
**MINORITY REPORT ON CHAPTER 9 –
INVESTMENT BY SUPERANNUATION FUNDS – SENATOR KERNOT:**

The first part of recommendation 9.2 states:

The committee recommends that no investment controls be placed on superannuation funds to compel them to invest in particular areas such as development or venture capital or infrastructure.

The assumptions underlying this recommendation are that :

- the investment choices made by superannuation fund trustees and their fund managers are superior in all circumstances to any mandated investment policies;
- superannuation funds having been given massive commercial advantages against other institutions in competing for savings, should then be able to invest purely as they see fit, without any regard to the welfare of the nation and the economy; and
- superannuation funds are not an integral part of the economy, but exist in a vacuum which involves only the maximisation of monetary returns irrespective of the effects of such a policy on the Australian economy.

This recommendation and the assumptions underlying it are not supported by the Australian Democrats.

Fund management is a specialised function. There is no doubt that the decentralisation of investment management throughout the economy has some benefits in terms of risk diversification and in terms of producing a competitive fund management market. Professional fund managers employ sophisticated investment strategies and techniques. Notwithstanding this, recent experience has shown that private fund managers can also deliver poor returns to members. This is particularly so for funds which have large commercial property holdings at the moment.

Added to this have been the very conservative investment strategies pursued by many funds during the 80's, especially the concentration of investment in capital-guaranteed products.

The second argument goes to the core of the legitimacy of the concessional taxation treatment of superannuation. The Parliament has decided that superannuation is important to national welfare and as such it encourages savings in this form. Without this concessional treatment it is certain that assets in superannuation funds would be greatly below what they are today.

The tax expenditure involved in this concession is approximately \$3.5 billion and is by far the largest granted by the Federal Government. This is expected to grow. This means that the public incurs an opportunity cost of public expenditure equal to \$3.5 billion every year. Certainly fund members benefit from this system, but does the public get value out of this foregone revenue?

The third point is perhaps the most important. It is argued by the industry that their duty is to maximise the returns to members and that there will be losses if any interference takes place. This ignores the possibility of greater returns from investments in Australian firms because of higher levels of general economic activity which arise from increased local investment. Increased local employment will also obviously lead to increased total membership of superannuation funds.

What we are dealing with is a massive part of national savings. Why is it so unreasonable that there is some regulation by the Government to try to ensure that not only are individuals assisted to enjoy a higher level of retirement income, but also that Australian businesses are assisted?

SPECIFIC AREA – DEVELOPMENT CAPITAL

The venture and development capital sector has long been perceived as weak in Australia. Various governments have identified the need for patient equity investment in Australian businesses and have introduced measures to try to address the inadequate supply of such capital.

Moreover, the financial market has not reached a state of maturity which will ensure that funds are automatically channelled into this vital area of investment. In this regard, the evidence given by Mr D Hanley of the Industry Research and Development Board (IRDB) is most instructive:

The problem is that in Australia we have a very underdeveloped capital market by comparison with the rest of the world. I have had to plead for money in all of the markets. This market is probably at the cowboy end of the spectrum, and because of that there is a great need for it to be nurtured and developed. People talk about the market as if it were a real market – it is not. It is controlled by a whole series of interests that I do not think are present in some of the larger and more liquid markets available overseas. We should not compare ourselves with New York, we certainly should not compare ourselves with London and probably, thank God, we are not the same as Tokyo.¹

The Australian Industry Development Corporation (AIDC) is a public institution created to assist developing businesses. AIDC is a specialist manager in this area and has operated successfully.

The Management and Investment Company (MIC) scheme, which provided generous 'up-front' taxation concessions for venture capital investments, was severely affected by the flight to quality which occurred after the 1987 stock market crash and has now been terminated.

Evidence given to the Committee shows that the problem of lack of development capital is still unaddressed. Given the long term nature of compulsorily preserved benefits,

¹ Evidence, p 1965.

superannuation funds are the ideal patient capital providers; superannuation is also the Government's chosen growth area in national savings, and as such should provide more of the capital for the future growth of Australian industry.

