MCKELL INSTITUTE VICTORIA

Economic Benefits of Universal Superannuation

HOW SUPERANNUATION *works* FOR ALL OF US

MARCH 2020

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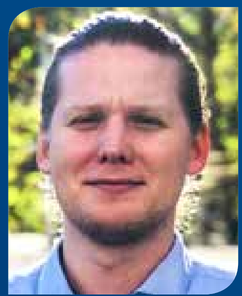
ABOUT THE AUTHORS

JAMES PAWLUK

James is the Executive Director of the McKell Institute Victoria. Prior to taking on the role, James was Manager of Business Development for Australia Post, focusing on developing business strategies for the company's parcels business including overhauling its domestic air freight arrangements. James has also served as Senior Advisor and Deputy Chief of Staff to various Federal Cabinet Ministers with experience across areas such as government service delivery, digital transformation, budget processes, policing and customs.

James completed a Bachelor of Arts and Bachelor of Commerce at the University of Melbourne majoring in Economics and Political Science.



KYLE TAYLOR

Kyle joined the McKell Institute in May 2019 as Policy Officer. Prior to this, he held several positions in the NSW Government where he conducted research and evaluation across an extensive portfolio relating to various policy issues, including skills shortfalls and future skills needs.

In addition to his public sector experience in Australia, Kyle had the opportunity to conduct research and evaluation at the United Nations Office on Drugs and Crime in Lao PDR and for Global Affairs Canada at the Balsillie School of International Affairs in Canada.

Kyle holds a Master of International Public Policy, with concentrations in Human Security and International Economic Relations from the Balsillie School of International Affairs. He also holds a Bachelor of Arts, Honours Political Science with Legal Studies and Research Specialisation Options from Wilfrid Laurier University.

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The opinions expressed herein are solely those of the authors and not necessarily those of Professor Thorp and Professor Hodgson.

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THE McKell Institute VICTORIA

FOREWORD

Almost three decades ago, when Australia introduced compulsory superannuation, our retirement income system has gone on to become the envy of most nations around the world. In raw terms, it's seen the 13th largest national economy accumulate the 3rd largest private savings pool with around $3 trillion in assets under management and allowed millions of low and middle income Australians to find greater dignity in their later years by entering retirement with a supplement to their age pension.

To be sure, there are things that need improving: too many Australians find themselves in underperforming funds; others accumulate multiple accounts when they change jobs; or are simply exposed to excessive fees or cost structures that eat into their returns. Some unfortunate Australians get hit with all three and it should be a priority of policymakers to fix this.

But even these shortcomings do not eclipse the gains that we've already made, including for the people described above. In the past those switching employers under a defined benefits scheme could simply lose all entitlements whatsoever. Meanwhile many of the low-fee and high-performing public offer funds we know today simply did not previously exist and were only brought into being by a system of compulsory contributions that generated scale via member numbers in lieu of high initial balances and representative trustees charged with maximising sustainable returns.

This unleashed a new breed of institutional investors faced with the challenge of investing on behalf of multiple generations, which has encouraged longer-term horizons unlocking capital for unlisted assets such as infrastructure and stewardship of all assets that better manages risks to long-term returns, in particular short-term focussed behaviour that might damage a business's reputation or drive increased costs through damages or fines.

Australian superannuation sometimes been described as a decentralised sovereign wealth fund, that has helped the nation to diversify its asset and income base equipping it to better respond to economic shocks. The decentralisation means households, that wouldn't be able access many of the assets held on their behalf, can share in those same benefits of diversification as can the regional economies that they are part of.

28 years ago, the core building blocks of our system – the Superannuation Guarantee, the industry-based default allocation and the switch to defined contributions – kicked off a gradual and conservative disruption to how capital is managed in Australia. A process that has strengthened our economy and made it more resilient. But there's a sobering point. By abandoning the original path to 15% contributions we inevitably slowed down the pace of this disruption and diminished its benefits. Meanwhile for workers themselves, we've denied them the opportunity of reaching higher balances sooner in their working lives and the increased engagement and compounding returns that brings.

It's time to get that journey back on track and turn our attention to how make the system more efficient, more effective and more universal.

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EXECUTIVE DIRECTOR
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EXECUTIVE SUMMARY

Australia's superannuation system not only ensures that working Australians can retire with dignity but also provides a number of broad economic benefits for the Commonwealth Government and the Australian economy.

This report outlines the evidence that universal superannuation has benefitted and will continue to benefit all Australians. It does so by collating the wide variety of research that has been undertaken detailing the various benefits of Australia's superannuation system. This report also updates that work and provides detail on further ways in which universal superannuation has benefitted and will continue to benefit Australians and the Australian economy.

It also provides confirmation of the large benefits to Australians and the Australian economy from increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent, keeping the default selection process in the industrial relations system, and safeguarding the compulsory nature of the Superannuation Guarantee.

Enhancing Financial Stability and Long-Term Economic Growth

Superannuation boosts Australia's national saving. The amount of national saving has important implications for the Australian economy; it provides a source of funds available for domestic investment, which in turn is a key driver of labour productivity and higher future standards of living.

The Treasury estimated that the boost to national saving from the introduction and increases in the Superannuation Guarantee was about 1.5 per cent of GDP as of 2011, and if the Superannuation Guarantee rose from 9.5 per cent to 12 per cent by 2019-20, as initially planned, the estimated contribution of superannuation to national saving would have been more than 2.0 per cent of GDP today, rising to roughly 3.0 per cent by 2040.

Superannuation funds reduce Australia's reliance on foreign sources of finance. For much of its modern history, foreigners have owned more equity in Australian companies than Australians have owned in foreign companies. But since 2013, Australians have owned more foreign equity than foreigners have owned Australian equity.

This has put the country in a net foreign equity asset position, and largely reflects the significant allocation to foreign equity by the Australian superannuation industry together with the fact that the superannuation sector is relatively large as a share of the Australian economy. The ongoing accumulation of both Australian and foreign equities by Australia's large superannuation sector has also partially offset continued equity inflows to Australia from foreign investors.

The shift to a net foreign equity asset position also reflects asset valuation effects, as foreign equities have outperformed Australian equities over the past decade. The shift also reflects the depreciation of the Australian dollar over this period.

Superannuation has a positive fiscal effect on the federal budget in the long-term. It is estimated that increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent over the period 2021 and 2025 will save the government roughly $34,306 million over the period 2021 and 2060, averaging a gain of $857 million per financial year over the long-term. By 2038, the net budgetary cost of superannuation tax concessions would be positive, meaning that the gains in superannuation contribution and earnings taxes and savings on the age pension will exceed the costs of the superannuation tax concessions.

Superannuation supports Australia's infrastructure needs. Australian superannuation funds have played a significant role in funding Australia's increasingly pressing infrastructure needs, and that role will only increase in the future. The long-term investment horizon of superannuation funds makes them natural investors in less liquid, long-term assets such as infrastructure.

Superannuation increases capital's focus on long-term sustainable returns. The reliable flow of funds from existing and future members via the Superannuation Guarantee, and through default arrangements, provides a steady stream of capital-seeking investment opportunities and has provided a source of demand for equities issued by companies. A consequence of this is that superannuation funds, being invested in a company over the long-term, are more concerned with environmental, social and governance (ESG) factors than other types of investors, ensuring that funds are maximising members' long-term returns while mitigating negative externalities. Another consequence is that investing strategies of superannuation funds can act counter-cyclically to movements in equities prices, and thereby reducing volatility in the equities market.

Superannuation offsets ageing population effects on economic growth. Australia's ageing population could have a significant impact on economic growth, particularly on aggregate demand. As workers' superannuation rises, it will increase their overall wealth and fuel consumption in retirement, which would otherwise be at lower levels without universal superannuation.

Universal superannuation has also had an impact within the Australian economy through superannuation funds investing directly in real assets, such as property and infrastructure projects, and an indirect impact through investing in the Australian share market. As household superannuation assets rise, investment from superannuation funds increase the economy's capacity to produce goods and services.

Superannuation helps counter the boom-bust cycles' adverse effects on the Australian economy. Without universal superannuation in place, the cyclicality of resources industries would have been even more pronounced with more income hitting the economy during the boom than being saved and built into a savings pool for when workers reach retirement. There are three main ways in which superannuation mitigates adverse effects posed by the boom-bust cycles of Australia's resources industries. First, the Superannuation Guarantee ensures that a growing share of unusually high incomes is saved for longer-term benefit rather than being used for current consumption. Without the Superannuation Guarantee in place, the pro-cyclicality of boom-bust cycles would be even more pronounced as wages and local profits would be recycled back into the economy in lieu of superannuation, pushing prices up further.

Second, increased investment in superannuation through incremental increases in the Superannuation Guarantee have helped to diversify household balance sheets, which in turn would have mitigated the damage from a bubble in the property markets of resource-rich communities. Australians tend to have a high allocation of wealth in non-financial assets, which leaves them prone to negative shocks from a boom-bust cycle.

Finally, superannuation funds themselves ease pressure on trade-exposed sectors by dampening the appreciation of the exchange rate arising from the boom, in particular, by investing in foreign assets. Without superannuation, investors would hold more domestic assets, meaning that the global portfolio share of assets denominated in Australian dollars would be higher than otherwise, risking a further appreciation of the dollar.

Increasing Financial Independence for More Australians

Superannuation helps Australian workers fairly benefit from the wealth that they help create. Superannuation provides employees with recognition as stakeholders who are due a share of the productivity gains paid out when profits rise. Investing workers' capital in the businesses where they work is an important mechanism to ensure that workers' interests are represented regarding investment decisions. In an age of excessive short-termism and declining private investment, superannuation provides a durable means to ensure long-term corporate prosperity.

Economic inequality cannot be solved through wage increases alone; the gaps in individual wealth are too large. Along with other ways to build assets, a clear way to rebalance wealth in the Australian economy is for employees to have a share of the wealth in the businesses where they work via superannuation.

Superannuation expands workers' benefits by adapting to a changing work environment. Universal superannuation enhances the retirement incomes and well-being of retirees in an increasingly insecure work environment. Globalisation, technological progress and demographic change are having a profound impact on society and labour markets. And in the face of such change in the job environment, staying competitive means adapting to that change.

In an era where job opportunity matters more than job security and where flexibility and mobility mater more than stability and company loyalty, universal superannuation allows older workers to adapt to the forthcoming changes in the labour market without forgoing their retirement incomes that would have otherwise been impacted under a superannuation system with limited access and pension portability.

As superannuation funds grow, they increase value for money for members. The fees charged by superannuation funds remains a hotly debated issue in Australia. There are still inefficiencies in unnecessary multiple accounts, subscale funds that struggle to deliver value, and underperforming superannuation products. However, overall, the superannuation sector is continuing to improve its offer to members by improving services and benefits and increasing returns while reducing its headline fee rates.

Significant economies of scale have been realised in the superannuation system over the last decade. However, there is little evidence that these cost savings have been systematically passed through to members in the form of lower fees. Scale benefits may have been passed through in the form of member services or increases in reserves or offset by the costs of meeting new regulatory requirements. Scale benefits may have also been realised through increasing returns to scale.

Superannuation reduces exposure to financial shocks by diversifying Australian household assets. The strong growth in superannuation has facilitated a broadening of the range of assets held by Australian household, particularly in asset classes where households have relatively small direct holdings, such as in equities.

Increased investment in superannuation may help to diversify the household balance sheet, which in turn may lower the risk of the household asset portfolio. Australian households' high allocation of wealth to non-financial assets may leave them more vulnerable to adverse movements in property prices. As the property market changes, households may reduce the riskiness of their portfolio by investing more in financial assets. Investing in superannuation also reduces the weighting of domestic assets in the direct investments of Australian households.

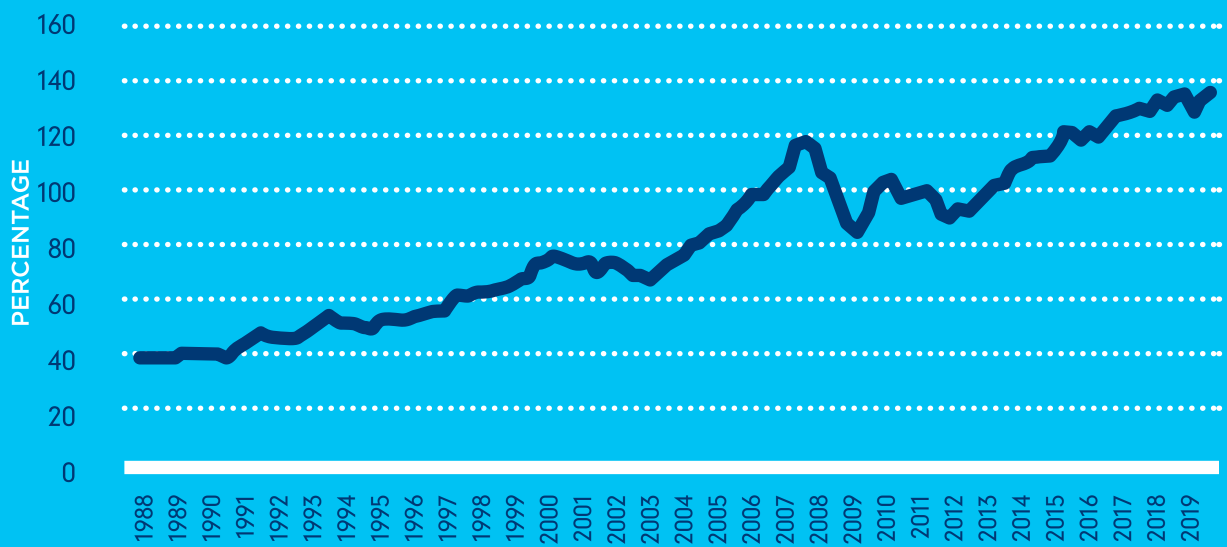
INTRODUCTION

Over the last 30 years, the Government of Australia has encouraged Australians to save more for their retirement through a range of saving schemes, including the Superannuation Guarantee and tax incentives for voluntary contributions.

