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PRIVATISING THE PENSION

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The stated objective of the retirement incomes policy which was developed and implemented by the former federal Labor Government was to provide the opportunity for all Australians to enjoy higher retirement incomes. The Labor Government was committed, "... on grounds of equity and social justice, to assisting lower income workers to live better in retirement through a combination of the age pension supplemented with tax-assisted superannuation" (Dawkins 1992a, p.1). To achieve this objective a policy framework was established which encompasses the age pension and social security systems interacting with both voluntary and, more recently, compulsory superannuation arrangements. Although the recently elected Coalition Government has indicated that it intends to make changes to the current superannuation system, such as providing employees with greater choice, it has indicated that it will retain the broad features of the current superannuation system. (Short 1996b, p.3).

Implicit in this bilaterally accepted policy is that self-funding of retirement incomes will replace the age pension, either in part or in full, with compulsory superannuation savings mandated by Superannuation Guarantee (SG) legislation. Treasury estimates indicate that as retirees begin to rely on SG contributions, few will be eligible for the full government pension (cited in Senate Select Committee on Superannuation (SSCS) 1992b). Although government projections indicate that the overall number of retirees claiming the pension will not change significantly, there will however be a substantial increase in the number receiving only a part pension (National Commission of Audit 1996, p.325).

With the introduction of the SG arrangements, the former Labor Government clearly indicated a continuing emphasis on the private sector character of Australia's retirement income market (Dawkins 1992a, p. 25). Also, the SG arrangements represented another step in the government's withdrawal from playing a direct role in providing retirement incomes. By forcing workers to save for their retirement and placing the management of those savings with the private sector, the government effectively institutionalised the role of the private sector. Consequently, the primary emphasis has shifted from a government-provided pension to funding future retirement income with compulsory earnings-related individual savings accumulated in decentralised private funds (Olsberg 1994, p.6). It is argued here that this fundamental shift in policy direction effectively represents *privatising* the pension.

Despite this shift in policy direction, there has been an absence of debate about whether the public or private sector can best manage retirement income savings to meet policy objectives.[1] In particular, two major assumptions have remained virtually unchallenged. First, an assumption underlying the traditional privatisation view is that competitive forces in the private sector will maximise chances of achieving retirement incomes policy objectives. The second major assumption is that in order to achieve policy objectives the government is able to effectively regulate the private sector to manage retirement savings.

The optimality of such a market-based model for superannuation savings is challenged in this paper. First, the emergence of the present superannuation system from a simple government-funded pension system to a complex private sector arrangement involving layers of participant groups is reviewed. Second, the private sector model and the relevance of the traditional privatisation arguments are analysed. The findings indicate that these traditional arguments are not applicable to the complex interrelated organisational forms that have emerged in the

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1 An exception is the Australian Democrats who advocated a national superannuation system, similar to the public sector-administered Singapore pension system. See Senator Kernot's Minority Report in Senate Select Committee on Superannuation, Second Report, *Super Guarantee Bills*, June 1992.

superannuation industry. Specifically, four areas of market failure are identified: monopoly power of key industry participants, inherent information asymmetry problems, significant deficiencies in accountability due to agency problems in the complex organisational arrangements, and the presence of seemingly unresolvable equity issues. Government responses to these market failures are also examined and a number of inadequacies in existing and proposed regulation are identified. Market failures combined with inadequate regulatory responses cast doubt on whether the objectives of an adequate, equitable and secure superannuation system can be achieved. Finally, given the shortcomings of the present system, we identify a need to reappraise the system as a whole, with consideration given to the full range of both private and public sector options.

Emergence of a Private Sector-based Superannuation System

Since 1909, retirement incomes for the majority of Australian retirees have been provided by a government-funded, means-tested pension system. Reliance on the pension peaked in 1980 with 87.1 per cent of the eligible population receiving some form of the pension[2] and the quantum of the full age pension reaching 25 per cent of male average weekly earnings. Although there were concerns about the adequacy of the pension, issues of security, sustainability and equity were mostly irrelevant for future retirees.

There had been a number of unsuccessful pre- and post-World War II attempts to replace the non-contributory pension system with a national superannuation system (SSCS 1992a).[3] Despite repeated rejection of a national superannuation scheme by both conservative and Labor

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2 These statistics include recipients of service, widow, invalidity and age pensions. By 1991 this percentage had declined to 75.6 per cent as successive governments imposed more restrictive means testing to curb growing government outlays (DSS statistics cited in SSCS, 1992a).

3 For a summary of the history of various proposals for a national superannuation scheme see Paatsch and Smith (1992).

governments, the union movement continued to support the introduction of a national scheme through to the early 1980s.[4] The policy impetus for the ACTU to pursue the issue of superannuation centred on concerns about the failure of existing superannuation schemes to secure adequate retirement incomes. Specific problems included: the general lack of access to superannuation for a range of workers, the absence of portability arrangements and discriminatory provisions against women, part-time and casual workers (Deery & Plowman 1991, pp. 268-9).

