SUPER IMPOSED: AUSTRALIA RECONSTRUCTED'S SUPERANNUATION STRATEGY

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Australia Reconstructed (*AR*) foreshadowed that superannuation funds were to provide a pivotal role in capital formation for the Australian economy. In particular, it was argued, superannuation funds had the potential to significantly increase the level and alter the direction of investment in Australia. *AR* argued that this impact was only achievable if a proportion of superannuation funds returns were channelled into a National Development Fund that would direct the investment away from speculative short-term ventures toward 'productive' areas. Since *AR* there have been many changes in the superannuation arena. The funds have grown significantly and the assets in which superannuation is invested are changing. In particular, the proportion that these funds are investing in equities and overseas assets has increased. These changes are part of a broader process associated with the internationalisation of accumulation. They cast a question over the ability of a development fund to direct superannuation into the type of long-term 'productive' investment desired by *AR*.

The *AR* proposals for superannuation presented an issue which has been of lasting significance in Australian policy debate. *AR* represents a forerunner to current arguments about the need for strategies to increase national savings. Although the national savings and superannuation issues are not the same, both respond to the current account deficit,

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promoting the savings of workers or 'households' as central to a national economic solution. In this paper it is argued that in both types of proposals workers endure the cost of 'national adjustment' in either forgone income or consumption. In the case of 'left' strategy presented in *AR*, these costs are more poignant. *AR's* intention to direct the foregone earnings of workers into a development fund to provide soft finance to capital represents not just a cost to current income and consumption but also to future retirement income. In general, the investment strategy of *AR* would have meant workers would receive a lower rate of return on their superannuation. This means that labour would have been effectively subsidising domestic capital. These costs question the potential of the *AR* 'left' alternative for superannuation to promote both job creation and increased retirement incomes.

The *AR* Argument: the Role of Superannuation in the Creation of a National Development Fund

Concern about how to arrest the decline in manufacturing industry in Australia led to *AR* focusing on methods of increasing the availability of capital and influencing levels of investment in the Australian economy. The aim was to not just increase the quantity of investment but to alter its 'timing and direction'. *AR* argued that investment was not being channelled into the productive areas of the economy such as manufacturing and the service sectors (*AR*: ix). Trade in financial assets was displacing 'productive' investment. According to *AR* the "short-term horizons of the institutional investors ... constrains long-term investments and research and development" (*AR*: 20). Emphasis on trade in securities, it was argued, was the result of financial deregulation as "inexperienced local companies" gained access to unprecedented large amounts of foreign capital, using this finance for short-term gains (*AR*: 20). Long-term investment needed to be focused into import replacement and export oriented industries (*AR*: 21).

AR argued that superannuation had significant potential to provide the required capital for productive investment:

> Superannuation, as a deferred wage, has played a central role in those Mission countries committed to collective capital formation. These funds are channelled into domestic productive activity which creates not only current economic stability but builds on infrastructure capable of supporting a socially adequate standard of living. Bringing superannuation funds back from overseas to Australia is crucial to an improvement in domestic investment" (*AR*: 95)

It was recommended that there be a "consolidation of emerging superannuation arrangements to ensure they contribute effectively to the growth of productive investment" (*AR*: 21). Furthermore there would be a concerted effort made to "reduc(e) the level of superannuation funds currently held off shore".

The envisaged mechanism by which superannuation funds were to be channelled into productive investment was through the formation of a National Development Fund (NDF) (*AR*: 14). The NDF would be formed by diverting 10 to 20 per cent of the superannuation fund's future income into a fund managed by the Australian Industry Development Corporation (*AR*: 21). The role of the NDF would be to direct investment into 'non-speculative' areas. Tax treatment of investment through superannuation funds would provide the lever to redirect part of their investment portfolio into longer-term investment.

AR viewed the potential size of the investment fund optimistically. As Table 1 indicates, at the 20% level [1], the fund was predicted to build up from about $1 billion to just over $4 billion by 1997. The justification for this significant generation of capital comes from *AR's* projected estimates of the growth of superannuation funds.

