ECONOMIC MANAGEMENT, SAVINGS AND THE FINANCIAL SECTOR: LABOR'S VIEW

Address by the Hon Gareth Evans QC MP, Deputy Opposition Leader and Shadow Treasurer to the Investment and Financial Services Association (IFSA), Sydney, 18 June 1998.

These are heady days for the Australian economy, and all whose interests sail with her, including IFSA members and your clients. After being assured by the Treasurer late last year that the impact of the Asian economic crisis on Australia would be "barely measurable" and by both him and the Prime Minister constantly ever since that we were well enough "fireproofed" or "insulated" to avoid being burned, we now face a situation of falling output, falling exports, falling business confidence and profit expectations, falling consumer confidence, and a fragile dollar - along with a rising current account deficit, rising foreign debt, rising unemployment, rising home mortgage rates and potentially official rates, and potentially rising inflation.

Any government confronting this situation - including the new Labor Government after August! - is going to have quite limited economic policy choices open to it. Australia of course cannot single-handedly turn around the international events that are now buffeting us - although we can and should be a strong regional voice, through APEC and other channels, for the structural and institutional reforms necessary to get our major Asian trading partners back on a stable growth trajectory. And we can and should be doing more through active government support to help find opportunities for our traders and investors to maximise our export returns and future investment earnings from those markets which are accessible and exploitable. Domestic policy management is going to be tough - with a need, in the face of declining growth and a seriously deteriorating current account, to maintain tight budget discipline, despite the crying need for major expenditure initiatives in key priority areas like jobs, health and education.

The tragedy for Australia is that, as a result of the Coalition's performance over the last two years, we face this gloomy period ahead in a very much weaker position than we could and should have been in. Part of the problem, although I won't pursue it in any detail here, is our loss of credibility and respect on the international stage: as a product of a whole series of misjudgements and ineptitudes, not least the Prime Minister's handling of the Hanson phenomenon, we have been reduced to the status of marginalised bit player at the very time we could have been a seriously influential policy force. It is inconceivable, for example, that last November's APEC Summit, occurring at a critical time in the development of the Asian crisis, would have been the non-event it was had Paul Keating been carrying the Australian flag.

The key point I want to make about domestic policy is that the last two years have been tragically wasted years. Because of the Government's obsessive talking down of the condition of our national finances - even though our public debt and budget deficit situation was in remarkably good shape by any relevant international comparative standards - consumer confidence was wrecked and the decline in private consumption took a substantial slice off our growth performance. That was compounded by the Government's determination to address budget deficit reduction through obsessive and unnecessarily harsh public expenditure cutting, which took another half a per cent or more off our national growth, and ensured that there would be no further significant inroads made into unemployment reduction. So we face the period ahead, one of falling growth, with unemployment still over 8 per cent, and against the background of a dramatic deterioration in resources and outcomes for health and education and industry innovation and infrastructure development - and a dozen or more other program areas where the community is crying out for public goods which the private sector simply can't or won't ever deliver.

It's no good Labor complaining about all this if we couldn't or wouldn't have done any better ourselves. But there is plenty of evidence before you on the public record that we *would* have - and not just the fact that we grew the economy more than a percentage point faster, and jobs more than twice as fast, during our last two years in office as compared with the Coalition's first two. I said after the Coalition's first budget in 1996, and have been saying ever since, that a much more moderate approach to expenditure reduction would have brought us back to budget balance or better by 1998-99: we in fact specifically nominated the necessary task as being $1 billion of cuts in the first year (as compared to the Coalition's nearly $8 billion), growing to $3 billion in this coming financial year.

This year's Budget Papers show that prediction was absolutely spot on. In round figures to keep things simple, the Coalition has estimated for 1998-99 a surplus of $3 billion, built on accumulated budget cuts taking effect this coming year of $6 billion: without those cuts, the no-policy change starting point for this year would have been a deficit of $3 billion, which is exactly the target we set ourselves back in 1996!