In an early response to concerns about adequacy, several unions initiated superannuation schemes during the 1970s[5], but it was not until the 1986 National Productivity Case (NPC) that superannuation was broadened as an employment entitlement. Both the ACTU and the Labor Government agreed to a productivity claim in the form of a 3 per cent award superannuation entitlement. This agreement was formally implemented through the 1986 and 1987 National Wage Cases (NWC) and led to a significant increase in occupational superannuation coverage.[6] However, employer non-compliance, and a desire by the Labor Government and union movement to increase the breadth of coverage of superannuation resulted in the introduction of the SG legislation in 1992 (SSCS 1992b).

The introduction of award superannuation had important implications for both the government and the ACTU. From the government's perspective, award superannuation represented a means of both reducing pressure on pension outlays and reducing inequities due to the taxation concessions enjoyed by a minority with superannuation coverage (Paatsch & Smith 1992). From the ACTU's perspective, award superannuation allowed trade unions to seek improvements in wages and conditions, despite wage restraint under the Accord. Additionally, it

4 The ACTU's preferred option was a Medibank-style national superannuation scheme (ACTU 1992).

5 Examples include the schemes initiated by the Pulp and Paperworkers Federation of Australia in 1974 and Storemen and Packer's Union in 1976 (Paatsch & Smith 1992, p.143).

6 Following the 1987 NWC, superannuation was extended to 90 per cent of federal awards and over 70 per cent of all awards (SSCS 1992b).

allowed the union movement a direct role in managing the superannuation funds, thus providing some opportunities for limited control over members' benefits and the investment policies of funds (McCallum & Shaver 1986).[7]

The outcomes of the 1986 NPC and subsequent National Wage Cases were significant in their broader social and economic implications. First, superannuation was instituted as a feature of the industrial bargaining environment. Second, by trading-off wage rises for compulsory superannuation contributions the union movement implicitly agreed to a private sector-based superannuation system. Third, with its preferred option of a Medibank-style superannuation system proving impossible to obtain, the ACTU abandoned its goal of a national superannuation scheme and accepted industry funds as the means of achieving its goal of improving superannuation coverage (ACTU 1992). Finally, the government's regulatory role was strengthened through the *Occupational Superannuation Standards Act 1987* (OSSA). OSSA legislation also enshrined a role for both employee representatives and employers in the management of the government-mandated superannuation savings by requiring equal employee and employer representation on the governing boards of superannuation funds. Paatsch and Smith (1992, p.144) suggest however that the inclusion of equal representation of employers was a compromise to allay employer concerns over excessive union influence in superannuation funds.

Although the OSSA regulatory framework was put in place to protect the superannuation rights of members, some aspects were fundamentally flawed. First, the only penalty for fund trustees failing to comply with the legislation was withdrawal of tax concessions, meaning that members rather than deviant trustees were penalised. Second, members' only redress against trustees was through costly and uncertain litigation. Third, the legislation did not define the trustees' duties nor the responsibilities of fund managers, auditors and other financial advisers to

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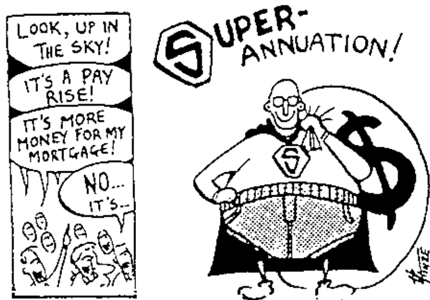
7 Reducing the level of off-shore investment and establishing a National Development Fund to promote the achievement of national economic goals were also stated aims of union-sponsored superannuation funds (ACTU/TDC 1987, p.21).

the funds. Fourth, the superannuation industry regulator, the ISC, had no power to take action to protect fund members, and there was no formal dispute resolution mechanism (SSCS 1992a).

The Government responded with new prudential arrangements enacted in the *Superannuation Industry (Supervision) Act 1993* (SIS), which includes codifying the duties and powers of trustees, specifying the responsibilities of auditors and actuaries, and allocating direct enforcement powers to the ISC. These measures are intended to "... strike a balance between the level of protection for superannuation savings and the additional costs imposed [given that] excessive compliance costs would significantly reduce the ultimate benefits available to retirees ..." (Dawkins 1992b, p.3).