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1 AR gave two example rates at which a proportion of superannuation earnings could be paid into a NDF. These rates were at 20 per cent and 10 per cent of superannuation earnings (AR, 1987:22-3).

The 'wish list' for the funds was also extensive. They were to (*AR*, 1987:22-3):

- provide soft loans and equity capital for investment in new capacity industry;
- give priority to those who wish to invest for import replacement, export expansion, industry modernisation and restructuring activities;
- provide funds for a training, education, skill formation and research and development packages: and
- review the possibility of allowing some of the funds to be used in housing.

Considering there would be a maximum inflow of $4 billion in the NDF by 1997, the range of proposed investment activities was ambitious.

Table 1: Accumulation of funds in a National Development Fund

Year	20% Scheme Inflow Billions ($)	Accumulated Billions ($)	10% Scheme Inflow Billions ($)	Accumulated Billions ($)
1988	0.9	0.9	0.4	0.4
1989	1.1	1.1	0.5	0.9
1990	1.2	3.1	0.6	1.5
1991	1.4	4.5	0.7	2.2
1992	1.6	6.1	0.8	3.0
1993	2.0	8.1	1.0	4.0
1994	2.3	10.2	1.2	5.2
1995	2.8	13.2	1.4	6.6
1996	3.4	16.7	1.7	8.3
1997	4.2	20 9	2.1	10.5

Source: *AR*: 22

An Assessment of Superannuation Since 1987

The NDF never gained enough support in policy circles to be implemented. Instead policy measures effectively privatised public pensions (Gallery, Brown & Gallery, 1996). The introduction of compulsion into superannuation generated forced household saving, with scarcely more than minimal prudential restrictions on the use of accumulated funds.

Hence, since 1987 the function and importance of superannuation has changed markedly: policies supervising superannuation have changed, the pool of funds has grown and the uses of these funds have altered. Each of these dimensions of change warrants brief consideration.

Policy Changes Since 1987

AR's emphasis on the importance of superannuation funds reflected ACTU general support of the implementation of superannuation provisions into employment awards and contracts. These provisions became progressively implemented from the late 1980s. Productivity agreements were formed that required employers to pay 3 per cent of wages as contributions to new or improved superannuation coverage. "Award superannuation raised coverage from 40 to 80 per cent of employees by 1992" (Gallagher, 1996: 26). In 1992 the Labor Government announced the Superannuation Guarantee. This measure aimed to:

- further increase superannuation contributions coverage to lower wage earners;
- begin the 'envisaged' employee contribution at 3 per cent; and
- raise the minimum employer contribution to 9 per cent by 2002/03:

In May 1995 the Labor Government began the phased introduction of employee contributions to employer-sponsored superannuation schemes (Gallagher, 1996: 27). Each of these developments has been broadly consistent with the agenda of *AR* and the belief that employees should support the profitability of industry and at the same time save the basis of their future income. The current Liberal Government has indicated it will continue the employee and employer contributions schedule. However, in the May 1997 Budget it announced a new savings vehicle - Retirement Savings Accounts - and introduced a flat 15 per cent tax rebate on all forms of savings. This can be seen as a limited alternative to compulsory superannuation.