We further argue, of course, that there would have been a growth dividend from a less manic fiscal policy - with a faster growing economy, and more people in work, operating to increase revenue and reduce outlays to the point where the actual surplus this coming year would have been of an order of magnitude around the Government's own estimate.

The point is simply that there *are* nearly always choices in economic management, and what choices governments make depends on the values they hold dearest. In this instance, small government values triumphed completely over any sense of priority for jobs, living standards and the well-being of ordinary Australians. The Government made the wrong choices, and we've had as a result, two tragically wasted years.

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Some of the choices the Government has made in its economic management over the last two years have had very direct implications for this industry. None has been more important than its approach to the issue of national savings.

With public debt now - just as it was under Labor when we left office - at the second lowest level in the industrialised world, Australia does not have a *public* saving problem. But we do have - as we have had for a very long time, a *private* saving problem, one which lies at the heart of our foreign debt worries and our structural problems with the current account deficit, and which continues to accentuate our problem with every cyclical increase in that deficit.

I strongly believe that the most irresponsible single decision this Government has made - and one about which this industry should continue to be livid - was its abandonment in last year's budget of Labor's superannuation co-contribution scheme, which would have meant a combination of employer, employee and government contributions growing eventually from the present planned 9 per cent to 15 per cent: enough on Vince Fitzgerald's calculations to ensure that future generations of wage and salary earners would be able to retire on an income of around 70 per cent of pre-retirement levels. This would not only have given us a world's best solution to the universal problem of providing a decent retirement income regime for an ageing population, but would have translated, over the period to 2020, into an addition to the national savings pool of some $400 billion.

Instead of all this we have the ill-thought out, valueless, half-baked introduction of the Government's savings rebate - at less than half the cost of the co-contribution scheme but still involving over $2 billion a year of government expenditure. Because this rebate rewards those with existing savings (even if they are run down during the course of the year), and the government rebate itself is as likely to be spent as saved, the overall impact of the rebate on total national saving is bound to end up negative. It takes some genius to devise a scheme which produces this result, and which at the same time is supposed to contribute to the development of a private savings culture in the country by providing a benefit you can get by not adding to your saving at all!

And then of course you will remember the Prime Minister saying that he wouldn't in fact *accept* the rebate - creating the Alice in Wonderland situation where apparently it was wrong to accept the rebate when you have a high enough income to be able to save enough to be able to claim the full amount, yet okay to accept it provided you earned so little you would never be able to save enough to be able in practice to ever actually claim it.

Labor continues to strongly favour superannuation as our preferred private savings vehicle. There is no other area of savings policy which can be harnessed to the great macro-economic task facing the nation of increasing national savings in the way that superannuation can. The point needs to be constantly made that superannuation remains a very good investment for all working people:

> - All employees receiving contributions, even very low income earners, are better off from a taxation point of view than if they received their employer contribution as wages. These contributions face a maximum rate of tax of 15 per cent, which is lower, and often considerably lower, than the marginal tax rate faced by the employee.
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> - Furthermore, all employed fund members are tax advantaged by having a maximum tax liability of 15 per cent on the investment income of their superannuation funds. They would otherwise face at least 20 per cent and more likely 34 per cent on the annual

increase in their retirement nest egg. In addition, saving through superannuation avoids the imposition of provisional tax which would otherwise be payable on bank accounts or other like savings vehicles.

- Finally, for those who retire after age 55 there is a further significant component of tax preference in the tax-free benefit amount of over $90,000, which covers most ordinary wage and salary earners.

Even for those on much higher income levels - and who have to face, among other things, the 15 per cent surcharge on contributions (with all its nightmarish administrative complexity, which is producing additional costs and burdens for all super fund members and which Labor has pledged to review) - superannuation remains a very tax-attractive savings vehicle. So much so that Treasury has in its annual Tax Expenditures Statement estimated the "cost" of the current arrangements - in the sense of the value of the tax breaks involved - at $8.5 billion for 1997-98, rising to over $10 billion in 2000-01.