The 1980s represented a watershed in retirement income policy in Australia. Over this period, the Government implemented its preferred private sector-based superannuation model by persuading the union movement to abandon its objectives for a national superannuation scheme in return for productivity-linked award-based superannuation, and by providing the union movement with a direct role in the management and control of award superannuation. The superannuation system which has emerged from this process of negotiation and compromise is significantly more complex and involves a much broader range of stakeholders than the traditional non-contributory publicly provided pension system. Furthermore, ongoing regulatory changes demonstrate the Government's concern about security and equity, in addition to the greater concern about adequacy, in this private-sector based system.



Privatisation Debate [8]

The role of the public sector has undergone a transformation following the promise of the early 1970s of improved social infrastructure and urban renewal, to the late 1980s where the public sector was "portrayed as a dead weight on prospects for economic revival" (Davis, Wanna, Warhurst & Weller 1993, p.113). Attempts to reform the public sector have involved a range of private sector-based solutions, including contracting out and privatisation of services, often combined with funding restraints on public sector activities (Labor Resource Centre 1987, p.33). A common assumption of the advocates of these methods is that improvement in both technical and allocative efficiency cannot be attained without the introduction of market forces. More recently however, a number of critics have challenged the assumed nexus between public sector reforms and an expanded role for the private sector. For example, Quiggin (1995) presents evidence that the long-term fiscal position of governments is more likely to be improved with reforms *without* privatisation. Similarly, Stretton and Orchard (1994, p.83) warn that a rigid belief that private enterprise is superior to public enterprise, or vice versa, "... encourages reformers to concentrate on shifting activity from one mode to another, rather than improving the quality of either". Thus, they conclude that an ideological approach to the role of the private-sector has the potential to produce sub-optimal outcomes.

The shift in the provision of retirement income from the public sector in the form of age pensions to the private sector through superannuation represents a less conspicuous, although significant, privatisation of a major public sector funded activity. The former Labor Government mandated compulsory superannuation savings to improve workers' retirement incomes and boost national savings, but responsibility for managing those savings and deciding investment targets was placed within the private sector. The rationale behind the Government's "hands

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8 Privatisation is generally concerned with the sale of government assets to provide revenue supplementation, although it also "involves the total or partial transfer of assets, goods or services from the public sector to the private sector" (Wanna, O'Faircheallaigh & Weller 1992, p.72).

off' approach to superannuation funds' investment decisions is based on the belief that competitive "market forces" are expected to ensure superannuation funds operate efficiently to maximise returns to members (Dawkins 1992a).

However, a comparative analysis of the investment performance of public and private sector superannuation funds provides no support for the assumed superiority of the private sector in delivering more efficient outcomes. Table 1 summarises the results of a recent survey of corporate, industry, retail and public sector funds, clearly showing that the three-year annualised investment returns for a sample of government-managed superannuation funds averaged 8.7 percent, which is higher than the averages of each of the three private sector groups of sampled funds.

Table 1 Three-year Annualised Earnings (1993-1995) of Superannuation Funds

Sector	No. of funds surveyed	Mean 3-year annualised earnings (%)	Median	Standard Deviation
Corporate Funds	196	8.6	8.5	2.29
Industry Funds	21	7.4	7.4	0.93
Retail Funds	22	7.8	7.7	1.21
Public Sector Funds	11	8.7	8.8	1.45

Source: Laurence, M "How your super fund is performing", *Business Review Weekly*, 3 June 1996, pp. 41-49.

Given the results of this survey[9], government policy adherence to the market-based solution appears to be more consistent with an ideological belief, rather than empirical justification, of the superiority of the private sector to successfully deliver retirement incomes.

The increased role of the private sector in the management of retirement savings presents a number of complex issues not encountered in more

9 The total assets of the surveyed funds is $76.2 billion which represents 46 percent of the assets of all funds in those sectors at June 1995, broken down to 57% corporate, 55% industry, 9% retail and 68% public sector funds.

common forms of privatisation of public sector activities. For example, Altman (1992, p.91) contends that the tension between equity, adequacy and security has to be balanced against ensuring employers' flexibility, minimal complexity and lower costs, and that this balance is much more difficult to achieve in countries with high levels of private pensions. The Australian government attempted to address the problems arising from a private-sector model with the introduction of a regulatory framework of prudential supervision. However, as highlighted by Altman (1992, p.90) such an approach typically leads to a more complex regulatory environment with greater administrative expense and "less fair and less secure" retirement outcomes. Thus, government attempts to avoid market failures which inevitably arise in private sector-based models often create additional problems and lead to regulatory failures (World Bank 1994).

