New powers ready for the 'Rio consensus' era

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the Globalist

CONVENIENTLY scheduled at the end of the World Cup, Brazil hosts the leaders of fellow Brics members Russia, India, China and South Africa in a meeting that presents them with a truly historic opportunity. While in Brazil, the five countries hope to establish a new development bank and reserve currency pool arrangement.

This action could hit a trifecta: recharge global economic governance and the prospects for development as well as put pressure on the World Bank and the International Monetary Fund (IMF) to get back on the right track.

The Bretton Woods institutions, headquartered in Washington, originally put financial stability, employment and development as their core missions, with good reason. That focus, however, was derailed in the last quarter of the 20th century.

During the 1980s and 1990s, the World Bank and the IMF pushed the Washington Consensus, which offered countries financing conditional on a doctrine of deregulation.

With the benefit of hindsight, the era of the Washington Consensus is seen as a painful one. It inflicted significant economic and political costs across the developing the world.

What is more, the operations of the World Bank and the IMF are perceived as rigged against emerging market and developing countries. The unwritten rule that the head of the IMF is always a European and the World Bank chief is to be an American is a superficial but no less grating public expression of that.

Worse is the fact that the voting structure of both institutions is skewed towards industrialised countries, and grants the US veto power.

It was not always that way.

As Eric Helleiner shows in one of his two new books, *Forgotten Foundations of Bretton Woods: International Development and the Making of the Postwar Order*, China, Brazil, India and other countries wanted development goals to remain a core part of the Bretton Woods institutions. Some of their proposals eventually made it into the policy mix of the World Bank and the IMF, including short-term financing, capital controls and policy space for industrial policy.

When these institutions failed to predict the global financial crisis of 2008, however, the Brics and other emerging market and developing countries said enough was enough. First, they tried to work inside the system by proposing reforms that would grant them more say in voting procedures.

However, the US Congress has failed to approve reforms.

Brics and other emerging market nations also joined the Group of 20 (G20) in hopes that it would be a more pluralistic venue. The G20 held a landmark 2009 meeting where a new vision was articulated for global economic governance, but none of the promises – especially the co-ordination of macroeconomic stimuli to recover from the crisis and comprehensive reform to prevent the next one – was realised.

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Now the Brics powers are taking matters into their own hands. Their governments have been diligently putting together two new institutions that hold great promise: a new development bank and a new reserve pooling arrangement.

The development bank would provide financing to Brics and other developing countries for infrastructure, industrialisation and productive development. The reserve pool would allow Brics and other nations to draw on pooled reserves in the event of balance of payments crises or threats to their currencies.

When these institutions are launched in Rio de Janiero, the Brics leaders could and should forge a "Rio Consensus" – provided they do not make the mistakes of other, mostly Western-inspired, "models" in the past.

The key is to make it a model for global economic governance in the 21st century. The vital elements of a Rio Consensus are a definite step in that direction. At its core is a commitment to financial stability and productive development in a manner that is inclusive, honours human rights and is environmentally sustainable.

Organisations carrying out such a mission should also have a more equitable organisational structure with open and transparent rules. This includes the mechanism for picking leaders and a more equal voting system for existing and new members.

Not only will such a framework and structure enable more appropriate finance for development and stability, it can also serve as a moral model of reform that can someday be achieved in the two Washington-based institutions themselves. This will give Brics more leverage, and an opt-out if the industrialised countries stay set in their ways.

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President Jacob Zuma observes a silent guard of honour on arrival at the Galeao Air Force Base in Brazil yesterday. Zuma is on a working visit to Brazil where he will attend the sixth Brics summit, which will be held in Fortaleza and Brasilia. PHOTO: GCIS

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Spotlight On Effective Retirement Planning

Don't stop saving while regulators diddle

Bongani Mageba, MD Stanlib Retail.

THE retirement industry will most likely look a very different beast in five to ten years' time from the current model – but it would be unwise for individuals to refrain from saving towards their retirement in that anticipation.

Richard Carter, head of product development at Allan Gray, says: "National Treasury's proposals for reforming the retirement savings environment are not yet finalised, so there is still some uncertainty in the air, especially around timing of the proposed changes.

"However, this should not be allowed to inhibit employees' willingness to save for retirement, as it is very difficult to make up for lost time."

It was once estimated it could take as long as 15 years for government's retirement reform process to be phased in, but the announcement by the Minister of Finance at this year's Budget Speech that a capped savings vehicle would be introduced as early as January 2015 marks the first, vital step in the process, highlighting the urgency government attributes to the process.

Stanlib Retail MD Bongani Mageba says that he suspects that before this year is ended "government will come out with a lot more clarity on its time frame for reform".

"While the new savings vehicle is not strictly a retirement vehicle, it is an important step and I would expect government to be ready for the reform process to roll out by then. We are talking of a process which is imminent," he says.

