

Investing in our future – the role of the New Zealand Superannuation Fund

New Zealand faces both short-term and longer-term economic challenges.

In the short term, the global financial crisis has hurt all the world's economies. These economies, including New Zealand's, are going to require time and money in order to recover.

New Zealand has taken the appropriate steps to this point to deal with the serious short-term issues, and these are consistent with the steps taken internationally. There has been bipartisan agreement on the actions needed to ensure the stability of financial markets, and National will continue to co-operate positively with any further short-term measures that are required.

Longer-term, there are a number of underlying issues in the New Zealand economy that have not been addressed, and it is critical that these be addressed in the changed international circumstances. These issues include low productivity, poor incentives in the tax system, and difficulties retaining our skilled workforce in New Zealand.

Failure to address these underlying problems will result in long periods of low growth and a declining standard of living relative to the rest of the developed world. The fiscal position of the New Zealand government would also stay negative for longer, and this prospect was laid out in the Pre-Election Fiscal Update (PREFU) last week.

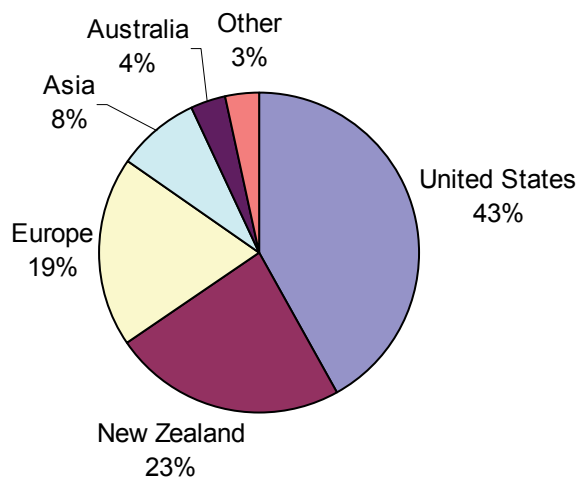
Looking forward, the international financial crisis brings additional complications. Banks will not be lending as easily or as readily as they have been, and overseas investors will be more cautious about where they put their money. New Zealand is particularly vulnerable because we are a small nation with large and persistent current account deficits.

The New Zealand Superannuation Fund

The taxpayers of New Zealand are making contributions of around \$2 billion every year to the New Zealand Superannuation Fund, most of which is subsequently invested overseas (Figure 1).

As at 30 June 2008, the Super Fund had almost \$14 billion of investments, of which less than a quarter was invested in New Zealand. This means that more than \$10 billion is currently invested overseas.

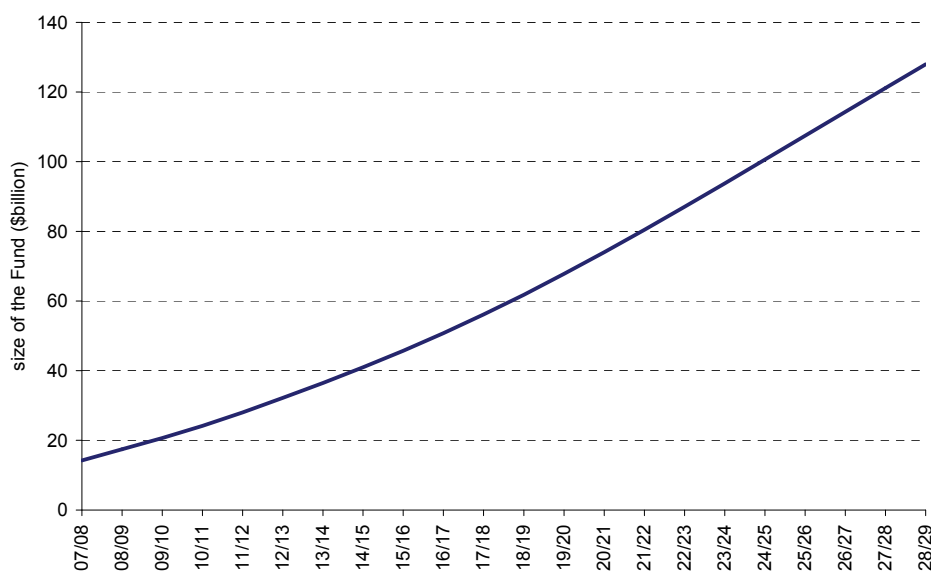
Figure 1 – Location of the New Zealand Superannuation Fund's investments, as at 30 June 2008



Source: New Zealand Superannuation Fund Annual Report 2008, Note 7(d).

The Super Fund will grow every year and is projected to grow to more than \$100 billion by 2026/27, when capital begins to be withdrawn from it (Figure 2).¹

Figure 2 – Projected size of the New Zealand Superannuation Fund



Source: New Zealand Treasury, PREFU Fiscal Strategy Model.