In 1986, the Government of Australia and the Australian Council of Trade Unions (ACTU) struck a deal for 3 per cent superannuation and tax cuts in exchange for a 2 per cent discount of a Consumer Price Index (CPI) based wage increase for award-reliant workers. Since, at the time, superannuation did not affect payroll tax, workers' compensation and the like, it gave workers' a share of productivity gains and offset labour costs to employers, putting downward pressure on prices and reducing inflation.

Since the introduction of the Superannuation Guarantee in 1992, super contributions have become a central part of Australia's retirement income system. Household assets in superannuation as a per cent of Gross Domestic Product (GDP) have risen progressively since the 1990s (Figure 1). As of June 2019, household superannuation assets were around $2,657 billion, or roughly 137 per cent of GDP.

FIGURE 1 HOUSEHOLD ASSETS IN SUPERANNUATION, PER CENT OF GDP



***Source:** ABS, RBA, Authors' calculations.*

The particular dynamics and history of Australia's superannuation system have resulted in it having several structural characteristics that distinguish it in important ways from other major world pension markets. Notwithstanding the fact that it is mandatory, there has also been a seismic shift away from defined benefit (DB) occupational pension schemes to define contribution (DC) schemes, making Australia the most DC-centric of any of the world's developed market pension systems. At the same time, many superannuation funds have expanded beyond their origins as industry-based, single-employer entities to become more broadly-based financial institutions representing multiple employers across a variety of industries.

These characteristics are often cited as a trendsetter of future developments in other nations, as policymakers explore options to transfer increasingly unaffordable pension liabilities from government and corporate balance sheets to individuals.

The superannuation system is still relatively immature in the sense that many people are yet to have made contributions above 9 per cent or more over an extended period of time. And there are still inefficiencies in unnecessary multiple accounts, subscale funds that struggle to deliver value, underperforming superannuation products, and the gaps in universality, such as the $450 monthly income threshold for employer superannuation payments, or superannuation while on parental leave.

While it is important to acknowledge that the system is in need of improvement, this should not minimise the inherent benefits of superannuation to the Australian worker and to the Australian economy.

The lack of transferability of superannuation before the Superannuation Guarantee created a serious obstacle to labour mobility, as it would disincentivise workers from switching employers, and those who did would lose out on accruing cumulative balances.

Universal superannuation has brought into effect a system of where workers benefit from the wealth they help create, and where economies of scale are realised so that services and benefits for members are continually improving, reducing headline fee rates, while maximising long-term returns.

To ensure that the system is sustainable to provide an adequate income in retirement, superannuation funds have invested in a way that generates benefits in the long-term, such as in illiquid assets, promoting sustainable commercial investment in nation-building infrastructure projects. This approach avoids concentrated risk by highlighting the importance in creating long-term value in contrast to seeking to maximise short-term return.

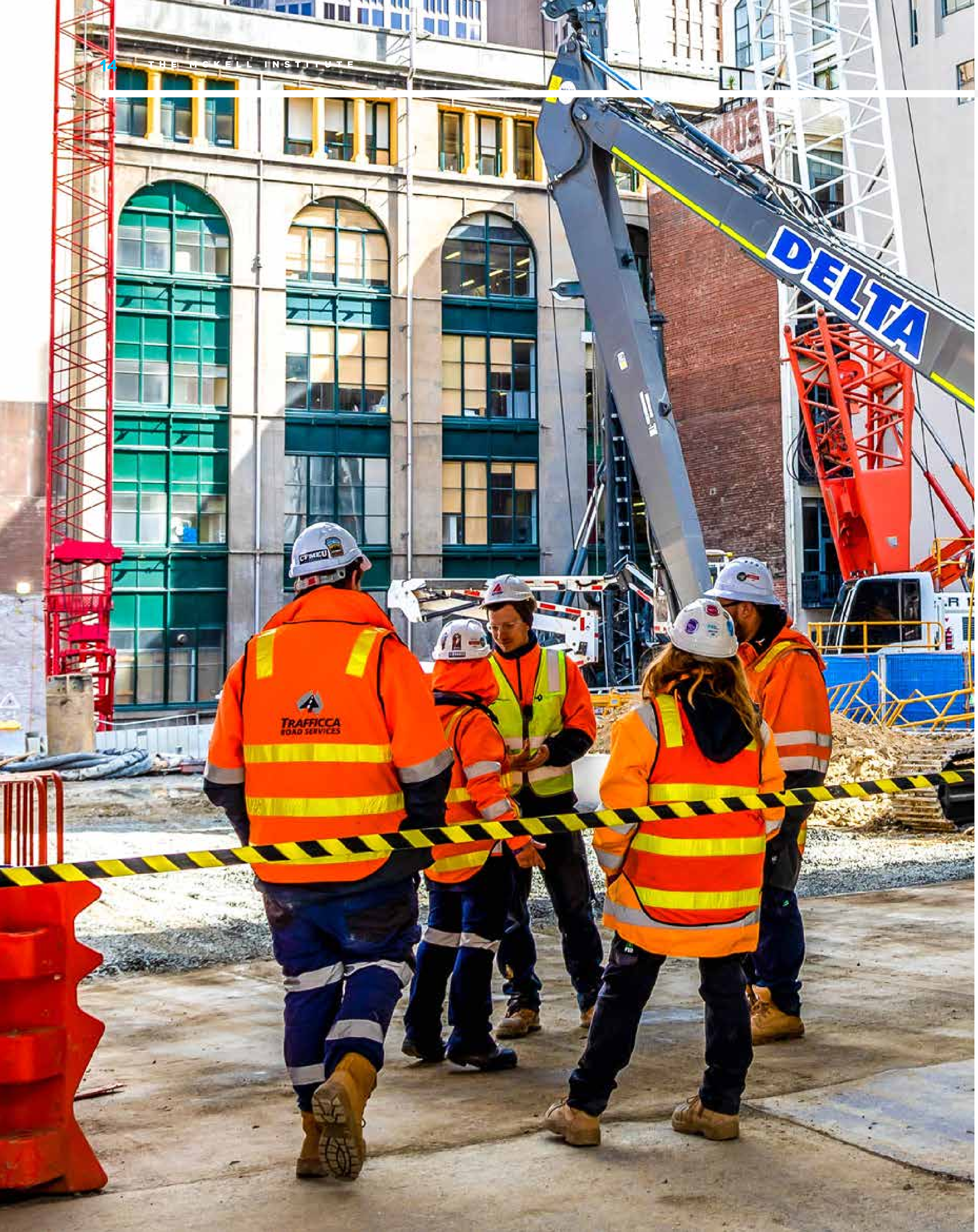
Superannuation is a decentralised form of boosting national savings, which reduces the risks of decision-making by any one entity. This means that Australian enterprises do not have to be as reliant on overseas borrowing, which can reduce risk at a time of currency volatility. These benefits have also been extended to households by providing access to asset classes where they would have had relatively small direct holdings.

Australia's superannuation system has also played a significant role in disrupting the traditional channels for financial services, making the market more contestable. But this disruption along with the many benefits identified and described within this report were destabilised when the decision was made to forgo a 12 per cent rise in the Superannuation Guarantee in 2014. Freezing increases to the Superannuation Guarantee has already costs workers millions in higher retirement balances. And with talks of another freeze in 2021 – which could be permanent – would strip workers of an adequate retirement and harm the broader economy.

Had we stuck to the rise in 2014, the efficiency and performance of Australia's superannuation system would not only have more scale, but workers would have reached higher balances sooner and accrue greater benefit earlier. Ensuring that the push to 12 per cent moves forward would increase the superannuation savings of millions of Australians to ensure dignity in retirement while boosting the national pool of capital required to generate jobs and economic growth.

This report outlines the evidence that universal superannuation has benefitted and will continue to benefit all Australians. It does so by collating the wide variety of research that has been undertaken detailing the various benefits of Australia's superannuation system. This report also updates that work and provides detail on further ways in which universal superannuation has benefitted and will continue to benefit Australians and the Australian economy.

It also provides confirmation of the large benefits to Australians and the Australian economy from increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent, keeping the default selection process in the industrial relations system, and safeguarding the compulsory nature of the Superannuation Guarantee.



PART ONE: ENHANCING FINANCIAL STABILITY AND LONG-TERM ECONOMIC GROWTH

Superannuation boosts Australia's national saving

The amount of national saving has important implications for the Australian economy; it provides a source of funds available for domestic investment, which in turn is a key driver of labour productivity and higher future standards of living.

The Treasury estimated that the boost to national saving from the introduction and increases in the Superannuation Guarantee was about 1.5 per cent of GDP as of 2011, up from around 0.5 per cent of GDP in 1992.[1] If the Superannuation Guarantee rose from 9 per cent to 12 per cent by 2019-20, as initially planned, the estimated contribution of superannuation to national saving would have been more than 2.0 per cent of GDP today, rising to roughly 3.0 per cent by 2040.[2]

However, opponents to increases to the Superannuation Guarantee have doubts about the magnitude of the effect on national saving, and if there is an impact on national saving of any kind. If the introduction and increases in the Superannuation Guarantee results mainly in switching saving from one vehicle to another there may not be an increase in overall individual saving.

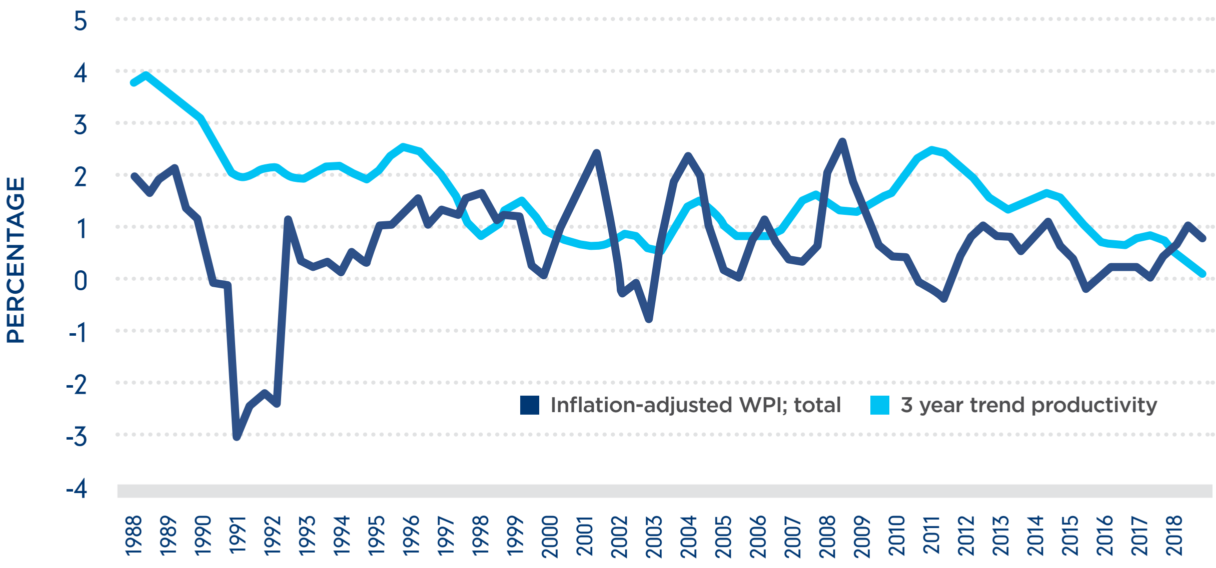
With limited empirical literature on the estimated impact of the superannuation on national saving, there are at least four good reasons to take the view that the superannuation system in Australia contributes to national saving:

1. The design of the phase-in of employer contributions to superannuation should ensure that existing real wages are not lowered so that existing saving can continue;
2. The historical low financial saving among Australian households means that they have had restricted capacity to offset superannuation saving by reducing other financial saving;
3. The design of the policy means that superannuation is a poor substitute for other forms of saving; and
4. Most economists believe or estimate that savings offset for superannuation is between 30 per cent and 50 per cent.

These are discussed in more detail in the following pages.

THE PHASE-IN OF THE MINIMUM EMPLOYER CONTRIBUTION RATE HAS BEEN DESIGNED NOT TO DECREASE REAL WAGES

FIGURE 2 INFLATION-ADJUSTED WAGES GROWTH AND TREND LABOUR PRODUCTIVITY GROWTH



Source: *ABS.*

The Superannuation Guarantee has been effectively phased in at an average rate of 0.5 per cent per increase. This is well below estimates of average labour productivity growth, measured as GDP per hour worked, of roughly 1.55 per cent since 1998 (Figure 2). If nominal wages growth was consistent with inflationary expectations and workers received their share of productivity gains, average real wage rises could be 1.00 to 1.50 per cent per annum.

In our research paper, *'Does higher superannuation come out of workers' wages?'*, we argued that there was scant empirical evidence of a causal relationship between superannuation increases and low wages growth to support the assumption of a one-for-one trade-off between superannuation and wages.[3] If we assume conservatively that the superannuation-wage elasticity of all workers to be less than -0.50, increasing the Superannuation Guarantee by 0.5 percentage points would divert 0.25 percentage points from real wages growth to superannuation. This still leaves scope for real wage rises. As long as real wages do not fall below 0.25 per cent, workers should be able to afford the same standard of living and attain higher balances at retirement when the Superannuation Guarantee increases from 9.5 per cent to 12 per cent over the period 2021 to 2025.

Increases in the Superannuation Guarantee minimum employer contribution rate have also been implemented in the context of a wage rise – so existing financial savings would not necessarily fall from a further increase in the Superannuation Guarantee. Given that roughly two-thirds (62.5 per cent) of Australian workers are covered by award or enterprise bargaining agreements, it is quite reasonable to expect that increases in the Superannuation Guarantee will reflect productivity rather than a drop in real value of take-home pay.

