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The point of saving, for nations and households, is to increase the resources available for future consumption.

National saving and investing create the physical and human capital needed to generate future incomes. By increasing the national saving rate we increase the future capital-labour ratio, labour productivity and incomes, and thereby create additional resources to support an ageing population.

Rising productivity is also likely to increase the labour supply by making it more attractive to work than, for example, to retire. Rising real incomes almost certainly have played an important part in increasing the labour force participation rate of older males. Of course the recent tax reforms should continue that process. We don't know how far that phenomenon has to go, but I was reminded when I was preparing for this session that in the late 1950s 75% of American 65-year-old males were still in the workforce. Australian 65 year olds are now a lot healthier and better educated, on average, than their grandfathers at the same age.

It is of course not necessary for saving to equal investment in every country and at every point in time.

Foreign investment that adds to the future capital stock will increase the Australian capital-labour ratio and the incomes of Australians. But our rate of saving will determine the proportion of future income that ultimately is available for Australians to consume.

For households, long-term saving for retirement increasingly is in the form of equity investment through superannuation funds. Equities are considered the most appropriate form investment for this purpose because, relatively to fixed interest securities, they offer higher rate of returns, including capital gains, over the long term.

As a result, Australian households increasingly are dependent on capital gains to provide a rate of return on their savings. Since most households ultimately determine their rate of saving, they are required to make a judgement about permanence of any increase to their wealth as a result of capital gains.

Whether they are regarded as income or an indicator of expected future income, capital gains complicate the interpretation of changes in our saving rate. But they are not the only source of complication. There are also important issues about the definition of consumption. The national accounts treat spending on durable goods (cars, household goods, etcetera) and, more importantly, spending on education and health as consumption. Economists usually assume that individuals engage in saving in order to smooth their consumption over their life time - although, as Dr FitzGerald points out, the evidence in support of this is scarce.

This is a point of more than just academic interest, because it affects the way we judge the adequacy of Australia's measured saving rate.

A decline in the household/national saving rate, which might otherwise be regarded as an economic disaster, could, in the context of the life-cycle consumption smoothing, be taken as a sign that incomes are expected to rise.

Since the first half of the 1980s, net saving by households from current income has collapsed from around 8 per cent of GDP to less than nothing. The critical issue is why?

If we think of saving as the outcome of some kind of lifetime consumption smoothing exercise, we can run a finger down a list of changes that might explain this dramatic change. Using this framework, and borrowing Karen Dynan and Donald Kohn, of the US Federal Reserve, we might expect consumption to increase (and saving out of current income to fall) if:

1. Expected future incomes rise. This may be because the capital gains on our equity holdings were telling us so. Or it may be because we have been investing more in education and the creation of human capital.
2. If uncertainty about the economy's future is reduced and was expected to remain so. This reduces the need for precautionary saving.

3. If house prices rise strongly. If we plan to downsize and leave our children to their own devices, that is a real increase in wealth.

4. If our access to credit markets and our consumption had been constrained - we had been restricted from borrowing all that we thought we could afford - and the constraint is removed as a result of financial deregulation and innovation.

5. We might also save less as a community if more of us are retired and living off our savings.

6. And of course we might save less and consume more out of current income because we have greater need of instant gratification, have become less patient or less risk averse.

On the related issue of household debt, if inflation falls, we might also decide that we can afford to carry more debt, since lower inflation means lower nominal interest rates. We will also need to borrow more if we are entering the housing market and find house prices have risen because of lower interest rates. We might also borrow on the home equity to invest in superannuation, as large numbers of people have done recently to take advantage of tax changes – or to invest in rental housing, or equities, or to expand our small business, simply because don't want to leave all our retirement eggs in one basket.

When you look at the last two decades, it seems that most of this list of possible explanations for a decline in saving applies to Australia.

1. Income growth has accelerated. The 10 year average growth rate of per capita GDP is now 1.5 times the rate of the mid 1980s.

2. Growth has become more predictable. The standard deviation of per capita GDP growth of the past 10 years is about half that of the previous 10 years.

3. The terms of trade, which have risen dramatically since the early part of this decade (2003), have actually been on a clear rising trend since 1987, after having been on a declining trend since the 1960s.

4. The 10 year average labour productivity growth is now double the low levels of the mid 1980s.

5. The average ratio of equity prices to nominal GDP over the past decade has been about 3 times that of the 1980s, and 1.5 times that of the 1990s.

6. The ratio of net financial assets to disposable income is 12% up on the level of the late 1980s.

7. The financial markets have been deregulated, and the range of financial products has expanded enormously.

8. There has also been a significant increase in the stock of human capital. As estimated by the Australian Bureau of Statistics, the stock of human capital increased by

more than 60 per cent in the 20 years from 1981 to 2001; around 20 per cent per capita because of increased investment in education. In this period, the proportion of bachelor degree holders nearly tripled, from 4.5% to 13.8%, and the share of those with no formal post-school qualifications has dropped from 55% to 36%.

9. At the same time, the proportion of the population aged 65 and over increased by almost a third, from around 10 to 13 per cent.

These observations, it seems to me, should qualify our judgement about the extent to which households may be under-saving.

Yet, as Dr FitzGerald has point out, there is evidence that a large proportion of households may not be making adequate provision for their retirement, and more general evidence that people do tend to systematically underestimate their saving needs. My guess is that most economists would be relieved if Australian households decided to save more rather than less.

For that reason I must say I am attracted to the idea of an increase in the rate of compulsory superannuation. Initially this would be nothing more than an increase in private saving at the expense of public saving: a tax cut in the form of an additional superannuation contribution.

Over time the objective might be to use the tax-superannuation channel to raise the rate of national saving.

However, because of the issues discussed earlier, it may be worth considering some further modification of the original compulsory superannuation model.

The equity implications of raising national saving by imposing compulsory saving on cash-constrained households have always been a troubling issue. If we are less certain about the welfare gains from an increase in saving, perhaps we should include an “opt out” provision.

I suspect that a large proportion (any case, about the right proportion) would grab the chance to engage in some additional, compulsory retirement saving.