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'ENHANCING SAVINGS IN THE ASIA PACIFIC'
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The subject is savings in the Asia Pacific. And perhaps the place to begin is to first examine the large macro economic and trade picture, so we have some idea of the larger influences at work.

The Pacific is now dominated by trade between China and the United States. Between Chinese manufacturers and American consumers. And between those traditional partners, Japan and the United States.

Lower trade and non-trade barriers have promoted ever increasing market penetrations of goods and services.

The effect of these massive trade flows has been to set up a stock of financial imbalances on a scale not previously seen. And the satisfaction of these imbalances has, in turn, promoted a flow of savings on a massive scale.

The huge current account and budget deficits run by the United States and the large current account deficits run by countries like Australia and the United Kingdom are a reflection of the surplus savings of the rest of the world. These imbalances are now of substantial proportions. To repair them a couple of things need to happen: a reduction in aggregate demand in deficit countries like the US and Australia, including measures to promote supply and, especially in the case of the United States, a depreciation of the real exchange rate.

This would have or induce two effects: a reduction in demand would provide a larger exportable surplus as domestic demand switches product to exports thereby reducing the call on overseas savings; and a depreciation of the real exchange rate would make imports more expensive and exports more competitive, accelerating the switch from higher to lower domestic demand.

The United States wants the gentle depreciation of its exchange rate to repair its trade account and hence its current account deficit. But this process is being severely hampered by a group of countries which link or tie their currencies to the US dollar. So, when the dollar goes down, they go down with it, giving the US no net competitive advantage.

This group has been termed the informal or shadow dollar area, which includes among them, countries like China and Japan, which spend a large part of their huge foreign reserves buying US dollars, attempting to thwart the natural fall in the US dollar. In Japan's case, to keep the yen cheaper and more competitive

These heavy exchange rate interventions by the Bank of Japan and the People's Bank of China have the effect of blocking the natural corrective qualities that a real depreciation of the US dollar would bring. A large part of the world economy is now in this shadow dollar area, which means the burden of adjustment falls on those not seeking to strike some dollar parity or heavily intervene in their forex markets. In the main, this weight is carried by Europe, whose Euro has been made less competitive by a large appreciation against the US dollar and, of course, ourselves with the Australian dollar.

All these currency links or foreign exchange interventions lead to the central banks of these countries buying US securities thereby underwriting the growing and continuing imbalances of the US. The resort by US policy-makers to this easy financing of its current account and budget deficits, is leading the US into a debt mire. And the debt mire is deferring the kind of internal adjustment the US economy badly needs. A point made by a number of commentators including Martin Wolf of the *Financial Times*.

In other words, massive surplus savings are slopping into the United States displacing what used to be direct or equity investment. Normally, developing countries like China use their income to promote their own internal development. But the behaviour of the IMF in Indonesia and Thailand during the crisis of 1997-98 has encouraged countries like China to have an in-house IMF of their own by garnering a massive foreign reserve surplus.

Were the Government of China to unhook the renmimbi from its US dollar peg, and let the currency drift upwards, less investment in China would go into net exports and more would go into domestic investment like housing, motor vehicles and consumer finance. The very change which will employ more people in China, especially in the cities; the kind of changes which China needs. In fact, the current arrangements are very bad for the Chinese. The Chinese make and sell real goods and get in return US$ securities which then decline in value. By over 30% in the past year. By giving up the hoarding of reserves, the Chinese Central Bank would encourage the Americans to curb their debt habit.

But while ever the Bank of China and the Bank of Japan fall over themselves to buy dollars, US policy-makers will give the rest of the world second best policy settings, and second best outcomes.

What we have to keep our eye out for is a sharp or catastrophic fall in the US dollar. Such an event would turn Alan Greenspan's policy of gradual interest rate increases on its head. And interest rates would go up sharply world-wide. And a precipitate fall in the dollar remains a possibility while ever the current depreciation seems unable to adequately adjust the trade account.

The fact is, the United States is relying on the rest of the world to maintain its living standards; Muslim oil and Chinese capital. In the 1980s and 90s, it was Japanese capital.

Foreign holdings of US Treasury bonds is now over 50% for the first time ever. In the 1990s it averaged 20%.

And all this is compounded by the fact that the US savings rate now stands at zero.

The savings of the savers – is offset by the disaving of the disavers.

And at a time when demographic changes are forcing more Americans into retirement relying for income support on the public pension.

Vice President Cheney recently announced a proposal for the US Government to borrow $740 billion on the Budget for payment into private savings accounts. The reason for this is that if nothing is done to deal with the US Budget imbalance, public pension benefits will be unaffordable.

Fortunately for Australia, this problem was thought about 21 years ago. The change came in 1984 when the then Labor Government, newly in office, changed the tax treatment of lump sum retirement payments and set up approved deposit funds to encourage the growth of annuity income for retirement. It was the first move towards a more rational retirement income system.

