Comment on adequacy of superannuation

By M SCOTT DONALD SF Fin

The paper by Professors Piggott and Evans addresses the key issue in Australian public finance policy over the coming decades. Whether the financial needs of the growing population of retired Australians can be met from their superannuation entitlements will influence all aspects of government economic policy, from welfare and taxation to industrial relations and, ultimately, monetary policy and industry assistance. However one should be careful of assuming that the conclusions one can draw from the micro-economic analysis presented by Professors Piggott and Evans apply at a macro-economic level.

A brief discussion should make the reason for this clear. The first observation is that Australia is a democracy in which almost all citizens over the age of 18 are eligible to vote. That right is not means tested (as say in 19th century England) nor is re-tested after a certain age (as with a driver’s licence in NSW). This makes a nonsense of the idea, current in some quarters, that retirees must provide for themselves out of superannuation or face poverty under the age pension. A single constituency of the size represented by retired Australia, galvanised by the fear of impending retirement poverty, would certainly find a voice in the democratic process to ensure that the age pension provides an effective safety net. If existing parties do not represent that interest today, they will soon feel the pressure to do so, or be bypassed by the arrival of a new, single-issue grey vote. More importantly, though, they are in still involved in the economy and, critically, in the setting of prices. Put crudely, working Australians, through wage claims and salary negotiations, are much less adversely affected by inflation than retirees. A re-emergence of inflation, especially consumer price inflation, is the single greatest danger to the financial well-being of those on fixed means, such as retirees. Might not working Australians react to the apparent affluence of retired Australians by demanding higher wages, thereby driving price levels generally up, and the real purchasing power of retirees down? Of course such a strategy would never be publicly articulated, but as the Howard government of the past decade has shown, strategies that promote a widespread sense of economic well-being (e.g. through asset price inflation) are powerful electoral allies.

This simplified model of the electorate highlights two aspects of the debate that are often missed. First, when you move from the micro level to the macro level, the adequacy of superannuation is primarily about wealth distribution, not the level of savings. In a dynamic system in which different actors have competing interests (here retirees and workers), the game is contested over the share of wealth to each group. The
equilibrium will be based on the relative power of the actors and the strength of their motivation. Tax rates, welfare entitlements, price levels: all will be determined (on a generation- al timescale) by these broad socio-economic forces, acting through the agency of representative government. Institutional frictions will make progress towards new equilibria jerky rather than smooth but the changes do happen (recall the government’s introduction of tax on superannuation earnings in 1988, as a case in point).

Second, it doesn’t matter how much you save, so long as you save more than your peers. This may sound petty but it is a sensible objective. This is because the equilibrium arising from the generational wealth tussle is unlikely to deliver a windfall to either retirees or workers. In a modern democracy there is little real risk that a sizeable minority, such as that represented by retirees, will be forced en masse into poverty by government policy. The result is likely to be (somewhat) fair to both sides since neither side really has an incentive to see the negotiation break down. The danger for an individual is that they fail materially behind their peer group, either in the amount they have put away in superannuation (the retirees) or the amount they earn from their labour (the workers). Because the logic presented here merely suggests that individuals in the different groups will be OK on average. Fall behind that average and you are likely to be disappointed. In other words, saving 9% will be OK so long as every one does that, but potentially not enough if everyone else saves 12% and builds a larger nest egg for retirement than you do. It wasn’t that long ago (perhaps 30 years?) that someone retiring with net assets excluding their residence of $100,000 would have felt well-insured for their retirement. That number seems scarily inadequate today.

So what does matter? Aggregate wealth matters, because that’s what is available to divide between retirees and workers. And whilst aggregate saving does influence the accretion of aggregate wealth, it only does so if the money is re-cycled into the economy in productive ways. Keynes demonstrated over 50 years ago that merely pumping additional savings into investment would ultimately prove disappointing. The marginal efficiency of capital declines. Put another way, in a reasonably efficient capital market, the monies available for investment find the highest uses first, but as more and more money seeks new investment opportunities, the projects funded become less remunerative, more risky or both. The big challenge is to sustain the rate of return on capital at levels that make the additional savings mandated by superannuation worthwhile. If that sounds a bit far-fetched, note that the accumulated superannuation earnings in 1988, as a case in point).

Professors Piggott and Evans point out the implications for adequacy if the rate of return earned by superannuation funds turns out to be lower than everyone currently expects. Notably, this was one of the prime motivations behind the Myners Report in the UK in 2001 (before it was highjacked by industry interest groups). UK policy makers realised that ensuring that rapidly accumulating pension assets found productive uses whilst also ensuring that interesting new technologies and business ventures found patient capital was key to the UK’s economic future. That the Myners Report was sidetracked into investigating agency costs (at best a secondary issue) was a tragedy for the UK.

For Australia, the challenge has now therefore shifted. The Superannuation Guarantee has been important for broadening participation. It reduces (but by no means eliminates) the degree to which people are left behind. It has also underwritten the accumulation of a $1tr treasure chest to invest for the future. The key now is to ensure that the monies set aside for investment within the superannuation system find prudent, productive uses. The investment and governance provisions of SIS and the advent of Fund Choice have freed up some of the performance-leaking distortions in the system. However this must be reinforced by more effective links to scientific and business innovation, not ever-more convoluted and fee- fat investment structures. It also means we all need to pay more attention to long-term funding and less to short-term performance. And it means more attention to financial literacy so that fund members understand how to make the choices that are best for them. These imperatives matter in the narrow context of Australia’s superannuation system, but they matter just as much for the future of our whole economy. 

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