

**IFSA/Deloitte Member Luncheon Address – Four Seasons  
Hotel, Sydney  
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Today I want to address the future of the Investment & Financial Services Association and the critical importance of Financial Services to Australia's future.

The members of IFSA – Australia's leading wealth managers – exist to achieve three outcomes for Australians:

1. To increase their wealth;
2. To protect their lives; and
3. To provide them with a comfortable retirement.

Over the past twenty years our industry has grown significantly to meet these challenges.

Ladies and Gentlemen.

In 1990 the Financial Services sector constituted 7.2 per cent of the Australian economy, behind manufacturing at 15.3 per cent and construction at 7.4 per cent.

Over the last twenty years, mostly as a result of the introduction and expansion of compulsory superannuation, funds under management increased from \$200 billion to \$1.4 trillion.

Australia's funds under management are now larger than the capitalisation of the Australian Stock Exchange and larger than the GDP of the nation.

And we have the fourth largest pool of managed funds in the world.

As a result, Financial Services has grown considerably and now constitutes 10.8 per cent of the economy - making us the largest industry in Australia.

At the same time the role of the Financial Services sector as an aggregator and allocator of capital has grown exponentially - in effect channelling foreign investment and domestic savings to productive capacity in Australia.

In the next twenty years the size of Australia's funds pool will grow to an extraordinary \$5 trillion.

Ladies and Gentlemen

Increasing Australia's savings pool is critical to the future of our economy.

Despite twenty years of compulsory superannuation, Australia still has low levels of domestic savings, which means we must draw on savings from other countries to fund investment.

This is apparent in Australia's high current account deficit, which at 4.1 per cent of GDP, is the fourth largest in the OECD.

Australia has had no difficulty financing our current account deficit over the past two decades since capital was readily available from international markets. However, as the recent financial crisis has shown, we cannot always rely on international markets.

Indeed, one of the factors that underpinned Australia's ability to ride out the crisis was our superannuation savings pool and ongoing contributions through this period.

While companies around the world struggled for funds with which to recapitalise, Australian companies were able to draw on our superannuation funds. Australia accounted for 10 per cent of the world's total recapitalisation in 2009 - a staggering figure given the size of the Australian economy.

While the benefits of higher savings were recognised by the Keating Government when it introduced compulsory superannuation, I don't think it was ever envisaged that it would play such a large part in saving the Australian economy from an economic crisis the scale of the Great Depression.

While we will remain a net capital importer as a country for the foreseeable future, and our experience in the recent financial crisis shows the strength of our system, we still need to build on this position to further strengthen and insulate the Australian economy.

By saving more through superannuation, national savings will be higher, and Australian businesses will have a larger domestic pool of savings on which to draw.

In turn this reduces the reliance on foreign investment and capital flows, lowering the current account deficit and ultimately providing a cheaper and more stable pool of funds upon which Australia can draw.

Ladies and Gentlemen

The size and significance of the Financial Services sector in the Australian economy will continue to grow.

With this growth we need to ensure Australia has the best investment, regulatory and business environment for the \$1.4 trillion we invest now – and the \$5 trillion we will invest in twenty years time.

IFSA is respected and trusted for the advice we give government on policy and regulation in our sector.

However, as the largest sector in the Australian economy - responsible for managing the savings of all working Australians and facilitating investment in all industries - we have an obligation to speak on broader economic policy issues.

As the custodians of the savings of Australians, we must influence the environment in which we invest on their behalf and in their best interests.

Governments, public policy makers and the media expect the manufacturing, mining, and agriculture sectors to comment and advocate on the macro issues in the Australian economy. Financial Services must now play its role.

Today I am announcing a new organisation to lead economic policy debate in Australia.

Next month the Investment and Financial Services Association will become the Financial Services Council.

The Financial Services Council will contribute to policy development on a broader range of issues than IFSA has done in the past and will continue to advocate on behalf of our members on core issues.

The Financial Services Council will work to improve the well being of all Australians.

We will do this by leading policy development and regulatory reform to:

- Maintain Australia's strong economic growth;
- Improve the lifestyles of all Australians;
- Continue to showcase Australia as a leading global economy; and
- Cement the world leading position of our Financial Services sector.

We believe these priorities are important because they enhance the investment environment and assist in building the retirement savings, wealth and ultimately the lifestyles of all Australians.