Growth of Superannuation

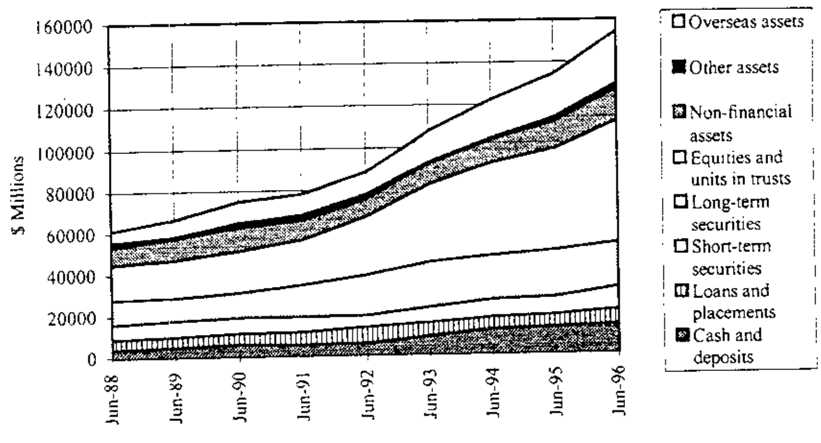
The growth of the superannuation funds - stimulated in part by these policy changes - has been significant. *AR's* predictions about the size of superannuation are surprisingly accurate, if not courageous considering employee and employer contributions schemes had not been foreshadowed in 1987. Superannuation assets were $19 billion at the end of June 1995 (ABS Cat 5656.0) and have since exceeded $20 billion. However, this growth will take time to have an impact. The Retirement Incomes Modeling (RIM) Task Force forecasts that the effects of the superannuation guarantee will not be felt until after 2000, estimating superannuation will add about 1% of GDP per annum to national savings by 2005/06 (Gallagher, 1996: 32).

How are Superannuation Funds' Assets Being Invested?

AR placed emphasis on compulsorily channelling superannuation into 'productive' assets to rebuild Australia's manufacturing base. Clearly, there has been no such encumbrance. It is therefore interesting to see exactly where these superannuation funds have flowed, to identify just how different the *AR* proposals would have been from the actual decisions of funds managers over the past decade.

Tracing the type of investment taking place with superannuation funds is complicated both by the convergence taking place between funds managers, life insurance companies and banks, and the associated convergence between their investment products. ABS data on superannuation funds exclude those funds administered by life insurance offices[2]. For this reason the information presented on superannuation assets will be a significant underestimation. This is because the life insurance companies control over 40 per cent of total superannuation assets (Industry Commission, 1991: 52). However, the assets in which life offices invest are approximately the same proportions as the superannuation funds. The limited evidence of superannuation funds' asset spread can still provide a indicator of where the funds, in general, are being invested.

Figure 1: Superannuation Funds by Asset Type 1988-96 [3]



Source: ABS Cat. 5655.0

The assets of superannuation funds from June 1988 to June 1996 are shown in Figure 1. The main changes in the types of assets were a large

2 The ABS Cat No 5656.0 does include the superannuation assets controlled by life insurance offices. However, this series was discontinued in 1995.

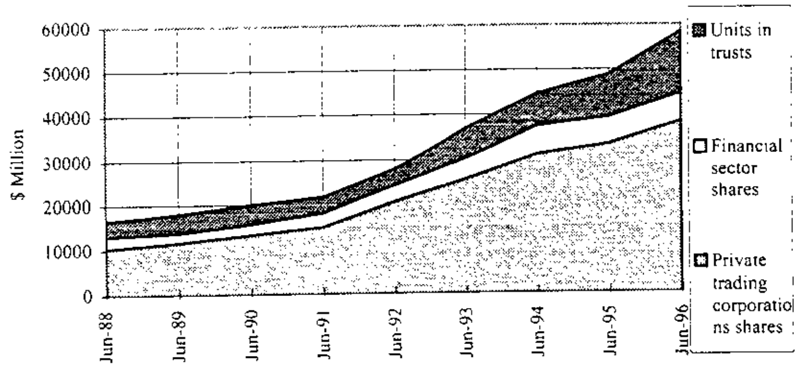
3 Figures exclude superannuation funds that are invested and administered by the life insurance offices.

increase in superannuation assets has taken the form of equities, and a proportionally large increase in overseas assets [4].

Equities and units in trusts are the main form of superannuation asset. In June 1988 investment in equities and unit trusts was $16.7 billion (representing 27 per cent of all superannuation assets) increasing to $58.4 billion (37 per cent of all the funds) in June 1996.

The majority of this investment has been in equities of private trading corporations, as shown in Figure 2. In June 1988 $10.4 billion of superannuation assets were held as equities in private trading corporations and by June 1996 this had increased to $38.2 billion.

