the new zealand institute

DISCUSSION PAPER 2005 / 2

Opportunity for a lifetime:

Creating an ownership society in New Zealand

DAVID SKILLING

APRIL 2005

The New Zealand Institute

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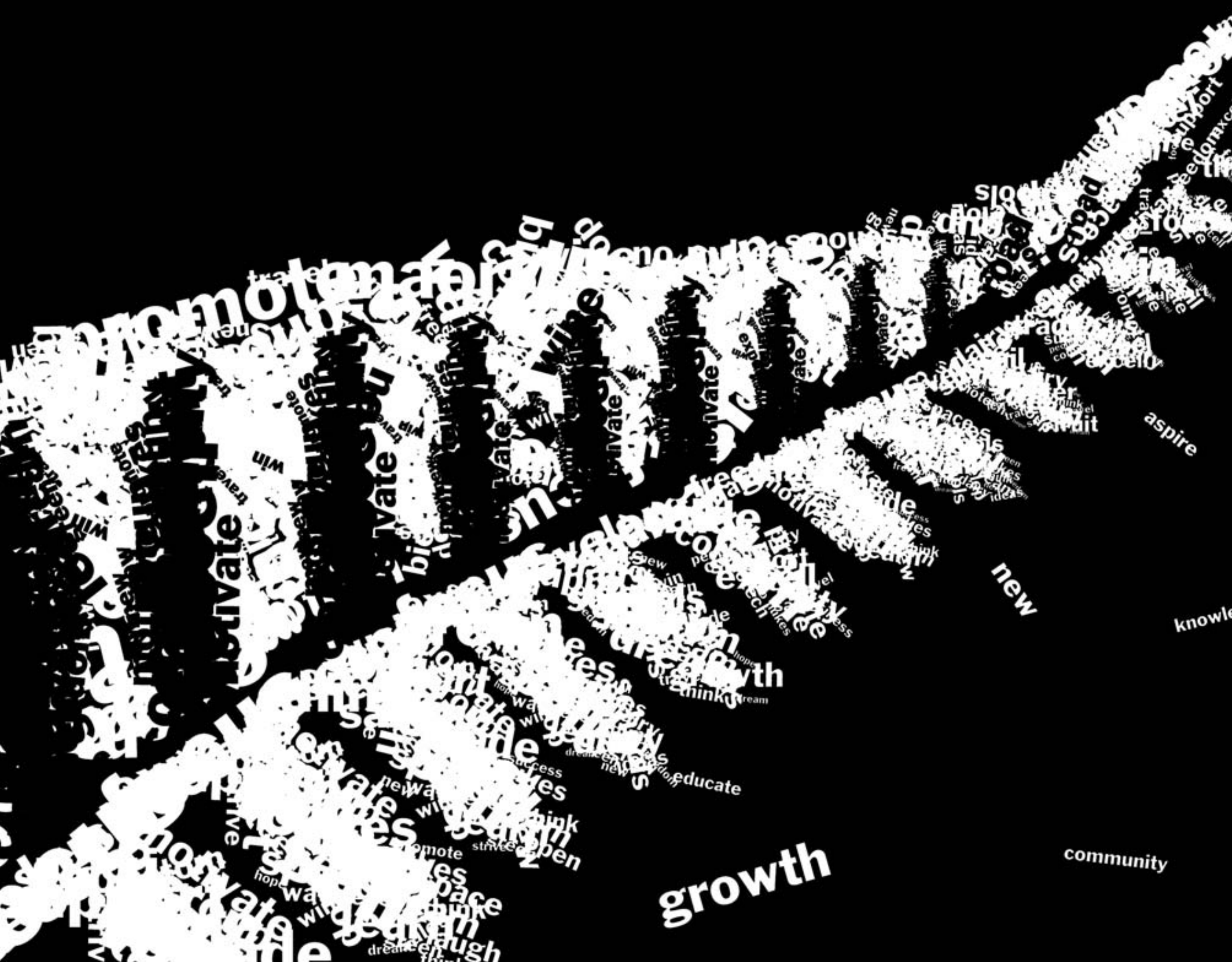
The New Zealand Institute
PO Box 90840
Auckland 1030
New Zealand
P +64 9 309 6230
F +64 9 309 6231
www.nzinstitute.org

‘Opportunity for a Lifetime’ is the fourth and final paper in a series that forms part of the New Zealand Institute’s initial research program on Creating an Ownership Society. This paper follows on from our first three papers, ‘The Wealth of a Nation’, ‘It’s Not Just About The Money’, and ‘Home is Where The Money is’.



FOREWORD: CREATING AN OWNERSHIP SOCIETY

Asset ownership is increasingly important for meaningful participation in society and the economy. Ownership enhances the ability of people to access opportunities and to invest in the future – by buying a house, financing education, and so on – and allows people to cope with shocks. Assets provide greater security, control, and independence. A broad distribution of ownership also generates enhanced social cohesion at a national level, and ensures that more New Zealanders obtain the benefits of economic growth. So helping all New Zealanders acquire assets will make a significant contribution to New Zealand's economic and social future.

In recognition of the increasing importance of asset ownership, many countries are introducing and expanding 'asset based policies' that assist and encourage people to accumulate wealth. Creating an ownership society, in which ownership of assets is broadly distributed through the population and in which all people are able to accumulate wealth over their lifetimes, is a policy priority across many countries. And such policies are advocated by governments and political parties from across the political spectrum; it is not a policy solely of the left or of the right.

However, many New Zealanders do not have any real wealth holdings. And many New Zealanders – particularly young New Zealanders – are finding it increasingly difficult to advance financially and build an ownership stake; rising house prices and declining home ownership rates, student loan debt, and an emerging debt culture, all make wealth accumulation harder. Further, New Zealand's overall level of household wealth is substantially lower than in most other countries, and this is likely to constrain domestic investment, productivity and growth.

Although New Zealand has historically had policies that assisted people to accumulate wealth – like assisted home ownership – these policies have been removed over the past two decades, and there are currently no deliberate policies that assist New Zealanders to build an ownership stake. This sets New Zealand apart from the international policy mainstream, and increasingly so as countries pursue asset based policies to encourage ownership.

We have chosen 'Creating an Ownership Society' as our initial work program because increasing the number of New Zealanders with an ownership stake – and increasing the overall level of asset ownership in New Zealand - will have a profound effect on New Zealand's economic and social future. We also believe that New Zealand policy settings in this area are increasingly out of date and we want to contribute new and creative thinking to the New Zealand debate, drawing on developments in international policy and thinking. Our focus is on identifying ways in which New Zealanders can be assisted to acquire assets over their lifetime.

So over the past several months we have released a series of papers examining different aspects of this issue. This is the final report in the series and it recommends ways in which the government, business and community organisations can assist many more New Zealanders to build an ownership stake.

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EXECUTIVE SUMMARY

New Zealand is facing a serious ownership challenge. Many New Zealanders do not have a meaningful asset ownership stake, with over 800,000 New Zealanders owning less than $20,000 and with a median household wealth of just $68,300. At an aggregate level, New Zealand household savings are amongst the lowest in the OECD and New Zealand has one of the highest levels of external debt in the developed world.

These ownership outcomes have substantial economic and social implications. Asset ownership is linked to improved life outcomes for individuals as well as to more cohesive communities, and the level of savings matters importantly for the level of investment, productivity and growth.

This report identifies policy solutions that will generate a material improvement in ownership outcomes and create an ownership society in New Zealand – to provide opportunity for a lifetime for many more New Zealanders.

Deliberate policy is needed to broaden the distribution and raise the level of asset ownership

A key reason for New Zealand's low and declining ownership outcomes, in an otherwise supportive economic environment, is the absence of policies to support asset accumulation. Whereas debt accumulation has been made considerably easier over the past decade, nothing has been done to make savings and asset accumulation easier.

In contrast, all other Anglo countries – Australia, Canada, the UK and the US – have significant policies in place to promote and encourage savings and asset ownership. The international evidence shows that these policies do generate improved ownership outcomes. So the good news is that there are policies that can improve the savings and asset ownership position of New Zealanders.

The objective of ownership policy in New Zealand is to simultaneously broaden the distribution of asset ownership and also raise the level of ownership. Ensuring that many more New Zealanders are able to build an ownership stake will generate substantial benefits, both financial and non-financial, to the individuals involved and the communities in which they live.

And increasing the level of household savings and asset ownership will generate substantial benefits to the national economy, by providing a larger pool of capital to finance domestic investment and by reducing the size of New Zealand's external debt.

A broad and substantial challenge demands a broad and substantial policy response

New Zealand's existing ownership outcomes and the evidence on the social and economic benefits from asset ownership mean that improving New Zealand's ownership outcomes is one of the key challenges facing New Zealand. To improve these outcomes in a material way, both in terms of broadening the distribution and raising the level of asset ownership, a substantial and sustained policy response is required.

Achieving this will require a policy response that has the following design characteristics:

- Mass participation, so that most, if not all, New Zealanders receive encouragement and assistance in building an ownership stake.

- Flexibility, so that a range of asset ownership challenges can be addressed, from student loan debt to home ownership to retirement savings.

- Creation of a savings culture, so that the increase in household savings is sustained through time and continues to grow.

Achieving a material improvement in ownership outcomes will require a significant and sustained fiscal commitment from the government. In short, the size of the policy solution needs to be aligned with the size of the ownership challenge.

This report proposes that the government make a commitment of $4 billion p.a. – roughly $1000 per New Zealanders – to asset ownership initiatives. This number is chosen because it is sufficient to make a material difference, it benchmarks well against the government's current spending on other initiatives and what other countries spend on promoting asset ownership, and it is consistent with the government's fiscal projections.

Establishment of a Kiwi Savings Account

The major recommendation in this report is the establishment of an individual lifetime savings account.

Kiwi Savings Accounts will be created automatically for everyone at birth, with the government providing a $500 endowment at birth and again at age 5 and at age 10. The government will also match voluntary contributions into this account 1:1 up to an annual limit of $200 until age 18, although additional contributions are welcomed. The endowment and the matched savings will accumulate in the account tax free until age 18. Under conservative assumptions, a balance of over $14,000 by age 18 is likely, which for many people will eliminate the need for a student loan.

For those earning taxable income, it is proposed that the government make an annual lump sum contribution to the account in the form of an across the board reduction in the personal marginal tax rate of two percentage points. People will be required to save the tax rate cut into the savings account, at least initially.

And the government will match additional voluntary contributions to this account at a rate of 0.5:1 up to an annual limit of $1000, with a supplemental match for those in the lowest tax bracket (earning under $38,000) to make it a 1:1 match. Employers will also be encouraged to make contributions to these accounts.

Money can be withdrawn from the account for four purposes: to finance education and the repayment of student loan debt (the portion that relates to tuition costs); to finance the deposit on a first home; to finance retirement; and for transfers to the accounts of other family members.

This proposed savings scheme will have a substantial effect on the ability of New Zealanders to build wealth. And it will also lead to a material increase in the level of national savings – perhaps up to 4% of GDP p.a. – which will lead to a significant improvement in the external balance.

A range of other policies are required to supplement this savings policy

Achieving the desired improvement will require a series of policy changes in addition to the Kiwi Savings Account – no one policy can achieve everything. In particular, there is scope for policies in at least four areas to be altered so as to promote asset ownership.

Financial education is critical to achieving a change in the savings culture, and the establishment of a universal savings account provides a great vehicle for this. Strengthened financial education initiatives at school and university, in the workplace, and among the general public are required.

Efforts should be made to reduce the amount of student loan debt that is incurred, through financial education, and to encourage the rapid repayment of this student loan debt – for example, through rapid repayment incentives and increasing the default repayment rate.

Housing policy needs to be refocused to provide a much greater emphasis on home ownership. Substantial effort and resource is currently committed to housing policy, but there are very few initiatives aimed at home ownership. This needs to change.

And finally, welfare policy should increasingly focus on ways to assist low income people accumulate assets and to get out of debt in addition to the standard focus on incomes. Internationally, asset building policy in low income communities has been very successful, and there is considerable scope for moving in this direction in New Zealand.

In sum, broadening the distribution and raising the level of savings and asset ownership needs to be a top priority for government, business, and community organisations. Improving ownership outcomes will generate profound economic and social benefits for individuals, communities, and for New Zealand as a whole, and this report contains a series of bold and creative proposals to achieve this objective.