LOW EXISTING FINANCIAL SAVINGS AMONG AUSTRALIANS

Since most Australians have very little financial assets outside superannuation, they have little capacity to offset superannuation saving by reducing other financial saving. Indeed, historical low financial saving among low-income Australian households means that they have had restricted capacity to offset superannuation saving by reducing other financial saving (Table 1). Because superannuation assets cannot be borrowed against, holding superannuation assets do not increase the borrowing capacity of Australian households.

TABLE 1 INFLATION-ADJUSTED WAGES GROWTH AND TREND LABOUR PRODUCTIVITY GROWTH

QUINTILE	TOTAL FINANCIAL ASSETS, EXCLUDING SUPERANNUATION	VALUE OF SUPERANNUATION FUNDS	TOTAL NON-FINANCIAL ASSETS, EXCLUDING TOTAL PROPERTY ASSETS	VALUE OF TOTAL PROPERTY ASSETS
Lowest	$7,400	$17,200	$25,600	$18,100
Second	$30,600	$75,500	$65,500	$213,500
Third	$51,900	$122,900	$91,300	$512,100
Fourth	$124,700	$216,100	$119,600	$802,900
Highest	$855,200	$646,600	$185,200	$1,854,000

Source: *ABS.*

As shown in Table 1, predominant form of saving for most Australians is the family home. However, given the resistance of Australians to home equity conversions, only what is held in financial assets would be likely to generate a retirement income outside of superannuation. In the absence of the Superannuation Guarantee, most Australians would likely need a full rate pension.

SUPERANNUATION IS A POOR SUBSTITUTE FOR OTHER FORMS OF SAVING

Superannuation is a poor substitute for other forms of saving because a fixed amount is put into people's superannuation accounts and because withdrawal of superannuation is heavily regulated. Controlled entry, preservation until age 60 (people born after 1 July 1964), and very limited circumstances of access before retirement (mainly related to specific medical conditions or severe financial hardship) mean that capital stays in the system and that abuse of tax concessions by funds movers is limited.

ESTIMATES OF THE SAVING OFFSET BY ECONOMISTS

The extent to which the superannuation boost national saving depends on the extent to which money saved in the system is offset by reductions in other forms of saving and by the cost of tax concessions.

For low-income earners, credit constraints imply limited capacity to reduce other forms of saving in response to increases in the Superannuation Guarantee – which suggests that the offset is likely to be small for these people.

For high-income earners, credit constraints are less binding and reductions in other forms of saving from a rise in the Superannuation Guarantee seem entirely plausible.

However, there are also a series of behavioural factors that impact saving, such as hyperbolic discounting – tendency to choose smaller short-term gain over a larger long-term gain – and loss aversion biases – tendency to view less money in the short-term as a greater loss than equivalent gains in the long-term.

There have been a few attempts to estimate the extent to which other forms of private saving are reduced in response to the Superannuation Guarantee.

Philip Gallagher of the Treasury made assumptions in RIMGROUP model based on a review of previous studies, such as by FitzGerald and Harper and Covick and Higgs.[4] Gallagher suggested a private saving offset between 30 per cent to 50 per cent.[5] Put differently, net private saving increases 50 cents to 70 cents per dollar of superannuation.

Perhaps the most compelling of these estimates, based on an analysis of microeconomic survey data from the Household Income and Labour Dynamics in Australia (HILDA) survey, is by Ellis Connolly of the Reserve Bank of Australia (RBA) who estimated a private savings offset between 10 per cent and 30 per cent.[6] That is to say, net private saving increases 70 cents to 90 cents per dollar of superannuation.

The household saving ratio has been less than 5 per cent since 2017, and currently sits at 2.6 per cent as of June 2019. If workers were paid employer contributions to superannuation as increased wages, it is hard to imagine more than 30 per cent of the increase in take home pay being saved for retirement in the form of financial assets.

Subject to some caveats, the increases in private saving should translate over the medium-term to an increase in national saving.

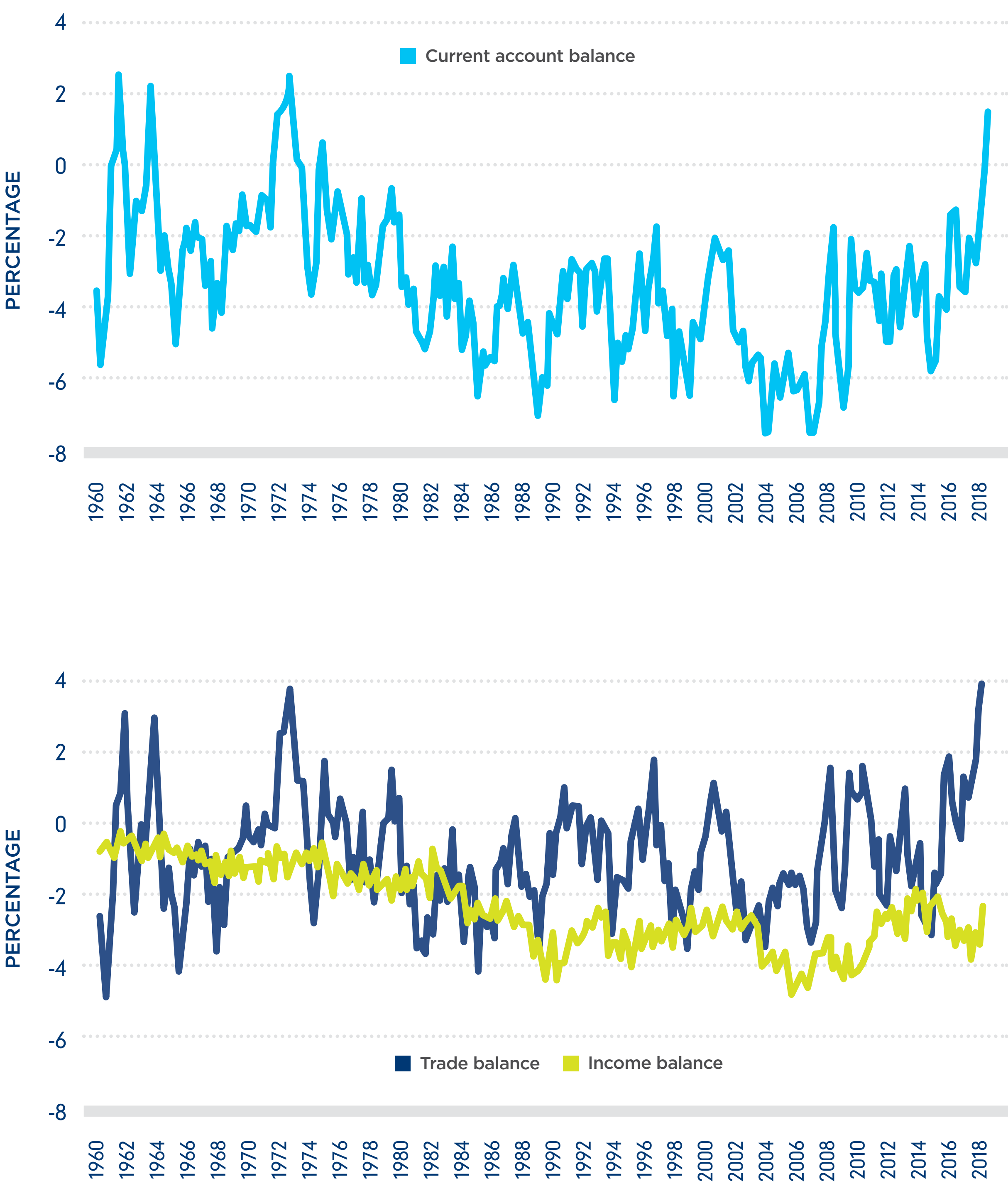
Part of the increase in private saving comes from the government, because of the concessional taxation of superannuation. The government forgoes tax revenue that otherwise would have been collected had the Superannuation Guarantee been paid as wages to employees or remained with companies as additional profits. For the increase in private saving to translate to the same increase in national saving requires that the shortfall to tax revenue from the Superannuation Guarantee be offset by raising public saving rather than cutting public investment. It also requires that making up the shortfall elsewhere in the budget does not lead to lower private saving in other financial assets. These budget savings are primarily from lower age pension payments.

Superannuation funds reduce Australia's reliance on foreign sources of finance

For much of its modern history, Australia has been a net importer of capital. Because there are a lot of profitable investment opportunities in Australia relative to the size of the Australian savings pool, it has sourced capital from elsewhere around the world either in the form of debt or equity. This is not because savings in Australia is particularly low; its saving rate exceeds that of the United States, Canada, and the United Kingdom.[7] Rather, it is because the share of investment in the Australian economy is higher than that in many other advanced economies, as foreign investors see Australia as a relatively safe and attractive place to invest with good long-term capital gains.

The counterpart to Australia being a net importer of capital is that the country runs a current account deficit (Figure 3). For three decades, the current account averaged a deficit around 4 per cent of GDP. But since 2015, the current account had narrowed to a deficit around 1 per cent of GDP. As of June 2019, the current account posted its first surplus in 44 years, of $7.5 billion, or 1.5 per cent of nominal GDP.

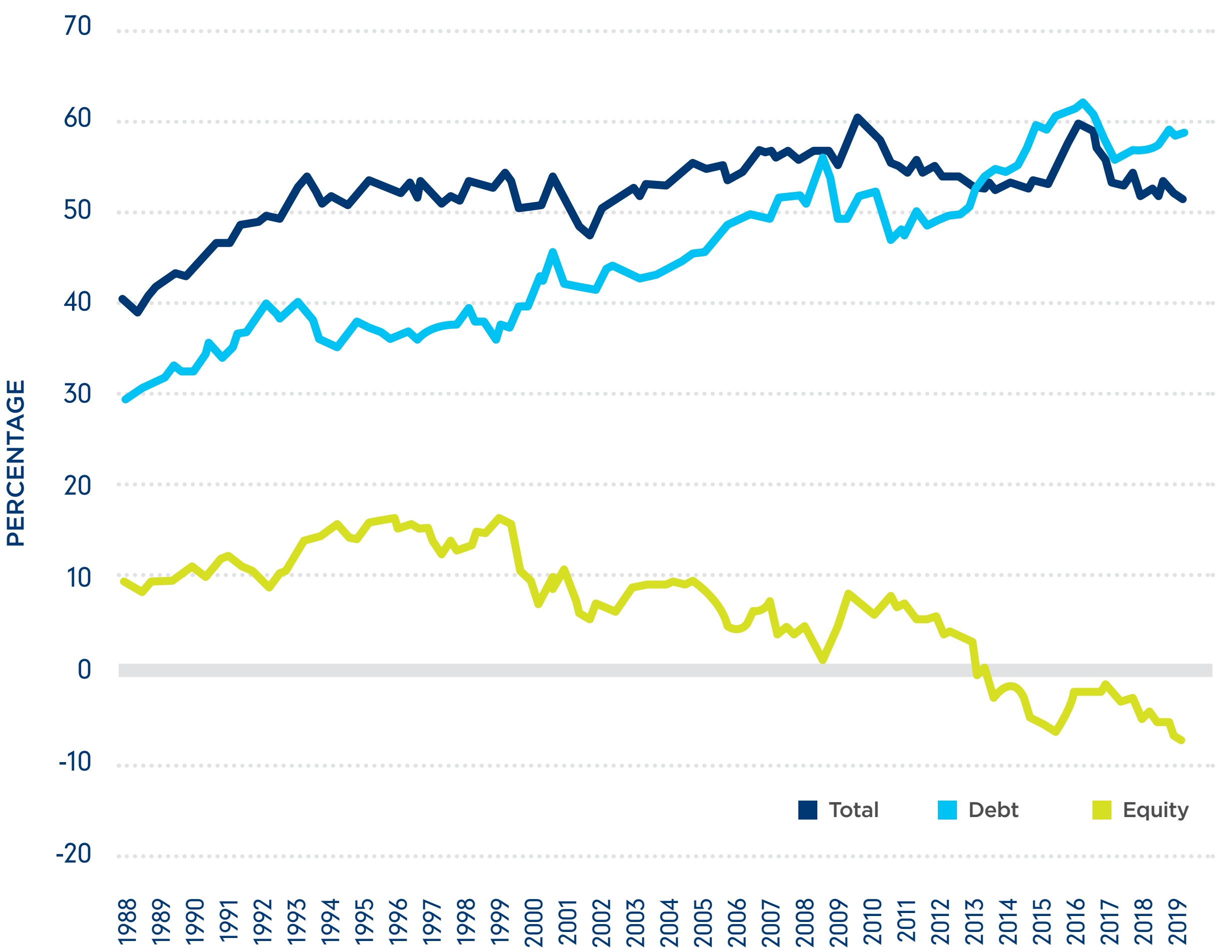
FIGURE 3 CURRENT ACCOUNT BALANCE, PER CENT OF NOMINAL GDP



Source: *ABS, Authors' calculations.*

Each quarter that Australia finances its current account with borrowing from, or lending to the rest of the world, it will add to, or deduct from the stock of net foreign liabilities it owes to the rest of the world. As Australia ran current account deficits through the 1970s, 1980s, 1990s and 2000s, the stock of net foreign liabilities grew, peaking roughly 60 per cent of GDP in 2009.