Market Failures

From an economics perspective, regulations are generally viewed as responses to perceived "market failures", where competitive markets fail to make efficient allocations, or where the characteristics of transactions between buyers and sellers in the market differ from those considered desirable to achieve certain objectives (Phillips & Zecher 1981; Needham 1983; Sappington & Stiglitz 1987). While market failures have many forms and many causes, two main types of market failures are commonly identified by traditional economic analysis: those that result from monopoly of the selling side of the market (monopolies), and those that occur when transactions between market sellers and buyers have external effects on third parties not directly involved in those transactions (externalities) (Phillips & Zecher 1981; Needham 1983). This latter argument includes regulation to reduce risks to consumers or the public, to ensure adherence to moral standards, to set reasonable limits on an activity, or to provide stability in an area of endeavour experiencing unsettling changes (Francis 1993).

More recently two contrasting approaches in the interpretation of traditional market failures have emerged. Under one approach, property rights or public choice theorists argue that significant market intervention

by governments leads to inefficiencies in the form of government or regulatory failure, and have challenged the circumstances that are claimed to give rise to market failures.[10] These claims have been supported by arguments that many markets involving public monopolies can be made contestable and hence, exposed to the benefits of competitive pressures (Baumol, Panzar & Willig 1982). Moreover, government intervention can be reduced or eliminated by the introduction of a number of mechanisms including: effective antitrust laws, a system of marketable property rights, the use of bargaining between market participants, adequate disclosure standards, or taxes or subsidies in key areas to promote effective competition (Breyer 1982).

Under an alternative approach, theorists have extended the concept of market failure to include situations that result from constraints confronting parties to market transactions. One such constraint is the "information asymmetry" problem of imperfect information preventing either buyers or sellers from making efficient market decisions, as well as uncertainty and asymmetry in the information possessed by different individuals (Needham 1983; Noll 1985; Sappington & Stiglitz 1987). A second but closely related constraint is the "agency problem" arising from principal-agent relationships associated with many market transactions (Needham 1983). A third constraint relates to the inequitable outcomes arising from "transaction failures". Transaction failures encompass a broader concept of market failures, not only including exchanges of goods and services or assets for money, but also inequitable exchanges among individuals (Reynolds 1981; Needham 1983; Kling 1988).

The arguments presented by the second group of theorists is consistent with the universal justification for government intervention in ensuring the effective provisioning of retirement incomes.[11] However,

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10 This approach is based on the seminal works of Stigler (1962), Peltzman (1972), Posner (1974) and Wolfe (1979).

11 The justifications for government intervention are summarised by the World Bank (1994, p. 7) as shortsightedness on the part of many citizens, inadequate savings instruments, insurance markets failures, information gaps, and the need to avoid long-term poverty brought about by inadequate earnings during working lives.

government intervention is also claimed to have introduced inefficiencies and inequities in the provisioning of retirement incomes in industrial societies (World Bank, 1994) which suggests that the possibility of regulatory failure in Australia cannot be ignored. The following analysis considers market failures arising in the Australian superannuation system with respect to monopoly power, information asymmetry, agency problems and equity issues, and the actual and potential regulatory failures emerging from government attempts to redress those market failures.

Monopoly Power

Under the policies of the former Labor Government, most occupational superannuation funds operated as monopolies under a government-mandated arrangement whereby funds did not compete for members. This situation is expected to change when the new Coalition Government implements policy proposals designed to provide members with fund choice, including the option of Retirement Savings Accounts (RSA). These policy measures are intended to address problems arising from the fund choice decision being determined by an award provision or employer rather than workers themselves. Further, the Coalition Government takes the view that:

> [p]roviding employees with greater choice of fund will expose funds to greater competitive pressure by removing the virtually guaranteed flow of contributions. As in other areas of the economy, increased competition can be expected to lead to greater efficiency and a better deal for consumers (Short 1996b, p.6).

Although fund choice is intended to increase competition, it is questionable whether the proposed changes will deliver a more efficient system, given the measures will increase complexity with further layers of regulation, and involve constraints on the level of competition. These constraints include allowing funds to impose a twelve-month notice

period on members to mitigate the expected effects of frequent swapping between funds (Short 1996b, p.7), restricting the choice to a maximum of five funds, and requiring RSAs to be capital guaranteed (Short 1996a). The Government's stated expectation that RSAs will have lower investment returns than other superannuation products (Short 1996b, p.5) has implications for the long term adequacy of retirement incomes of overly cautious members who may persist in holding their superannuation savings in RSAs earning little or no income.

A more fundamental problem associated with fund choice is the assumption that fund members are able to effectively monitor fund performance to make informed choices, and are sufficiently motivated to exercise that choice. Such necessary vigilance by fund members is considerably hindered by information asymmetry problems.

Information Asymmetry

Since freely functioning markets require adequate information, disclosure can be viewed as augmenting the preconditions of a competitive marketplace. Disclosure is likely to be effective only where the users can understand the information disclosed, where users are free to make choices on the basis of that information, where users believe the information is materially relevant to their choices, and where it has been transmitted to users in a simple and meaningful way (Breyer 1982).