¹ For more information about the Super Fund, see <http://www.nzsuperfund.co.nz>

New Zealanders are entitled to take a view as to where this large pool of capital, funded by taxpayers, is invested. They are entitled to decide that these resources will be used to invest in our future growth and to underwrite our future prosperity.

At a time when credit and capital are both going to be in short supply, we would be negligent if we did not employ our own superannuation fund to grow our own economy.

National, therefore, believes that a greater proportion of the New Zealand Superannuation Fund, which belongs to all New Zealanders, should be invested in New Zealand to grow our economy.

Drawing an analogy with a bank, it makes no sense for New Zealand businesses to be waiting at one teller's window to make withdrawals while the Super Fund is lining up to make big deposits with the teller next door.

It is better to use more of those funds here at home to invest in our productive sector and broaden and deepen our own capital markets. This will have both short-term and longer-term positive impacts.

In the short term, in a world where money for investment is going to be more tightly held and more closely guarded, it will help ensure New Zealand has the investment capital we need to get out of recession and into a period of solid and sustainable growth.

In the longer term, it will give New Zealand businesses a greater opportunity to grow from a domestic base and grow under New Zealand ownership further than they would otherwise have been able to.

National's Policy on Investment of the New Zealand Superannuation Fund

National's policy is for the Super Fund to invest a greater proportion in New Zealand, while also safeguarding the fund as a source of future New Zealand superannuation payments, and overseen by independent guardians.

National will, therefore, amend the New Zealand Superannuation and Retirement Income Act 2001 to allow the Minister of Finance to give a direction to the Guardians of the Fund in relation to the proportion of the fund which is to be allocated to New Zealand.

National will set the target of at least 40% of the Super Fund to be invested in New Zealand.

In every other regard, the Guardians of the Fund will continue to invest as they do now. They will invest on a prudent, commercial basis, and by making their own decisions about what asset classes to invest in, in line with best-practice portfolio management.

In particular, the guardians will determine the appropriate rate at which to increase their investment in New Zealand to 40%, taking into account their need to manage their overall risk profile, the availability of quality investments, and the impact of increased investment on local markets.

To give an example, if half the Fund's income (the Crown's capital contribution plus the Fund's net earnings) is allocated to New Zealand investments each year, then by 2015/16 40% of the Fund's total assets would be invested in New Zealand. This would mean the Fund would have \$18 billion of investments in New Zealand in 2015/16, rather than \$11 billion under the current level of domestic investment.

Investment Opportunities for the Fund

We expect this range of investments to include:

- New Zealand-listed equities.
- Government bonds.
- High-quality commercial paper.
- Local government fixed-interest securities.
- Private equity.
- Property, infrastructure, forestry, and commodities.

National will also work to create more investment opportunities for the Super Fund in New Zealand.

In particular, we intend to develop longer-dated infrastructure bonds to help fund New Zealand's future infrastructure requirements. There is strong demand for these sorts of long-term investment opportunities.

Theoretically, the fund could already invest more heavily in New Zealand assets. But in reality it doesn't because Labour has done nothing to generate new investment opportunities.

National knows that New Zealanders want better infrastructure sooner. Using the resources of the Super Fund is a way to achieve a step change in the infrastructure of New Zealand and help drive greater productivity in our economy.

Q&A

Will the Government be telling the Super Fund what to invest in?

No. The Minister of Finance will be setting a broad parameter for the fund to invest 40% of its capital in New Zealand. The Guardians of the Fund will continue to have total discretion to allocate the increased investment in New Zealand as they see fit.

Is this what other countries allow?

The closest equivalent to the Super Fund is Australia's Future Fund, which was set up in 2006.

Under the legislation governing the Future Fund, Ministers are able to give the Board of Guardians a direction setting out the policies to be pursued by the board in relation to the allocation of financial assets. This is a wider power than National is proposing for the Super Fund. At present most of the Future Fund is invested in Australia as equities or as cash held with the Reserve Bank of Australia.

What New Zealand assets would the Super Fund invest in?

The decision about what New Zealand assets to invest in would be made by the Guardians of the Fund.

They will want a balanced portfolio of assets within New Zealand, so would be likely to maintain and develop their current range of investments in New Zealand equities, government bonds, commercial paper, local government fixed-interest securities, private equity, property, infrastructure, forestry, and commodities.

Will this change undermine the purpose of the Super Fund?

No. The purpose of the fund is to help offset the costs of New Zealand superannuation payments in the future, when the 'baby boom' generation reaches retirement age. That purpose does not change.

If New Zealand has a smaller economy when people retire, the whole country will be worse off as a result. This change is about strengthening the New Zealand economy though increased investment in our companies and our infrastructure.

Will this change help the New Zealand funds industry?

Yes. We will insist that fund managers for New Zealand assets operate an office in this country. This will help re-build a stronger finance sector in New Zealand.

Last year, the Super Fund paid more than \$60 million in fees, the majority of which went to overseas-based fund managers.