To this end, the Financial Services Council will be at the centre of major economic policy debates in Australia – a position that is entirely consistent with the sector's role at the centre of the Australian economy.

Today we start that journey in the following areas of significant economic policy for Australia:

- We will advocate for a "Big Australia". Our population must be capable of:
  - driving future economic growth;
  - keeping a cap on wages and inflationary pressures; and
  - reducing the pressures of an ageing population;
- We will champion real tax reform. The GST is unfinished business, and remaining inefficient state taxes must be removed;
- We will advocate to increase productivity and participation – particularly for older workers. We must make greater use of our existing skilled population and reduce the risks of longevity on retirement incomes; and
- We will advocate for improvements to our corporate and prudential regulation and against the adoption of unnecessary and reactionary US and European regulation that will undoubtedly harm the Australian economy.

Ladies and Gentlemen, I want to expand on some of these issues today. I will begin by discussing Australia's ageing population as this is central to much of the debate on Australia's future prosperity.

The first Intergenerational Report – the IGR – was commissioned in 2002-03 to consider the Commonwealth's fiscal outlook over the long term, and identify emerging issues associated with an ageing population.

The numbers in the third IGR remain alarming, but less so than they were in the first.

Rather than a quarter of the population being aged over 65 by 2050 as stated in the first IGR - Treasury now projects the proportion will be 20 per cent.

There are two reasons for Treasury's more optimistic forecasts on population. Firstly, they underestimated the 21st century mini baby boom in Australia – or as the leading demographer Bernard Salt puts it, the baby boom echo, echo.

The baby bonus and the echo of the baby boomers, both contributed to higher levels of fertility in Australia than was expected.

And the Government's paid parental leave scheme will further assist in maintaining high fertility rates.

A second contributing factor is the larger than expected migration inflow since 2003.

Rather than the 90,000 per annum intake Treasury had estimated in the 2003 IGR, Australia accepted an average of 244,000 migrants a year over the three years to June 2009.

High levels of migration are good for Australia.

Migration tends to reduce the rate at which the population ages since migrants are generally younger than the average age of the Australian population. Around 89 per cent of migrants are aged under 40 compared to 55 per cent of the existing Australian population.

Migration also assists in providing skilled and unskilled labour.

Without substantial migration there is upward pressure on wages as business competes for a shrinking pool of labour, ultimately driving up inflation.

We need unskilled as well as skilled labour. Currently the policy is too focused on skilled labour alone, but this ignores the fact that labour shortages exist at all skill levels.

Increasing population, whether through higher fertility or higher net migration adds to economic demand, improves the tax payer to retiree ratio, takes pressure off the tax base and puts downward pressure on inflation.

To quote the IGR:

*“A key lesson from international experience is that countries with low population growth or declining populations such as Japan and Italy face lower potential rates of economic growth than countries with relatively healthier population growth.”*

For these reasons, the Financial Services Council is a strong advocate of a “Big Australia”.

The current IGR assumes a steep reduction in net migration from 244,000 to 180,000 per annum.

While we are pleased that the level of migration remains above the post World War Two long run average, we must maintain strong migration levels which are appropriate for our ageing population and labour needs.

We cannot let arguments for a stagnant population outweigh the need to deal with the economic impact of an ageing population.

Nor should we surrender to the debate on current underinvestment in infrastructure as an argument against a “Big Australia”.

There have been many predictions in history of the end of civilisation due to population growth.

Now, as then, technological and societal change will give us the answers to environmental or infrastructure challenges presented by a “Big Australia”.

At the same time, it is not enough to simply have a larger population. Australia also needs to make better use of the skills and talents of the population we already have.

That is, we need to continue to increase participation in the labour market.

At 76.5 per cent, Australia’s participation rate is lower than that of Iceland, Switzerland, and Denmark.

Australia has done a good job at increasing the participation of women in the workforce, which has increased from 48 per cent in 1978, to 58 per cent in 2010.

However, we have failed to make similar progress for older workers.

We must do better at retaining people in the workforce beyond the age of 60.

Let me be clear – we are not saying people have to work past the age of 65. And we are not saying that they must work in the same job and at the same pace. Rather, we are saying that it should be easier to work longer if you choose.

We must end the concept of full retirement in Australia.