1. INTRODUCTION

New Zealand is facing a serious ownership challenge, as has been described in a series of previous reports.[1] Many New Zealanders do not have a meaningful asset ownership stake, with over 800,000 New Zealanders owning less than $20,000 and with a median household wealth of just $68,300.

Going forward, there are concerns about the ability of New Zealanders, particularly young New Zealanders, to successfully build an ownership stake. Low and declining household savings and financial wealth, increasing student loan debt, and declining home ownership rates, all represent serious challenges to the asset ownership position of New Zealanders.

These ownership outcomes have substantial social implications. Asset ownership is consistently linked to improved life outcomes for individuals as well as to more cohesive communities.

And at a national level, New Zealand's persistently low level of savings – amongst the lowest in the OECD – has led to New Zealand being one of the most indebted countries in the developed world. This position imposes significant economic costs, in terms of external vulnerability and higher real interest rates as well as lower levels of business investment, productivity, and growth.

There are, then, compelling social and economic arguments for action to both broaden the distribution and raise the level of asset ownership. Indeed, improving New Zealand's savings and ownership outcomes is one of the most important and pressing challenges facing New Zealand, and should be treated as a national priority for action.

However, although New Zealand faces a significant challenge, the good news is that there are policies that can be put in place to improve the ownership position of New Zealanders. The evidence is clear that policies aimed at promoting asset ownership generate better outcomes, and a key lesson from the international experience is that New Zealand policy needs to be more deliberate in promoting savings and asset ownership.

This report identifies a series of solutions that are designed to broaden the distribution of asset ownership and to significantly raise the level of asset ownership in New Zealand. The proposed solutions draw on a large body of international thinking and practice, together with an analysis of the particular challenges that need to be addressed in the New Zealand situation.

Implementing these policies, and generating a material improvement in ownership outcomes, is likely to generate significant economic and social benefits. It will provide opportunity for a lifetime for many New Zealanders as well as provide opportunities for growth for the New Zealand economy.

[1] *The New Zealand Institute has released three reports in its series on Creating an Ownership Society: 'The Wealth of a Nation: The level and distribution of wealth in New Zealand', 'It's Not Just About The Money: The benefits of asset ownership', and 'Home is Where The Money is: The economic importance of savings'.*

2. THE NEED FOR OWNERSHIP POLICY

Introduction

This section considers two issues. First, it considers why a deliberate policy response is required to improve ownership outcomes, by exploring the extent to which New Zealand's ownership outcomes are due to the New Zealand policy environment and describing the evidence on the effectiveness of policies that promote asset ownership.

And second, this section considers the appropriate objectives for ownership policy in a New Zealand context. What is it that ownership policy should be directed to achieve?

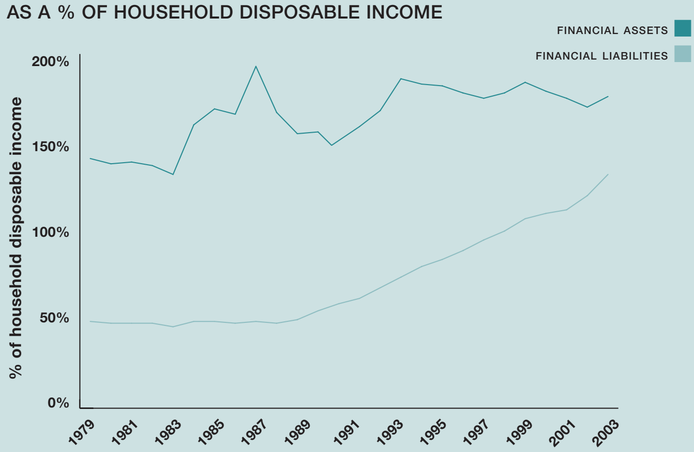
The cause of poor ownership outcomes

Many factors have contributed to the lower level of household wealth in New Zealand, and the difficulties that New Zealanders face in accumulating wealth, relative to the situation in other Anglo countries – Australia, Canada, the UK and the US. For example, New Zealand's lower level of income and the relatively generous nature of public provision for retirement in New Zealand go some way to explaining why household wealth is lower in New Zealand than in Australia.

However, although these factors capture a part of the story, they cannot explain the size of the household wealth gap between New Zealand and other Anglo countries. Nor can they satisfactorily explain why New Zealand's performance on a range of ownership outcomes has worsened over the past decade when New Zealand has generated strong economic growth, has reduced the generosity of public provision, and has had an otherwise supportive environment for savings in terms of factors like favourable demographics, tax cuts, and high real interest rates.

Indeed, it is over this period that household savings, financial wealth, and home ownership rates have declined, as shown in Figures 1 and 2, while private consumption spending and household borrowing have grown strongly. Because of this, ownership

FIGURE 1: HOUSEHOLD FINANCIAL ASSETS AND FINANCIAL LIABILITIES AS A % OF HOUSEHOLD DISPOSABLE INCOME



Source: Reserve Bank of New Zealand

outcomes are unlikely to improve spontaneously – and factors like an aging population could worsen New Zealand's ownership outcomes further.

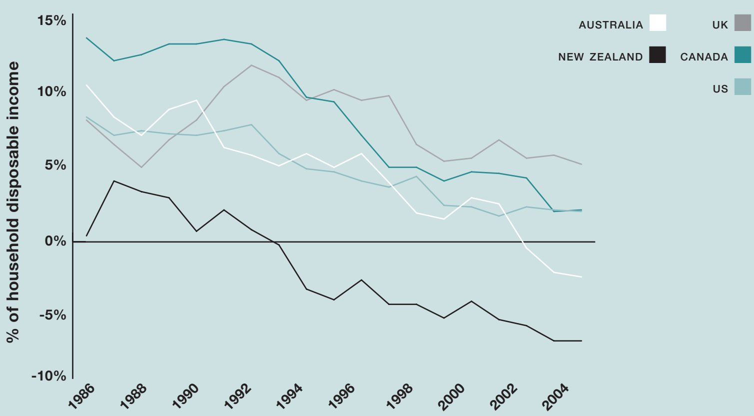
Neither does it seem likely that New Zealand's ownership outcomes simply reflect a fixed preference by New Zealanders for spending rather than saving. It seems unlikely that New Zealanders are significantly different than people in other Anglo countries in this regard. Indeed, the borrowing behaviour of New Zealand households in response to the liberalisation of credit markets, which made it easier for households to accumulate debt, is very similar to that observed in other Anglo countries.

Rather, much of the difference between New Zealand and other Anglo countries is likely to be due to differences in policies and institutions that encourage and support household wealth accumulation. New Zealand no longer has policies that deliberately promote savings and asset ownership. But over the past decade, debt accumulation has become considerably easier as credit markets were deregulated and the student loans scheme was introduced. The outcomes – a substantial increase in household debt and declining financial wealth – are as might be expected in such an environment.[2]

The New Zealand ownership policy environment is markedly different to that in other Anglo countries. New Zealand is the least supportive country of asset accumulation among Anglo countries. All other Anglo countries have policies that encourage or require households to accumulate assets in terms of savings (e.g. compulsory superannuation, tax incentives for savings), home ownership (e.g. assisted first home ownership schemes) and so on. And many of these savings and other asset ownership policies have been expanded over the past decade.

And New Zealand's ownership outcomes are also markedly different from those generated in other Anglo countries.

FIGURE 2: HOUSEHOLD SAVINGS AS A % OF HOUSEHOLD DISPOSABLE INCOME



Source: OECD, Datastream

[2] *Previous reports in the series contain more detail on these outcomes.*

INTERNATIONAL POLICIES TO PROMOTE ASSET OWNERSHIP

	General savings	Home ownership	Other
Australia	Superannuation Guarantee: compulsory contribution of 9% of earnings. The 2004 federal budget includes incentives for low-middle income earners to save more via superannuation	First home owners grant (A$7,000) by the federal government, and numerous state government initiatives	Lump sum maternity payments (rising to A$5,000 by 2007)
UK	ISAs: tax free savings accounts for UK residents	Schemes to encourage home ownership, including the 'right to buy' state homes and 'shared equity schemes' run by local authorities. No capital gains tax on property	Universal kid's savings accounts through the Child Trust Fund Savings Gateway for low-income adults
US	Tax concessions for savings through 401(k) and IRA schemes	Various federal, state, and local schemes to encourage home ownership. Mortgage interest deductibility	Tax concessions on education savings accounts
Canada	RRSP scheme, with tax concessions. Compulsory superannuation to top up the public pension (CPP)	Individuals can withdraw up to C$20,000 from RRSP accounts for buying/ building a home. Federal and state first home ownership assistance	Education savings accounts; recently extended to low income families
New Zealand	**No deliberate savings policy**	**No major policy initiatives, although a small pilot initiative through Kiwibank**	**None, with welfare policy based on income transfers**

Although household debt has increased strongly across Anglo countries over the past decade, as it has in New Zealand, the rise in borrowing has been more than offset by increases in holdings of financial assets. Across Anglo countries, household financial wealth is higher than in New Zealand and is increasing further, with these countries generating household savings rates that are significantly higher than in New Zealand. And home ownership rates in these countries have also tended to increase over this period – and in many cases are now higher than in New Zealand.

Indeed, the international evidence shows clearly that savings policies work to raise savings and levels of asset ownership. This is why countries that have these policies in place tend to generate better outcomes.

For example, the evidence shows that compulsory savings schemes substantially increase savings. Recent

Reserve Bank of Australia analysis suggests that about two thirds of the compulsory savings in the Australian superannuation scheme represents new savings (Connolly & Kohler (2004)). This is consistent with international estimates of the size of the compulsory savings offset, which are generally well under a half (Bernheim (1999), Feldstein & Liebman (2001)). Indeed some studies have found that compulsory savings 'crowds in' new savings, where people begin to save amounts additional to the compulsory savings amount because they form a savings habit.

Similarly, the evidence on US policies that encourage savings through tax advantaged accounts is that they lead to higher household and national savings (Poterba et al. (1995, 1996, 2001)).[3] Much of the savings into these accounts is estimated to be new savings that would not otherwise have taken place. This increase in savings is partly due to the tax advantage, but is also due – probably in larger measure – to the institutional context.

The evidence shows clearly that the institutional context is very important in determining participation and contribution rates (Choi et al. (2001a,b, 2004) and Madrian & Shea (2000)). Employees seem to be passive decision-makers and take the 'path of least resistance' in making savings decisions. For example, participation rates in savings schemes are substantially higher when people are automatically enrolled and need to deliberately opt out if they do not want to participate, as opposed to being required to make a deliberate decision to join the scheme. The increase in participation is particularly high for young and low-income employees. Similarly, requiring that employees make a decision with respect to their participation by a particular date tends to increase participation rates relative to an open-ended process (Choi et al. (2003)).

In a New Zealand context, there is evidence that household wealth is significantly higher for those people who participate in an employer based superannuation schemes than those who do not, controlling for a range of personal characteristics (Scobie & Le (2004)). A likely reason for this is that these people save more because it is easier for them to access a savings scheme.

Indeed, the basic intuition underlying these results is that if things are made easier for people, they tend to do more of it – savings decisions are not always fully rational, and are often as much about psychology as economics.[4] New Zealand, along with other Anglo countries, has made debt accumulation easier and more accessible, and households have responded by taking on more debt. And countries that have encouraged asset ownership, and made savings easier, have generated better savings outcomes than in New Zealand.

So, it seems that poor savings outcomes in New Zealand are not due to New Zealanders being intrinsically bad

[3] Hubbard & Skinner (1996) and Berheim (1999) provide good reviews of this evidence.
[4] Much of the behavioural economics literature on savings highlights the importance of making it easier for people to exercise self-control with respect to savings in order to improve savings outcomes (e.g. Laibson et al. (1998)).

savers, but are rather because of the absence of policies to promote asset ownership. Because of this, policies that make saving easier for New Zealanders are likely to generate improved savings outcomes.

This analysis has a positive message for New Zealand, because it suggests that there are ways in which to improve ownership outcomes. Deliberate policy and action to promote savings and asset ownership tend to lead to better outcomes. And New Zealand can now learn from the international experience to implement ownership policy that incorporates the most successful features of policy settings overseas.