The prudential framework which has been established to protect members' superannuation interests relies "... on a well informed membership with the right to participate in managing the affairs of their fund" (Dawkins 1992b, p. 1) through equal representation on the governing boards of funds. In addition, disclosure of adequate and appropriate information enables members to influence the direction their fund takes, which, in turn, will enable them to evaluate its performance (Dawkins 1992b, p. 13). Therefore, for the prudential framework to function effectively it is assumed that all fund members have a direct say in who represents them on the board of trustees, have access to comparable information about their own and other funds to evaluate relative performance, and have the necessary financial knowledge and

skills to analyse that information and make decisions about the management of their funds based on those analyses.

The validity of each of these three assumptions is questionable. First, in many superannuation funds, particularly industry funds, members do not directly participate in the selection of member representatives on the board of trustees. Member representatives are often nominated by a union, rather than through a competitive process of member nomination and election by vote of all members.[12] While members may have the right to participate in the management of their fund, in practice they lack that opportunity. Unlike shareholders of corporations who have the power to remove non-performing directors through the ballot process, industry fund members do not have access to a similar process to remove non-performing trustees.

Second, access to relevant information on fund performance is largely confined to the members' own fund. Availability of public information about other funds, which would enable assessment of the relative performance of their fund, is severely limited.[13] In competitive markets, such as the equity market, corporations have incentives to disclose information to attract capital, stockbrokers have incentives to employ analysts to "translate" that information into useable form for current and potential clients, and shareholders have incentives to gather and use that information in their buy, sell and hold decisions. Given that superannuation members cannot trade their equity, there is an absence of competitive forces in the industry to encourage disclosure, to generate and publish fund-specific performance analyses, or to motivate members to acquire information.

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12 Also, non-union members of superannuation funds effectively have no input to the member representative selection decision. Given that union coverage is less than 30 percent (ABS 1992), the majority of members are excluded from the selection process.

13 Analyses of between-fund performance are largely limited to superannuation industry publications such as *Superfunds*, and these analyses are often based on information gathered from voluntary participation member surveys. These published analyses are therefore limited and suffer the usual response biases of surveys.

Comparative performance data can alleviate the information asymmetry problems as the performance of one firm serves as a natural behaviour monitor of another, provided the firms have similar characteristics and the comparative information is freely available (Sappington & Stiglitz 1987). Although SIS legislation requires disclosure of fund information to third parties to ensure that funds are open to public scrutiny and to facilitate industry analyses and comparisons between funds (Duval 1994), the search costs of gathering the information individually from a large number of funds acts as a disincentive for market and other analysts to undertake such research (Gallery 1994).

The third assumption that members have the necessary knowledge and skills to evaluate information about their fund is critical for the effectiveness of information disclosure as a prudential control. Superannuation has developed into a complex and difficult-to-understand system due to frequent changes to the arrangements, as well as the associated "grandfathering" and transitional rules (Bateman & Piggott 1994). A complex superannuation system is a major barrier to members understanding and actively participating in the management of their superannuation funds. For example, an Australian Consumers' Council phone-in survey (1994, p.29) reported that almost 80 per cent of respondents said they read correspondence from their fund, but about 60 per cent said they could not understand some or most of the information. Further, the report notes "[b]ecause the superannuation product and the legislation surrounding it is complex, it is only the technically proficient consumer who is able to monitor the information to check whether it is correct or incorrect". The implication is that members require a degree of superannuation expertise to effectively monitor funds and make informed choices.

This implication is reinforced by a prominent commentator suggesting that the intricacies of the superannuation system should be left to the experts. These comments motivated Andrew Thomson MP[14] to ask:

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14 Mr Thomson states that he recalls with dismay the remarks made by Dr Vince Fitzgerald in an address to an ASFA-sponsored conference in Canberra in June 1995. He states that Dr Fitzgerald drew an analogy between the superannuation regime and a Sony music box: it looks slick and attractive on the outside but

> If it is permitted for legislatures and governments to create a regime for superannuation that is so ferociously complicated that the ordinary citizens, whose funds are the subject of these laws, are not permitted implicitly to investigate and understand this for themselves, then where are we ever going to generate the enthusiasm that is required beyond what exists now? (Australian House of Representatives Hansard, 24 August, 1995)

The combination of a complex system and lack of perception of ownership of the superannuation savings by members translates into significantly reduced incentives and likelihood that fund members will effectively monitor their funds.

The ACTU counters these concerns by claiming that members will become more interested in and knowledgable about investments as account balances grow (ACTU 1994). While the ACTU does not state how members' knowledge of investments will be increased, the superannuation industry and the former government attempted to bridge the information gap. For example, the superannuation industry has sought to make fund information more understandable to members by simplification and graphic presentation. However, the trade-off for simplification is information loss. Also, it is very difficult to evaluate the investment performance of a particular fund on the basis of reported one-year or three-year rates of return, without considering returns from each sector of the fund's investment portfolio and making comparisons with general market performance. Such analysis would be beyond the capacity of the vast majority of fund members. The former Labor Government also funded a $12.5 million media campaign aimed at explaining the basics of the superannuation system.

