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ASFA Research and Resource Centre

Enhancing Financial Stability and Economic Growth – The Contribution of Superannuation

Summary

Report prepared for ASFA by The Allen Consulting Group

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Association of Superannuation Funds of Australia

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In 2009 ASFA commissioned the Allen Consulting Group to prepare a report detailing the benefits of Australia's compulsory superannuation system[1]. In 2011 ASFA commissioned the Allen Consulting Group to prepare a further report.

This new report updates the earlier work and also provides detail on further ways in which the Australian superannuation system continues to benefit all Australians, including through enhancing the stability of the Australian financial system. It also provides confirmation, through modelling, of the large benefits to the Australian economy of the Government's announced policy of increasing compulsory superannuation from nine per cent to 12 per cent.

The full report is available from the ASFA website, with a summary of the report's main findings set out below.

BACKGROUND

- The pre-eminence of superannuation as the preferred financial vehicle for household savings is the product of a series of reforms by various Australian governments. Since the mid-1980s, governments (both Labor and Coalition) have introduced a variety of initiatives to promote private retirement saving, primarily in superannuation.
- Some major initiatives, such as the phasing in of the Superannuation Guarantee (SG), commenced during the course of one government but were not completed until well into the course of the following government.

SUPERANNUATION AND FINANCIAL STABILITY

- The superannuation sector played a very important role in Australia coming out of the global financial crisis (GFC) in far better shape than most other countries.
- Superannuation funds were one of the main sources of equity financing for companies through private placements when debt financing became unavailable or unaffordable for Australian companies. The superannuation industry played a disproportionately large role in assisting corporate Australia to lower corporate risk during the GFC.
- Superannuation has been responsible for a significant proportion of the growth in Australia's growing financial services and insurance industry and currently accounts for 45 per cent of the finance and industry sector in Australia.
- Superannuation investment underpins a substantial portion of the financial sector, both as deposits in Australian deposit taking institutions (ADIs), as well as in the equity of ADIs. As of March 2011, superannuation funds had invested about $163 billion in ADI deposits. A further $16.8 billion was invested in the bonds of financial corporations (bank and non-bank), and $115 billion invested in the equity of financial corporations (bank and non-bank).
- The longer term investment horizons of superannuation funds have also led to investment decisions that have assisted in reducing stock market volatility.

WHY AN INCREASE IN THE SUPERANNUATION GUARANTEE TO 12 PER CENT IS NECESSARY

- The current level of contributions is not sufficient to support Australians' lifestyle expectations for their future retirement.
- A nine per cent SG will generate low retirement incomes by international standards, well below average Organisation for Economic Co-operation and Development (OECD) replacement rates for the average worker.
- Since compulsory superannuation was first introduced there has been a significant increase in life expectancy. In 1983, an Australian female reaching the age of 65 could expect to live on average for another 18 years, while an Australian male could expect to live for a further 14 years. By 2002, these figures had risen to 21 years for females and 18 years for males. Even if nine per cent contributions were sufficient when the SG was announced, these increases in life expectancy imply that a substantial increase in the rate of the SG is required.
- Survey evidence indicates that a large majority of Australians support an increase in the SG to 12 per cent.

AN INCREASE IN THE SG IS AFFORDABLE FOR EMPLOYERS

- The analysis in this report indicates that in the long-run there will be no negative impact on employers, because employers will pass on the burden of increase either in the form of price rises on the goods and services they sell, or in the form of lowered wages (or wage growth) for their employees, or both.
- Employer costs could be increased in the short-term but the impact in any given year would at most be 0.25 per cent or 0.5 per cent of wages. For a small employer with a wages bill of $100,000 this amounts to $250 to $500. As well, the Government has announced a reduction in the company tax rate and also accelerated depreciation provisions for small businesses. Both of these measures will assist employers to deal with any cash flow issues.
- The economic literature suggests that an increase in the SG is likely to have no negative impact on employment by lowering the real wage, and empirical modelling appears to confirm that.

1 The Allen Consulting Group, Better living standards and a stronger economy: the role of superannuation in Australia, September 2009.

AN INCREASE IN THE SG IS AFFORDABLE FOR THE GOVERNMENT

- The net fiscal cost of compulsory superannuation (including the increase in the SG) is estimated by Treasury to peak at less than 0.5 per cent of gross domestic product (GDP) before gradually falling to less than 0.2 per cent of GDP. In comparison, the current fiscal cost of the Age Pension is around 2.7 per cent of GDP and this is expected to increase to around 3.9 per cent of GDP by 2050.

IMPACT OF THE INCREASE IN THE SG ON THE ECONOMY GENERALLY

- Econometric modelling indicates that an increase in the SG after 12 years (compared to the base case of leaving the SG at nine per cent) will:
    - Increase investment by 1.3 per cent.
    - Increase exports by 1.04 per cent.
    - Increase the capital stock by 0.9 per cent.
    - Have no discernable impact on the Consumer Price Index (CPI) or the level of employment.
    - Increase the real wage rate by 1.06 per cent.
    - Increase real GDP by 0.33 per cent (equivalent to around $200 a year for every Australian).

SUPERANNUATION AND INVESTMENT IN AUSTRALIA

- Superannuation has a substantial impact on real investment within the Australian economy. This impact is both direct and indirect. The direct impact is through funds investing directly in real assets (like infrastructure projects or property) as part of their investment portfolios. Indirect investments include funds investing in the share and other capital markets.
- Australian superannuation funds directly own hundreds of major commercial real estate properties, including office buildings, shopping centres and industrial parks. Specific examples are provided in the report.

SUPERANNUATION AND INFRASTRUCTURE

- Australia is the country of domicile of seven out of the 20 largest infrastructure managers in the world, with superannuation funds the major source of investment for such managers.
- Around $45 billion in total currently appears to be invested by Australian superannuation funds in infrastructure and this could rise to $200 billion by 2025 on the basis of likely asset allocations. The future amount in infrastructure would be lower if self-managed superannuation funds increase their share of assets in superannuation.
- Examples of infrastructure owned or financed by superannuation funds include airports, toll roads, ports, pipelines, hospitals, and educational facilities. Specific examples are provided in regard to a number of superannuation funds and managers.