FIGURE 4 NET FOREIGN LIABILITIES, BY TYPE, PER CENT OF GDP



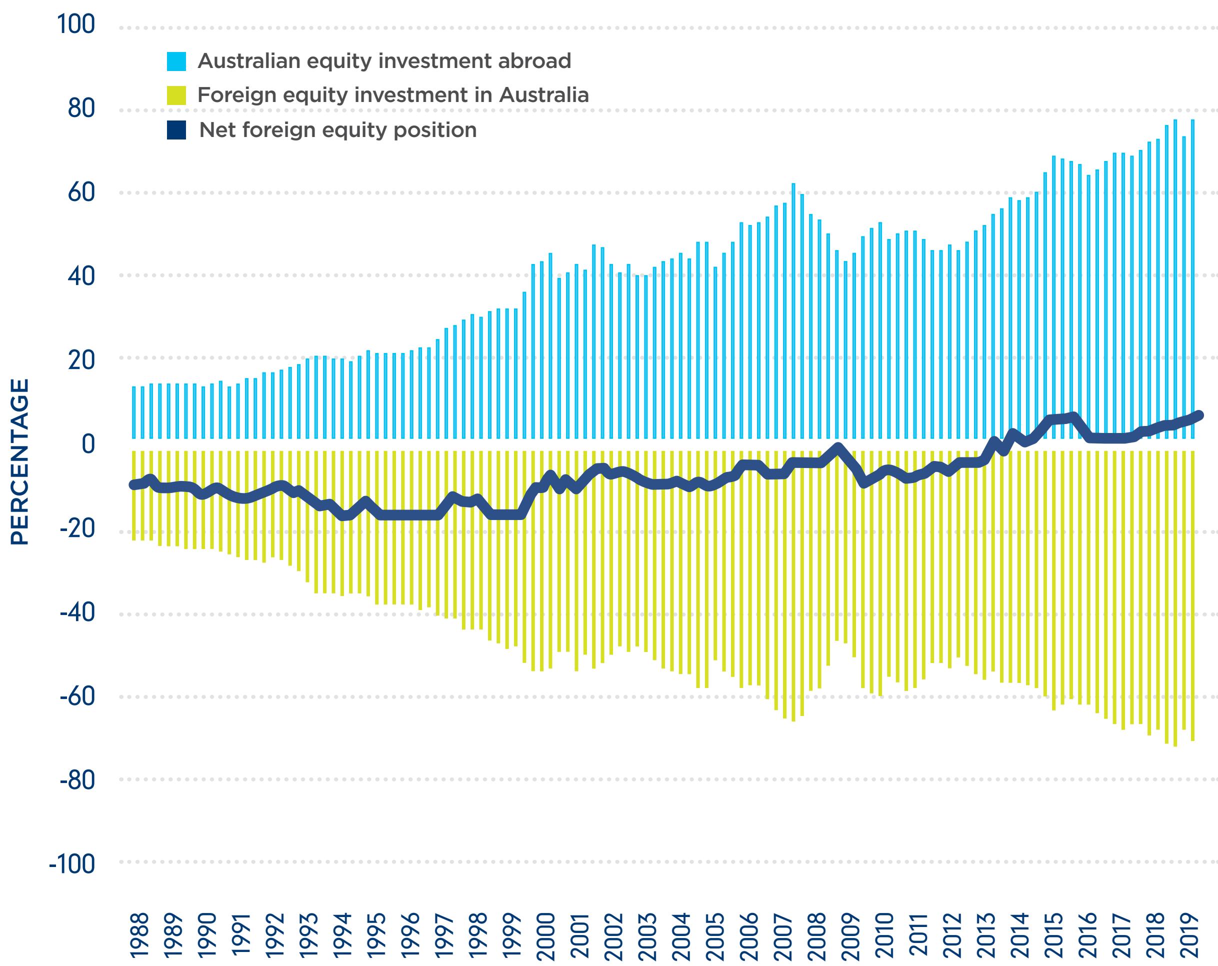
Source: *ABS, Authors' calculations.*

But since then, reflecting the shift of the current account from deficit to surplus and correspondingly lower net capital inflows, the stock of Australia's net foreign liabilities (as a share of GDP) has declined over the past decade to be roughly 50 per cent of GDP (Figure 4). The decline in the net foreign liabilities as a share of GDP masks some significant changes in the composition of both the gross foreign liabilities and gross foreign assets, including a shift in the net equity position.

For much of its modern history, foreigners have owned more equity in Australian companies than Australians have owned in foreign companies. That is, the country has had a net foreign equity liabilities position, averaging 10 per cent of GDP between 1990 and 2010. But since 2013, Australians have owned more foreign equity than foreigners have owned Australian equity (Figure 5).

This has put the country in a net foreign equity asset position, and largely reflects the significant allocation to foreign equity by the Australian superannuation industry together with the fact that the superannuation sector is relatively large as a share of the Australian economy. As of June 2019, 24.4 per cent of assets held by Australian Prudential Regulation Authority (APRA)-regulated superannuation funds were allocated to international shares, valuing $448 billion, or 23 per cent of GDP.[8] The ongoing accumulation of both Australian and foreign equities by Australia's large superannuation sector has also partially offset continued equity inflows to Australia from foreign investors. With more than $1,838 billion, or roughly 94 per cent of GDP in total assets in APRA-regulated superannuation funds as of June 2019, Australian superannuation funds have the scale to compete with large foreign investors both at home and abroad.[9]

FIGURE 5 GROSS EQUITY POSITIONS, PER CENT OF GDP



Source: *ABS, Authors' calculations.*

The shift to a net foreign equity asset position also reflects asset valuation effects, as foreign equities have outperformed Australian equities over the past decade. Since 2010, the Australian Securities Exchange (ASX) All Ordinaries Index, which is made up of the share prices for 500 of the largest companies listed on the ASX, has had an average annual return of less than 5 per cent. In comparison, the S&P 500, which measures the stock performance of 500 of the largest companies on stock exchanges in the United States, has had an average annual return of 12 per cent.

The shift also reflects the depreciation of the Australian dollar over this period. The Australian dollar has seen historic lows in the exchange rate when compared to the U.S. dollar. At the peak in the last 10 years one Australian dollar bought $1.10 U.S. dollars. The Australian dollar has depreciated significantly since then and now sits at less than 70 U.S. cents. Because Australian equity investment abroad are predominantly denominated in foreign currency, the value of Australian equity investment abroad in Australian dollar terms increases when the Australian dollar depreciates. But the value of foreign equity investment in Australia, which are denominated in Australian dollars, does not change. However, foreign investors may take advantage of a depreciating Australian dollar by increasing investment in Australia, especially by speculators who may be expecting a rise in the value of the Australian dollar in the future.

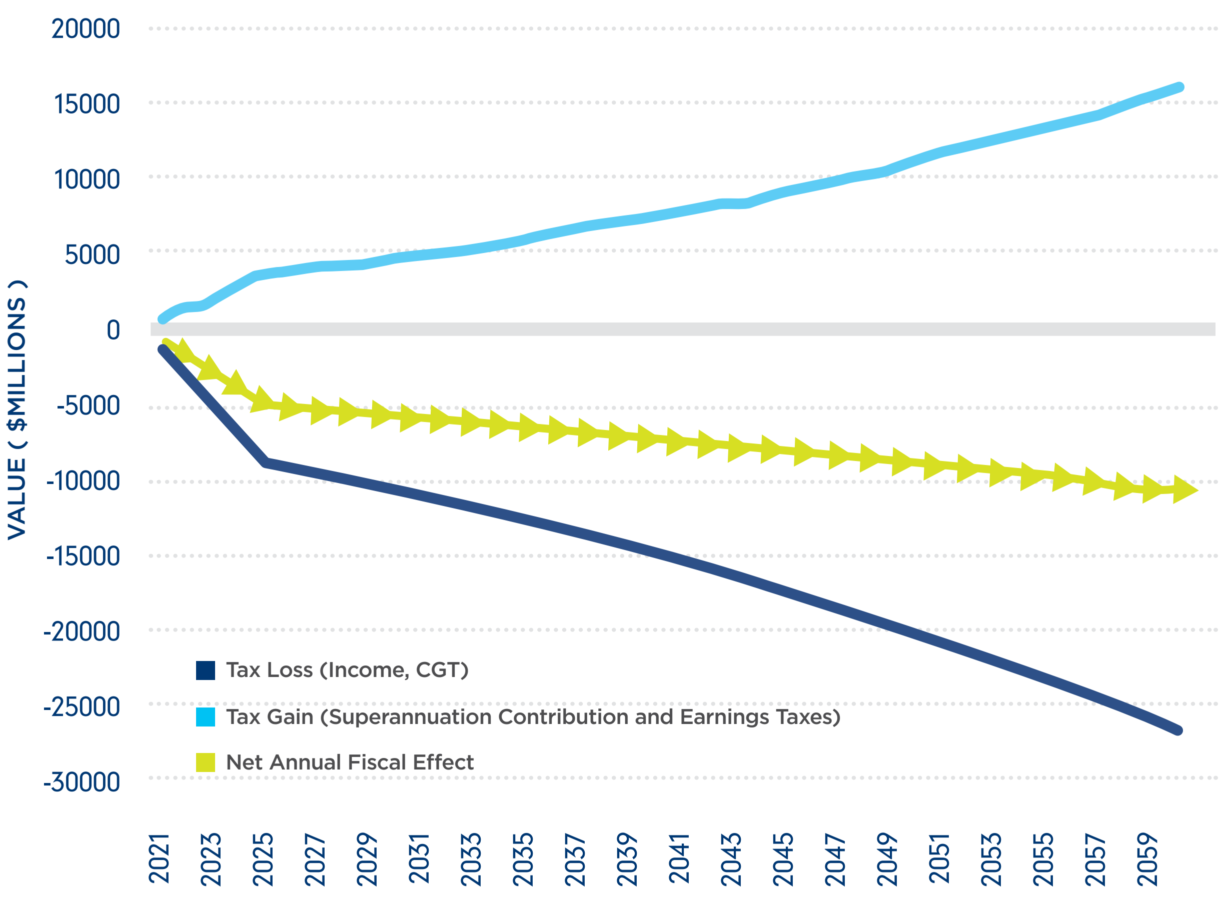
Superannuation has a positive fiscal effect on the federal budget in the long-term

The Treasury's Tax Benchmarks and Variations Statement, which outlines tax expenditures, is often used to claim that the Superannuation Guarantee is a burden on the federal budget. In 2018-19, the estimated tax expenditures were $19,550 million for concessional taxation of superannuation entity earnings and $17,750 million for concessional taxation of employer superannuation contributions.[10]

Tax expenditures are estimated as the expected difference in revenue between the existing tax treatment and the benchmark tax treatment. In the context of superannuation, this effectively means estimating the difference between the tax paid on superannuation contributions and earnings, and the tax that would have been paid if contributions and earnings were taxed as personal income.

FIGURE 6

EFFECT OF INCREASING SUPERANNUATION GUARANTEE FROM 9.5 PER CENT TO 12 PER CENT ON GOVERNMENT REVENUE, SUPERANNUATION-WAGE ELASTICITY -1.00, $ MILLION



***Source:** Authors' calculations.*

Employer contributions to superannuation are generally taxed at 15 per cent,[i] compared to a marginal income tax rate, if it were paid as wages, of between 19 per cent and 45 per cent. Additionally, superannuation earnings are generally taxed at 10 per cent, compared to a capital gains tax (CGT) between 9.5 per cent and 22.5 per cent for individuals.[ii]

Based on the Treasury's assumptions, it is estimated that increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent over the period 2021 and 2025 will cost the government roughly $288,480 million over the period 2021 and 2060, averaging a cost of $7,212 million per financial year over the long-term (Figure 6).[iii]

However, estimating the tax collected under the superannuation concessional regime with the tax that would be paid if the income were taxed at an individual's marginal rate of personal income tax is based on the assumption that there is a complete and immediate trade-off between employer contributions to workers' superannuation and their wages. This assumption is not supported by economic theory or empirical evidence, and should be rejected.[11]

In our research paper, *'Does higher superannuation come out of workers' wages?'*, we argued that there was scant empirical evidence of a causal relationship between superannuation increases and low wage growth to support the assumption of a one-for-one trade-off between superannuation and wages.[12]

Given our findings, if the Superannuation Guarantee was not introduced in 1992, it is difficult to imagine a scenario where workers' salaries and wages would be 9.5 per cent higher today than otherwise, which is the underlying assumption among estimates that suggest that the superannuation is a burden on the budget. Indeed, we note in passing that the very weak wages growth experienced over the past few years coincided with a freeze on the planned increase in the Superannuation Guarantee. If there were indeed a trade-off, surely wages growth would have been higher during a period of stable employer superannuation contributions.

A more likely explanation, supported by economic theory, is that employers have responded on multiple fronts to the introduction of, and the subsequent increases to, the Superannuation Guarantee.

Some employers may have responded to the Superannuation Guarantee by passing on the added labour costs in the form of higher prices. Indeed, in a purely competitive economy, where all firms are experiencing the same increases in labour costs, economic theory predicts a share of the labour cost increases will be passed through to consumers.

In cases where the Superannuation Guarantee is passed through to consumers, employer contributions to workers' superannuation would be a valuable source of net government revenue; the higher taxable employer superannuation contributions provide tax of 15 per cent (and superannuation earnings tax to a maximum of 15 per cent over the accumulation period), in addition to a goods and service tax (GST) rate of 10 per cent on the added value of taxable goods, services and other items sold or consumed in Australia. Employer income taxes would remain unaffected, as would tax from salary and wages.

Alternatively, some employers may have absorbed a share of the extra costs from the introduction of the Superannuation Guarantee and subsequent increases by accepting lower profits. The gap between productivity and a typical workers' compensation has increased dramatically since the mid-1990s.[13] Industries with high productivity-pay gaps may be able to pay for workers' superannuation without lowering their wages. They would have the gains in productivity to draw on for more resources.

i Low income earners (earnings below $37,000 per annum) are effectively refunded the tax on their contributions through the low income superannuation tax offset (LISTO). Contributions on behalf of high-income earners (earnings of $250,00 and over per annum) are taxed at 30 per cent.

ii Superannuation earnings are taxed at a 15 per cent, compared to capital gains which are taxed at the marginal rate for individual taxpayers and between 27.5 per cent and 30 per cent for companies. If an asset is held for at least 1 year, then any gain is discounted by 50 per cent for individual taxpayers, or by 33.3 per cent for superannuation funds. The 50 per cent CGT discount is not available to companies except for small businesses (business entity with an aggregated turnover of less than 2 million).

iii Modelling assumptions and methodology can be found in Appendix One.

