Agricultural Competitiveness White Paper Submission - IP344
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Re: Availability of Investment Capital in Australia

I am concerned about the long term wealth and security of Australia when we appear unable to generate sufficient savings for investment in long term nation building assets and export industries and instead rely on foreign equity with its long term drain on future current accounts.

There are two major personal assets held by members of the Australian community which, apparently, are unavailable in sufficient volume to fund long term investment: superannuation and domestic housing.

Superannuation

The asset value of Australian superannuation funds is about $1500bn and growing quickly. Approximately 80% of total superannuation fund assets are held in accumulation funds.

There are two types of superannuation fund: benefit promise and accumulation.

Benefit promise funds are no longer popular because of the potential liability imposed on the guarantor; they are a minor and declining proportion of the superannuation pool.

Accumulation funds depend for their growth on individual (and employer) contributions and investment returns; they are the largest group and growing rapidly.

Upon retirement, an individual can access the asset in their accumulation fund account as a "lump-sum", which may be taken as cash or converted to an annuity (the periodic payment of income and a portion of the capital over a defined number of years). The value of the individual's account depends upon the market value of the invested assets at the date of retirement or conversion to an annuity.

Because market cycles and retirement dates rarely synchronise to an individual's advantage a lump-sum system places a premium on assets that can be liquidated quickly without significantly affecting the price. The outcome of this situation is to mostly restrict the range of investment opportunities to listed stocks with a large capitalisation and high market turnover. Also, it encourages managers to adopt a short term "trading" mentality rather than a long term investment approach.

The objective of a private superannuation system is to provide retirees with an income stream sufficient to maintain their standard of living without relying on the public purse. The important factor is income rather than the underlying capital asset, although the level of income is largely determined by the size of the capital base.

Under the now declining benefit promise schemes a retiree's benefit was an annual pension, generally related to their final salary. The capital remained in the fund, with income from investments funding the pension payments. Under this system management focussed on soundly financed well managed companies/projects with an assured future income stream. Short-term fluctuations in stockmarket prices were much less important.

There is no logical reason why an accumulation type superannuation fund could not fund retirees' standard of living via a pension payment rather than the lump-sum/annuity system currently in vogue. The individual's annual pension payment would be proportional to the fund's annual income and the individual's accumulated contributions to the fund's capital pool.

With capital remaining in the fund and a longer term perspective there would be no impediment to investment in suitable projects such as roads, rail, ports, agriculture, research and value adding to primary commodities. A side benefit for individual retirees would be removal of the temptation to participate in highly risky leveraged financial products peddled by unscrupulous operators.

The formation of accumulation/pension funds in preference to accumulation/lump-sum funds could be encouraged by adjusting the superannuation fund tax so that accumulation/pension

funds paid, say, 13% and accumulation/lump-sum funds paid, say, 17%.
Employees/contributors would need to nominate in which type of fund they wished to participate when they commenced making contributions.

Domestic Housing

Relative to many other developed countries Australia invests a disproportionate amount in domestic housing. In part, this is driven by the tax protection enjoyed by this asset class, that is, it is exempt from capital gains tax. Other asset classes do not enjoy this advantage so they are less competitive when seeking investment funds.

The playing field needs to be levelled so that a stronger economy can be built using a greater proportion of internal funds rather than foreign equity or debt. However, it would be political suicide for any government to levy a capital gains tax on domestic housing and appropriate the resultant revenue stream into the general revenue account.

Most voters are rightly suspicious of government's promises and would not tolerate an attack on their largest single asset (their house and land), so an alternative asset must be offered to ease the pain and offer a regular return.

The following would require fine tuning but could provide the basis for levelling the investment playing field.

Upon sale of a domestic dwelling, fifty percent of the net gain, above the CPI adjusted cost, would be subject to capital gains tax. The tax funds would be used to subscribe for shares in a "National Development Fund", such shares to be issued in the name of the vendor of the house and land.

To ensure transparency, the "National Development Fund" would be incorporated and subject to the Companies Act; the Board of Directors would be chosen by shareholders and the company would be listed on the Australian Stock Exchange, thus providing shareholders with a secondary market for their shares.

The "National Development Fund's" charter would be to seek a commercial return from investments in suitable projects such as roads, rail, ports, agriculture and value adding to primary commodities. Investments would not necessarily be restricted to Australian based projects.

From the perspective of the vendor/investor such a diversification would not alter the total value of their assets but would lower their total investment risk.