Commission for
Financial Literacy
and Retirement Income

Encouraging personal responsibility, individual choice and control

Introduction

This position paper is about *voluntary saving* of money and other assets that are not intended to be drawn down until the owner reaches their "old age". By voluntary, we mean savings that are made by choice (i.e. the money could have been used for something else) whether or not there are incentives such as tax subsidies[1]. The alternative is *compulsory* saving, where there is no choice about whether or not to save.

History

The model of voluntary saving in New Zealand owes much to the 1992 Task Force on Private Provision for Retirement (the so-called Todd Task Force) which advocated a non-subsidised, voluntary saving option for New Zealand in preference to a tax-incentive option or a compulsory saving scheme.

This recommended approach was later incorporated as a principle in the 1993 multi-party Accord on Retirement Income Policies which said that: "People should be encouraged to save for their retirement through the availability of appropriate savings products, supported by education and the provision of information about retirement matters, but should not be compelled by law, or given tax incentives, to do so."

This approach was endorsed in each of the subsequent reviews of retirement income policy (1997, 2003, 2007 and 2010). Throughout that time, voluntary saving has continued to sit alongside universal entitlement to New Zealand Superannuation (NZS). In other words, individuals' savings have been used to "top up" their NZS payments. The advent of KiwiSaver has provided another means of building up personal savings and overall, New Zealand's system of retirement income has continued to uphold longstanding principles of adequacy, simplicity, flexibility, certainty, equity and fairness (Cook, 2006).

The case for voluntary saving

A New Zealander's life may take a wide variety of courses. Some will start families or go into business at a young age and they might not get into serious saving until the children have left home, or the business is sold. Others may either aim to retire early or put aside regular, small amounts of money and work as long as possible. And flexibility is important – anyone can experience a setback that requires access to emergency funds.

A voluntary savings model encourages New Zealanders to take responsibility for managing their own finances in a way that best suits their long-term interests. In a voluntary system, each person chooses when and how much to save, given their working life and other

[1] Although it can be argued that incentives generate savings that are not purely voluntary.

circumstances. However, the voluntary model only works if a number of elements are in place:

- Individuals and families are able to earn enough income for them to save
- A good level of financial literacy among the population and access to sound financial advice to support their choices
- A well-functioning and regulated financial market that is transparent and trustworthy
- A generally tax-neutral saving and investment environment to avoid distortions in decision making and
- A basic guaranteed level of income in retirement such as that provided by NZS, to remove the risk of poor investment choices or outcomes driving a saver into absolute poverty in old age (Crossan, 2010)

Compulsion is not the answer

There are many who still argue that saving for retirement should be compulsory. The grounds for these arguments vary, but are frequently based on beliefs that people won't save, or won't save enough, unless they are compelled to do so. There are also arguments that each generation should be made to pay for its own retirement, or that compulsion is needed to build national savings (Connolly, 2007)[2].

The above case for voluntary saving has shown that such a "one size fits all" approach is not appropriate because it fails to allow for the diversity of New Zealanders' needs, and reduces choice (Whitehead, 2007). But compulsion can also lead to greater inequality. In a compulsory system, low income people may have to forgo spending on essential items, while wealthier people are able to maintain the same standard of living by simply reducing other forms of savings. In retirement, these inequities are magnified.

Compulsion does not guarantee that people will reach retirement in good financial shape. In Australia where participation is compulsory, the value of net assets increased in the decade before the 2008 global financial crisis but so did debt levels (Infometrics Ltd, 2007) and levels of home ownership are declining, with many retired Australians either paying off a mortgage or renting (Rothman, 2011; Roy Morgan, 2011).

A compulsory system can be expensive because of the need to ensure compliance and because tax incentives are often still required to help make compulsion acceptable. With compulsion, there is little incentive for regulators and the finance industry to reduce complexity, increase transparency and allow for comparability of superannuation products (Cooper & Review Panel, 2010). Compulsion can also encourage savers to "set and forget" their contributions rather than reviewing them from time to time to check performance or "fit" with changing circumstances. In Australia a great many fund members, and particularly those a long way from retirement, do not take a keen interest in their superannuation (Fear & Pace, 2008).

[2] See position papers on "Intergenerational equity (cohort self-funding)" and "Fiscal restraint and investment".

In a voluntary system, financial services providers have to work harder to get customers, and to keep them. The Todd Task Force put it this way:

> …voluntary provision can be seen as the fairest of the three options for all industry participants since it maintains an environment that does not favour one form of saving over another. The improved voluntary regime will allow all parts of the saving industry to compete on an equal basis. This should produce better returns for savers if only through reduced management expenses, In turn this will attract more savers and greater earnings for the whole industry.

The task force also noted that a likely outcome of a compulsory savings system would be the introduction of means testing for NZS. This would represent a fundamental change to the system of retirement income that has served New Zealand so well over several decades.

Conclusions

While there are strong arguments for many New Zealanders to save in order to “top up” their income from New Zealand Superannuation, there is no compelling argument for making those savings compulsory. The downside risks of compulsion outweigh the likely benefits, particularly for less well-off people. Compulsion is likely to create pressure to means test NZS, and would remove competitive pressures from the marketplace.

A better approach is for a financially literate population to voluntarily choose to save in ways that meet their own individual or household needs. It is also important to focus on policies that grow incomes and to ensure that savers are getting good value from the schemes they already have (Scobie, Gibson et al., 2004; Coleman, 2006).

Finally, retention of the mix of voluntary private schemes and publicly-funded NZS is essential so that New Zealanders can be confident of a basic income “floor” for those who are either unable to save, or suffer from poor savings outcomes.

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