After more than a decade of following a hands-off approach to savings and asset ownership in New Zealand, there is now sufficient evidence to show that it has not worked well and is unlikely to work in the future. This evidence suggests strongly that it is unlikely to be a coincidence that New Zealand has the most hands-off approach to savings and wealth accumulation in the Anglo world, and also amongst the worst outcomes. Achieving material improvements in these outcomes will require deliberate action.

Policy objectives

There are two primary objectives for policy aimed at creating an ownership society – to broaden the distribution of asset ownership within the population by ensuring that many more New Zealanders are asset owners, and to increase the level of savings and household wealth.

The current distribution of asset ownership in New Zealand is highly concentrated, and the challenge is to

ensure that many more New Zealanders are able to accumulate wealth through their lifetime. Increasing the number of New Zealanders who have an ownership stake in New Zealand confers a series of profound financial and non-financial benefits on people and the communities in which they live.

For individuals, asset ownership provides direct financial benefits in terms of the returns and capital gains. Indeed, returns to assets have consistently out-stripped wage growth in New Zealand. Further, the benefits from economic growth are often capitalised into asset values, so that asset owners benefit disproportionately from growth. As a result, those who own assets – like shares or real estate – are in a much better position to get ahead financially than those who do not own assets, who may get priced out of the market.

Asset ownership also provides a buffer, allowing people to better manage risks and exercise more control in terms of responding to various unexpected life events.

The ability to access opportunity and get ahead, and to better manage risks, generates powerful social and psychological benefits. Asset ownership gives people a sense of control and independence, allows them to focus on the future to a much greater extent, and is an increasingly important determinant of meaningful participation in society. Asset ownership has been strongly linked to better health and employment outcomes, quality of life, and educational outcomes for children. Encouraging asset ownership seems an important way in which to build a genuinely inclusive economy.

Widespread asset ownership also has significant community-wide benefits in terms of generating social cohesion and a feeling that everyone has an opportunity to get ahead and build a future. Asset ownership provides people with a stake in the social and economic prosperity of New Zealand – if the country moves ahead, they are likely to do so as well. This is why communities with widespread asset ownership in which most people have a stake – a ‘property owning democracy’ – tend to function better.

Conversely, communities in which many people do not have an ownership stake – and where people feel marginalised – tend to experience worse outcomes. Tensions will be generated if there are big gaps in the asset ownership position of groups of New Zealanders, for example, between different demographic groups.[5] These tensions need to be proactively managed by ensuring that all New Zealanders are able to build an asset ownership stake. The success with which this is done will have a major impact on New Zealand’s social outcomes over the next few decades.

The second objective is to raise the level of household wealth, and particularly the level of household financial wealth. New Zealand’s household savings rates

[5] Australian Reserve Bank Governor Ian McFarlane (2003) recently identified potential social tensions in Australia associated with asset-poor younger people being required to pay higher taxes to finance the healthcare and superannuation costs of asset-rich seniors as the population ages over the next few decades. The same issues are relevant in a New Zealand context.

and household financial wealth are low and in decline, at the same time as home ownership rates are also declining.

Increasing household savings and asset ownership – particularly of financial assets – is likely to generate substantial macroeconomic benefits. For example, increased household savings will provide a larger pool of capital for the financing of productive investment in New Zealand – home is where the money is for the financing of much New Zealand investment – and this will have a positive effect on productivity and growth. Indeed, increasing business investment is a top economic priority for New Zealand in terms of achieving higher productivity growth.

Increased domestic savings will also reduce the reliance on foreign savings to finance domestic investment. Over time, this will reduce the level of New Zealand's external debt – currently amongst the highest in the OECD – and this is likely to reduce interest rates in New Zealand, as well as reducing New Zealand's external vulnerability to changes in the cost and supply of foreign capital.

The available evidence does not allow for a judgement to be made as to whether it is more important to broaden the distribution or to raise the level of asset ownership. Both of these objectives are critically important, and policy ought to proceed with a focus on improving both outcomes simultaneously.

So rather than simply focusing on increasing savings by the wealthiest households with a view to lifting aggregate household savings but with little impact on the distribution of asset ownership, or just focusing on encouraging asset accumulation by those on the lowest incomes but without a material increase in the level of national savings, the policy solutions need to be designed to make a contribution to both of these objectives in parallel.

Summary

There are some broad-based ownership challenges facing New Zealand, which are likely to have substantial economic and social effects. A key reason – probably the primary reason – for New Zealand's poor and declining ownership outcomes, is the absence of policies to support asset ownership.

On the basis of the international experience, adopting a more deliberate policy approach to the promotion of savings and asset ownership in New Zealand can be expected to lead to much improved ownership outcomes. The positive message from this evidence is that there are things that can be done to improve New Zealand's ownership outcomes in a material way.

And creating an ownership society – by simultaneously broadening the distribution of asset ownership and increasing the level of household savings and asset ownership – will generate significant economic and social benefits. This provides a clear motivation to pursue ownership policy to achieve these objectives. And indeed, countries across the Anglo world are continuing to implement and expand policies to improve savings and asset ownership despite outcomes that are generally improving and already better than in New Zealand.

3. DESIGN PRINCIPLES

Introduction

In designing a scheme that will have a material and sustained impact on both the distribution and level of asset ownership, it is necessary to direct the solution towards addressing the specific ownership challenges that confront New Zealand. In particular, this section identifies three design principles that any policy solution will need to possess.

These three principles are:

- Mass participation
- Flexibility
- Create a savings culture

Further, it is important that the size of the policy solution be aligned with the scale of the challenge. This will require a substantial and sustained fiscal commitment from the government, and this section proposes an appropriate fiscal commitment.

Mass participation

The asset ownership challenge in New Zealand is a broad-based one and affects many, if not most, New Zealanders. The challenges of low rates of household savings, the rising levels of student loan debt, and declining home ownership rates, are not confined to a small or specific group of New Zealanders. Rather, they are pervasive challenges, with many people in New Zealand without a meaningful ownership stake and facing difficulties in building wealth.

To illustrate, consider New Zealand's current ownership outcomes:

- The median household wealth is just $68,300 and over 800,000 New Zealanders own less than $20,000
- Over 400,000 people currently have student loan debt outstanding and over 100,000 owe more than $20,000 in student loan debt
- Reported home ownership rates have reduced sharply over the past decade, from 74% in 1991 to 68% in 2001
- Only about 20% of households own financial assets, and savings are concentrated among the top 20% of income earners

In other words, this is a middle New Zealand problem. Because of this, the response needs to be correspondingly broad-based if it is to lead to a material improvement in outcomes and ensure that most New Zealanders can build a meaningful ownership stake. Simply targeting a small part of the population is not an adequate response to the scale and importance of the challenge.

Moreover, raising the national level of savings in a material way will require many more people to save more – particularly middle and high income earners – and this will not be achieved by focusing on small groups of people.

However, the claim that the ownership challenge is broad, and demands a broad response, is not to suggest that the ownership challenge affects everyone equally. There are particular challenges facing a few groups and these may demand slightly more specific responses.

For example, the ownership challenge is particularly acute among young New Zealanders. The current cohort of young people is the first to be affected by student loans and this has coincided with a period of worsening housing affordability. Together, these changes

have placed new and substantial pressures on young New Zealanders. Any solution needs to find ways to give young New Zealanders an enhanced ability to build a meaningful ownership stake in the New Zealand economy.

There are also specific issues among low income New Zealanders. A high proportion of New Zealanders have negative wealth, and the high level of debt among many low income New Zealanders is a critical issue. For these people, the absence of income is a primary constraint on wealth accumulation – and there is a redistributive motive for deliberate policy action to encourage and assist asset accumulation by low income New Zealanders.

Flexibility

The ownership challenge also manifests in a number of different ways: student loan debt, inadequate savings by some for retirement, declining home ownership, and low household savings in general.

Because the ownership challenge is so broad, a flexible policy response is required in which asset ownership is encouraged in a general way rather than promoting a particular form of asset

Lifetime savings accounts

Increasingly savings schemes are being created around the world that recognise the importance of access to assets during a lifetime. These are often called 'lifetime savings accounts'.

In Canada, withdrawals are now allowed from the tax advantaged retirement savings accounts (the RRSP accounts) for investing in education and home ownership. For example, Canadians can take out a C$20,000 loan against the RRSP account for home ownership, although this needs to be repaid. And in the US, some 401(k) schemes (tax advantaged retirement savings accounts) provide flexibility by allowing people to take out loans against the account balance for things like a deposit for home ownership.

In Singapore, the uses of the compulsory savings (CPF) contributions have been widened over the years so that withdrawals can be made for education and home ownership although these have to be repaid into the fund. For example, people can withdraw for a 20% down payment on the purchase of government constructed housing (Asher (1999)).

And the UK Conservative Party has recently proposed a lifetime savings account in which withdrawals can be made for a wide range of purposes before retirement, but the government contribution to this account would be forfeited unless the money was repaid prior to retirement (Norman & Craig (2004)).

ownership. If the policy concern was simply about low home ownership or student loan debt then specific policy responses targeted at those problems would be appropriate. But this is not the case, and the concern is more general.

It is also difficult to prioritise between encouraging different types of asset ownership; low and declining household savings, increasing student loan debt, and declining home ownership rates are all major concerns. And the inter-related nature of the ownership challenge – for example, student loan debt affects home ownership and retirement savings – also suggests that an integrated approach is required.

Because of this, the solution should be reasonably agnostic about the form of asset accumulation and ownership, as long as people are engaged in some form of long-term asset accumulation. The overall aim is simply to assist many more people to build an ownership stake. It is not about pushing people into a particular asset class.

And it is about more than simply saving for retirement. People need access to these assets during their lifetime, so flexibility is required in which assistance is provided to promote savings for major investments like education and home ownership.

This is a better approach than one in which there are several specific schemes to promote savings for home ownership, education, or retirement. Such an approach can be complex, costly, and not very flexible if your preferences or circumstances change. And because preferences for, say, home ownership may change over time, approaches that do not advantage one particular form of asset accumulation are preferred.

Such a flexible approach to encouraging asset accumulation also recognises that people will choose to accumulate wealth in different ways. Some people may want to get into home ownership while others will want to invest in education or save for retirement. The nature of the demands will vary as life experiences are very different and so, rather than being prescriptive, the scheme should adapt itself to people's preferences as much as possible.

However, some limits do need to be imposed on the degree of choice. There is a trade-off between allowing for the flexible use of assets through a lifetime, and addressing issues relating to self-control. Recall that a major reason for having deliberate savings policy in the first place is due to the recognition that people may not act in a systematically rational manner with respect to savings decisions.

If uncontrolled flexibility was allowed for in terms of withdrawing funds, many people may not increase their long term savings – money would be saved initially and then withdrawn as required, including for consumption. The trade-off struck in many programs around the world is to restrict withdrawals to specified purposes that are consistent with increased long-term asset ownership.

Create a savings culture

In order to achieve and sustain a material increase in household savings, it is necessary to ensure that people develop positive attitudes towards saving. Although the government cannot directly change attitudes and habits, it does have an important leadership role because the policy environment shapes attitudes towards saving. For example, the ease of access to credit in New Zealand and the introduction of the student loans scheme have made a significant contribution to the development of a debt culture in New Zealand.

Conversely, the establishment of compulsory superannuation in Australia has had a positive effect on attitudes towards savings in Australia over the past decade. Share ownership is very widespread (ASX (2005)), there is much improved financial literacy, and people now have a much better understanding of the importance of saving. Because of the apparent power of 'learning by doing' the government's policy approach to the promotion of savings and asset ownership can have a significant effect on the development or otherwise of a savings culture over time.

Some useful things that the government can do to promote a savings culture in New Zealand include the establishment of individual accounts and rewarding savings behaviour.

Although national savings can be improved through higher levels of government savings – and indeed, government contributions to the New Zealand Super Fund will make an important contribution to the level of national savings – this is unlikely to do very much in terms of encouraging the creation of a savings culture. And as a result, public savings

may not generate a material increase in household savings.[6]

This contrasts with the effects of private compulsory savings in Australia and Singapore where there are individual accounts, and where attitudes to savings and financial literacy have changed significantly. The international and New Zealand evidence demonstrates the powerful benefits of personal asset ownership; having assets in your own name and over which you can exert some control leads to changed attitudes and has significant benefits in terms of financial education.