Figure 2: Superannuation Assets Held as Equities and Units in Trusts [5]



Source: ABS Cat 5655.0

The increase in investment in equities is a result of increased requirement, by a growing body of superannuation funds, for stable long-term assets in which to invest. It is also the product of greater

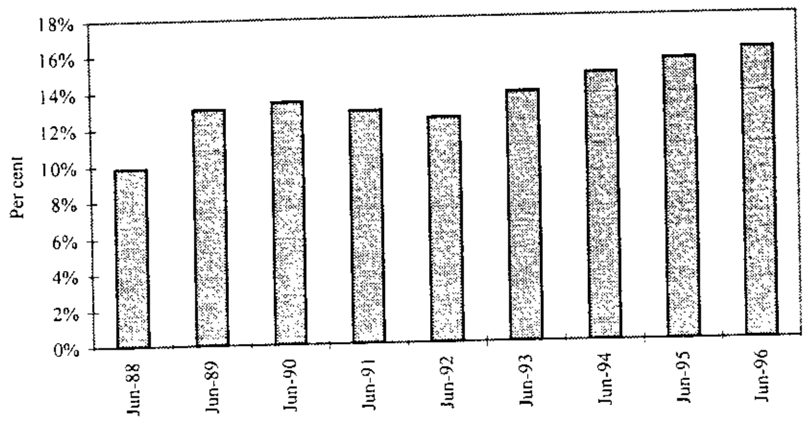
4 The ABS defines assets overseas as "physical assets located overseas and financial claims on non-residents" (ABS Cat 5655.0).

5 Again figures exclude superannuation funds that are invested and administered by the life insurance offices.

supply of equity on the stock market. This shift to equities was a significant transformation, for it followed both a period of unprecedented access to international finance, leading to the rapid growth financial assets of superannuation funds, and the stockmarket crash of 1987, which placed insecurity in the equities market. Figure 2 shows that, after 1991, preference for equity increased significantly as equities markets resumed growth, and as a reaction against debt exposure. Whether this shift can be equated with a shift towards 'productive' investment and away form 'speculative' investment, as *AR* had called for, is an issue which will be raised in the next section.

The other principal change to the allocation of superannuation funds has been the significant increase in funds held as overseas assets, as shown in Figure 3. In 1987 *AR* had expressed concern about the loss of 'Australian' superannuation funds to off-shore investment. Since that time, the proportion going off-shore has increased steadily. From 1988 to 1996 the percentage of superannuation held as overseas assets increased form under 10 per cent to 16 per cent.

Figure 3: Percentage of Superannuation Assets held Overseas as a Proportion of Total Superannuation Assets



Source: ABS Cat. 5655.0

Overall, there has been a number of changes to the superannuation since publication of *AR*. The superannuation guarantee has been introduced, making worker contributions compulsory, and these funds have been placed in the hands of private sector funds managers. The size of superannuation funds has grown significantly making them a major source of capital. Further, more investment of superannuation funds in overseas assets is taking place which is a product of the process of internationalisation. These trends imply a role different from the role for superannuation that *AR* had envisaged.

The Potential Effectiveness of the NDF and Capital Restrictions

Even though the development of superannuation unfolded differently form the path projected in *AR*, it is important to consider whether *AR's* proposed National Development Fund (the means by which superannuation funds would be redirected towards the revitalisation of productive industries in Australia) would nonetheless still provide an effective regulator.

The NDF depended on two critical policy intentions: the control of speculative investment, and the control over the international movement of superannuation funds. How have these issues changed in the past decade?

AR focused strongly on the dangers of speculative investment, arguing that speculation was undermining the growth of 'productive' investment, especially in manufacturing. Immediately, we hit the problem that it is impossible to distinguish between 'productive' and 'speculative' investment. As Stilwell (1988) observes drawing such a conceptual distinction can lead to confusion. Nonetheless, this conceptual problem is not new, so the more interesting question relates to whether speculative investment has increased or decreased in the sense understood in *AR* - where speculation is associated to short term investment driven by anticipation of appreciating asset values.