Past and present governments, the union movement and superannuation industry have all acknowledged that the present superannuation system is difficult for fund members to understand, but believe that appropriate education will enable informed decisions and choices about investments or funds. A key question is whether Australian workers have the

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inside it is fiendishly complicated, and therefore any investigation into its workings should be left to experts.

incentives and capacity to acquire the necessary knowledge about financial markets to become effective "investors".

Agency Problems

Coupled with information asymmetry problems are agency problems which arise where the interests of the agent (professional manager) and the principal (owner of the capital) are incongruent, requiring the establishment of effective monitoring and incentive structures to ensure that the principal's objectives are achieved. Failure to implement appropriate control measures can lead to inefficiencies, such as agents reducing effort, shirking their responsibilities, and over-consuming perquisites (Alchian & Demsetz 1972; Jensen & Meckling 1976; Fama 1980). Although agency problems can arise in both private sector and public sector enterprises, it is claimed that the monitoring and incentive structures are more effective in private enterprises due to the presence of three forms of market discipline: contractual arrangements between profit-seeking shareholders and managers aligning both parties' interests; threat of takeover; and, threat of bankruptcy, where managers risk job loss and damage to their reputation in the managerial labour market (Vickers & Yarrow, 1991).

In superannuation funds, fund members are the principals with trustees acting as their agents. However, trustees engage other agents such as fund managers, investment consultants and other advisers in the management of the fund's assets. These extra layers of agents give rise to multiple agency problems (Lakonishok, Shleifer & Vishny 1992), making it very difficult for the principals (members) to effectively monitor fund performance. Figure 1 depicts this complex web of multiple agents which exists for most medium to large superannuation funds, and illustrates the difficulties faced by members in their task of evaluating the trustee's performance.

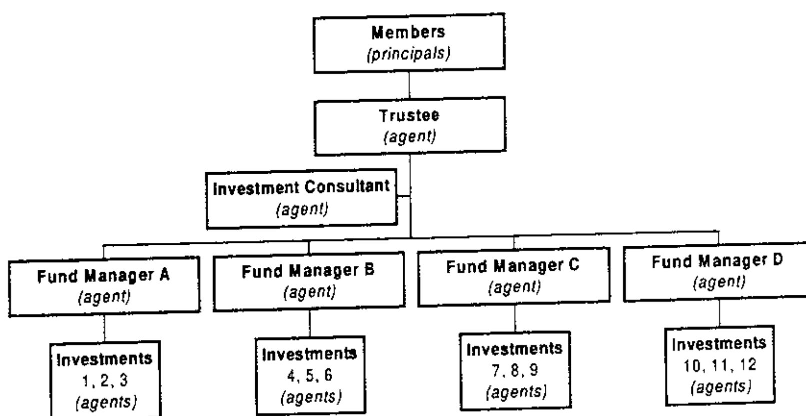
For example, if a fund's actual performance is worse than the trustee predicted, the cause of the poor performance may be due to the failure of one or more of the agents. That is, failure may be due to the trustee's poor choice of investment consultant, the investment consultant's poor

recommendations in the selection of fund managers, the fund managers' sub-optimal selections of investments in their portfolios, the investments performing poorly because (in the case of equity investments) of inferior company management, or any combination of the above. To isolate and evaluate the decisions and outcomes of each layer of agents in this situation would be an extremely difficult, if not impossible, task for a highly skilled financial analyst, and certainly beyond the capabilities of most fund members. Although trustees are ultimately responsible for fund performance, the presence of other agents provides them with opportunities to distance themselves from poor investment returns by blaming advisers and fund managers, who can be changed or replaced.[15]

In a superannuation fund context, the only control mechanism available to members is monitoring agents' performance (other mechanisms such as threats of takeover and bankruptcy are not applicable). However, information asymmetry and multiple agency problems, and limited power to remove non-performing trustees, are significant barriers to the effectiveness of this control mechanism. Thus, market mechanisms that usually operate in the private sector to mitigate agency problems are largely absent or ineffective in private sector superannuation funds.

15 Lakonishok et al. (1992) found that although U.S. pension fund managers consistently underperformed the market, pension fund sponsors preferred to delegate the money management function to fund managers rather than manage the investments internally, suggesting that the reason for this preference is to reduce responsibility for potentially poor performance of the fund's assets. O'Barr and Conley (1992) similarly note that pension fund executives use external investment managers to avoid responsibility for bad investment decisions.

