FROM THE
Managing Editor

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This issue of *JASSA* focuses on a number of critical economic, taxation and equity markets issues currently facing the finance industry, policy makers and regulators, both in Australia and internationally. We open with a detailed discussion of some of the key explanations for the relatively low growth in advanced economies in recent years, and whether this is due to secular stagnation.

The special section of this issue is based around two longer papers prepared for the Centre for International Finance and Regulation (CIFR) and the Australian Centre for Financial Studies (ACFS). These formed the basis of two recent symposia of 'Dividend Imputation: What effects has it had; and should it be dismantled?'. The short extracts from those papers presented here are accompanied by two further invited papers by Andrew Ainsworth and Stephen Gray. This discussion is particularly timely in the lead-up to the federal Budget as the Government considers a range to tax policy options, including whether to remove imputation, as a number of other countries have done in the past 10 years. While not subject to the usual double-blind process, each of these papers was reviewed by a member of the Editorial Board and by me prior to inclusion.

The first paper in the main section of the journal is also an invited paper. Ivailo Arsov and Ashvini Ravimohan from the Reserve Bank of Australia provide an overview of the secular stagnation hypothesis as well as several alternative explanations for the slow economic recovery in the major advanced economies since the global financial crisis (GFC). Arsov and Ravimohan conclude that while secular stagnation, either demand-side or supply-side, is one possible explanation for the recent economic performance in advanced economies, there are a number of other possible explanations that emphasise less secular developments (such as a post-GFC debt overhang). They suggest that it is too early to be conclusive about whether the lower growth in these economies is due to secular stagnation or structural issues, and that while estimates indicates that the natural rate of interest has fallen, particularly through the GFC period, it is not clear that this is acting as a binding constraint on monetary policy.

The next two papers were submitted and subject to the usual double-blind refereeing process. Clive Gaunt examines the Australian evidence on momentum crashes. He notes that while previous studies have reported that significant alpha can be generated in various international equity markets by employing a momentum strategy — i.e. buying past winners and short selling past losers — the strategy sometimes crashes, generating large negative returns over one or more consecutive months. Gaunt's study, which uses Australian data, generally confirms recent US findings that momentum crashes tend to occur following steep market declines and are characterised by large positive returns by the past Loser portfolio rather than large negative returns by the past Winner portfolio. The author indicates that asset managers who employ a (long–short) momentum strategy should be aware that the strategy will infrequently crash, but that these crashes may to some extent be predictable as they tend to follow periods of very large losses to the loser portfolio. He believes that understanding this, and the significant risk changes that occur, potentially offers managers the opportunity to modify the strategy at those times to mitigate losses, or perhaps even generate positive returns.

Also focusing on equities markets, Ron Bird and Hamza Ajmal address the mispricing of Australian initial public offerings (IPOs) and the well-known anomaly of the incidence of high returns on the first day that an IPO is listed. Overall, their findings suggest that investors do very well both from purchasing IPOs when they are issued, holding them for up to the first year of trading, and also purchasing IPOs after they are listed and holding them for at least the first year of trading. Based on the average returns across their sample, Bird and Ajmal find evidence of large underpricing of IPOs consistent with that found in many previous Australian and international studies but they do not find any evidence of a large subsequent reversal suggesting that the average Australian IPO is significantly underpriced. They also identify that the IPO returns are heavily right-skewed suggesting that the median return might provide a better insight into the pricing behaviour of IPOs.

The special section of this issue of JASSA begins with a paper in which I provide an overview of the effects of dividend imputation on the Australian financial system. The paper addresses the ongoing debate about the precise effects of the dividend imputation system on the Australian financial sector, company and investor behaviour, and real sector consequences. It argues that in any discussions about the costs, benefits and the future of imputation, a critical but largely ignored issue is the need to identify the appropriate counterfactual. Any alternative will involve some differences between Australian and overseas tax systems and differential treatment between investors, which will involve various types of distortions. Based on the available evidence, the paper argues that the benefits of imputation outweigh its costs. Moreover, the disruption to financial markets caused by substantive change such as abolishing imputation would be substantial. Consequently the conclusion drawn is that the case for change is not proven.

The focus of the study by Andrew Ainsworth, Graham Partington and Geoffrey J Warren is on the impact of dividend imputation on share prices, the cost of capital and corporate behaviour. They argue that although the theory and evidence may be unclear, the notion that imputation has no impact on share prices and the cost of capital sits at the extreme of the spectrum of possibilities. Instead, they suggest it is more likely that imputation has had some effect on share prices, even if just in certain situations such as for smaller, domestic companies. Further, they say imputation appears to have influenced behaviours, some of which have been beneficial: it has encouraged higher dividend payouts, and possibly lower corporate leverage and a propensity for Australian companies to invest domestically at the margin. On balance, they believe that the imputation system has made a positive contribution to the Australian economy.

Stephen Gray's paper indicates that the contentious debate about the valuation of dividend imputation credits, which has continued since the system was introduced in 1987, has been heightened in the regulatory setting. Gray suggests that although an accurate estimate of the cost of capital is important for every firm, it is particularly important for regulated infrastructure firms where a regulator sets the allowed revenue each year in accordance with its estimate of the cost of capital. The paper explains how the regulatory allowance depends on the estimated value of imputation credits and summarises the debate that has occurred, over many years, in this setting. Gray notes that if the regulator overestimates the value of imputation credits, investors in an infrastructure firm will be undercompensated and vice versa.

In the final paper of this issue, Andrew Ainsworth suggests that the international experience with dividend imputation is an overlooked aspect of the debate surrounding Australia's dividend imputation system. His paper argues that despite their political and economic differences, there is much that we can learn from the nine countries that removed dividend imputation systems similar to Australia's between 1999 and 2008. Ainsworth notes that if the debate surrounding the removal of imputation in Australia continues, there are two questions that will need to be addressed. What system might replace dividend imputation? Do we understand any potential unintended consequences from these different tax systems? He argues that the continued changes to how dividends are taxed by some of the countries that have removed imputation suggest that the answers to these two questions are not straightforward.

We are very keen to encourage papers, both from practitioners and those in academia, focusing on the pressing issues for those working in the finance industry and on rigorous discussions about the latest developments in applied finance. I encourage anyone interested in contributing to the journal to contact us at membership@finsia.com.