AR gave priority to long-term loans because they were considered a more stable method of financing 'productive' investment. The importance of equity markets in raising new capital was not ruled out; however *AR* treated equity markets with suspicion, as they can be subject to short-term speculative investment. As we learned from the crash of October 1987, this suspicion was indeed justified at the time *AR* was released. In the decade since *AR* and the stock market crash, it is clear that superannuation funds held an increasing portion of their assets in the stock market (see Figure 2). But it is difficult to assess whether superannuation funds have used equities for speculative purposes. It is hard to argue that the resale of shares is 'unproductive' compared to the issue of new shares. The 'second hand' share market is a necessary condition for attracting capital and therefore provides a 'productive' function.

Table 2: Annual Value of Equity Trading and Market Liquidity

Financial Year to 30 June	Value of Equity Turnover ($ Billions)	Average Annual Liquidity (%)
1986	31.4	34.4
1987	59.4	41.5
1988	67.6	39.3
1989	49.3	30.0
1990	56.7	32.9
1991	54.5	34.9
1992	63.1	33.9
1993	72.7	36.0
1994	128.4	45.5
1995	118.1	40.6
1996	159.3	48.0

Source: ASX Monthly Index Analysis (Bruce et al, 1996)

A tentative indicator is the extent of turnover on equities and level of liquidity in the secondary stock exchange, although it is not possible to differentiate fund managers from other stock exchange investors. Table 2 shows that the value of equity turnover and percentage of annual liquidity have increased. It does not provide emphatic evidence that superannuation funds held as equities have been used largely in speculation on private trading corporations; nevertheless it suggests the possibility of a trend.

Would a NDF now want to hold this much equity in private companies and how can speculation on equities markets be limited? If the indications about speculation are correct, the NDF would presumably wish to lower the investment in these assets. This could be achieved simply by preferencing soft loans over equity. However, soft loans will pay a lower return on superannuation funds. Furthermore, equities, when invested in the long-term, can be a more stable investment than soft loans. Funds managers often see equities as an asset of long duration with high yields and an expectation that profits will broadly offset inflation.

Clearly, holding a high volume of equities should not represent a problem for the *AR* approach. What is of concern to *AR* is the restriction of speculative investment. It raises a difficulty: how can 'productive' investment in equities be encouraged yet speculative investment be restricted? Perhaps time horizons would need to be employed with long-term equity investment preferenced over the short-term. However, flexibility is needed: if equity investments are under-performing, they may need to be sold to minimise loss, so as to ensure that workers receive the highest rate of return on future retirement income.

In relation to the issue of international investment by superannuation funds *AR's* proposal involved the (re)assertion of a discrete national capital market. *AR* tried to use superannuation as a domestic supply of capital in an attempt to head off a number of perceived problems associated with the internationalisation of finance (ie. lack of 'productive' domestic investment and an over-reliance on foreign capital). *AR* argued that all overseas investment by superannuation funds should be scaled down to 15 per cent by 1992 (*AR*, 1987: 23). The increase in the percentage of these funds leaving Australia has been dramatic and the current level still remains close to the (potential) limit laid out in *AR*: The overall trend is for the proportion of assets held overseas to grow, and this trend is not unique to Australia. In the UK, Ireland and Belgium foreign asset share of pension funds has grown to around 30 per cent of total assets (these countries, like Australia, have few restrictions on limits to overseas investment) (Reisen and Williamson, 1994:30).

Empirical evidence shows that national legislative restrictions can work to a degree. Norway, Germany and Canada all successfully restrict the level of overseas assets to less than 10 per cent (Reisen & Williamson, 1994: 30). However, the OECD has become aware that pension funds are getting around these barriers (Reisen, 1997). Pension fund managers in countries with capital controls are sometimes relying on swaps with their subsidiaries or with other foreign pension funds. The amount of 'swapping' is not known, but it does question the success of barriers.

The underlying issue, however, is that there has been not just a quantitative increase in funds held offshore, but a development of the global integration of financial institutions. Superannuation funds managers are increasingly looking to diversify their investments and therefore increase the number of non-Australian assets they hold. Global Portfolio Theory[6] is increasingly influencing fund manager's decision making and there is clear evidence that an increasing number of pension funds in the US and UK are beginning to pursue international diversification of assets (Reisen and Williamson, 1994; Solnik; 1988).