This has led, I understand, to some fear in the superannuation community that the Labor Party is targeting superannuation in the development of our taxation package. I can assure you this is not the case. As you would understand, we will await the announcement of the Government's taxation package before we announce the detail of ours. However, I can assure the industry that we're not seeking to single out the retirement income sector for punitive treatment. We support the current system of preferential taxation because we introduced it. If people are to provide for their retirement, it is appropriate that the government provides adequate incentive to allow them to do so.

The major issue in personal income tax, as we see it, is the high effective marginal tax rates faced by ordinary families, and that is the point behind the Tax Credit for Working Families that Kim Beazley has already announced in principle. I can assure you that we have no intention of paying for either this, or any other tax benefit we introduce, by increasing the tax rate faced by superannuation funds, or abolishing access to the imputation system.

That is not to say there may not be a case for reviewing, during our period in office, the whole question of the most appropriate taxation regime applicable to superannuation, taking into account practice elsewhere, but also the need for any outcome to be more or less revenue neutral. This is an issue on which we retain a quite open mind.

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Let me finally address some issues relating to legislation currently before the Parliament about which I know the industry has some concern.

Choice of Superannuation Fund. Many in the industry believe that this exercise is now dead in the water, but the Government's proposed legislation has been reintroduced into the Parliament as a separate bill, something which Labor called for from the beginning, and is scheduled to be debated next week. It is fair, nonetheless, to say that as the Government's new legislation is almost exactly the same as that excised from the earlier bill, it is difficult to see choice progressing rapidly through the Senate given the positions expressed by Labor, the Australian Democrats, the Greens and the independents.

The Opposition has had some discussions with the Government, but these have simply identified the differences between the Government's choice of fund model and that proposed by Labor, based mainly around the issue of award superannuation. The Government is trying to undermine the role of awards in the regulation of superannuation through the introduction of the *Workplace Relations Amendment (Superannuation) Bill 1997*. While the Government remains committed to that philosophy, it is difficult to see its choice of fund legislation receiving Labor's support.

I do wish to make it clear, however, that at no stage has Labor opposed the *principle* of choice of fund. We are simply yet to be convinced by the Government that its choice of fund model will lead to higher retirement incomes and improved national savings. The Opposition has proposed an alternative model which we believe educates employers and employees about investment options and allows employees to exercise real choice of fund with appropriate safeguards.

Stage one of Labor's choice model would require accumulation-type superannuation funds with more than fifty fund members to offer a minimum of three *investment* choice options to fund members - that is, choice within existing funds. Investment choice within funds is an appropriate way to begin to educate fund members about their retirement income options and control of their superannuation savings.

The second stage of our choice proposal is designed to allow those employees who want choice of *fund* to have it. The key feature of our employee choice model here is that if an industrial award requires an employer to pay superannuation contributions to a specific superannuation fund, employees and employers can agree to alter that arrangement and pay superannuation contributions into a different complying superannuation fund.

Regulations would govern standard disclosure provisions applying to key feature statements, particularly to enable simple comparison of fees, charges and fund earnings - a crucial issue in the choice debate. In the event of a dispute between employers and employees, the Industrial Relations Commission would act as the independent arbitrator.

Importantly, Labor's choice of fund model would begin only after an extensive education campaign designed to inform employees of the benefits and pitfalls of changing superannuation funds. Labor's choice model recognises that the demand for choice of superannuation fund should be driven by workers, rather than be choice driven by government. It is simple to administer and avoids the complications of the Government's model.

Managed Investments Bill. This is of critical importance to the regulation of managed investment schemes in Australia, and our position has been clear from the start, in that we have given in-principle support to the application of the Single Responsible Entity concept to the non-superannuation managed investments industry in Australia.

The model proposed by the Government in the *Managed Investments Bill 1997* differs from that proposed by Labor in 1995, particularly in the area of custodial separation of investors' assets. However, on the face of it, we are satisfied that the *Managed Investments Bill* does not significantly weaken investor protection, provided that certain conditions are met.