Therefore, he doesn't expect the process to take 15 years, but nonetheless there is still a great deal of engagement required and an infrastructure to be put in place to facilitate crucial issues such as retirement fund preservation, the products necessary to include not only the millions in the formal employment sector not currently saving towards their retirement, but also those in the informal sector, as well as issues such as low cost products.

He describes the major changes he expects to see in 5-10 years:

"I expect to see a lot more people saving towards their retirement in line with government policy to reduce the number of people dependent on the social security system.

"There will be greater transparency in retirement products which I expect to drive our highly-intermediated business closer to the model of countries like Australia and the UK where there is a far closer relationship between product providers and end user, a model in which clients are far more in tune with what is happening in their fund.

"Few South Africans currently understand their retirement product or underlying investments," says Mageba.

"Tighter controls on preserving savings are being proposed, by limiting withdrawals and forcing people changing jobs to transfer balances into a preservation fund. This, more than anything else, will grow the size of the industry.

"With this increase will inevitably come disruption of the industry with new players, particularly banks, intruding into the market space.

"This will increase competition, to the ultimate benefit of the client, but ultimately market forces are likely to result in some consolidation – though not for many years," he says.

"There are currently more than 50 asset managers in South Africa.

Costs will also come down due to consolidation among funds themselves, as it is widely expected that the reforms will ultimately lead to the number of funds available in the retirement sector dropping from 3 000 to as little as 100 — while potentially halving costs.

Approximately 80 percent of retirement schemes in South Africa were "very small", says Alexander Forbes research, with the vast majority having fewer than 50 members and many fewer than 10 members.

While umbrella schemes are being promoted as one solution to the need for consolidation, Allan Gray's Carter suggests that modern unit trust-based retirement annuity funds (RAs) are already structured for income at retirement and to enforce preservation.

"There are several reasons why an RA works well for individuals.

"In many ways RAs managed through a group system are a better choice for employers and their employees than other retirement funding options, such as umbrella funds, which have high set-up costs and time-consuming administrative requirements.

"By selecting a group RA system, employers can focus on managing their businesses while not detracting from the importance of retirement saving for their employees," adds Carter.

Group systems allow employers to ensure that their employees get all the benefits of an individually managed RA. Carter lists some of these:

"Employees join the RA in their individual capacities and become individual members – with autonomous and member-specific investment choices and options. This gives each member control of his/her retirement savings.

"RAs are a move away from the paternalistic culture of traditional pension and provident funds, which often do not offer choice. Members can select their underlying investment options from a range of unit trusts across different sectors, from different providers."

"While we caution against switching too often, members may switch between these unit trusts, as their needs change, giving them flexibility over time," says Carter.

RAs essentially defer tax until employees retire. The government is planning to streamline the tax treatment of all retirement funds, and the changes scheduled to be introduced in 2015 will benefit retirement annuity members.

Modern RA fee structures are generally transparent and competitive and offer good value for money. RAs under a group system are individually owned, which means employees can either continue contributing if they leave their employer, or they can stop contributing without any penalties.

"Each month you put off helping employees to plan for their retirement either increases the amount that will have to be saved at a later stage, or pushes out their retirement date, Time is an essential ingredient in long-term savings," Carter adds.

Encouraging early savings is the fact that the exceptional returns enjoyed over the past 10–15 years may not be repeated over the next decade, according to Coronation.

The implications of compounding at lower rates of return over long periods of time are dramatic.

This could be even more dramatic for individuals who don't preserve their retirement benefits when changing jobs, already putting themselves at risk of having inadequate savings at the point of retirement.

Pieter Koekemoer, head of personal investments at Coronation, says: "Investors need to remember that the end value of their retirement savings depends on both the amount that you are able to save during your working years and on the return that you achieve on those savings.

"If you expect returns to be lower in future, it is clear that in order to achieve the same level of retirement savings at the end of your working life, you would need to make up the potential shortfall by saving more or by saving for longer; and to have the discipline to not access your retirement benefits when you change jobs.

You would need to make up the potential shortfall by saving more or by saving for longer

Koekemoer adds: "To illustrate the impact of compounding at lower levels of return over long periods of time, let's consider the annualised return of 19.1 percent delivered by our flagship Balanced Plus fund over the last 10 years (to end June 2014).

"If you compare this return to an inflation rate of around 6 percent annually over the same period, the investor would have achieved a real rate of return of 13.1 percent annually.

"Our view on current valuation levels, however, leads us to the conclusion that a very good outcome for investors in balanced funds are more likely to be in the region of around 5 percent annually real.

"What does this mean for retirement savers?

"The real rate of return sets the increase in purchasing power achieved by the investor over his/her investment horizon.

"It is the reward for delaying consumption and represents one of the few free lunches that are available in the market.

"At a real rate of return of 13.1 percent (which was achieved by Balanced Plus over the past decade) you enhance purchasing power by 3.4 times over a 10-year investment horizon, and an incredible 40 times over a 30-year horizon.

"However, at a real rate of return of 5 percent, your 10-year purchasing power gain declines to 1.6 times and, over 30 years, to 4.3 times," explains Koekemoer.