Moreover, this development cannot be conceived simply as an increasing 'leakage' of superannuation funds off-shore. Over the past decade, it is not just the assets which have globalised, but the financial institutions themselves. Most of Australia's major pension fund investors are multinationals in their own right so it is difficult to delineate a discrete population of 'Australian' superannuation funds. The consequence is that assigning a nationality to this mesh of investments increasingly arbitrary.

This development makes *AR's* aspiration of drawing 'Australian' superannuation funds back to Australia appear increasingly

6 The theory encourages global diversification by touting the benefits of a higher rate of return through investment in 'emerging markets'. This literature argues that international diversification can reduce risk by investing in securities that are uncorrelated with domestic investments. If there exists a higher correlation there is a possibility of joint exposure to shocks (Reisen & Williamson, 1994).

anachronistic. It certainly signals the need for a large regulatory agency overseeing the adherence of superannuation funds!

From Superannuation to Savings: The Class Effects of National Investment Policies

The NDF was discussed in *AR* with little detail. Nonetheless, it was central to the proposal that there be generated a pool of domestically-sourced investment funds. This aspiration has continued over the past decade, although the way the pool is characterised, and the way it would be tapped have changed. While *AR* focussed on the compulsory control over (some part of) superannuation funds, the more recent formulation has been framed as a national savings agenda. There are some significant differences between the two sorts of proposals, for they have quite different conceptions of the requirements for Australia's external viability, but they share an essential common theme: in an era when constraining capital is deemed unacceptable (and ineffectual) it is labour which is 'tapped' as the source of investment funds, and, thereby, labour which is required to carry the burden of national investment policies.

In the *AR* proposal, assuming that compulsory employee superannuation was introduced alongside a NDF, what impact would this have on worker's income? To assess this it is necessary to know if workers' payments to the fund would operate as either:

- a tax, with 10 to 20 per cent of superannuation fund's predicted earnings being paid into the NDF for investment; or
- a forced investment paying a rate of return back to workers.

If the fund operates as a tax it would be extremely regressive. Assuming compulsory superannuation were introduced alongside the NDF, most workers would forgo part of the return on their future wages to fund investment in domestic capital. Regardless of workers' capacity to pay they would be taxed the same rate on their superannuation earnings (10 or 20 per cent). This represents a redistribution of income from the poor to the rich.

Assuming a rate of return on NDF investments is paid, this raises the issue of 'how much of a return?'. As superannuation funds are the forgone earnings of workers, anything below the market rate of return is a subsidy paid by labour to capital. The 'efficiency' of private sector versus public sector administration of superannuation (Gallery *et al*, 1996) is not being questioned. Rather, there is a contradiction between a reasonable return for workers and the provision of soft finance and purchase of generous equities. It is unlikely that a market rate of return could have been provided under the NDF scheme, for the following reasons:

- by definition, the provision of 'soft-loans' means a rate of return is paid below market average;
- as superannuation fund managers can sell equities in those companies that are not performing they are able to minimise risk. To lock funds into equities in a company for a specified period increases the likelihood of lower returns on the entire equity portfolio held by the NDF;
- investment in overseas assets generally pays a higher rate of return. In the UK, 78 per cent of funds held in overseas assets are invested in "emerging markets" because of greater returns (Reisen & Williamson, 1994: 30). These funds take advantage of arbitrage. They also lower risk by diversifying their investments and decreasing the likelihood of correlated price movements between assets (Reisen, 1997; Reisen & Williamson, 1994).

Under the *AR* scheme it is workers, through their lower superannuation payouts, who must endure the financial costs of attempting to generate stronger domestic industry.

In its current guise, the issue of providing a domestically-generated pool of investment funds has focused into a more general call for increased national savings. The rationale now is not the danger of speculative investment, but the desire to restrict the perceived need for capital inflow[7] (see Edey & Britten-Jones, 1990; Flynn, 1993; Byrne, 1993; FitzGerald, 1994; CEDA; 1994; Willis, 1995).