First, the Australian Securities Commission must receive sufficient funding to ensure it has the capacity and the resources to effectively fulfil the role it has been given under the Government's Bill. The $7.1 million allocated to the ASC in the 1998 Budget might be sufficient in years one and two, but we will be seeking assurances from the Government that it will provide the ASC with adequate funding in the outyears.

Secondly, given that much of the debate on managed investments has focused on custody arrangements of scheme assets, Labor will be moving an amendment to the bill to ensure that custodial arrangements for the assets of managed investment schemes are appropriately disclosed in fund prospectuses. Labor's amendment is not prescriptive but is designed to act as a signpost for investors who will invest in future managed investment schemes which are regulated as Single Responsible Entities.

Thirdly, the issue of investor choice is one that has also been prominent in the managed investments debate. Labor does not support the amendments proposed by the Australian Democrats which would allow the operation of a dual regulatory structure, one which has a single responsible entity regulatory scheme and another which maintains the current prescribed interests regulatory regime.

However, the Opposition will be moving an amendment which will allow investors in *existing* managed investment schemes to choose their preferred custodial arrangements through a vote of the scheme members if neither the funds manager or trustee vacates the field within 12 months. This addresses the anomaly under the Government's bill, where investors in existing managed investment schemes will essentially only have one choice if they are not satisfied with the custodial arrangements offered to them by the single responsible entity - that choice is to leave the fund they have invested, in which will of course involve transaction costs. Investors in *new* SRE schemes will be able to exercise choice by voting with their wallets and choosing to invest in a scheme which does or does not have a preferred custodial arrangement.

I do not expect Labor's amendments to delay the passage of the *Managed Investments Bill* through the Parliament. The Bill is scheduled to be debated in the Senate this coming Monday and should proceed without unnecessary delay.

Wallis Financial Sector Reform Package. Labor has generally supported the Wallis recommendations and is keen to see the legislative package pass through the Parliament before 1 July this year to provide certainty to the financial services industry. However, the Opposition did differ on some aspects of the Wallis recommendations.

First, when the Wallis package was introduced into Parliament, Labor made it clear that we opposed any weakening of the four pillars banking policy. Allowing bank mergers would reduce competition amongst the banks and would not be beneficial for Australian consumers. The Government has refused to rule out allowing further bank mergers in the future, and this issue is becoming the subject of increasingly lively speculation, but we have not changed our position.

Secondly, Labor does not support any substantial weakening of the role of the Australian Competition and Consumer Commission as the industry-wide consumer protection watchdog when it comes to competition and pricing issues. At the very least, the Opposition believes that the ACCC and the Australian Securities Investment Commission should maintain a close working relationship, preferably under a clear operating agreement. We are negotiating with the Government to address the issue of the ACCC's role in the financial services industry and hope to ensure the Wallis bills pass through the Parliament smoothly as a result.

Thirdly, I should mention that we had moved amendments to the Wallis package - it being a convenience vehicle for this purpose - designed to deter unscrupulous parent companies from stripping assets out of subsidiary companies with the aim of sacking an entire workforce, as occurred in the Patrick's case. The Senate supported these Patricks amendments.

However, in view of the importance of the Wallis package of bills to financial sector reform - and getting them through without further delay - Labor will not be pursuing our amendments in the context of the *Financial Sector Reform Bill* when it returns to the Senate next Monday. Instead, we will be seeking Senate support for an inquiry into corporate avoidance of the *Workplace Relations Act* protections for employees when the Senate resumes sitting next Monday.

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I hope I have said enough today to persuade you that, while we may not see eye to eye on everything, Labor will adopt a responsible approach in government both to the overall management of the economy, and on the particular policy issues which of most immediate concern to this industry.

But none of this should come of any surprise to you. After all, as I like to say to all the business audiences I talk to: we're from the Labor Party, and we're here to help you!