We must embrace phased retirement. Older Australians must be encouraged and given incentives to apply their skills beyond the traditional retirement age.

Increased participation for older workers will stretch retirement incomes by supplementing superannuation through part-time work and require smaller amounts to be drawn down in early retirement.

We cannot underestimate the size of the change required.

Australia ranks poorly when it comes to older workforce participation - 7.6 per cent compared to the OECD average of 11.3 per cent. We rank 13<sup>th</sup> among OECD countries and significantly below Korea (30.0 per cent), Mexico (29.2 per cent), the US (15.1 per cent) and even New Zealand (11.7 per cent).

The benefit of working longer is not restricted to better individual retirement incomes and less stress on public finances. Australians remaining in the workforce for longer periods will lessen our skills shortage.

We have to cease the culture of throwing people on the employment scrapheap at 55 and 60. These people have skills we need. The difference is that we may not need them to work full time.

Why does our culture dictate that we have to retire at our highest career point rather than phase down to less responsible, but still important, roles?

Why can't a school principal stand down at 60, but continue to work two days a week as a teacher-mentor until 70, 75 or 80?

The present retirement income rules allow people to continue to earn some income and contribute to their superannuation whilst drawing down from their superannuation tax free. Equally, people can earn some income without losing the pension.

But there is more to be done.

There are a number of remaining regulatory barriers which do not assist older Australians to maintain financial self sufficiency. For example, over 75s cannot contribute to their super at all.

And superannuants must compulsorily draw down their savings at a rate of up to 14 per cent per annum.

These factors encourage less saving and increased spending – and increase the likelihood of people running out of superannuation earlier and becoming fully reliant on the government for their income, health and aged care needs.

However, it is cultural change in business that can have the greatest benefit in making use of older workers and there is a role for Government to play as a catalyst for change.

Increasing the participation rate, maintaining high levels of immigration and increasing superannuation will greatly assist the Australian economy to continue to grow long into the future, and minimise the burden on future governments and taxpayers.

Failure to deal with our ageing population will put unsustainable fiscal pressure on governments as demand for services continues to grow.

To ensure economic growth is maximised - and governments raise the revenue required to deal with the challenge of an ageing population - we need to ensure that our tax system is as efficient and effective as it can be.

Notwithstanding the tax changes of the last 15 years, further structural reform is needed.

The original Intergovernmental Agreement on Commonwealth/State Relations – the IGA - signed by the Premiers and John Howard in 1999, introduced the Goods and Services Tax and abolished some – indeed too few - state taxes.

At the time it was rightly described as “*a gigantic step*” forward for our tax system and Commonwealth State Financial Relations.

However, the IGA listed a number of state taxes to be reviewed at a later date. These taxes still remain, despite the fact that the GST was the mechanism to fund the States expenditure into the future.

It is now clear that even with the introduction of the GST some 10 years ago, it has not provided sufficient funding for the States, and is no longer a guaranteed source of revenue.

The recent claw back of GST revenue to fund health reforms hollows out the GST and undermines the original intent behind the IGA.

The Government had the opportunity to put the GST into the mix during the Henry Review. Its decision to specifically exclude it from the Review was a mistake.

Modelling conducted for the Henry Review shows that six of the 10 taxes that have the highest marginal cost on society are state taxes.

Taxes on insurance, payroll, motor vehicles, real estate and stamp duties are among the most distortionary and inefficient in the economy.

Just this week Ken Henry stated that the Review panel:

*“ . . . [was] struck by the inefficiency of taxes currently relied upon by State and Territory Governments.”*

One obvious example is stamp duty paid on life insurance premiums.

The Henry Review estimates that for every \$1 of insurance tax collected, society loses close to 70 cents.

The Johnson Report into Australia as a Financial Centre makes the same point:

*“...state taxes add significantly to the cost of insurance [and]...they are undoubtedly a factor contributing to underinsurance, with consequent*

*increased demands on the public purse...they also act as a barrier to new entrants to our insurance sector.”*

Abolishing inefficient state taxes is an investment imperative. It will remove distortions which affect investment decisions – such as how assets are purchased, how long they are held and how they are structured.

The abolition of inefficient state taxes will also improve the returns of shareholders by increasing the efficiency of business, which will no longer be saddled with a myriad of different taxes across eight jurisdictions.