Further, simply transferring public money to individuals to finance private savings may not have an ongoing effect on household savings because this transfer may not have a significant impact on people's attitudes towards the importance of savings. Attitudes towards saving are more likely to change as people work to save, rather than as the result of being given an asset. In this sense, there is a difference between first home owner grants and schemes which assist people to save for a deposit.

For example, matched savings schemes, in which savings behaviour is rewarded

[6] *Indeed, increased public savings may 'crowd out' household savings, and so may have a negative effect on the development of a savings culture.*

through a matching contribution, seem to generate good result in terms of changed attitudes and ongoing savings behaviour. Participants in matched savings schemes like the Savings Gateway in the UK and the American Dream Demonstration in the US became more regular savers and also developed new habits and behaviours like planning for the future (Kempson et al. (2003), Schreiner et al. (2002)).

Another feature that is likely to matter in terms of changing savings behaviours and habits is the ease with which people can participate in the scheme. In particular, the savings scheme needs to be simple, clear and accessible – something that everyone can understand and participate in, even without a high degree of financial literacy.

Fiscal implications

Moving towards the creation of an ownership society is a significant social and economic challenge given New Zealand's current and projected ownership outcomes. And so the proposed policy solution needs to be sufficient in scope to generate a material improvement in the ownership position of New Zealanders and of the New Zealand economy.

These objectives cannot be achieved in a meaningful way without a substantial and sustained government commitment. Of course, the creation of an ownership society in New Zealand will require much more than government action – this is a national priority, and will require broad commitment and support – but government leadership in both a financial and non-financial sense is vitally important. In short, the size of the policy solution needs to be aligned with the size of the problem.

So what type of fiscal commitment is required? In order to benchmark the appropriate scale of government action, three factors have been considered.

First, the importance of improving ownership outcomes as a policy priority. On the basis of the profound economic and social benefits that accrue to individuals, the community, and the country as a whole, promoting asset ownership ranks as a first order priority. And the nature of the savings and ownership outcomes currently generated in New Zealand makes this an urgent priority that needs to be tackled aggressively.

The government currently has very few initiatives that are deliberately aimed at encouraging asset ownership. However, the 2004 Budget contained $3.8 billion of additional annual operating spending, including the announcement of the 'Working for Families' package, which provides increases in various types of income transfers to those on low and middle incomes, and will cost about $1.1 billion p.a. And overall, the government currently spends about $10 billion p.a. on various welfare benefits (Treasury (2004a)).

Given the demonstrated importance of asset ownership for individuals, communities, and the national economy, a major fiscal commitment to promoting asset ownership is warranted and the amounts currently spent on income-based welfare provide a useful benchmark.

Second, the amount of money that is spent in other Anglo countries to promote asset ownership. The 2005 US federal budget contained about US$320 billion in annual spending on initiatives to promote asset ownership, including over US$150 billion p.a. in tax deductions for savings policies and over US$110 billion p.a. on home ownership initiatives (Cramer et al. (2004)). This is the equivalent of about US$1000 per capita. This federal spending is additional to the considerable spending on asset ownership that occurs at state and local government level.

And there is significant spending by federal and state governments in Australia on home ownership and savings initiatives, in addition to the private and public commitment to the compulsory savings scheme. The federal Australian government spent A$4.3 billion on first home owner grants to about 550,000 first home buyers between July 2000 and January 2004 (Productivity Commission (2004)).

Given that New Zealand currently spends close to nothing on initiatives that promote asset ownership, a substantial increase in the size of the fiscal commitment is required to get New Zealand to the commitment levels of these countries.

Third, the government's current and projected fiscal position – how much is available to be committed to the promotion of asset ownership? It is important that the proposed policy solution be fiscally responsible and not create a hole in the government's fiscal accounts. The international experience shows that governments commonly get into fiscal trouble by over-committing in good times, and it is important that New Zealand does not do this.

The government has run large fiscal surpluses over the past several years, and this provides flexibility to consider new tax and spending initiatives. Although the fiscal surpluses are projected to decline over the next few years and there are existing commitments for a portion of this money, there is scope for a substantial commitment to promoting asset ownership, as described in the accompanying Box.

Fiscal headroom

The government's fiscal projections include a planned increase in operating spending of between $2.1 billion and $2.4 billion in each of the next four budgets – for a total increase in operating spending of $9 billion p.a. by the 2008 budget.

Although the fiscal surplus is projected to decline from $6.5 billion in 2005 to $5.4 billion by 2009, and the government has to finance capital spending and contributions to the New Zealand Super Fund, the government considers this spending track to be fiscally prudent and consistent with achieving its long-term fiscal targets.

The proposed spending on asset ownership has been chosen on the basis of these projections. The proposal is to allocate less than half of the planned new spending over the next four years to promoting asset ownership – a total of $4 billion p.a. out of an overall increase of $9 billion p.a.

Although there are competing priorities for this spending, and some of the budgeted increase in operating spending has already been committed to increased health and education spending, this proposal strikes a good balance between existing spending commitments, the government's fiscal position, and the importance of creating an ownership society.

The choice is essentially about priorities – the areas to which these funds are allocated – rather than about the availability of funds. Will the government choose to spend the available money on existing spending initiatives or on promoting asset ownership?

On the basis of these considerations, the recommendation is that a sum of $4 billion p.a. be committed to the promotion of asset ownership. This is equivalent to about $1000 p.a. per New Zealander.

This package of spending can be structured with fiscal sustainability in mind, and to manage the fiscal risks. For example, the $4 billion commitment could be phased in over, say, the next 4 years, by raising spending by about $1 billion a year. Or some aspects of the package could initially have time-limited aspects so that there is an option to alter the fiscal spending path if necessary.

And, as will be discussed in more detail below, there is significant scope for more efficient allocation of existing spending, which will act to offset some of this expense. Moreover, initiatives to promote asset ownership are likely to significantly reduce the government's fiscal obligations in some areas over the next few decades.

Summary

To satisfactorily address the ownership challenge, the policy solution needs to be able to assist many, if not most, New Zealanders to save and accumulate assets, to do so in a flexible way that assists them to respond to a series of ownership challenges – from student loan debt, to home ownership, to savings in general – and that has a long-term impact by helping to create a savings culture in New Zealand.

To achieve this will require a significant and sustained fiscal commitment from the government. This section has proposed that the government specify a fiscal commitment with respect to asset ownership initiatives of $4 billion p.a., to be phased in over the next few years.

The next two sections describe the type of policy initiatives to which this fiscal commitment should be directed. These policies are designed to broaden the distribution of asset ownership, and to raise the level of household savings and wealth.

The first proposed policy is a comprehensive savings scheme that will assist many more New Zealanders to accumulate assets and repay debt more rapidly. Over time, this scheme is intended to cover all New Zealanders and lead to a material improvement in ownership outcomes.

And second, a series of policy changes in a range of areas to encourage asset ownership. Because there is no one single policy or initiative that will be sufficient to achieve the desired change in outcomes given the nature and scale of the challenge, there is a need to proceed on several different fronts simultaneously.

To design these policies, the best international thinking and practice has been drawn on. There are now a few

decades worth of evidence to evaluate from a wide range of asset ownership policies overseas, and this provides a good sense of what works and what doesn't work. In turn, this provides a base for designing a scheme that is likely to generate good results in New Zealand.

Indeed, New Zealand has an opportunity to implement a best practice scheme as we can 'cherry pick' the best features out of the international experience. The absence of existing savings and asset ownership policies in New Zealand provides significant flexibility to design a world class savings scheme.

4. KIWI SAVINGS ACCOUNTS

Introduction

The main proposal in this report is the creation of lifetime savings accounts – called Kiwi Savings Accounts (KSA) – that are designed to provide a vehicle for asset ownership over a lifetime in a variety of forms. All New Zealanders will have these individual accounts, enabling many more New Zealanders to build an ownership stake. And the scheme is designed to increase national savings in a material way.

This section outlines the nature of the contributions to the KSA as well as the purposes for which withdrawals from the KSA can be made. The section will also examine the degree to which people will be required to participate in aspects of this scheme. Lastly, issues relating to the institutional and operational design of the scheme are considered.

Contributions

The key elements of the contributions framework for the lifetime savings accounts are:

- Automatic creation of endowed kid's accounts
- Tax relief to finance savings
- Matched savings

Automatic creation of endowed kid's accounts

The first element in the establishment of the KSA scheme is that individual savings accounts will be created automatically at birth. This will be a universal scheme, in which every New Zealander has an account and can begin to accumulate assets.[7]

The initial contribution will come in the form of an endowment by the government. This up-front endowment by the government will make the accounts real for people and will ensure that everyone will have a positive balance from birth.

The proposal is that an endowment of $500 be paid into the KSA at birth, with repeat endowments of $500 at age 5 – when the child starts school – and again at age 10.[8] The repeat endowments will function as a reminder of the benefits to saving, and will make the amounts in the account more material.

To encourage the development of savings habits by children, a matched savings scheme will be implemented. The proposal is that voluntary contributions of up to $200 p.a. will receive a 1:1 matching contribution from the government until age 18. This $200 limit has been chosen to make it accessible for as many people as possible; receiving the full match amount requires savings of less than $4 a week for each child. Unlimited additional contributions can also be made, but these additional payments will not receive the matching contribution.

To obtain the full benefits of compounding, and to signal the importance of savings, it is also proposed that returns on money in this account be exempt from taxation

[7] These are individual accounts, which can only be used in the name of the individual and cannot be accessed by others (e.g. parents).
[8] It is also possible to make this endowment conditional on family income, so that children born into lower income families receive a supplemental endowment.

until age 18. This exemption will cover returns earned on the endowment payments, the matching payments, and voluntary contributions up to $200 p.a. Although additional contributions are welcomed, the returns on these additional funds will not receive the tax exemption.

This will encourage saving from a young age and allow people to obtain the benefits of compound interest over an extended period. By creating good savings habits early, and providing financial education to accompany this scheme, there will be substantial longer term benefits through the development of a savings culture as generations of children grow up with personal experience of savings and a higher degree of financial literacy.

The establishment of these endowed accounts will have a significant equalising effect on household wealth, and will ensure equality of opportunity to a far greater degree. It will give all young adults a good start in life, and provide a base from which to access opportunities. And this scheme will have particular benefits in terms of broadening the distribution of asset ownership given that fertility rates are highest in the Maori and Pacific Island populations, who currently have much lower levels of household wealth than the New Zealand average.

These accounts have the potential to have a significant impact on the ability of young New Zealanders to build wealth. Even in the worst case scenario, in which no voluntary contributions are made to the account, the balance by age 18 will still be around $3,000. And contributions from birth of $1 a week would generate an account balance of about $5900 by age 18.[9]

Stakeholder accounts

The Child Trust Fund in the UK

The Child Trust Fund scheme is currently being established in the UK in which every child receives an endowment of £250 at birth, with a supplemental £250 for children born into low income families. Another payment will be made at age 7 although the amount has not yet been confirmed. Contributions of up to £1200 p.a. can be made to these accounts, and funds accumulate on a tax free basis. There are no restrictions on the use of these funds at 18. Accounts are available from April 2005. (www.inlandrevenue.gov.uk/ctf/)

The ASPIRE Act in the US

In legislation introduced into the Senate and the House of Representatives in 2004, children's accounts would automatically be created at birth with a US$500 endowment. Contributions, up to US$500 p.a., would attract 1:1 government matching, and the funds would accumulate tax free. The money could be used for education, to buy a home, or for retirement. Proponents estimate that many accounts would have a balance of US$20,000 by age 18. (www.aspireact.org)

[9] These calculations assume a nominal rate of return on the account balance of 5% p.a. and a real rate of return of 3% over this period.

And if contributions of $200 were made into the child's account every year from birth, it is likely that by the child's 18th birthday they would have an account balance of around $14,300 in nominal terms (or $11,700 in real terms).[10] To put this amount in context, the median student loan balance is currently about $9500, and so this scheme will mean that many students will not need to access the student loan scheme in the future to finance their studies – and certainly will need to access less student loan debt, even taking into account increases in tuition and living costs.

Such an asset-based approach is a much better way of ensuring that everyone has the opportunity to participate in tertiary education than the current debt-based approach that relies on the student loan system. In this proposed scheme, students will finance their tuition costs out of their own money, and may well be more financially disciplined as a result.