The next change came in September 1985, which was to extend superannuation to workers in Australia via industrial awards. The aim was for workers to take an initial 3% of their income as savings rather than as cash and for the contribution to be made by employers as part of a set of productivity related offsets.

It took just on six years for that 3% to go into place and then as Prime Minister, in 1992, I introduced the Superannuation Guarantee Charge legislating a mandatory 9% of wages to be put away as savings into individual savings accounts to be privately managed. When we began the changes in 1984, there was $42 billion in superannuation fund assets. Today the pool stands at about $700 billion.

The reforms put Australia at the front of OECD countries in planning and provisioning for the retirement bulge from the 1940s baby boom. As it turns out, Australia is now better set up, in these respects, than comparable countries.

But not as well set up as it should be.

The problem is that the 9% is not enough to sustain workers in retirement without resort to the public pension.

The Government I led planned in 1995 to move superannuation contributions for all workers from 9% to 15% by paying tax cuts off the budget as savings – preserved to age 60 - and by a co-payment from workers themselves.

The current Government rescinded that policy, with the result that retirement income mandatory provisioning is today stalled at 9%.

It is true that many people elect to salary sacrifice and devote more discretionary income to superannuation. Some will even be contributing at 15%, but not the majority.

Had Australia not had an incomes policy in the 1980s and 90s, the current scheme may not have gone into place. But the Government did have an accord with the trade unions at the time, and the scheme did go into place.

The trick now is to build on the current scheme and improve it, especially when we are relying heavily on overseas savings to fund our current lifestyle and living standards.

At the moment the Australian current account deficit is financed overwhelmingly by borrowings by our four major banks. In the past it was financed by direct capital investment and portfolio investment. These days the four banks hold these Australian dollar liabilities, in the main, in maturities of less than 12 months. A higher level of domestic savings will diminish our overall call on overseas saving and lessen the vulnerability to the way it is financed.

Superannuation in Australia is also doing another thing. It is turbo-charging the Australian capital market.

In 1985, as Treasurer, I introduced in Australia, the world's purest system of dividend imputation; to remove the double taxation of dividends. Before this, in Australia, we were taxing debt once and equity twice while leaving capital gains untaxed. I wanted a country where if there was any tax break about it was given to the dynamic production of income rather than by lazy resort to inflationary capital profits.

The removal of the double tax on dividends completely changed a company's capacity to save. Now with a 30% corporate rate, a company can retain 70% of earnings in the business. Before the 1985 changes, that was 22%.

And now, if a business wishes to pay dividends, the shareholder enjoys a tax credit against his or her personal tax up to the level of the corporation tax paid - hence the phrase imputed credits.

The interesting thing for an audience of this kind is to realise that in 1987, dividend imputation was extended to superannuation funds. A superannuation fund can reduce the tax liability on its fund earnings by streaming imputed credits into its accounts or, put another way, by buying equities. This policy has had remarkable consequences:

(1) superannuation funds are more directly involved in capital formation

(2) it has put real pressure on managements and boards of directors to pay their full corporation tax and fully frank their dividends

(3) it has put pressure on managements and boards to declare dividends – where in the past this was much more a matter for the discretion of managers and boards

(4) it has tipped the balance of power within companies – public companies – much more in the direction of shareholders providing some real equilibrium

(5) and most importantly, it has produced a fashion for dividends in the Australian stockmarket which has set yields such that the amplitude

within which stock prices rise or fall is much diminished when compared with comparable bourses.

The thick rope of dividends which now runs through the Australian stockmarket has given us a much less volatile market. And superannuation is the flag carrier of this system. It is unique in the world.

It has set Australia up in retirement income production and management, but the system still needs more adequacy of income contribution. It goes without saying that efficiency in income delivery and growth will be keys to aggregate income earnings.

In a 5 to 6% world, obviously fees of 2% to 3% will no longer wash. No-one is going to watch a third of their income swallowed up in fees. For, if such were to be the case, income adequacy in the longer term would suffer. Choice and efficiency in delivery will, I hope, make the system more peppy and competitive.

Perhaps I could sum up.

As a savings deficit country, Australia cannot afford to run a structural current account deficit of 4% to 6% of GDP.

While in absolute dollars, compared with, say, the United States, this is not, in world terms, a dislocating sum, but with Australia at $700 billion of GDP it amounts to around $35 to $40 billion of new debt per year.

Prudence should tell us that we have to cut demand and improve the supply capacity of our economy in order that the trade account may structurally improve.

This was the essence of the Reserve Bank's message last week.

But we have to do more than that. We have to structurally add to savings, before harder assessors begin examining the growing stock of our external liabilities.

There will be no prizes for being out there with the savings begging bowl if and when the surplus countries decide to change tack.

Superannuation is our most successful mandated savings scheme.

It is imperative, in national savings and retirement income terms, that we move the system to greater adequacy.

We should be putting in place, now, the steps to take superannuation contributions to a mandatory 15%.

By building this savings buffer we will underwrite a larger share of our own capital formation while providing for those in retirement, other than by a greater burden on our children.