Like the *AR* strategy, the national savings argument also calls for sacrifices so as to attain national gains. In the mid 1990s version it is not the rate of return on superannuation being reduced, but consumption cuts by workers, being called for to provide a pool of 'domestic' savings.

The similarity between *AR's* superannuation policy and the national savings agenda is that both represent national responses to a number of perceived 'external constraints' impacting on investment levels in the Australian economy. Both arguments place an emphasis on domestic capital creation as a response to the current account deficit, but the depiction of this external constraint is being framed differently.

The *AR* agenda was predicated upon increasing international viability via 'productive' investment; the national savings agenda of the 1990s is based on complying with, and rectifying, national accounting identities. Accordingly, *AR* saw commodity trade as key to the current account deficit and argued for capital investment in export growth industries to generate an increase in exports over imports. The NDF would facilitate the further evolution of import replacement and export orientated industry under local conditions via a reliance on domestic finance. Conversely, the national savings argument analyses the current account deficit in terms of the ramifications for capital flows. This shift in emphasis reflects a growing focus on international finance, not trade, as the national 'constraint'.

In the new savings agenda, the current account deficit is expressed as savings minus investment plus taxation minus government expenditure: CAD = (S-I) + (T-G).

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7 Arguments about national savings seem to have entered public debate via the famous 'savings-investment gap thesis' (discussed further below). In 1995, the argument became explicit when, under the introduction of the superannuation guarantee, the then Treasurer Willis, argued that compulsory superannuation was crucial to increasing national savings (Willis, 1995). This argument was widened in the 1997 Federal Budget as Treasurer Costello introduced a tax break for all forms of savings, claiming it would assist in increasing national savings by encouraging households to save.

The equation is then organised into: CAD = (S + T - G) - I. The current account deficit is thus expressed as the difference between national saving (the aggregation of private saving and government saving) and investment (Byrne, 1993). The gap between investment and savings are therefore the cause of the current account problem. An increase in national savings, it is argued, is necessary to halt reliance on capital inflow and to fund investment domestically.

The 1994 FitzGerald Report to the Federal Treasurer, entitled *National Saving*, embraced this framework, arguing that the "twin of national imperatives", in relation to the current account deficit, are to "raise national competitiveness and to raise national saving" (1994: 15). But the savings agenda comes with a perverse edge which creates a parallel with *AR*. The current obsession with 'competitiveness' has placed an emphasis on lowering real wages, yet there is a standard recognition that the propensity to save is dependent on the level of income. The cutting of real wages has undermined workers capacity to save, yet it remains workers, not capital, which remains the targeted source of a pool of national savings. Inevitably, therefore, it is only by compulsion that workers savings can be increased - a point made clear in the FitzGerald Report:

> ... the key element producing increased saving - over the long term - through the superannuation guarantee is that it is compulsory, raising the saving of many who without it would not be saving much in any form (FitzGerald, 1994:51).

What makes *AR* different from the FitzGerald formula is the belief that a NDF could nurture productive investment which would deliver competitive tradeable goods industries - a belief at odds with current neo-liberal ideology. Both, however, involve the compulsory depletion of worker's lifetime incomes, on the supposed promise that economic growth will follow.

It is interesting that attempts to raise capital from workers are currently occurring in most OECD nations (Block, 1995), and the emerging national savings agenda in Australia is very much part of this process. *AR's* superannuation strategy was an earlier attempt to deal with this same problem of 'external balances'. Its solution, of implementing a

NDF and constraining the overseas investment of superannuation funds, would have been hard-pressed to compensate for the number of the changes taking place with superannuation associated with the changing scale of accumulation. As *AR* perceived the short-fall of domestic finance as a national problem it is easy to forget that workers would pay the cost of the strategy by receiving lower returns on their retirement income. In dealing with the limitations associated with globalisation, *AR's* strategy is constrained by the fact that capital can escape internationally (swaps are one way around the barriers on superannuation funds investment overseas). This means that in the pursuit of a national investment fund the sacrifices fall to labour as the 'immobile' factor of production. That theme appears to be an on-going dimension of economic policy in Australia.

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