Given the size of these financial benefits, this proposal has a modest fiscal cost. Once the scheme is fully implemented, the cost of providing a $500 endowment to all New Zealanders on their birth, and then on their 5th and 10th birthdays, will cost approximately $85 million p.a.[11] And the fiscal cost of financing the matched contributions may be as high as $205 million p.a., if the full $200 annual contribution is to these accounts of everyone under 18. The fiscal cost will obviously be lower to the extent that people do not contribute to the $200 annual limit.

The maximum cost of the tax exemption on the returns on the funds depends on the returns, but is likely to be around $50-60 million p.a. in nominal terms once the scheme is fully implemented. This generates a maximum total cost for the scheme, once it is fully operational, of around $350 million p.a.

It is proposed that this scheme be implemented immediately, with everyone under 18 being eligible for the endowment and the matched savings contribution.[12] This is a response to the immediate ownership challenges

[10] If the funds were invested in equities, it is likely that the account balance at age 18 would be significantly higher. For example, an annual nominal rate of return of 7% p.a. generates an account balance of $17,600 by age 18 in nominal terms (or $14,300 in real terms).
[11] Assuming 57,000 births p.a., the average birth rate over the past 10 years and slightly higher than the birth rate in the 'medium fertility' scenario in the Statistics New Zealand population projections.
[12] The alternative is for the scheme to be phased in, with people becoming eligible at birth.

facing many young New Zealanders – it will be useful to assist asset ownership by as many young people as quickly as possible. In recognition of the fact that those aged between 10 and 18 when the scheme is established won't receive a $500 endowment, a one-off endowment of $500 could also be made to this group at a one-off fiscal cost of about $250 million.

Over time, implementing this scheme is likely to lead to some significant fiscal savings. Indeed, these savings may be sufficient to more than cover the cost of this scheme. As detailed in the accompanying Box, the government spent about $320 million on the student loans scheme in 2004, and this amount is likely to rise as the student loans scheme expands. However, this proposed savings scheme will act as a substitute for the student loans scheme for many people, meaning that the government's spending on the student loans scheme is likely to reduce substantially.

Spending up to $350 million on the promotion of individual savings that enable people to finance tertiary education is a much better use of the money than spending a similar amount on a student loans system that is generating significant costs, both financial and non-financial. Simply put, it is better to spend money helping all young New Zealanders build an asset and develop a savings habit than spending it on doubtful debts and interest write offs.

As will be discussed in the next section, the establishment of these accounts can be supplemented with systematic financial education in schools. New Zealand used to have widespread children's savings accounts combined with financial education, and this is often said to have developed good savings habits that stayed with people through their lifetime.

The establishment of this endowed account will place all young adults on a solid footing, irrespective of their family's economic situation, and gives everyone a start as an adult. It makes

Spending on student loans

The government incurred about $320 million in costs on the student loans scheme in 2004 (Ministry of Education (2004)). This was due largely to the costs of writing off interest on the student loan debt and provisioning for doubtful debts.

The government's current policy is not to charge interest on student loan debt while the borrower is studying, or if the borrower is under the income threshold for repayment. In 2004, the cost of interest write offs was $208 million.

The government also expects that some of the money it lends will not be repaid; for example, where the person becomes bankrupt or dies with an outstanding student loan debt balance. The current provision for doubtful debts is 11.4% – that is, for every $1000 lent, the expectation is that $114 will not be recovered. The government is currently lending about $1 billion p.a., which means a significant doubtful debts expense every year.

education and home ownership a realistic aspiration for many more New Zealanders, and provides additional motivation for ongoing saving. This will generate profound financial and non-financial benefits.

Because everyone receives an account at birth, over time all New Zealanders – whether in the workforce or not – will have an asset that is increasing in value through time. These accounts are lifetime accounts and will remain with individuals as they move through life.

Tax relief for savings

Kiwi Savings Accounts (KSAs) will also be created automatically for all those who are currently earning taxable income. To finance ongoing contributions to these savings accounts, reductions in the personal marginal tax rate will be made with this money being diverted into the individual's savings accounts. Tax relief that is targeted in this way will enable people to save without reducing their current levels of consumption. This is particularly important for those on low and modest incomes who may find it difficult to increase savings out of current disposable income.[13]

The proposal is that an across the board reduction in personal marginal tax rates of two percentage points be made; so, for example, the 33c marginal rate will reduce to 31c with the 2c difference being contributed to the individual savings account. For someone earning $30,000 p.a. this is an annual contribution to the KSA of $600, and for someone earning $50,000 p.a. this is an annual contribution of $1000. These contributions will be paid into the KSA at the end of the tax year once the individual's taxable income has been assessed, in the form of an annual lump-sum payment.

A two percentage point tax rate reduction will make the amounts saved in the accounts more material than if it were just financed by individual savings out of disposable income. This increased materiality will make the KSA loom larger in people's minds.

The Treasury estimate that an across the board personal tax rate cut of one percentage point will cost $715 million, and so a two percentage point cut is likely to cost about $1.43 billion p.a.[14] This estimate does not incorporate any dynamic gains from the lower tax rate, and so the actual cost may be lower.

Directing the tax cuts to savings accounts will lead to higher national savings than if unrestricted tax cuts are given. A tax cut, which reduces public savings, is likely to reduce national savings to the extent that household savings do not rise to offset this; for example, because households consume a good portion of the tax cut. Indeed, this has been the New Zealand record, where tax cuts and income growth have been consumed rather than saved.

And from the perspective of macroeconomic stability, directing tax cuts to saving is likely to be particularly sensible. Given the current state of the New Zealand economy, and the

[13] *Because tax is deducted from welfare benefit payments, all beneficiaries will also receive a benefit from the tax cut.*
[14] *This estimate is based on the Treasury's Tax 'Ready Reckoner' for the 2005/06 financial year.*

likelihood that a tax cut will be consumed, an unrestricted tax cut is likely to cause inflationary pressure and cause a worsening of the current account. Because this will lead to higher interest rates, the tax reduction may not generate significant benefit to households. These arguments were made in the context of the Irish and Australian experiences, and savings were chosen rather than distributions that would have raised incomes (Feldstein (2001)).

A major reason why OECD governments have got into fiscal difficulties is a systematic tendency to loosen fiscal policy too much in good times and not be able to tighten sufficiently in bad times. So preserving fiscal flexibility is a desirable characteristic of any policy solution. One way of ensuring fiscal sustainability is to place a time limit on these tax cuts, say for a five year period, with an option to extend the tax cuts if the fiscal position allows. Or the tax rate cuts could be phased in over a few years rather than in one step.

Special dividends

Creating individual accounts also provides a new tool for fiscal management. Going forward, the government will be able to provide one-off or time limited transfers of fiscal surpluses or other revenues to these individual accounts rather than providing permanent tax cuts or spending increase that may be unsustainable. This is also a way of ensuring that fiscal loosening does not result in a reduction in national savings as well as being a means of promoting asset ownership.

Matched savings

In addition to transfers into individual savings accounts, through the initial endowment and the ongoing tax relief, it is important to encourage and promote voluntary savings by individuals. Although simple transfers of assets may increase the level of personal asset ownership, it may not do much in terms of stimulating the development of a savings habit that is critical to sustaining any increase in household savings.

It is important to get people into the habit of savings. The international evidence shows clearly that matched savings schemes work well in this respect. In these schemes, the government (or another sponsor) provides a financial match that is proportionate to the amount that is saved. People are rewarded financially for saving, but they need to save before they get the benefit. It is not free money.

Matched savings schemes are a superior way of encouraging savings than tax concessions, which are the traditional way of promoting savings. Tax concessions tend to benefit those on higher incomes, who have more to save, and are better at encouraging increased savings by existing savers rather than encouraging savings by people who have no existing savings habit (unless they are supplemented with institutions that encourage savings by new savers, like automatic enrolment). Tax concessions also tend to be relatively complex, and may require a greater degree of financial literacy to fully understand their benefits.

"However, matched savings would encourage me to save a lot more, it would show that the government thinks about us, we're not ignored and that the government is trying to help us out."

FEMALE, 23, WELLINGTON, STUDENT

"You don't want to encourage people to be lazy and dependent on the government but you do want to be rewarded for it [trying to support yourself]. Matched savings are a good idea."

FEMALE, 22, WELLINGTON, STUDENT

"There are benefits from the feeling that the government is trying to help you, that there is someone on your side, that every time I take a step forward, someone else is helping me take another step forward."

MALE, 36, WELLINGTON, BENEFICIARY

In contrast, matched savings schemes can be directed to provide more savings assistance to those on low incomes. And matched savings schemes are simple and understandable – the 'buy one, get one free' approach to savings – and as a result tend to be better at developing savings habits among non-savers. Because of the effectiveness of matched savings in raising household savings and developing a savings habit, this is an important part of the proposed savings scheme.

The proposal is that private saving into the KSA attracts a government match at 0.5:1, up to an annual limit of $1000 of voluntary contributions. This means that for people who save to the $1000 limit, the government will make a $500 matching contribution. The matched savings contribution can be implemented as a tax rebate at the end of the year, which will effectively provide a further significant tax reduction for those who save.

The cap of $1000 per year is chosen to ensure that the benefits from the matched savings scheme are broadly spread. Many people should be able to save to a good proportion of this match limit; at about $20 a week, $1000 seems a reasonable aspiration level of annual savings even for those on modest incomes.

Unlimited additional voluntary contributions can also be paid into this account, although these contributions will not attract the matching payment from the government.

Given that one of the key objectives for this savings initiative is to generate a broader distribution of asset ownership by assisting many more New Zealanders to save, it is also proposed that the matched savings scheme provide more assistance to those on lower incomes so that they can accumulate assets more rapidly.

To achieve this, a supplemental match is proposed for those on the bottom tax bracket (i.e. those earning below $38,000) of an additional 0.5:1, to make for a 1:1 match up to annual limit of $1000.[15]

Implementing this matched savings scheme represents a significant fiscal commitment, assuming that the scheme attracts significant participation.

Assuming high rates of take-up and of savings, the maximum fiscal cost is estimated at about $1.6 billion p.a.[16]

Other contributors

In addition to contributions from individuals and the government, the accounts will also accept contributions from other parties. For example, family members can contribute to these accounts, as well as community groups and other third parties.

Internationally, employers play a significant role in terms of contributing to employee savings and providing the infrastructure for participation. And in the proposal in this report, employers can make contributions to the accounts of their employees, either directly or through matching the savings of their employees (supplementing the government match). Indeed, an increasing number of employers already operate some form of savings schemes for their workers, but the level of coverage is still quite low.

And now may be a good time for New Zealand employers to get involved in employee savings schemes, given strong employment growth and some emerging wage pressures. In this environment, it is possible to allocate a portion of the wage growth to savings accounts, while still being able to deliver increases in disposable income to their employees. One scheme that works well in the US is where employees sign up to divert a portion of future wage growth into their savings account (Thaler & Benartzi (2003)). This may involve some costs for the firms involved, particularly for small firms. But there is also a lot of upside in terms

Worked example

Joe is a 23 year old worker who has just started a new job earning $30,000 p.a. He has no existing assets but plans to start saving $500 a year because he wants to get ahead and perhaps buy a house in Auckland.

When the KSA is introduced, Joe receives a $600 contribution in the form of a 2% marginal tax rate cut that is paid into his account. He also receives the full 1:1 match from the government of $500, because he earns below $38,000. His new employer has also recently introduced a matched savings scheme, in which they match Joe's KSA contributions 1:1 as well.

In his first year of employment, this adds up to $2100 in contributions to his KSA – much more than if Joe were saving by himself.

Assuming annual wage growth of 3% p.a., that savings grow at the same rate, and that funds in the account generate a return of 5% p.a., by age 30, Joe will have an account balance of about $22,120 in nominal terms. This provides a 6.5% deposit on the median Auckland house, the sale price of which is currently $340,000.

[15] The stronger match is unlikely to lead to higher participation rates for those who receive the supplemental match, but will increase the speed with which assets are accumulated (Choi et al. (2004), Bernheim (1999)).

[16] Assuming that everyone who earns income above $20,000 saves the full $1000 p.a., that those who earn between $10,000 and $20,000 save $500 p.a., and that those who earn less than $10,000 save $200 p.a.

Effect on national savings

This scheme is likely to have a material impact on the national savings rate for two reasons.

