi Saver would have been above 3%.

What is the future impact of Kiwi Saver? It is essentially inflationary (although it could be counter-deflationary in some possible future circumstances), in that it increases claims on future wealth without increasing future wealth. Kiwi Saver stands to be especially inflationary in the future, when the future claims represented by the balances of Kiwi Saver accounts are increasingly exercised by "baby boomers" in retirement. These claims of the retired will be exercised in competition with the claims being generated in future by those generations of working age who are creating the future wealth. There will also be ongoing future pressure to redistribute claims to the benefit of children (eg through tax credits to parents).

In addition to schemes such as Kiwi Saver being significant potential sources of future inflation, there are cost inflationary forces at work at present which are unlikely to abate over the next few decades. None of these forces can be addressed by anti-inflationary monetary policies; rather the costs of such policies are far more likely to aggravate the future problem of too many claims and not enough wealth.

We are already seeing riots in countries such as Egypt and Haiti over rising food prices. With global warming and other resource constraints becoming more apparent, there is upward pressure on prices simply because it is more costly in real terms (especially 'at the margin' where prices are set) to make food and energy.

Further, costs are increasing significantly in the services sectors of most developed economies. Partly it is the bureaucratic cost of implementing and managing more remedial policy initiatives (of which Kiwi Saver is just one such initiative). The costs of Kiwi Saver are much greater than that. We have to include all the extra people employed in financial services to implement Kiwi Saver. People producing Kiwi Saver related services are people who could otherwise be employed doing something else. The existence of these new jobs represents part of the rising cost of production overall that is creating an already evident 'stagflationary' environment in New Zealand and elsewhere.

What should we do instead of promoting costly saving schemes such as Kiwi Saver?

The answer involves creating a more investment-friendly environment, which means lower interest rates among other things, allowing productivity growth to act as a remedy to inflationary pressures. Further, we need to discourage the acquisition of positional goods, and to encourage people to use productivity growth to work fewer hours rather than to accumulate ever more goods.

The economy of the world and the national economies within it face many challenges this century. Policies to inflate our claims on future wealth are not helpful. We need policies that facilitate the sustainable growth of our productive capability, while also dampening our demands for the food and energy products (and the waste-disposal spaces) that place most pressure on our natural resources. We have to focus on how we can meet claims on our future wealth, rather than expending our energies on the creation of additional claims.

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