Figure 1: Multiple Agency Relationships of a Superannuation Fund



Inequities and Failures to Meet Broader Policy Objectives

Two sources of inequities are evident in the current superannuation system. First, at the macro level, the system has been criticised for perpetuating or creating inequities. An example of the former is the gender inequities arising from pay inequities and occupational segmentation which will inevitably translate into retirement incomes inequities (Paatsch & Smith 1992, p.159). A private sector retirement savings model limits the scope for governments to intervene on behalf of disadvantaged groups in society to address such inherent inequities.

With regard to inequities created by the system, an example is the differential taxation concessions available to high and low income earners. The Australian Council of Social Services (ACOSS) and other advocates for low income groups frequently criticise the system for unfair advantages available to high-income earners (see for example Nowland-Foreman 1991; ACOSS 1992 and 1995; Dixon 1993). The Coalition Government's 1996 Budget includes a measure to mitigate this inequity by imposing a surcharge on superannuation contributions for high-income earners. This surcharge has been widely criticised as

unworkable and costly.[16] Although it is estimated that only 355,000 taxpayers will be affected by the surcharge, records will have to be maintained for all 15.7 million accounts currently in the superannuation system (ASFA, 1996). The proposed surcharge is another example of regulatory failure in that it creates further inequities in the system by imposing costs on all fund members, contradicting the intention of this measure to rebalance the existing tax inequities.

The second source of inequities is at the micro or fund level, among members both within funds and between funds. Two major inequities are discussed here: the "small balances problem", and varying investment returns between funds. Factors contributing to these inequities are the combination of widely dispersed members over a large number of superannuation funds and the limitations on members to effectively make informed choices within and between funds. Stemming from these inequities are failures to meet broader social and economic objectives, such as lack of access to superannuation savings by low-income earners and young families for housing[17] and education, and meeting the needs of capital-deficient sectors of the economy, such as small businesses.

A major threat to the retirement incomes savings strategy arose with the erosion of small balances by fees and charges in many superannuation accounts, affecting predominantly lower income workers. This "small balances problem" first emerged during the late 1980s with the 3 per cent award superannuation payments, and then quickly became widespread with compulsory SG increasing superannuation coverage to almost all workers. An indication of the extent of this problem is illustrated by an

16 See for example the articles by Barrie Dunstan "Super surcharge plan unworkable, say CPAs" , "Pressure to drop or amend super surcharge", and the letter to the editor "Super surcharge sloppy, inequitable and dishonest" from Johnstone Rorke Chartered Accountants, published in the *Australian Financial Review*, 4 October 1996.

17 Some funds have joined an ACTU and National Mutual program which offers members home loans at lending rates below bank rates (Mace 1995), but this program does not give access for fund members to borrow directly against superannuation savings. Dixon (1993) is critical of this lack of access in that lower income earners may be denied the opportunity to participate in home ownership because of compulsory superannuation savings.

industry survey which shows that the 153 funds included in the survey had 3.6 million members with 1.4 million (35 per cent) of those having account balances of less than $1,000 (*Superfunds*, March 1995, p.43).

The government responded to this problem by enacting legislation (effective from 1 July 1995) requiring funds to "member protect" accounts with balances of less than $1,000. Funds are now not permitted to charge fees in excess of investment earnings, and if they are unwilling to do so, the account balances have to be transferred either to another fund, or to the Superannuation Holding Accounts Reserve (SHAR), operated by the Australian Tax Office (ATO).

The eight-year time-lag between the emergence of the small accounts problem and the enactment of corrective legislation suggests that substantial sums of money have haemorrhaged from the superannuation system. The delay in addressing the small balances problems highlights the failure of regulatory controls to adequately protect retirement income savings.

Apart from involving the ATO in managing superannuation funds, at least three other problems are perpetuated with the member protection arrangements. First, the system will have to continue for some time to carry a large pool of small stagnating account balances earning little or no returns; while fees cannot erode capital balances, members are not protected from the effects of inflation. Second, another potentially large pool of stagnating small accounts is likely to be created with the SHAR transferral arrangements. That is, when an account balance reaches $1,200, the individual is asked to transfer the money to a superannuation fund, and is given an "incentive" to do so by ceasing to earn interest on the account balance. Third, equity among members both within funds and between funds is problematic. Within funds, member protection can only work with cross-subsidies; that is, if some members pay reduced or no fees then other fund members are burdened with higher fees. Also, the extent of cross-subsidisation will vary between funds in accordance with the proportion of small account balances. As suggested by Altman (1992), new regulations which seek to correct shortcomings in an existing elaborate regulatory scheme can themselves create new problems; member protection legislation appears to be a classic example.