First, much of the fiscal commitment of $4 billion p.a. will represent an addition to national savings, as the proposal is that this scheme be financed out of money that has been allocated for increased operating spending by the government.

Second, there is likely to be a significant increase in household savings. Assuming that everyone who earns income above $20,000 saves the full $1000 p.a. that attracts the government match, that those who earn between $10,000 and $20,000 save $500 p.a., and those who earn less than $10,000 save $200, voluntary savings into the KSA will be about $2 billion p.a. And much of this will be new savings given that many people do not save much at the moment – and the evidence suggests that any offset in terms of reduced savings elsewhere is not likely to be large.

There will also be a significant increase in savings by young people because of the establishment of the kid's accounts. And to the extent that the scheme is successful in creating a savings habit, there will be new savings over and above the annual match limit.

Putting this together, an increase of about $6 billion p.a. in national savings is possible relative to a situation in which the $4 billion in government savings is spent. This is an increase in national savings of about 4% of GDP, which will make a significant contribution to reducing the size of the current account deficit, the level of external debt, and the interest rate risk premium.

of employee morale, reduced turnover and so on. And as the savings scheme becomes established, employers may view a policy of contributing to savings accounts as an important part of the recruitment process with workers selecting employers on the basis of the savings assistance that they offer.

Withdrawals

This is a lifetime savings account, which recognises that people need access to assets during their lifetime for major life events. However, as noted above, there is a trade-off between wanting to assist people to save money for the long-term, and flexibility to allow people to withdraw for key uses. This suggests that a limited range of withdrawal criteria will need to be specified.

The two key factors considered in making a decision on the nature of these criteria include the nature of the demand for access to assets (what are people likely to want to withdraw for) and the cost of monitoring (to ensure that the funds are used for the appropriate purpose). On the basis of these considerations, it is proposed that people be able to withdraw funds for the following purposes:

1. Financing education or the repayment of a student loan

Investing in education and skill acquisition is a key way for many to generate higher incomes through their life, and it is important to ensure that people are in a position to finance this investment. This may be tertiary education straight after school, or it may be for re-training or further education at multiple points in a person's life.

So the money in the account can be withdrawn to finance tuition fees and specified course-related costs at approved educational institutions. It will not be available to finance living costs while studying. Similarly, the funds can be withdrawn to finance the repayment of the student loan debt that is due to borrowing for tuition costs and course related costs. The Ministry of Education (2004) report that about 70% of student loan borrowing is due to these costs.

The endowed 'kid's account' proposed above will mean that many, if not most, tertiary students will be able to finance tertiary education without needing to access the student loan scheme. However, for those who do have a student loan, this withdrawal category will also allow those with student loan debt to repay it much more rapidly than is currently the case.

2. Deposit on a first home

Many New Zealanders have a powerful aspiration for home ownership. However, difficulties in assembling a deposit are a major obstacle for many people in getting into first home ownership. Although home ownership may not be appropriate for everyone – some may not

have the financial resources, or the desire for home ownership – the financial and social benefits generated by home ownership make a deposit on a first home an appropriate class of withdrawal.

This savings scheme is designed to put more people in a position where they are able to get into home ownership if they wish, but does not push people in this direction. As a result, this scheme is unlikely to lead to significant asset price inflation, although it may underpin more solid buyer demand in parts of the market.

The money is available for a first home deposit only rather than for paying off the mortgage because mortgage repayments can easily be used to finance consumption (as many mortgages are effectively large overdrafts). Because of this, withdrawals for mortgage repayment may not increase long-term savings.

3. Retirement savings

Another key motivation for saving is to finance consumption in retirement, and to supplement the publicly provided

Whai Rawa: The Ngāi Tahu savings scheme

Ngāi Tahu are currently investigating the possibility of implementing a savings scheme, which will involve the creation of individual accounts for all registered Ngāi Tahu. Details are still to be confirmed but it is anticipated that contributions will be made into these accounts by Ngāi Tahu by way of an annual distribution. In addition, there will be a matched savings component.

The funds will be available for education, home ownership, and retirement (with money available at age 55). The scheme will be accompanied by financial education and budgeting advice if required.

This is seen as a way of distributing a social dividend, while encouraging savings habits and financial literacy and generating economic and social benefits for the individuals and broader community. If approved for implementation the scheme is scheduled to be established by 2006.

pension. So it is proposed that once a specified age is reached, the funds in this account can be withdrawn for any purpose; paying off any outstanding mortgage, consumption, or continuing to save for retirement.

It may not be necessary to restrict access to the account until the current official retirement age at 65. It may be preferable to give people full access to their account balance at age 55 or 60, as people at this age are likely to have thought about how to finance retirement and are less likely to make short term decisions with respect to savings. And by bringing forward the date of access to these funds by 5 or 10 years, greater flexibility is provided as the use of the funds is restricted for a shorter period of time.

4. Family transfers

For those people who have sufficient savings for retirement, who are in home ownership or who have no other debts, the bequest motive is another key reason for saving. People may want to pass on money to their children. So withdrawals from the account will be allowed for the transfer of funds to the accounts of children e.g. to finance their tertiary education costs.

The ability to transfer wealth in this way allows for opportunity to be passed on to the next generation. As Michael Sherraden notes “asset accumulation enables the next generation to begin their lives with resources and therefore opportunities. This is important because social development is something which occurs across generations, not only within them” (2003, p. 29).

Summary

The ability to withdraw to finance education and a deposit on a first home will be of particular benefit to young people, and is a response to the specific ownership challenges that are currently facing young New Zealanders. It gives them a sense that they can build an ownership stake in New Zealand. And for older people, the scheme assists in the process of saving to finance retirement or saving for their children.

Overall, this scheme is designed to be flexible and to meet the demands of a population who have diverse preferences and circumstances. It is not intended to promote a particular type of asset accumulation, and the scheme is accordingly broadly agnostic with respect to the major forms of asset ownership. Put simply, the scheme is designed to assist New Zealanders to save money in order to access opportunity over a lifetime.

Nature of participation

Most of the proposed scheme is voluntary in the sense that people can choose whether they wish to contribute to the scheme and obtain the matching contributions. But should the tax relief be required to be saved, or should people have discretion as to whether to save the tax cut into the savings scheme, to spend it, or to save it in another form?

This decision will reflect a pragmatic judgement as to the most likely way in which to ensure that many more New Zealanders are saving. For example, if 80-90% of the population are expected to elect to save the tax cuts on a voluntary basis, then this is sufficiently close to universal participation to seem a worthwhile trade-off. But if the savings rate is projected to be only 30-40% then a more deliberate approach may be needed.

It is difficult to estimate precisely how many people will save the tax cut into the savings scheme. Recent New Zealand experience suggests that tax cuts will largely be consumed rather than saved – just as the recent income growth has led to high consumption growth and declining household savings rates. So providing unrestricted tax cuts is likely to lead to a reduction in national savings, which is inconsistent with the objectives of the savings policy.

But the design features incorporated into this savings scheme may make it more likely that people will elect to save the tax cut.

For example, if the receipt of the matched savings contribution is conditional on saving the tax cut, there is an incentive for people to do so. However, the international evidence suggests that even strong financial incentives can be insufficient to induce people to participate. For example, participation rates in the state sector employee scheme in New Zealand are about 50% despite a generous match. Participation rates in 401(k) plans in the US, which attract a tax concession and

"It should be compulsory otherwise people would spend it. From my own experience, I know that unless I was compelled to save, I probably wouldn't."

FEMALE, 83, PALMERSTON NORTH

"I'm a great believer in compulsory savings and I know others aren't – ...if it's optional you think about the pros and cons and may not do anything. If you don't think about it and it happens automatically, you just get over it."

MALE, 46, CHRISTCHURCH

often a matching contribution from the employer, are sometimes below 50% of the eligible workforce. For some, the desire for immediate access to these funds swamps the benefits to saving.

People are also more likely to save the tax cut where there is flexibility in the withdrawal criteria, as is the case in the proposed scheme. One reason that people do not join retirement savings schemes is that many people, particularly young people, have more pressing priorities like saving for a deposit on a home or repaying student loan debt. So even a generous contribution towards retirement savings may not be sufficient inducement for them to lock their savings away for the next few decades.

But if the withdrawal criteria are broadened to include a deposit on a first home, the repayment of student loans, and transfers to family members, saving through this scheme is likely to be seen as much more attractive – particularly for younger people.

Participation rates can also be raised through automatic enrolment – a presumption that people will save the tax cut, but with an option of withdrawal. The evidence from 401(k) schemes in the US is that automatic enrolment lifts participation rates significantly – in some cases, from about 40% to about 90% (Choi et al. (2004)). This seems to be because automatic enrolment overcomes the self control and procrastination problems – rather than having to make a deliberate decision to enrol, it now takes a deliberate decision to get out.[17]

However, it is not clear that even a combination of financial incentives, flexible withdrawal, and automatic enrolment will be sufficient to ensure that much of the tax relief will be saved. Given New Zealand's current outcomes, and the apparent absence of a strong savings culture, it seems appropriate to exercise caution and adopt a more deliberate approach. And there is a significant macroeconomic downside to having the tax cuts consumed.

On this basis, the judgement is that the tax cuts will be required to be saved with the money transferred from the government's accounts to the individual's account. However, at some stage in the future when the scheme is fully operational and savings habits have become embedded, it may be possible to relax this position.

[17] *This is an example of 'libertarian paternalism', in which institutions allow for as much freedom of choice as possible while also being deliberate about encouraging particular types of behaviour (Thaler & Sunstein (2003)).*

Summary: KSA key features

- Individual accounts will be established automatically at birth, with a $500 endowment by the government. Repeat endowments of $500 will be made at age 5 and 10. For voluntary contributions into the account of up to $200 p.a. the government will provide a matching contribution of 1:1, up to age 18. This money will accumulate tax free up to age 18, and additional contributions are also welcome.
- A two percentage point across the board reduction in the personal marginal tax rate will be diverted into the individual's savings account in the form of an annual lump sum contribution.
- For voluntary contributions into this account of up to $1000 p.a. the government will provide a 1:1 matching contribution. Other parties, such as employers, will also be encouraged to make contributions.
- Funds can be withdrawn from the account to finance education and the repayment of student loan debt (the portion that relates to tuition costs); to finance the deposit on a first home; to finance retirement; and for transfers to the accounts of other family members.

Scheme management

If these proposals are accepted, the next step is to consider the type of organisational arrangements that will be required; for example, how to manage the funds in these individual accounts. A specific recommendation on how to arrange the scheme is outside the scope of this report – which focuses on the objectives and design features of policies to create an ownership society – but the international experience does provide some guidance on the ways in which the scheme can be organised.

Broadly speaking, schemes operate in either a decentralised or a centralised fashion.

In a decentralised system, any approved financial provider (e.g. banks, mutual funds) can offer an account that has the KSA design features and people are free to open an account wherever they wish. For those people who do not make a choice, the government can provide a default fund and can contract out the management of these funds.

This is the approach that has been adopted in the UK with the Child Trust Fund, and was the approach proposed in the Compulsory Retirement Savings Scheme that was put to referendum in New Zealand in 1997. Once some restrictions have been imposed on the type of investments that can be made (e.g. risk profile), the investment choice is up to the individual.

In a centralised system, a scheme administrator offers participants a more limited array of investment options for their individual account – commonly three to five options, ranging from cash investment to various combinations of shares and bonds. Funds then compete to manage portions of these funds on

behalf of the scheme administrator (as is the case with the New Zealand Super Fund), but individuals only deal with the administrator in terms of making contributions and withdrawals. Alternatively, funds compete to be selected by the scheme administrator to be one of the funds managers available to participants to use, as is the case in the New Zealand state sector retirement scheme in which three managers were selected to offer services to participants.

President Bush recently proposed a centralised system in the context of reforming Social Security. His proposal was modelled on the Thrift Savings Plan, open to US federal employees, in which the Plan's 3.4 million participants have a choice of five broadly-based investment funds, and the scheme is very low cost.

Centralised plans tend to have significantly lower costs because there are lower marketing costs, reduced choice, and scale economies because of their large size – and the competitive tendering process will also tend to reduce margins (Diamond (2000)). Estimates suggest that this reduces costs by over half relative to investing in a standard retirement savings product (James et al (1999, 2001)). James et al. (2001) estimate cost of around 0.2% for passively managed funds.[18] These cost advantages are particularly important in a situation in which there are many small contributions and small balances, as is likely in the proposed scheme.