There is a solution to the dual problems of distortionary state taxes and horizontal fiscal imbalance.

The original IGA replaced some state taxes with the GST. This process was not without challenges, but the outcome has been overwhelmingly positive for the Australian economy.

For these reasons, the Financial Services Council advocates that the GST be put back on the agenda of the tax reform debate in Australia.

Lifting and/or broadening the GST is the unfinished business of Australian tax reform.

This is a difficult issue that poses significant political challenges, but just as the Howard Government forged ahead in 1998 and 2000, the States and Commonwealth must now acknowledge that the GST is the next step in the ongoing tax reform journey.

Whereas many state taxes have high economic costs, the GST has a low economic cost. By virtue of its broad base, it does not distort consumer decisions away from one product to another.

Before I leave tax reform, I want to make a comment about the Resources Super Profit Tax.

To be honest I was not going to talk about this today, but the election of a new Prime Minister provides the Government and the mining sector with the opportunity to abandon their entrenched positions and seek swift resolution to the impasse.

The investment community in Australia and internationally want a solution to the uncertainty. We acknowledge the need for a resources tax based on profits and the abandonment of inefficient state based royalties, but some elements of the current proposal – in particular retrospectivity – go too far.

While ongoing tax reform is always a requirement for economic growth, equally important are the regulatory settings in which Financial Services operates.

We should not forget that, in large part, it was the quality of our regulation that secured Australia's safe passage through the recent financial crisis.

Ladies and Gentlemen.

The crisis demonstrated that Australia is a world leader in financial regulation. We are now the international benchmark.

The implementation of the Wallis reforms which began in 1997 established the twin peaks regulatory structure of APRA and ASIC that subsequently protected Australia from the worst of the financial crisis.

At the time, the IMF described the Wallis reforms as:

*“...a package of path-breaking reforms, which puts Australia at the forefront of international practice...”*

How right they were. For confirmation look no further than Britain’s announcement last week to abolish the Financial Services Authority, effectively replicating Australia’s twin peaks financial regulatory structure.

In disbanding the FSA, the British Chancellor George Osborne said:

*“The FSA became a narrow regulator, almost entirely focused on rules based regulation.*

*No-one was controlling levels of debt, and when the crunch came no one knew who was in charge.”*

It is estimated that the failure of UK financial regulation cost British taxpayers £1.4 trillion.

Contrast this against the Australian experience, where the Government was not required to take ownership of any financial institution and where our institutions have arguably emerged stronger than they entered the crisis.

Clearly, Australia is in the near unique position to resist much of the new regulation being proposed by international bodies such as the G20, and by governments in the US, UK and EU.

We have to be vigilant in resisting regulation which has been designed to solve problems that do not exist in our market.

We should not be prescribed the medicine for an illness which we do not have and against which we have been inoculated.

Taxing transactions on financial services – proposed by the UK, Germany and France is a prime example.

It will not make the system safer and may instead perversely encourage greater risk taking by financial institutions to claw back any foregone revenue.

A tax on financial transactions will also inevitably increase the cost of capital and reduce the efficiency of capital flows at a time when they are critical to global recovery.

Reforms being canvassed in the United States provide another example of measures which have no relevance to the Australian market. The so-called “Volcker rule”, which would prohibit banks from managing private equity, operating hedge funds and engaging in proprietary trading, would have an immensely detrimental impact on Australia’s prospects as a leading financial centre.

Australia should be a net exporter of financial regulation. Australia should lead international regulatory debates through the G20 and other relevant fora such as the Joint Forum, currently chaired by the Chairman of ASIC, Tony D’Aloisio.

Ladies and Gentlemen.

The Financial Services sector has a massive responsibility to the people of Australia.

We are charged with growing their wealth, maximising their savings, protecting their lives and incomes in difficult and tragic times and helping them secure a comfortable retirement.

We do and always have taken this responsibility seriously.

We have and always will continue to advocate on behalf of the industry – our members – on core regulatory, taxation and retirement savings issues

And we have and will continue to advocate and support reforms to make Financial Services more trusted and transparent.

As the Financial Services Council we also have a responsibility to enter and lead the debate on economic policy in Australia.

The best tax system.

The best investment environment.

The best regulatory

And the strongest and most competitive economy.

Thank you for your support.

**(ENDS)**