If we assume, conservatively, that the superannuation-wage elasticity of all workers to be -0.50; that is, half of the increases in the Superannuation Guarantee came out of workers' wages and the other half came out of company profits, the estimated tax expenditures for concessional taxation of employer superannuation contributions would be significantly lower. This would reflect the difference in the benchmark when measured as a mixture of the corporate tax rate and the marginal rate of personal income tax compared to being measured as fully the marginal income tax rate, which would be higher. Based on Australian Taxation Office (ATO) data for the 2016-17 income year (latest available data), the estimated weighted average marginal rate of personal income tax is 37.5 per cent for individuals whereas the weighted average rate of corporate tax is 29.2 per cent for companies.

Additionally, the estimated tax expenditures for concessional taxation of employer superannuation contributions would be lower when measured as a mixture of the corporate tax rate and the marginal rate of personal income tax because a share of employees work for an employer who did not pay tax in any single financial year. Based on ATO data for the 2016-17 income year (latest available data), approximately 30 per cent of employees worked for an employer who did not pay tax, and the forgone profit that would have gone towards employers' contributions to workers' superannuation would not be enough to change the taxable status of these companies.

In the Treasury's forgone revenue estimates, there is also a need to measure the income tax that would have otherwise been paid on investment income which requires some assumptions of where people would otherwise have invested their savings. The Treasury's estimates show the tax expenditure based solely on the difference in tax treatment between superannuation earnings and the benchmark treatment, without the allowance for any behavioural responses. However, the treatment of investment income under this counterfactual scenario is inherently problematic.

The forgone revenue estimates do not make allowances for the fact that people would minimise their tax by making use of trusts or by investing in negatively geared assets or owner-occupied housing. Companies would also minimise their tax by making use of company tax structures, exemptions and concessions, such as research and development expenditure, or avoid paying tax entirely by relocating profits offshore to lower-taxed foreign jurisdictions.

Alternative savings vehicles are much less generous than superannuation, which would have incentivised people to save in the first place. Indeed, behavioural factors such as hyperbolic discounting and loss aversion biases influence peoples' behaviour on whether they would substitute superannuation with other forms of saving.

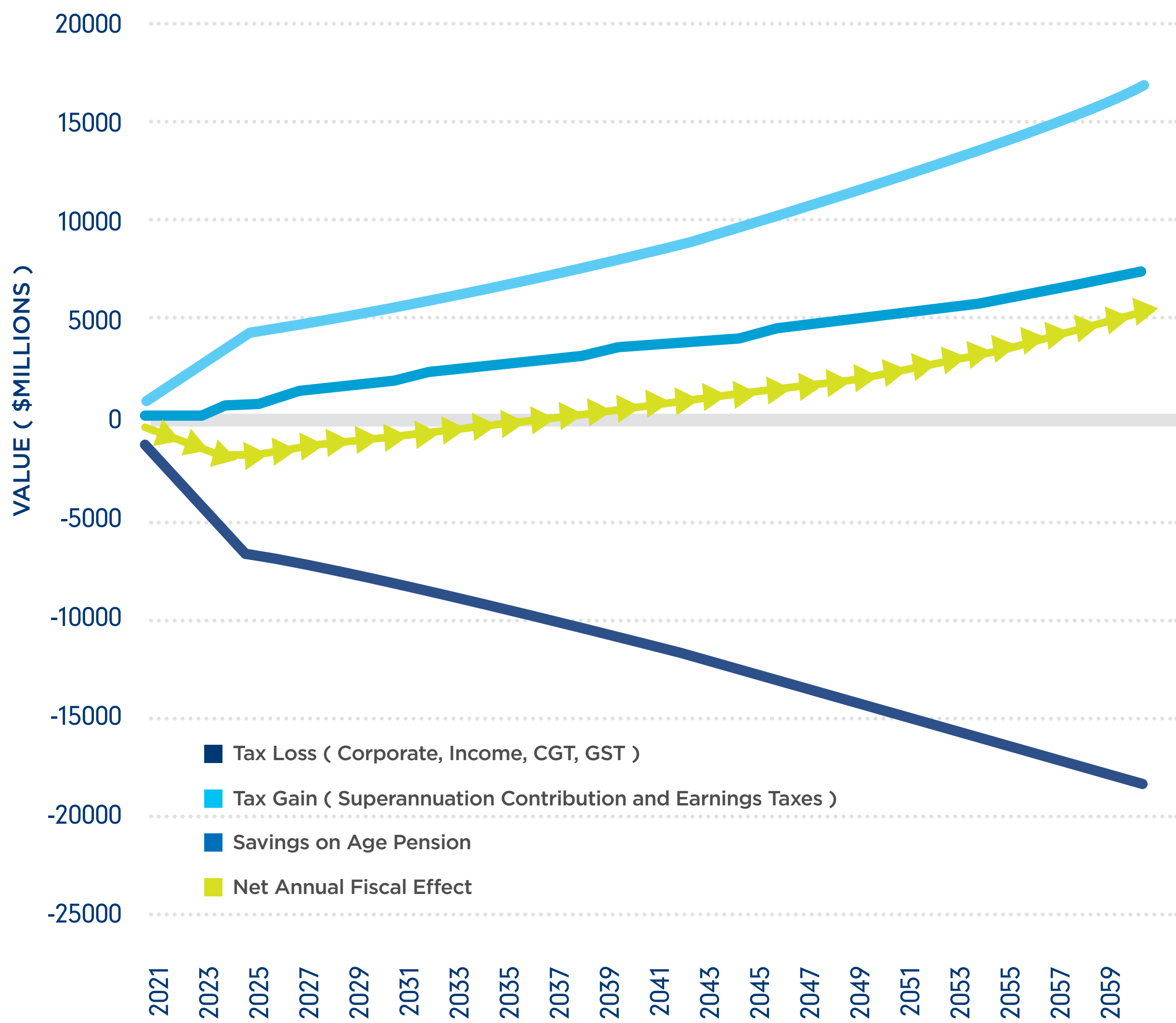
Additionally, when people's disposable income increases, they tend to consume more. The Reserve Bank of Australia (RBA) estimates that the marginal propensity to consume for Australian disposable incomes is 0.54.[14] This consumption would not be applicable to CGT at the marginal rate for individual taxpayers but almost certainly Goods and Services Tax (GST) at a lower rate of 10 per cent in any financial year.

The Treasury's tax expenditure estimates for concessional taxation of superannuation entity earnings are also based on the assumption that the rate of earnings on assets is the same whether taxed in superannuation or under the benchmark tax treatment. However, most Australians – if they substitute superannuation with other forms of saving – invest in cash deposits, Australian listed equities, or housing, which have average annual returns lower than average annual returns on superannuation earnings over the long-term. Furthermore, assets like housing are generally exempt from CGT.

Finally, superannuation savings is expected to increase the savings of people in retirement, resulting in reduced outlays on the Age Pension. This expenditure saving is not recognised in the estimates of the superannuation tax expenditures.

FIGURE 7

EFFECT OF INCREASING SUPERANNUATION GUARANTEE FROM 9.5 PER CENT TO 12 PER CENT ON GOVERNMENT REVENUE, SUPERANNUATION-WAGE ELASTICITY -0.50, $ MILLION



Source: *Authors' calculations.*

Based on the above mentioned assumptions, It is estimated that increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent over the period 2021 and 2025 will save the government roughly $34,306 million over the period 2021 and 2060, averaging a gain of $857 million per financial year over the long-term (Figure 7).[iv] By 2038, the net budgetary cost of superannuation tax concessions would be positive, meaning that the gains in superannuation contribution and earnings taxes and savings on the age pension will exceed the costs of the superannuation tax concessions.

iv Modelling assumptions and methodology can be found in Appendix Two.

Superannuation supports Australia's infrastructure needs

The infrastructure requirements of Australia are growing. To a large extent, this has to do with economic and population growth and a general underinvestment in the past

For example, population growth impacts are being felt in fast-growing cities as infrastructure is placed under pressure, including congestion on Australian roads and crowding on public transport. Australia's population is projected to reach between 28.3 million and 29.3 million by the year 2027 from 24.6 million as of 2017.[15] Additionally, the proportion of Australians living in capital cities is projected to increase to between 69 per cent and 70 per cent by the year 2027, up from 67 per cent as of 2017.[16]

The level of investment in infrastructure needed to meet anticipated demand cannot be financed by traditional sources of public finance alone. Failure to make significant progress towards bridging the infrastructure gap in Australia could prove costly in terms of slower economic growth and loss of international competitiveness. Australia currently ranks 18th in the world for ease of doing business, having dropped over the past decade from 9th in 2008.[17] Economic infrastructure, such as utilities, transportation and communication networks, drive competitiveness and support economic growth by increasing labour productivity, reducing business costs, diversifying means of production and creating jobs.

Australian superannuation funds have played a significant role in funding Australia's increasingly pressing infrastructure needs, and that role will only increase in the future. The long-term investment horizon of superannuation funds makes them natural investors in less liquid, long-term assets such as infrastructure. As of June 2019, 5.6 per cent of assets held by APRA-regulated superannuation funds were allocated to infrastructure investments, valuing $104 billion, or 5.3 per cent of GDP.[18]

If the Superannuation Guarantee rises from its current 9.5 per cent to 12 per cent by 2025, It is projected that the value of assets in the superannuation system could rise to $5,075 billion by 2030.[19] If the proportion of assets invested in infrastructure remained at roughly 5 per cent on average this suggests that there will be over $254 billion in assets dedicated to infrastructure development by the year 2030.

Superannuation increases capital's focus on long-term sustainable returns

It is well known that superannuation funds adopt longer term investing strategies than other types of investors. This is because the investment goal of superannuation funds is to maximise value far beyond the time of a members' retirement age, not the day-to-day return on assets.[20] Furthermore, they must achieve this across multiple generations of members, existing and future. The reliable flow of funds this creates via the Superannuation Guarantee, and through default arrangements, provides a steady stream of capital-seeking investment opportunities and has provided a source of demand for equities issued by companies.

A consequence of this is that superannuation funds, being invested in a company over the long-term, are more concerned with environmental, social and governance (ESG) factors than other types of investors, ensuring that funds are maximising members' long-term returns while mitigating negative externalities.

There are a number of reasons why superannuation funds are incorporating ESG factors in their investment strategy. First, companies may face public backlash, even when operating within the existing legal framework, as standards and laws may take time to catch up with public sentiment.

Second, capital stocks of a company are long-term assets, as most of the value is from cash flows that occur in the distant future. Such long-term cash flow forecasting is difficult to predict and can be affected by sudden changes in consumer preferences, standards and laws.

Finally, many superannuation funds as well as members have ethical considerations about investments. Superannuation funds want to ensure their members that the assets they acquire are compliant with human rights, labour rights, corruption and environmental laws, and more than this, that they are compliant with their own internal benchmarks for what is responsible investing.

Another consequence is that investing strategies of superannuation funds can act counter-cyclically to movements in equities prices, and thereby reducing volatility in the equities market. This is because long-term investors can afford to absorb short-term price fluctuations.

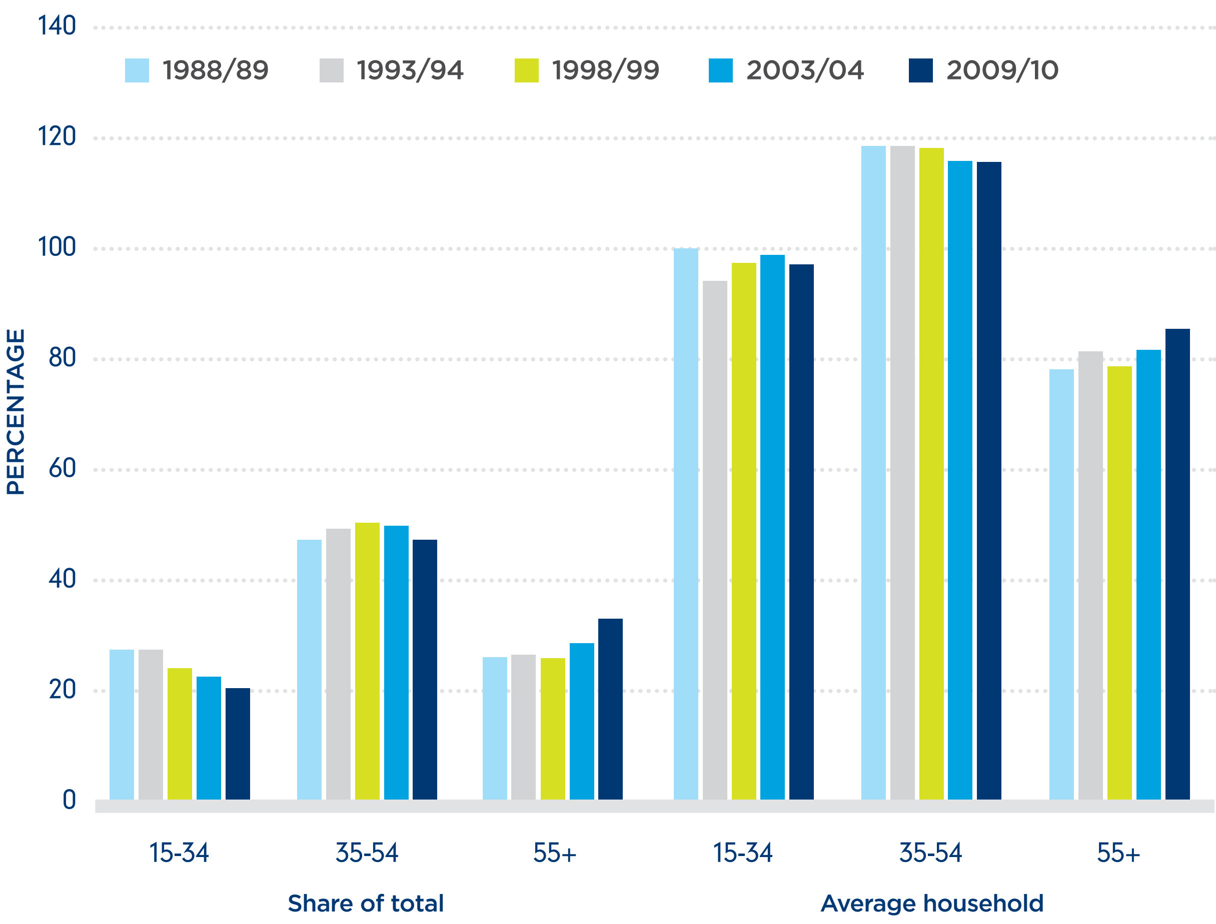
Superannuation funds comfort with counter-cyclical investing strategies can help stabilise financial markets by providing liquidity at critical times, such as during an economic recession.