One of the major reasons for why decentralised schemes cost more is because they allow for greater investor choice in terms of funds management and the type of investment. However, the evidence does not suggest that more choice necessarily leads to better outcomes for the individual. For example, many competing choices often leads to procrastination, with lower participation rates being observed in some schemes with more available funds (O'Donoghue & Rabin (2001), Choi et al. (2004)). And many investors do not seem to value choice (Benartzi & Thaler (2002)).

The dangers of excessive investor choice are well illustrated in the recent Swedish experience, where individuals had a choice of 456 fund managers to manage a portion of their pension accounts (Cronqvist & Thaler (2004)). In 2003, only a few years after the scheme was introduced, only 8% of workers entering the scheme elected

[18] The NZ Superannuation Fund (2004) reports a cost of 0.17% of assets under management for the period to 30 June 2004, although they do not have to manage a system of individual accounts and they also expect these costs to rise over time.

a fund with the remainder simply entering the government's default fund. And few people exercise choice after entry in terms of changing their portfolio allocations.

This is likely to be particularly true in situations where many participants do not have much financial education. So schemes in which there is mass participation may perform better with more limited choice – as long as everyone has low-cost access to a range of investment opportunities, including equities. A centralised approach also makes it easier to impose quality standards on the managers, reducing the risk that individual investors will have bad experiences.

Hybrid approaches ought also to be possible; for example, where there is a centralised scheme with an opt-out provision, in which people (likely to be the larger, more sophisticated investors) can elect to invest their funds in another approved fund and access a broader range of investment opportunities, probably at higher cost. This is essentially what has happened in the Swedish case; most are electing the government's default fund but they are able to choose another fund if they wish.

However, a centralised approach will be more expensive and difficult to establish, as it requires the establishment of a new organisation. A decentralised approach is less disruptive to current arrangements, as existing financial providers can offer these new KSA accounts and they have existing expertise in dealing with a retail market.

The choice as to whether to allow investors considerable discretion as to where and how to invest the funds in their accounts, or whether to offer people a limited array of investment choices at lower cost, depends on the type of savings scheme that is put in place – for example, the likely scale of participation – and on a more detailed analysis of the set up and ongoing costs under both approaches. Although the overseas experience provides confidence that these accounts can be managed in an efficient, low cost way, it is necessary to fully consider the New Zealand context before making a decision.

5. OTHER POLICY CHANGES

Introduction

To create an ownership society in New Zealand, in which all New Zealanders have an opportunity to build an asset ownership stake, additional policies will need to be put in place. This is both to bolster the effectiveness of the savings scheme and also to more directly assist those on low incomes or who are out of the workforce to accumulate assets and repay debt.

There is no one way to achieve the ownership policy objectives, and it will require sustained effort across a broad range of policy fronts. The idea is that the promotion of asset ownership and savings ought to be a primary focus of policy, and be used as a filter over existing and proposed policy.

Four policy areas are identified and discussed in this section:

- Financial education
- Student loans scheme
- Housing policy
- Welfare policy

This section does not offer detailed solutions or recommendations in these areas, but identifies some priorities for action in terms of future policy change to encourage asset ownership.

Financial education

A key goal in designing the savings scheme is to create a savings habit and ensure that there is a much greater understanding of the importance of savings. An important part of achieving this is strengthened financial education. The international evidence shows that financial education in schools and in the workplace delivers much improved savings and wealth outcomes.

For example, there is US evidence that financial education through the workplace has a significant effect on household financial behaviour, and leads to much higher savings rates – particularly for people who have no prior record of saving (Bernheim & Garrett (1996)). Similarly, Bayer, Bernheim, & Scholz (1996) find that "both participation in and contributions to voluntary savings plans are significantly higher when employers offer retirement seminars. The effect is typically much stronger for non-highly compensated employees than for highly compensated employees".

And financial education at secondary schools, covering topics like budgeting, money management, and compound interest, is also a powerful way to increase savings rates and wealth accumulation (Bernheim, Garrett & Maki (1997)). In New Zealand, financial education campaigns, such as those run by the Retirement Commission and the Enterprise New Zealand Trust, have had positive effects on savings behaviour.

But more needs to happen, as is suggested by New Zealand's ongoing poor savings and ownership outcomes. Indeed, the international evidence suggests that, although important, financial education is unlikely to be sufficient by itself to overcome self-control problems. People often need something more immediate and tangible in order to change their savings behaviour in addition to simply learning about the importance of savings.

It is common for people to report an intention to change their savings behaviour after exposure to financial education, but often they do not act.

In the US, for example, Choi et al. (2001a) note that less than one third of those surveyed report that they changed their actions in line with their intentions. And in New Zealand, savings surveys repeatedly find that people understand they need to save more but are not doing so.

However, financial education that is linked to a specific savings product is much more likely to be successful. A savings scheme of the type proposed in this report, in which there is intended to be universal participation by young New Zealanders, provides a great base for financial education initiatives. For example, there is high potential for financial education initiatives in primary and secondary schools because all pupils will have these accounts – teaching kids about saving is more likely to generate good outcomes if done in conjunction with an account that they actually have.

Indeed, the introduction of the Child Trust Fund in the UK is being used as a platform for adding financial education initiatives into the national curriculum. Similar ideas are being discussed currently in the US in the context of the proposed ASPIRE Act.

In addition, financial education in the workplace, before taking out a student loan, and among the general public are all important things to do. And the proposed savings scheme provides a great context for this. Banks and financial institutions also have an important role to play in this regard in terms of making their products accessible and easy to understand.

Student loans scheme

The proposals made in the previous section will go a long way to ensuring that many, perhaps most, students will not need to take out a student loan to finance their studies. So rather than having a debt-based policy to encourage tertiary participation, the emphasis shifts towards having an asset-based approach.

However, given that this scheme may take some time to implement, and that some will still require student loans, there is a need to consider ways in which to reduce the student loan debt burden and to accelerate debt repayment.

A few things can be done to reduce the size of the student loan debt burden. For example, there should be compulsory financial education and budgeting advice before the student loans can be accessed so that students have a much clearer idea as to the consequences of taking on a student loan. Many students claim that they would have done things differently had they known what they would be getting themselves into.

And although the criteria for accessing student loans have been tightened since the scheme was initially introduced, it is still a relatively generous system. This, combined with the interest write off policy, has provided an incentive to take on larger amounts of student loan debt. Particularly where there is increased savings in advance for tertiary education, it may be possible to reduce the generosity of the student loans scheme and bring it more into line with what is observed in Australia. A start may be to restrict the interest free portion of the student loan to the tuition cost component.

Policy should also be aimed at encouraging people to repay their student loan debt as rapidly as possible; for example, by offering some financial concessions for rapid repayment. This is unlikely to be fiscally costly because the government will get the money earlier.

Another initiative that may encourage the rapid repayment of student loan debt is to increase the default loan repayment rate while leaving the minimum repayment rate unchanged. The evidence from savings behaviour in the US is that default settings matter importantly in determining people's behaviour (Choi et al. (2004)) and that many people do not depart from the initial default settings.

Currently borrowers who are earning above the threshold income level are required to divert 10% of their income to student loan debt repayment, which is done automatically through the tax system. However, it may be that more borrowers will increase their regular repayments if the default repayment rate was raised – to, say, 15% of income. People can elect to continue to pay at the existing minimum repayment rate, but it is likely that many will repay at the higher default rate. Over time, this will translate into considerable interest savings and enable people to move out of student loan debt more quickly.

Finding ways to reduce the student loan debt burden is likely to generate long-term benefits that extend beyond the direct financial benefits, in terms of affecting attitudes towards debt, consumption and savings.

Housing policy

Home ownership is a common aspiration for those on low incomes, just as it is for those New Zealanders in the middle class. The savings scheme proposed in this report will assist many more New Zealanders to put together a deposit to get into first home ownership, but it may not be sufficient for those on low incomes.

Internationally, there are a range of policies to assist those on low incomes into first home ownership. For example, federal funding for home ownership initiatives has been expanded by the Bush Administration in the US, building on progress by the Clinton Administration. In the UK, there are a variety of programs to assist first home ownership by those on low incomes. And in Australia, there are first home owner grants of A$7,000 per person, on which over A$4 billion was spent in its first three years of operation, together with an array of state level initiatives aimed at encouraging home ownership among low income Australians.

New Zealand is unusual among Anglo countries in having few policies designed to get people into first home ownership. New Zealand spends very little on home ownership policy – with only a few small-scale initiatives, like the mortgage insurance scheme piloted through Kiwibank – but spends a substantial amount on rental assistance and other housing programs. And the government's draft Housing Strategy does not have a strong focus on home ownership but rather is focused on the rental market, ensuring that people can afford to rent, providing state housing for rent and so on (Housing New Zealand Corporation (2004)).

Although assisting people to pay the rent, and having a focus on affordable housing, are often good things to do, home ownership ought also to be a high priority for policy. This is particularly so given the projected ongoing decline in New Zealand's home ownership rates and the strong evidence on the significant benefits derived from home ownership, both for the people concerned and the broader community.

Home ownership is not appropriate for everyone, because of the ongoing financial obligations, but some targeted assistance can be useful and bring significant social benefits. There is considerable scope to re-balance the government's spending on housing policy, and assist more people into home ownership.

The recommendation is that housing policy – and the associated spending commitments – be shifted from a focus

Government spending on housing policy

The government currently spends about $750 million p.a. on the accommodation supplement, and a further $370 million p.a. on income-related rental subsidies, for an annual total of over $1.1 billion. The 'Working for Families' package is projected to increase this cost by a further $80 million p.a. Currently about 245,000 people receive the accommodation supplement.

The government also spends money on a tax concession to owner-occupied housing. The McLeod Tax Review estimated that one approach to removing this tax concession would raise $750 million p.a., a number that has likely since increased substantially (Tax Review (2001)). Adding these expenditures together, the New Zealand government spends around $2 billion p.a. on policy that provides rental assistance or assistance to those who are already in home ownership.

However, very little money is directed towards assisting people into first home ownership, with only a handful of relatively small initiatives; for example, the Kiwibank mortgage insurance pilot project on which $5 million was budgeted over 2 years.

New Zealand Housing Foundation

The New Zealand Housing Foundation is a non-profit organisation that is helping low income people into housing through shared equity schemes. In its version of shared equity, families are provided with a house and commit to paying a market rent for five years. This rental payment covers the costs of interest and other costs like rates and insurance.

During the first five years of occupancy, the family has an option to buy the house at the original price plus 25% of any capital gain since commencement. The 75% of the capital gain that the family retains provides the equity in the house, and enables them to obtain a mortgage to purchase the house.

The New Zealand Housing Foundation has so far placed four families into first home ownership through these schemes, and is planning to substantially expand its operations in this area.

on rental assistance to assisting with home ownership. Some creative schemes are required to get more low income people into home ownership, like rent to buy and shared equity schemes, which have demonstrated track records, both in New Zealand and overseas (Caplin et al. (2003), Smith & Robinson (2005)).

These initiatives are unlikely to cause asset price inflation in the way that more comprehensive home ownership schemes may.[19]

New Zealand used to have policies to encourage home ownership. The challenge now is to develop policies to assist low and modest income New Zealanders into home ownership in ways that are appropriate in 21st century New Zealand.

Welfare policy

New Zealand has a welfare system that is highly focused on income transfers. Whereas most other Anglo countries, and most OECD countries, have policies to encourage savings and home ownership in low income communities, New Zealand policy to assist those on low incomes is almost entirely based on income transfers. The government's 'Working for Families' package is an example of this approach.

However, asset ownership is also an important part of economic advancement. As Sherraden (2003) observes, "for the vast majority of households, the pathway out of poverty is not through income and consumption but through saving and investing in education, enterprise, and property" (p. 28). This is why there is a pronounced international emphasis on the expansion of ownership policy that is focused on assisting low income people to save and to accumulate assets. If there are powerful benefits to asset ownership

[19] *Although concerns about home ownership assistance causing asset price inflation are sometimes over-stated. The Reserve Bank of Australia (2003) state that "the net effect of these [first home owner] grants has been beneficial to first-home buyers" and the impact on house prices "has been relatively small" (p.31). The Productivity Commission (2004) agreed with this view.*

for the middle class, it is very likely that the benefits to those on lower incomes are even greater.