The major capital market failure is in the area of the commercialisation of research. This is particularly tragic for Australia, as we now acknowledge the need to diversify out of commodity-based trade and into higher value sectors. Yet we see our research effort continually acquired by foreign investors with a longer term investment horizon. The Gene Shears technology was one recent high profile example of the continuation of this disturbing trend.

Belatedly, the Government has announced the creation of the Australian Technology Group (ATG) to specifically address this market failure. However, there is great uncertainty as to whether it will be able to find private sector investors to match the \$30 million in equity. This is a ludicrous situation, addressed by the same old solution: 'wait for the market to provide'. Australia has been waiting for too long, it cannot afford to wait any longer.

The second Government initiative in this area is the Pooled Development Fund (PDF) proposal currently before the Parliament. This involves the creation of special entities to invest in small and medium sized firms. These will be taxed at 30 per cent instead of 39 per cent. As such, PDFs are not attractive to superannuation funds, although they might be attractive to other institutions and to some individuals.

A far simpler way would be to mandate that a small proportion of superannuation fund assets (one per cent) be diverted into a National Development Fund. This fund will provide capital to ATG and to PDFs and will be used to develop Australian industry. In addition, the fund would ensure that there is always a sum of money available to ensure that vital technology does not become controlled by foreign interests.

What must be remembered is that the long term interests of superannuation fund members are enhanced by, and largely dependent upon, a healthy Australian economy.

The Committee has recommended (Recommendation 9.3) that, as usual, the Parliament should ignore the problem and re-examine the matter later. This is simply not good enough. Both Senator Button and Mr Keating have previously stated that the Government was not impressed by the performance of the superannuation sector in this area, yet they have shown little inclination to be pro-active.

Mr Dennis Hanley, the retired chairman of the IRDB and current Board member of Memtec Ltd, gave evidence to the Committee that the short-term nature of the reporting of investment performance will always work against the provision of development capital:

In my opinion, nothing is going to happen in the present environment unless some form of compulsion starts the ball rolling.²

² Evidence, p 1959.

The Prime Minister has been very keen to urge us to integrate more fully into Asia. Why does not the Government learn from the successful economies? Much of the recent gains of the Asian region have come about because there has been a plentiful supply of cheap capital.

Alternative Recommendation 9.2 (Senator Kernot)

That a National Development Fund (NDF) be established with one per cent of the assets of superannuation funds, the money to be invested in the Australian Technology Group and to provide patient development capital for small and medium size Australian firms.

The performance of the NDF, and the general development capital market, should be reviewed after 10 years to see if the sector has developed enough to disband the NDF or whether the mandatory centralised fund is still necessary.

OVERSEAS INVESTMENT

Recommendation 9.4 states:

The Committee recommends that no special restrictions be placed on superannuation funds investing overseas.

There is no doubt that there are good reasons for superannuation funds investing overseas. The motivation is obviously the return which a particular investment is expected to yield and the broader question of portfolio diversification.

However, there are other effects of offshore investment which must also be taken into account. Foreign investment of Australian savings achieves the export of jobs to the actual destination of the investment.

Under the current system trustees must think solely of the welfare of their members. As such they are prevented by law from considering the national interest. Parliaments are charged with the responsibility of promoting the national interest. This conflict of interest in policy direction must be resolved.

There is no question that job creating investment in Australia increases national welfare and provides health, welfare and social benefits in excess of the direct monetary benefits to the employees concerned. This benefit must not be ignored by this Parliament.

I accept that it is neither feasible nor desirable to ban offshore investment by superannuation funds entirely. However, the Committee has adopted a completely hands-off approach which could theoretically lead to the investment of the total assets of the superannuation industry offshore.

The assets of superannuation funds benefit from taxation concessions. If these are then invested overseas, employment and taxation benefits accrue to the other country at the expense of Australian taxpayers. Did we learn anything from the corporate failures of the 1980s?

There must be a repudiation of the pursuit of the level playing field; it is a naive and atavistic experiment. I therefore recommend that:

Alternative Recommendation 9.4 (Senator Kernot)

- *an absolute limit of 20% of assets of a superannuation fund be allowed to be invested offshore; and*
- *the Parliament introduce a tax regime which is preferential to investments in Australia, rather than the absurd policy of capital export neutrality which has been another legacy of the 1980s.*