The current default fund process has played an important role in ensuring that members' best interests are represented in long-term investment decisions and strategies, balancing the interests of incoming, ongoing and outgoing members. The Commonwealth Government should ensure that any changes to the current default system do not reduce the long-term investment focus of superannuation funds, as it will dilute the contribution that superannuation can, and should, be making towards productive capital and sustainable returns by creating liquidity uncertainty.

Superannuation offsets ageing population effects on economic growth

Australia's ageing population could have a significant impact on economic growth, particularly on aggregate demand. Aggregate demand refers to the total level of spending in the economy, which includes household spending, investment by business and households, spending by the government, and net spending from overseas. Data on lifetime earnings, consumption and saving show that income, consumption and saving tend to rise during an individual's initial working years, peaks in the mid-to-later working years, and declines in the years leading up to retirement.[21] As a larger proportion of the ageing population falls into the older age categories, the level of consumption would be expected to fall with it. Consumption accounts for more than half of GDP so a declining level of consumption would generate a sharp fall in economic growth over the long-term.

FIGURE 8 HOUSEHOLD CONSUMPTION; BY AGE OF HOUSEHOLD REFERENCE PERSON



Source: *RBA.*

Universal superannuation contributes to economic growth in two ways. First, when wealth increases, Australian households consume more.[22] Data on household spending show that older households (those aged 55 years and above) now spend more, compared with the average household, than older household did two decades ago (Figure 8).[23] This trend reflects the growing importance of superannuation for older households. It has been estimated that an extra dollar in workers' superannuation balances adds between 70 and 90 cents to household wealth.[24] As workers' superannuation rises, it will increase their overall wealth and fuel consumption in retirement, which would otherwise be at lower levels without universal superannuation.

Second, universal superannuation has had an impact within the Australian economy through superannuation funds investing directly in real assets, such as property and infrastructure projects, and an indirect impact through investing in the Australian share market. As household superannuation assets rise, investment from superannuation funds increase the economy's capacity to produce goods and services. This includes constructing roads and other physical infrastructure, as well as undertaking research and development that can lead to innovation, increased productivity and boost the competitive advantage of Australian businesses.

Superannuation helps counter the boom-bust cycles' adverse effects on the Australian economy

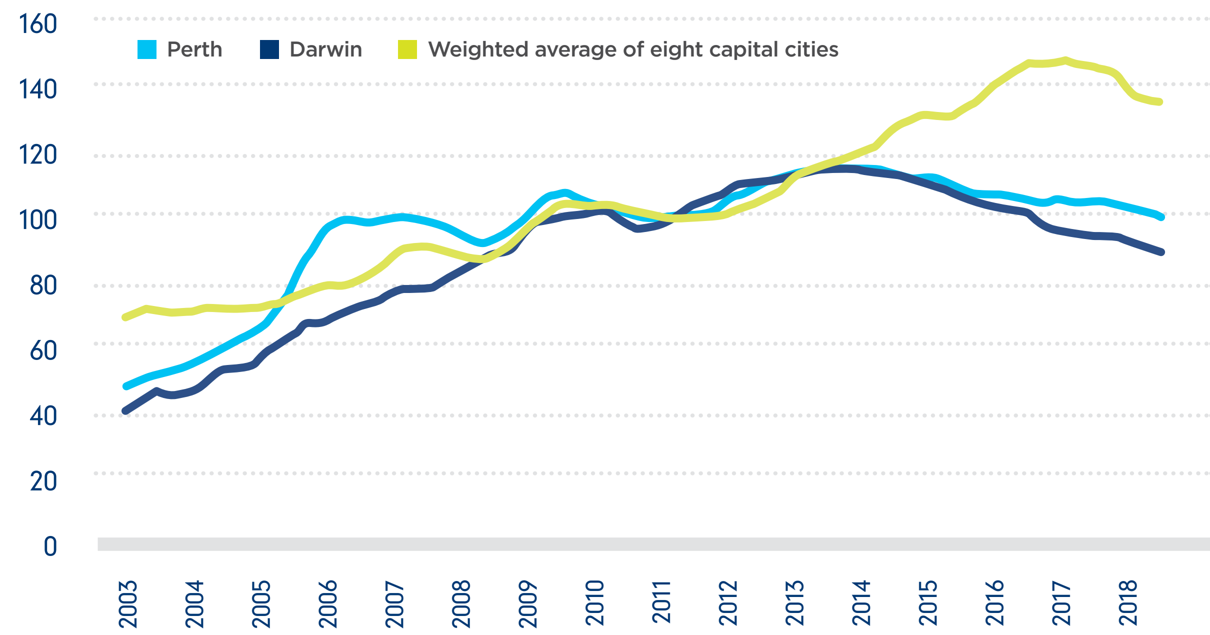
With unusually high incomes from rising commodity prices, booms typically involve a surge in consumption and other spending by direct and undirect workers, particularly a rise in demand for housing in resource-rich communities, such as in Western Australia, Queensland, and Northern Territory, as well as in fly-in fly-out capital cities, such as Darwin and Perth.

Booms are also followed by a decline in trade-exposed sectors, such as agriculture and manufacturing. This is caused by a large inflow of foreign currency into the economy from resources sales to foreigners. The inflow of foreign money into the Australian economy causes the exchange rate to appreciate or inflate, making exports less competitive. Also, labour and capital move into the booming sector, often the oil or mining sectors, from other sectors, further harming trade-exposed sectors' competitiveness. Consumers may also be harmed by a rise of prices in non-tradable goods and services, such as in construction.

The unusually high incomes experienced by workers in the resources industries sector combined with a rise of prices in non-tradable goods and services, such as in construction materials to build additional housing to meet the surge in demand, pushed housing costs higher in these affected communities because supply could not keep up with demand.

When the mining boom ended in 2014, interstate and overseas migration fell as employment in the resources industries fell, reducing demand for housing and rental properties which resulted in falling prices as supply exceeded demand (Figure 9).

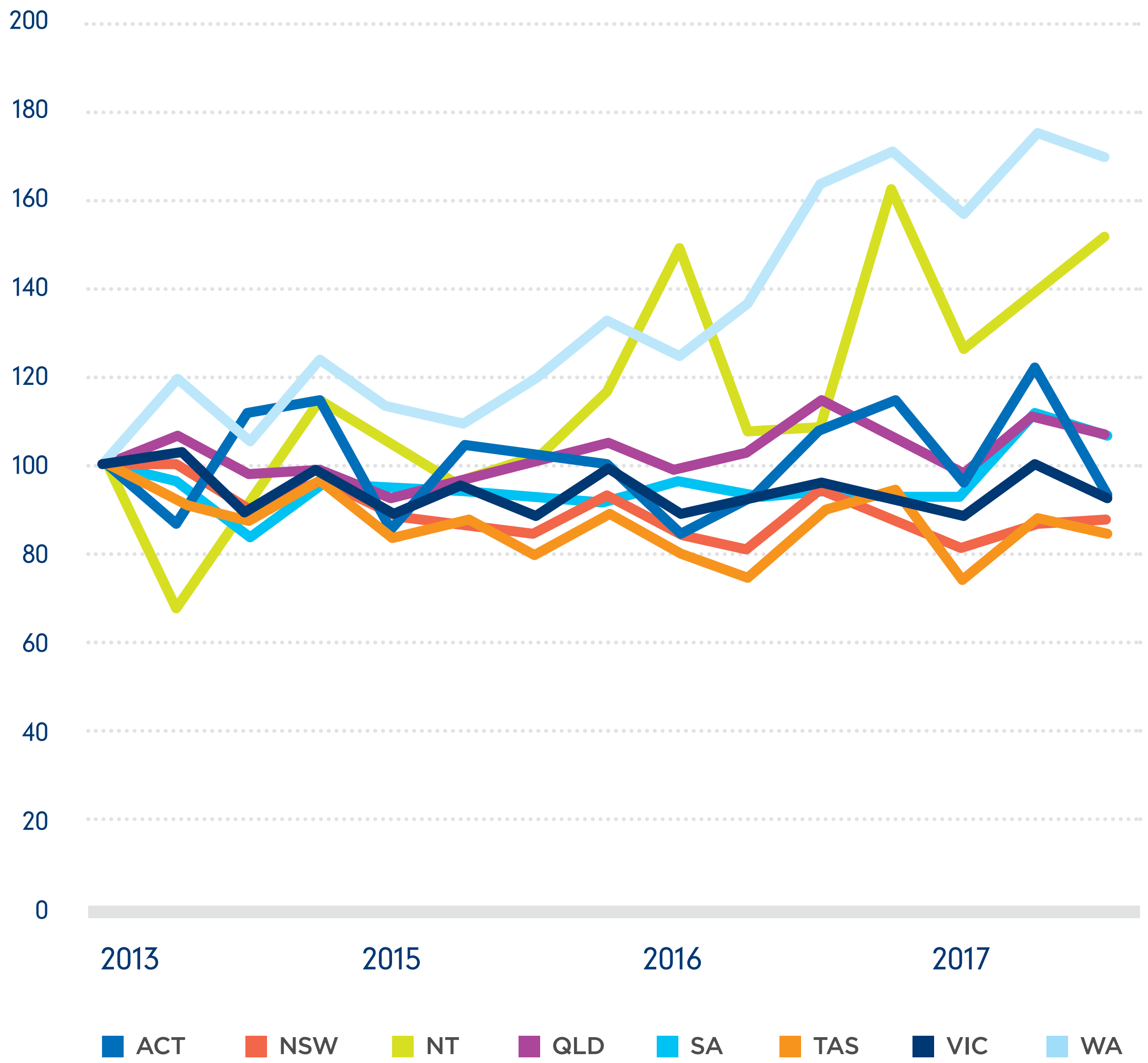
FIGURE 9 INDEXED RESIDENTIAL PROPERTY PRICES, AUSTRALIAN CAPITAL CITIES (2011-12 = 100)



Source: *ABS.*

The inherently cyclical nature of the resources industries leaves employees exiting those industries without sufficiently transferable skills to be readily accepted into adequate employment in other industries at comparable ‘boom’ incomes. The effects of a bust on consumption and other spending from unemployment and lower-paid employment can be devastating for Australians and local business. For example, Australian workers impacted by a bust could be at risk of having a mortgage that is not only unserviceable from loss of employment or underemployment, but workers could find themselves in negative equity.

FIGURE 10 INDEXED PERSONAL INSOLVENCY GROWTH, AUSTRALIAN STATES (2013 = 100)



Source: *RBA.*

The number of business- and non-business-related insolvencies in Northern Territory and Western Australia grew roughly 52 per cent and 69 per cent, respectively, over the period 2013 and 2017 (Figure 10). In comparison, insolvencies fell in every other state except South Australia and Queensland, which grew roughly 6 per cent and 5 per cent, respectively, over the period 2013 and 2017.

Without universal superannuation in place, this cyclicality would have been even more pronounced with more income hitting the economy during the boom than being saved and built into a savings pool for when workers reach retirement.

There are three main ways in which superannuation mitigates adverse effects posed by the boom-bust cycles of Australia’s resources industries. First, the Superannuation Guarantee ensures that a growing share of unusually high incomes is saved for longer-term benefit rather than being used for current consumption. The unusually high incomes experienced by workers in the resources industries sector is considered likely to be temporary and subject to greater than normal risks. Therefore, a rise in saving helps smooth consumption over time. Similarly, without the Superannuation Guarantee in place, the pro-cyclicality of boom-bust cycles would be even more pronounced as wages and local profits would be recycled back into the economy in lieu of superannuation, pushing prices up further.

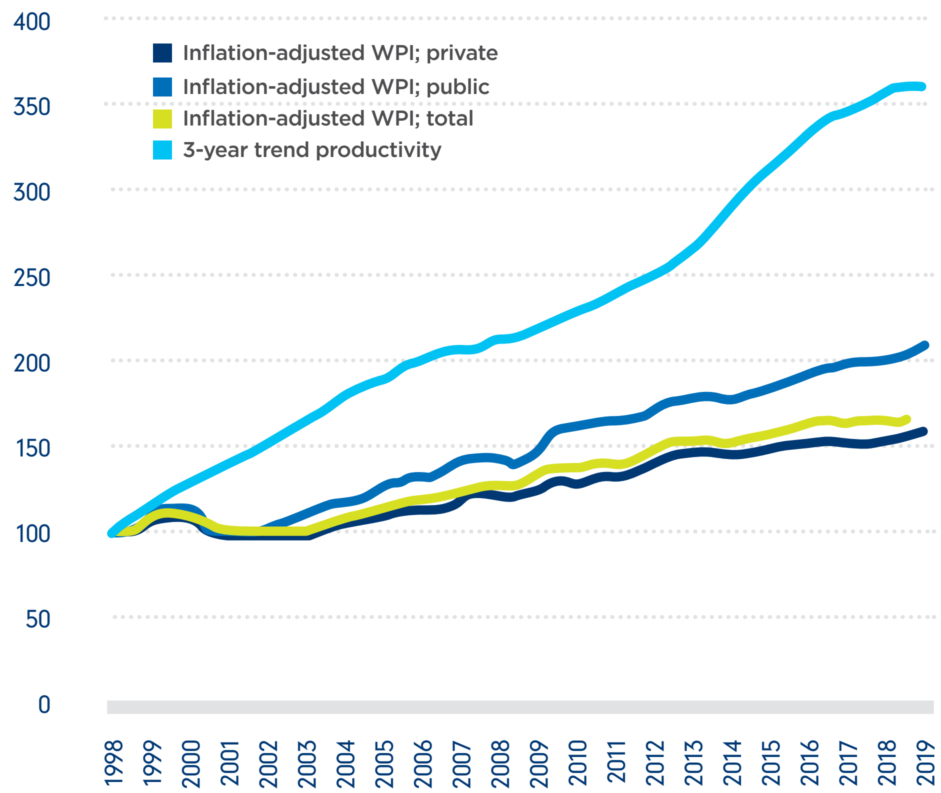
Second, increased investment in superannuation through incremental increases in the Superannuation Guarantee have helped to diversify household balance sheets, which in turn would have mitigated the damage from a bubble in the property markets of resource-rich communities. Australians tend to have a high allocation of wealth in non-financial assets, which leaves them prone to negative shocks from a boom-bust cycle. This impact is further mitigated by reducing the weighting of domestic assets in the direct investments of Australian households. Australian household direct investments are almost entirely domestic, while in contrast, more than one-third of Australian superannuation assets are invested overseas. This leads us to our third and final point.