These asset building schemes have been very successful at increasing savings among those on low incomes, including those who are receiving benefits. Although there was initial concern that low income people wouldn't be able to save, it turns out that many people on low incomes want to save, and are able to save when given some assistance and education.

For example, the Savings Gateway pilot in the UK led to higher savings (Kempson et al. (2003)) with many low income participants becoming regular savers. And the American Dream Demonstration initiative in the US also worked well, leading to improved financial outcomes and positive changes in savings behaviour (Schreiner at al. (2002)). Positive results are also reported from Canada and Australia.

The New Zealand government currently spends around $10 billion p.a. on various welfare benefits, with almost none of this aimed at encouraging and assisting those on low incomes to become asset owners. Over time, it seems appropriate to move towards a greater focus on initiatives that promote asset ownership; shifting from an approach that helps people to get by through income transfers to one that helps people get ahead through asset ownership (Boshara (2002)).

A start has been made by the savings proposals in this report, which are designed to ensure that everyone will have an asset irrespective of their economic background. And the matched savings scheme is designed to provide greater assistance to savings by those on low incomes. But more targeted assistance is likely to be required for those on low incomes. This may involve more intensive financial education, case management and some more aggressive matched savings initiatives for some groups.

One area of particular concern is debt levels for those on low incomes. The Ministry of Social Development estimate that about 15% of New Zealanders are in debt difficulty (Valins (2004)), and a large number of New Zealanders are in a negative wealth position in which their debts outweigh their assets. For many households this is not a temporary situation, but one from which they struggle to get out. Debt can have debilitating effects on people's lives in the opposite way to that in which asset ownership has positive effects (Valins (2004), Williams & O'Brien (2003)).

Debt to government agencies is a major part of the debt problem for low income people – for example, student loans and also money owed to agencies like Work & Income New Zealand. In this sense, policy seems to be focused on assisting debt accumulation rather than asset accumulation. A focus on addressing the debt position of low income New Zealanders is needed in addition to a focus on their incomes.

One form of policy assistance to this group may be an aggressive 'matched debt repayment' policy, in which debt is written off in proportion to debt repayments made by the borrower. The aim is to get families out of debt as quickly as possible and into a position of asset ownership.

More generally, the shifting of welfare policy from a cash transfer focus towards an asset building focus is the subject of intense and bipartisan public debate the world over, with an increasing number of initiatives being launched. Sherraden (2003) observes that whereas it is uncommon to observe expansions in traditional welfare policies, there are many expanding asset based policies in Europe, the US and the UK. Friedman & Sherraden (2001) speculate that it is likely that "asset accounts will have replaced social insurance as the dominant social policy strategy" across most developed countries, with universal asset accounts being established for people to finance investments, education, health, retirement and so on.

This is a policy movement that New Zealand should be learning from in order to make its policy assistance to low income New Zealanders more effective.

Summary

There is no silver bullet nor, given the scale and scope of the problem, can one single approach be expected to deliver material improvements for all New Zealanders. A range of measures will be required, and this section has identified four priority policy areas that are likely to assist asset ownership in addition to the establishment of the Kiwi Savings Account.

This is not intended to be an exhaustive list, simply to provide an indication of the type of policy areas in which progress can be made. Indeed, policy settings across government ought to be evaluated in terms of the extent to which they encourage asset ownership.

6 CONCLUDING REMARKS

This report has outlined a series of policies and actions that are aimed at creating an ownership society, by both broadening the distribution of asset ownership and raising the level of savings. There are a few key messages in this report.

Policies to promote asset ownership will lead to improved ownership outcomes, generating significant economic and social benefits

New Zealand is facing a serious ownership challenge. Many New Zealanders do not have a meaningful asset ownership stake, with over 800,000 New Zealanders owning less than $20,000 and with a median household wealth of just $68,300. At an aggregate level, New Zealand household savings are amongst the lowest in the OECD and New Zealand has one of the highest levels of external debt in the developed world.

A key reason for these poor outcomes is the absence of policies to promote asset ownership in New Zealand. Whereas all other Anglo countries have policies to deliberately encourage savings and asset ownership, many of which are being expanded, New Zealand does not. Indeed, the trend in New Zealand over the past 10 or 15 years has been to make debt accumulation considerably easier, but to do nothing to make savings and asset accumulation easier.

The international evidence shows clearly that savings policies do work to increase household and national savings, and enable many more people to build an ownership stake. And, as a result, these countries capture more of the economic and social benefits that are generated by asset ownership.

There are both economic and social arguments for initiatives to create an ownership society in New Zealand. Encouraging asset ownership among more New Zealanders is likely to generate improved life outcomes for individuals and more cohesive communities, as well as generating significant macroeconomic benefits in terms of increased investment, productivity, and growth, an improved external balance and reduced external vulnerability.

By themselves, the social and economic benefits are both sufficient to create a compelling case for action to create an ownership society. And taken together, the economic and social arguments create an overwhelming case for aggressive action.

The scale of the ownership challenge requires an aggressive and broad response

There is a simultaneous need to broaden the distribution of asset ownership in New Zealand, so that many more New Zealanders have an ownership stake in the New Zealand economy, and to raise the level of household savings so that more funds are available for productive investment in the New Zealand economy.

Given New Zealand's current ownership outcomes, the goal of creating an ownership society is a substantial national priority and demands an aggressive and creative solution in response. The way in which these challenges are addressed will profoundly shape New Zealand's social and economic prosperity over the next few decades.

Creating an ownership society will require a significant and sustained fiscal commitment. The proposal that the government move to spend $4 billion p.a. – approximately $1000 per New Zealander – on savings and ownership initiatives over the next few years reflects this judgement. A material improvement in ownership outcomes cannot be achieved without a significant policy effort – the size of the solution needs to be aligned with the size of the challenge.

Although the focus in this report is on policy changes to achieve an ownership society, this is a national priority, and will require the involvement of employers, educational institutions, community organisations, and others, to promote and encourage asset ownership.

Proposals are made to lift savings and provide more with a stake

Although this is a serious challenge, the good news is that there are ways in which ownership outcomes can be materially improved. The international evidence shows clearly that many policies to promote savings and asset ownership do generate substantially improved ownership outcomes. And some of these ideas have a New Zealand history, with policies to encourage asset ownership having been implemented in New Zealand previously – such as policies to encourage first home ownership.

This report has proposed an aggressive and creative policy response to improve New Zealand's ownership outcomes. The major recommendation is the establishment of an individual lifetime savings account – the Kiwi Savings Account – which is established at birth for everyone and moves with people through their lifetime. These individual accounts will provide many more New Zealanders with an ability to get ahead financially and to access opportunity for a lifetime – it places the financing of education, home ownership, and retirement within the reach of many more people.

The government can make a fiscal commitment to achieving these goals by endowing accounts at birth, and helping young people build an asset, providing across the board tax cuts to finance savings, and establishing a matched savings scheme that is designed to develop savings habits.

These policies have been designed to benefit most New Zealanders and move New Zealand towards being a nation of owners, in which many more people have a stake in the future. These policies will also generate a material increase in national savings, which will generate significant macroeconomic benefits. Over time, these policies have the potential to have a profound effect on New Zealand's economic and social future.

This initiative needs to be supported by a range of other policies to promote savings and asset ownership, from financial education, to assisted student loan debt repayment, to first home ownership policy and welfare policy.

There is substantial scope for policy in New Zealand to be focused to a much greater extent on helping people get ahead through asset ownership in addition to helping people get by through the traditional welfare system.

There is now a fantastic opportunity to create an ownership society that will positively shape New Zealand for decades to come. A window of opportunity exists with strong economic conditions, a healthy fiscal position, and a growing recognition of the social and economic benefits that can be generated through the creation of an ownership society – as well as a broader understanding of the social and economic consequences of failing to act. As a country, the challenge is to invest in the future of New Zealand while this window of opportunity exists.

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ABOUT THE AUTHOR

David Skilling

David is the Chief Executive of the New Zealand Institute. David was previously a Principal Advisor at the New Zealand Treasury where he worked primarily on economic growth issues. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce (Hons) degree in Economics and a Bachelor of Commerce degree in Accounting & Finance from the University of Auckland. He was a Teaching Fellow at Harvard University for three years, and has also worked at the OECD, McKinsey & Company, and Deloitte.

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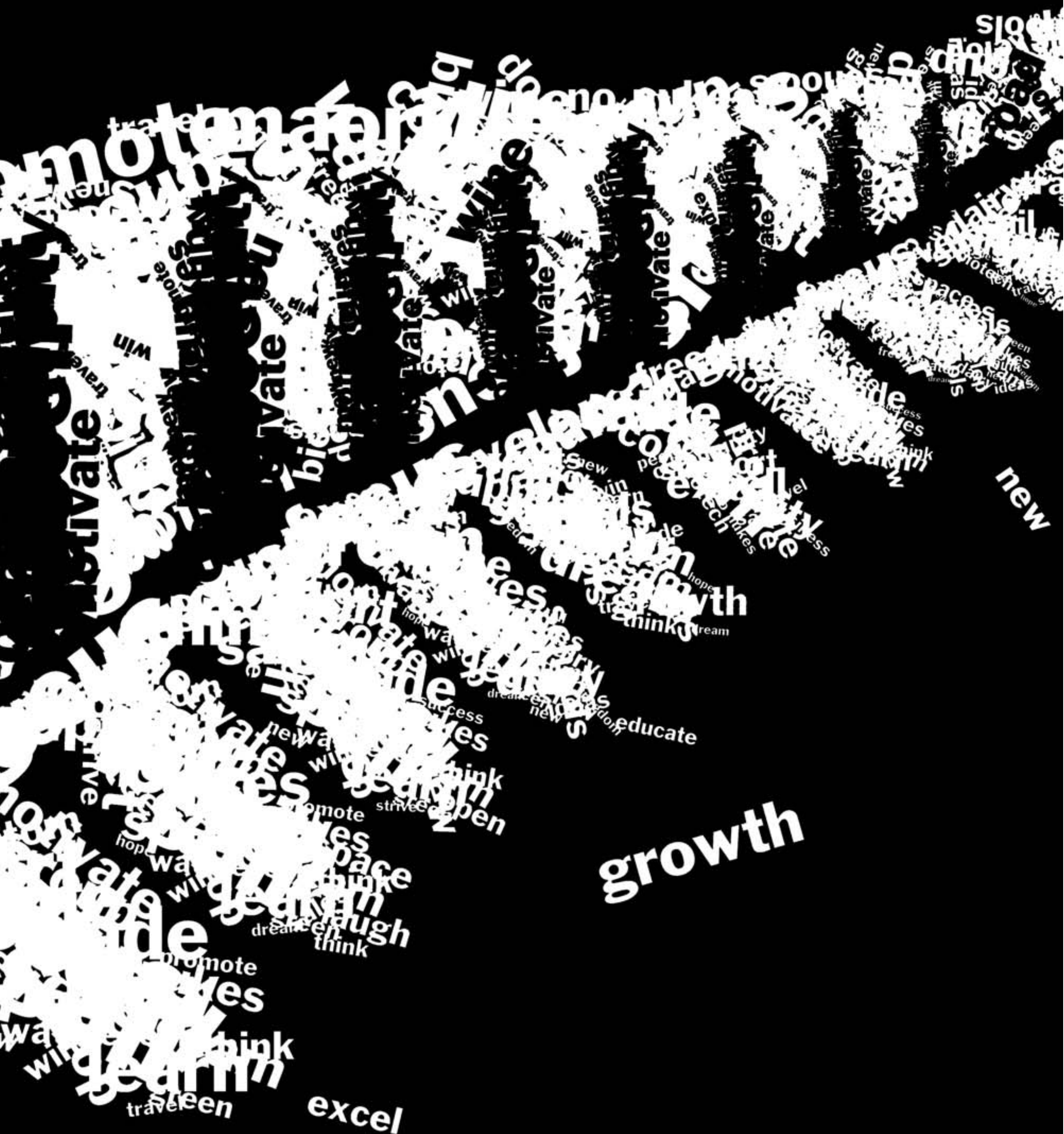

www.nzinstitute.org The New Zealand Institute
PO Box 90840
Auckland 1030
New Zealand
P +64 9 309 6230
F +64 9 309 6231