The second major inequity relates to variations in investment rates of return among different funds. Because SG contributions provide for an accumulation-type benefit, the amount of retirement income which will be ultimately received by beneficiaries depends on both the amount of contributions and the investment returns on the capital balance over the working life of the individual. If two individuals are assumed to have the same contributions paid into the same superannuation fund over the same period of time, then on retirement they will be entitled to exactly the same amount of superannuation benefits. However, if the only difference in these circumstances is that they are members of two different superannuation funds, then their ultimate retirement benefits could vary significantly. Given that superannuation accumulates over long periods of time, even small annual differences in the investment earning rates will compound over time into very large differences in account balances.

To illustrate, the crediting rates for nineteen major industry funds for 1994-95 are reported as ranging between the lowest at 3.0 per cent and the highest at 11.0 per cent (Quinlivan 1995); the average is 6.8 per cent with a standard deviation of 1.76. If these differences continued over a period of forty years, then the amount of retirement benefits at the end of that period, based on annual contributions of $1,800, would be $341,000 for an individual earning average returns (6.8 per cent), $226,000 for the average return less one standard deviation (5.04 per cent), and $541,000 for the average return plus one standard deviation (8.56 per cent).[18]

Finally, trustees and fund managers in the private sector-based system are accused of being overly conservative in their investment decisions, neglecting important investment opportunities such as infrastructure development and venture capital. ACOSS (1992, p.6) suggests that such "... conservatism is not in the best interests of members or the Australian economy". The former Prime Minister, Mr Keating, also criticised the

18 Such differences are further compounded by another inequity in the system caused by different percentages of salary contributed by small and large employers. That is, during the four-year period from 1992 to 1996, workers employed in small businesses had smaller percentages of their wages contributed to superannuation than their counterparts in large businesses.

superannuation industry and fund managers in particular for taking a short-term view of investment decisions, likening their behaviour to that of "lemmings" and "donkeys" (Australian House of Representatives Hansard, 19 October 1995). This conservatism and short-term decision making by fund trustees and their advisers suggests that the effects of the "market" mechanisms operating in the superannuation industry have led to sub-optimal asset allocations.

Conclusion

It has been argued in this paper that a market-based solution to retirement income saving effectively represents a privatisation of the pension system. By mandating retirement savings and placing the management of those savings with the private sector, the primary emphasis has shifted from a government-provided pension to funding future retirement income with compulsory accumulation of savings in decentralised private funds. Despite little opposition to the policy direction set by the former Labor government, and continued by the current Coalition government, the analysis here suggests that this solution is riddled with examples of market imperfections that appear to continually avoid being caught by the increasing layers of complex government regulation.

Although the recently elected Coalition Government has indicated that it is committed to seeking ways to simplify the superannuation arrangements, it has also acknowledged this will be a difficult task. The Government is also seeking "... to make the superannuation system more relevant by providing employees with greater choice, introducing more competition, and providing greater flexibility" (Short 1996b, p.4). These objectives appear to be incongruous in that introducing greater choice, competition and flexibility is likely to add complexity to the present system rather than move towards simplification. Also there appears to be no specific details of how the Government proposes to simplify the system. The Wallis Inquiry into the Australian financial system which commenced in mid 1996 would perhaps have been an ideal opportunity review the retirement incomes system. However, the Government has

specifically excluded retirement incomes policy from the Committee's terms of reference (Treasurer's Press Release No. 19, 30 May 1996).

The long-term nature of superannuation presents problems which gives rise to considerable uncertainties about the system. As noted by Altman (1992, p.88):

> ... a promise of retirement income support made today but not payable for decades is inherently insecure ... Even if funds are set aside in advance, the obligation may still be unsatisfied in the end as a consequence of poor investment or misappropriation of the set-aside.

Given such uncertainty and the market failure arguments presented in this article, the almost universally accepted "private sector is best" view represents a real cause for concern for the retirement savings of many Australians. It is suggested that there needs to be ongoing critical analysis of the system as it develops and a continual exploration of the full range of both public and private sector alternatives.

The Australian private sector-based superannuation system operates within a complex web of multiple agency relationships overlaid with a complex regulatory regime. The result is that few members understand the system and the ability to effectively participate in the management of their funds is severely limited. Results of a public opinion survey suggest that "[f]ull acceptance of superannuation principles by the public is dependent on the government playing a more active role in managing and supervising superannuation funds" (Zagorski 1995). However, given that "... the number and diversity of funds[19] ... restricts the level of active monitoring and surveillance that can be undertaken at a reasonable cost" by the regulator (ISC 1994, p.xii), it is difficult to see how the government might play a more active role within the present system. Nonetheless it is clear that to achieve the goal of a secure, adequate and equitable retirement income system for all Australians, urgent action

19 138,849 funds as at June 1996 (Insurance and Superannuation Commission 1996).

needs to be taken to address the significant flaws in the current private sector-based superannuation system.

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