Much like a sovereign wealth fund, superannuation funds themselves ease pressure on trade-exposed sectors by dampening the appreciation of the exchange rate arising from the boom, in particular, by investing in foreign assets. By investing member’s money in foreign assets, superannuation funds can help mitigate the adverse effects of appreciating exchange rates. Approximately one-third of superannuation assets are invested overseas in fixed income and equities, as well as international property and infrastructure. These are asset classes where households have relatively small direct holdings outside superannuation. Without superannuation, investors would hold more domestic assets, meaning that the global portfolio share of assets denominated in Australian dollars would be higher than otherwise, risking a further appreciation of the dollar during a boom.

PART TWO:
INCREASING FINANCIAL INDEPENDENCE FOR MORE AUSTRALIANS

Superannuation helps Australian workers fairly benefit from the wealth they help create

FIGURE 11
INDEXED INFLATION-ADJUSTED WAGES GROWTH AND TREND LABOUR PRODUCTIVITY GROWTH (1998 = 100)



Source: *ABS.*

The gap between productivity and a typical workers' compensation has increased dramatically since the mid-1990s (Figure 11). Real wages have grown an average of 0.64 per cent per annum since 1998. This is roughly 0.91 percentage points lower than three-year trend productivity growth of 1.55 per cent per annum over the same period. This means that workers are currently receiving only a small share of the wealth that they help create.

Superannuation provides employees with recognition as stakeholders who are due a share of the productivity gains paid out when profits rise. As of June 2019, 22.4 per cent of assets held by APRA-regulated superannuation funds were allocated to Australian listed equity, valuing $411 billion, or 21 per cent of GDP.[25] This is equivalent to roughly one-fifth of the market value of every company listed on the ASX.

Investing workers' capital in the businesses where they work is an important mechanism to ensure that workers' interests are represented regarding investment decisions. In an age of excessive short-termism and declining private investment, superannuation provides a durable means to ensure long-term corporate prosperity.

Economic inequality cannot be solved through wage increases alone; the gaps in individual wealth are too large. Along with other ways to build assets, a clear way to rebalance wealth in the Australian economy is for employees to have a share of the wealth in the businesses where they work via superannuation.

Superannuation expands workers' benefits by adapting to a changing work environment

Prior to the introduction of award superannuation in 1986, and subsequently the Superannuation Guarantee in 1992, superannuation was concentrated among professional managers and administrators, public sector employees, and employees in the financial sector.[26] The lack of transferability of superannuation before the Superannuation Guarantee created a serious obstacle to labour mobility, as it would disincentive a worker from switching employers.[27] This is because most superannuation assets were located in defined benefit accounts.[28]

Defined benefit superannuation accounts often did not allow a worker who changes employers as much retirement income as a worker who did not change employers because of the way such plans determine benefits. Define benefit plans use predetermined formulas to calculate retirement benefits and are generally based on salary and years of service with the employer sponsoring the plan.

A step towards more portability of superannuation assets was made in 1992 with the introduction of the Superannuation Guarantee. As a defined contribution scheme, Superannuation Guarantee allows employees to retain funds in their superannuation account from their previous employer, commence work with a different employer, and have their new employer's contributions to their superannuation balance to be made in the same account.

Universal superannuation enhances the retirement incomes and well-being of retirees in an increasingly insecure work environment. Globalisation, technological progress and demographic change are having a profound impact on society and labour markets. And in the face of such change in the job environment, staying competitive means adapting to that change.

In 1975, the average employment tenure for an Australian worker aged 45 years and over was approximately ten years compared to approximately seven years today.[29] In contrast, the average employment tenure for Australian workers aged 25 and under was approximately two years in 1975 and remains unchanged today.[30]

In an era where job opportunity matters more than job security and where flexibility and mobility mater more than stability and company loyalty, universal superannuation allows older workers to adapt to the forthcoming changes in the labour market without forgoing their retirement incomes that would have otherwise been impacted under a superannuation system with limited access and pension portability.

As superannuation funds grow, they increase value for money for members

The fees charged by superannuation funds remains a hotly debated issue in Australia. There are still inefficiencies in unnecessary multiple accounts, subscale funds that struggle to deliver value, and underperforming superannuation products. However, overall, the superannuation sector is continuing to improve its offer to members by improving services and benefits and increasing returns while reducing its headline fee rates.

As a percentage of assets under management, the reported fees members pay have fallen from 1.3 per cent in 2008 to 1.1 per cent in 2017.[31] This downward trend is apparent across most of the superannuation system, but is most evident in retail funds, where average administrations fees have fallen significantly. The decline in retail segment fees may partly be due to the MySuper reforms, which led to many retail funds moving their default members to lower-fee MySuper products.[32] It could also be a competitive response to members leaving retail funds to non-for-profit industry funds or to open self-managed superannuation funds. By contrast, average fees charged by not-for-profit industry funds have been largely flat over time but remain well below the fees charged in the retail sector.

A commonly investigated factor sought to explain the reduction in fees charged by superannuation funds is the size of the fund's assets under management. A number of studies show that a significantly negative relationship exists between the size of Australian superannuation funds and administration and investment expenses of those funds. The inverse relationship between size of funds and expenses paid by funds is consistent with the notion of economies of scale, in that smaller funds are required to increase fees to cover fixed costs that would have otherwise been spread across larger funds under management. Bateman and Mitchell, Sy, Higgs and Worthington, Basu and Andrews, and Cummings show that scale economies exist amongst Australian superannuation funds.[33]

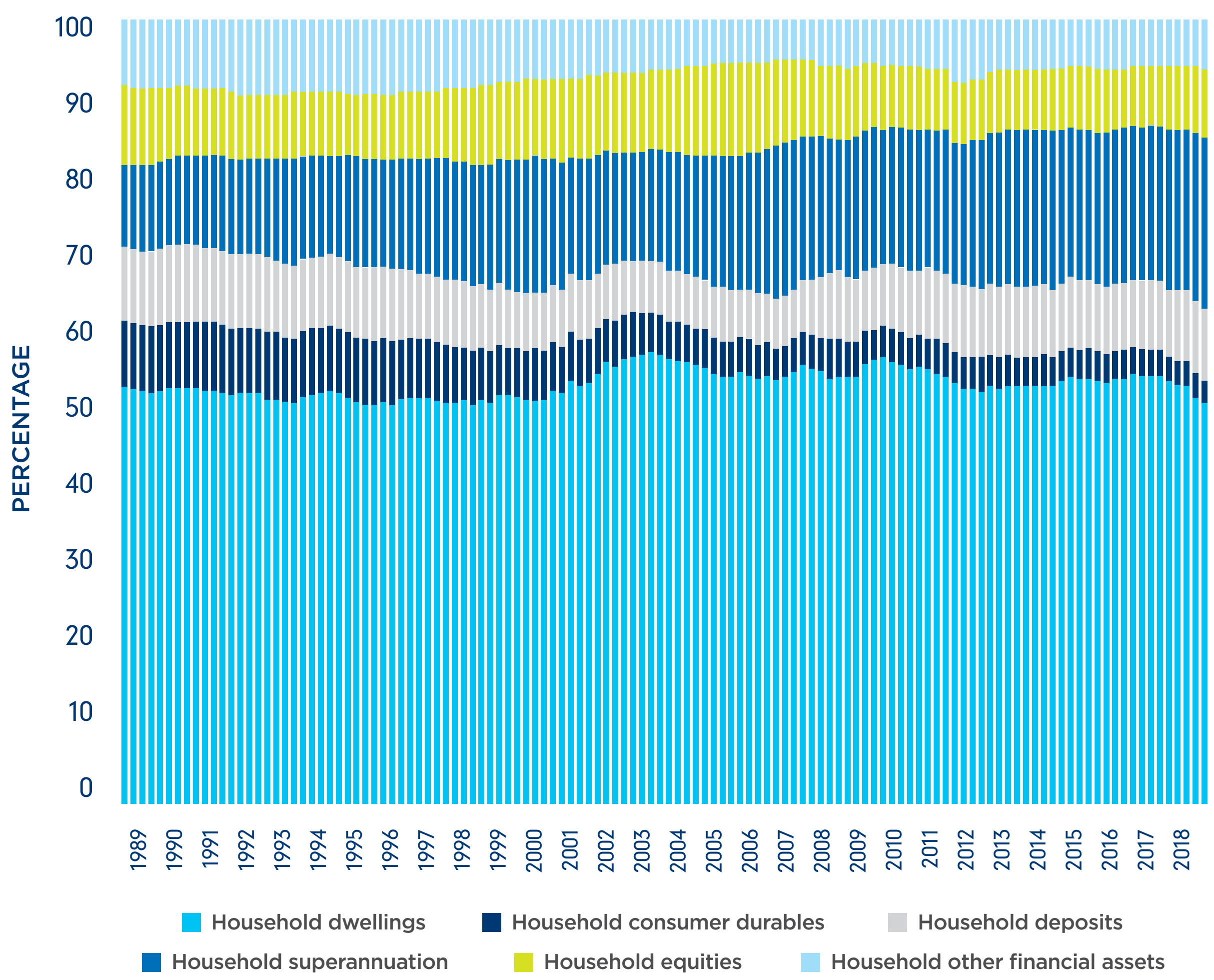
Productivity Commission analysis also reveals that significant economies of scale have been realised in the superannuation system over the last decade, particularly for administration expenses.[34] However, there is little evidence that these cost savings have been systematically passed through to members in the form of lower fees. Scale benefits may have been passed through in the form of member services or increases in reserves or offset by the costs of meeting new regulatory requirements.

Scale benefits may have also been realised through increasing returns to scale. The Productivity Commission found that net returns are positively correlated to size in the not-for-profit industry funds.[35] Stronger net returns among larger not-for-profit industry funds might be due to higher exposure to unlisted asset classes.

Based on the above-mentioned evidence, we would expect that members would benefit in some form of pass through of economies of scale when the Superannuation Guarantee increases from 9.5 per cent to 12 per cent over the period 2021 and 2025. With an increase in assets under management, the ability of superannuation funds to negotiate lower investments fees for large mandates, and the spreading of operational costs across a large amount of assets and members, could lead to lower fees and protect against future fee increases while still maintaining current high levels of service, especially in an increasingly competitive market and from merger activity. Members may also benefit in the form of additional or improved member services and by funds investing in more long-term asset classes to obtain higher returns for members.

Superannuation reduces exposure to financial shocks by diversifying Australian household assets

FIGURE 12 HOUSEHOLD ASSET COMPOSITION, PER CENT



Source: *ABS,RBA.*

The strong growth in superannuation has facilitated a broadening of the range of assets held by Australian household (Figure 12). In June 2019 roughly 54.35 per cent of Australian household assets were held in housing and consumer durables, compared to 61.71 per cent of assets in June 1989. Over the same period, Australian household assets held in superannuation grew from 10.63 per cent to 21.70 per cent. Superannuation, as of June 2019, represented 47.53 per cent of total financial assets held by Australian households, up from 27.76 per cent in June 1989.

In contrast, the majority of household's superannuation was invested in financial assets in June 2019, particularly equity and fixed income (Table 2), asset classes where households have relatively small direct holdings.

TABLE 2 SUPERANNUATION INDUSTRY ASSET ALLOCATION, JUNE 2019

PROPORTION OF INVESTMENTS	JUNE 2019	
Cash	**9.8%**	
Fixed income	**21.6%**	
Australian fixed income		12.7%
International fixed income		8.9%
***of which:* currency hedged**		*58.6%*
Equity	**50.9%**	
Australian listed equity		22.4%
International listed equity		24.4%
***of which:* currency hedged**		*30.9%*
Unlisted equity		4.0%
Property	**8.5%**	
Listed property		3.1%
Unlisted property		5.4%
Infrastructure	**5.6%**	
Listed infrastructure		1.5%
Australian unlisted infrastructure		2.6%
International unlisted infrastructure		1.6%
***of which:* currency hedged**		*62.2%*
Commodities	**0.1%**	
Other	**3.5%**	
of which: hedge funds		*1.7%*
Total investments	**100%**	

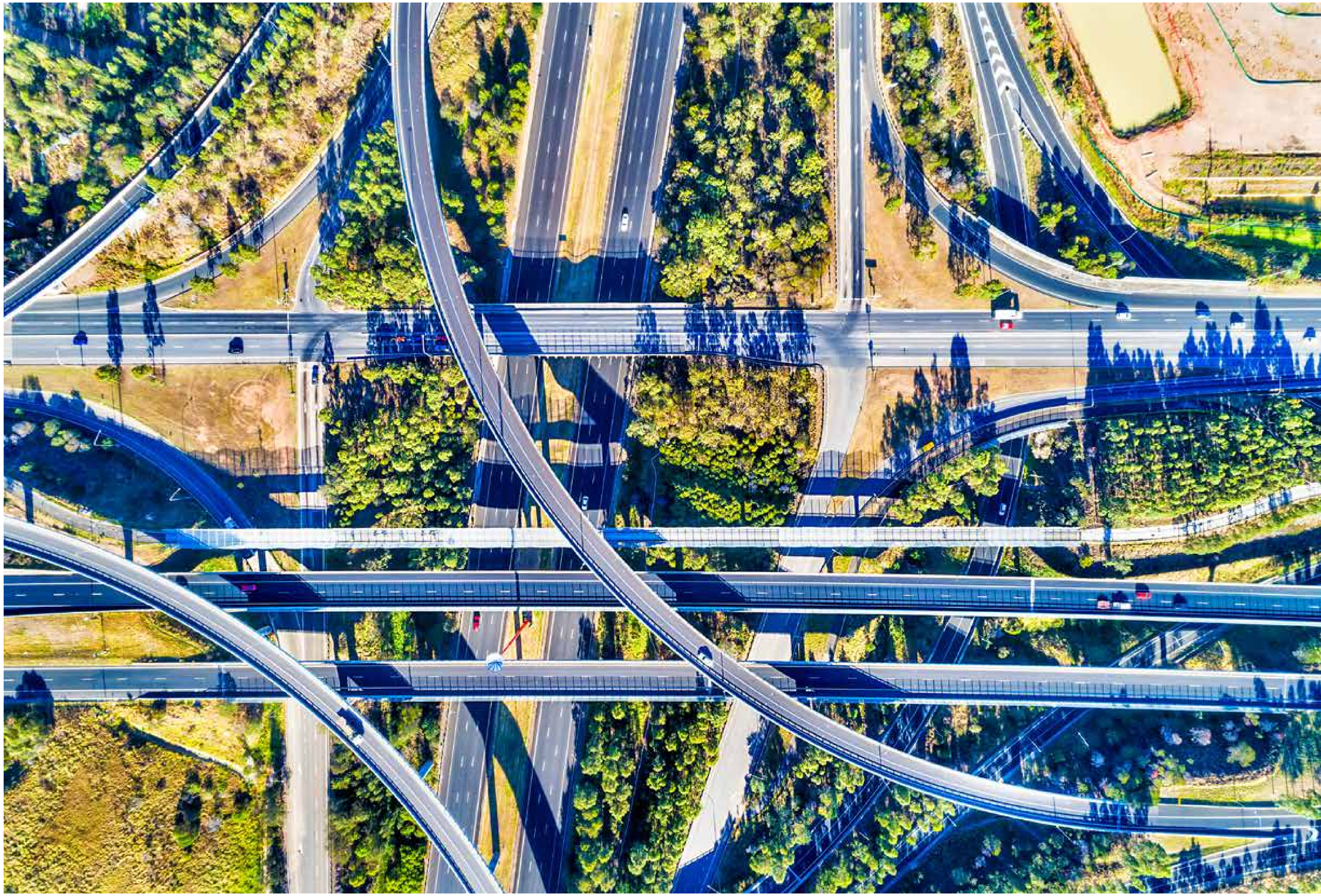
Source: *APRA.*

Increased investment in superannuation may help to diversify the household balance sheet, which in turn may lower the risk of the household asset portfolio. Australian households' high allocation of wealth to non-financial assets may leave them more vulnerable to adverse movements in property prices. As the property market changes, households may reduce the riskiness of their portfolio by investing more in financial assets.

Investing in superannuation also reduces the weighting of domestic assets in the direct investments of Australian households. Australian household direct investments are almost entirely domestic, while in contrast, more than one-third of Australian superannuation assets are invested overseas. This reduces the exposure of Australian households to domestic financial shocks but at the cost of exposure to exogenous exchange rate shocks. However, as shown in Table 2, 58.6 per cent of Australian superannuation assets held in international fixed income, 30.9 per cent of assets held in international listed shares, and 62.2 per cent of assets held in international unlisted infrastructure were currency hedged to minimise or eliminate foreign exchange risk.

CONCLUSION

Given these findings, it is clear that Australia's superannuation system has served and will continue to serve the nation well. Our analysis has built on previous work that confirms that universal superannuation has had a net positive long-term impact on Australia's economy and has improved the income security of Australian workers. However, many of these benefits have not been fully realised as the superannuation system is still relatively immature in the sense that many workers are yet to have made contributions of 9.5 per cent or more over an extended number of years.



Much of the debate around increasing the Superannuation Guarantee from 9.5 per cent to 12 per cent has been based on the assumption that there is a complete and immediate trade-off between minimum employer contributions to workers' superannuation and their wages. This assumption is not supported by economic theory or empirical evidence, and should be treated with appropriate caution.[36] However, this is not to say that there is no trade-off for any workers or at any time.

There could at some point in the future be a trade-off between superannuation and wages when labour costs growth encounters fundamental economic constraints. These include if and when real labour costs growth exceeds labour productivity growth; and if and when consumer price inflations rises to and beyond the targeted range for an extended period of time – similar to the trade-off that occurred when award-reliant superannuation was introduced in 1986.[37] At that point, and not before, it may be practical to discuss trade-offs between increases in the Superannuation Guarantee and workers' wages, and such a trade-off would need to be facilitated through policy discourse, not by the invisible hand of the market.

As far as public opinion goes, the majority of Australians appear to support increasing the Superannuation Guarantee. Of the 1,099 Australians aged 18 years and older surveyed in July 2019 by Industry Super Australia, roughly 87 per cent supported increasing the Superannuation Guarantee, with only 13 per cent saying that it should remain at 9.5 per cent.[38] Of the 87 per cent in favour of increasing the Superannuation Guarantee above its current level of 9.5 per cent, roughly 75 per cent thought that it should be increased to 12 per cent or higher.[39]

The current debate and uncertainty surrounding the legislated increases to the Superannuation Guarantee over the period 2021 and 2025 only serves to undermine confidence in the superannuation system and would deny many a dignified retirement as well as deter long-term economic growth and financial stability.

Even more stressing than the series of delays to the legislated increases in the Superannuation Guarantee is the push to take the compulsory out of the superannuation system, starting with appeals to allow low-income earners to withdrawal their superannuation savings altogether.

Allowing low-income earners to withdrawal their superannuation balances would be a backward step in reducing wealth inequality and would jeopardise the quality of life in retirement for millions of Australians.

Low-income earners may find it difficult to make ends meet. But allowing them to opt out of superannuation would make them even more reliant on the age pension and worsen their standard of living in retirement, or they would have to holdoff retirement altogether.

The ability to provide workers with a dignified retirement is also best realised through an industrial relations system with default funds determined in the Fair Work Commission. Superannuation through industrial defaults has on the whole delivered outcomes for workers, mainly through industry-based superannuation funds.

Moving the default selection process outside the industrial relations system may lead to a drive to short-term investment horizons and a race to the bottom on fees, which has implications of passive investment strategies likely to weaken long-term returns.

Overall, the evidence suggests that moving forward with the scheduled increases to the Superannuation Guarantee from 9.5 per cent to 12 per cent, ensuring that the compulsory nature of superannuation remains intact, and that changes to the current default system process do not dampen long-term sustainable returns is beneficial to the Commonwealth Government, to the broader Australian economy, and to working Australians seeking to retire with dignity.

APPENDIX ONE

MODELLING ASSUMPTIONS AND METHODOLOGY

Cumulative Earnings

We have assumed cumulative earnings for workers is $845 billion in 2019, based on the average cash earnings for all employees in the ABS Employee Earnings and Hours in May 2018 (latest available data from ATO) multiplied by the number of employees in the ABS Labour Force in October 2019 (latest available data from ATO). We have assumed average cash earnings for all employees is 3 per cent higher in 2019 than in 2018, based on wage growth assumptions. We have also assumed working age population growth to be in line with ABS Population projections (Series B).

Trade-off

We have assumed that increasing the Superannuation Guarantee by 0.5 percentage points would divert 0.5 percentage points from wage growth to superannuation.

Income Tax Rate

We have assumed an income tax rate of 37.5 per cent, based on the weighted average of 2016-17 taxpayers' marginal tax rates by percentile. The weight factor is the proportion of net tax by income percentile divided by the sum net tax.

Income Capital Gains Tax (CGT) Rate

We have assumed a CGT rate of 18.75 per cent, based on an assumed income tax rate of 37.5 per cent discounted at 50 per cent.

Superannuation Contribution and Earnings Taxes

We have assumed a superannuation contributions tax of 18.02 per cent and earnings tax of 10 per cent. The superannuation contributions tax of 18.02 per cent is based on the weighted average of superannuation contributions taxes by percentile. This includes earners who would have paid the additional Division 293 tax of 15 per cent for high-income earners as well as low-income earners eligible for the LISTO. The weight factor is the proportion of net tax by income percentile divided by the sum net tax.

Superannuation Returns

We have assumed annual superannuation investment returns of 7.0 per cent before fees and superannuation earnings tax.

Superannuation Fees

We have assumed annual fees of 1.0 per cent.

Alternative Investment Returns

We have assumed annual alternative investment returns of 7.0 per cent before fees and CGT.

Alternative Investment Fees

We have assumed annual fees of 1.0 per cent.

Wages Growth

We have assumed annual wages growth of 3 per cent.

Population Growth

We have assumed population growth for working age population (15 to 66 years) and population 67 years and older to be in line with ABS Population projections (Series B).

Inflation and Discounting Future Values

We have assumed annual inflation of 2.5 per cent. We have used this figure to discount all future values to 2019 dollars.

APPENDIX TWO

MODELLING ASSUMPTIONS AND METHODOLOGY

Cumulative Earnings

We have assumed cumulative earnings for workers is $845 billion in 2019, based on the average cash earnings for all employees in the ABS Employee Earnings and Hours in May 2018 (latest available data from ATO) multiplied by the number of employees in the ABS Labour Force in October 2019 (latest available data from ATO). We have assumed average cash earnings for all employees is 3 per cent higher in 2019 than in 2018, based on wage growth assumptions. We have also assumed working age population growth to be in line with ABS Population projections (Series B).

Trade-off

We have assumed that increasing the Superannuation Guarantee by 0.5 percentage points would divert 0.25 percentage points from wage growth to superannuation.

Effective Income Tax Rate

We have assumed an income tax rate of 28.5 per cent, based on the weighted average of 2016-17 taxpayers' effective tax rates by percentile. The weight factor is the proportion of net tax by income percentile divided by the sum net tax.

Marginal Income Tax Rate

We have assumed an income tax rate of 37.5 per cent, based on the weighted average of 2016-17 taxpayers' marginal tax rates by percentile. The weight factor is the proportion of net tax by income percentile divided by the sum net tax.

Income Capital Gains Tax (CGT) Rate

We have assumed a CGT rate of 18.75 per cent, based on an assumed income tax rate of 37.5 per cent discounted at 50 per cent.

Marginal Propensity to Consume

We have assumed that the marginal propensity to consume for Australian disposable incomes is 0.54.

Marginal Propensity to Save

We have assumed that the marginal propensity to save for Australian disposable incomes is 0.46.

Goods and Services Tax (GST) Rate

We have assumed a GST rate of 10 per cent.

Corporate Tax Rate

We have assumed a corporate tax rate of 29.2 per cent, based on the weighted average of 2016-17 corporate tax rates by company type and size. The weight factor is the proportion of net tax paid by companies eligible for a corporate tax rate of 27.5 per cent divided by the sum of net tax paid by all companies.

Corporate Capital Gains Tax (CGT) Rate

We have assumed a CGT rate of 29.2 per cent, based on an assumed corporate tax rate of 29.2 per cent.

Superannuation Contribution and Earnings Taxes

We have assumed a superannuation contributions tax of 18.02 per cent and earnings tax of 10 per cent. The superannuation contributions tax of 18.02 per cent is based on the weighted average of superannuation contributions taxes by percentile. This includes earners who would have paid the additional Division 293 tax of 15 per cent for high-income earners as well as low-income earners eligible for the LISTO. The weight factor is the proportion of net tax by income percentile divided by the sum net tax.

Superannuation Returns

We have assumed annual superannuation investment returns of 7.0 per cent before fees and superannuation earnings tax.

Superannuation Fees

We have assumed annual fees of 1.0 per cent.

Superannuation Contributions and Earnings Redirected to Other Tax-Preferred Investments

By comparing the difference in the Treasury's revenue forgone estimates and the revenue gain estimates – which take into account the potential for superannuation earnings and contributions to be redirected to other tax-preferred investments – it is estimated 5 per cent of superannuation employer contributions and 10 per cent of superannuation earnings would be redirected to other tax-preferred investments if the concessions did not exist.

Alternative Investment Returns

We have assumed annual alternative investment returns of 5.0 per cent before fees and CGT.

Alternative Investment Fees

We have assumed annual fees of 0.5 per cent.

Wages Growth

We have assumed annual wages growth of 3 per cent.

Population Growth

We have assumed population growth for working age population (15 to 66 years) and population 67 years and older to be in line with ABS Population projections (Series B).

Inflation and Discounting Future Values

We have assumed annual inflation of 2.5 per cent. We have used this figure to discount all future values to 2019 dollars.

FOOTNOTES

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CONTACT THE MCKELL INSTITUTE

VICTORIAN OFFICE
T. (03) 9456 1608
PO Box 21423,
Melbourne VIC 8011

SYDNEY OFFICE
T. (02) 9113 0944 F. (02) 9113 0949
E. mckell@mckellinstitute.org.au
PO Box 21552, World Square NSW 2002

@McKellInstitute www.facebook.com/mckellinstitute
www.mckellinstitute.org.au