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Dear Review Office

REVIEW OF THE COMMONWEALTH GOVERNMENT SECURITIES MARKET

I had hoped to provide comments as part of the Review of the Commonwealth Government Securities Market.

I note from his 30 October 2002 Press Release that:

- the Treasurer intended that the consultation process will ensure that all interested stakeholders have the opportunity to provide input into the Government's consideration of this important issue; and
- the paper … seeks to make the issues accessible for an audience without a financial market background.

I have a background in government administration, in accounting, in finance and in education in universities.

I have read the October 2002 Discussion Paper and I have attempted to prepare a submission. However, I regret that I have not been able to cope with the Discussion Paper. The approach and tone have been very unsettling to me. It appears to have been written for economists. It does not provide adequate evidence of the underlying premise having been first assessed, and accordingly may be proceeding from the flawed premise that the Commonwealth will not again be a substantial net borrower. To me, the Discussion Paper seems to unfortunately contain a flavour of the decision having already been taken, with the Paper providing the means of letting the industry and public make limited comments. It seems to me that long-term action is being proposed in what appears to be a short-term reactive mode.

These factors have alienated me to the extent that I feel unable to participate by inputting to the decision process.

While I do not deem this to be a submission on the Discussion Paper I am particularly concerned by the apparent attitude to the unfunded superannuation liability and I provide the following limited comment on this aspect.

Unfunded Superannuation Liability
It seems to me that the discussion on the unfunded superannuation liability [page 87 on] could reflect double standards.

Unfunded superannuation liabilities and cash reporting allow governments to understate their expenses and overstate their results as compared to entities making superannuation payments to external superannuation funds or reporting on an accrual accounting basis.

I consider the Government should impose on itself the same requirements it has imposed on the private sector as the ideal toward which the Commonwealth should be moving. This would require superannuation be funded and would require reporting on the accrual basis in accordance with accounting standards. Defined contributions employees would enjoy the same superannuation advantages and suffer the same superannuation disadvantages as private sector employees.

The question then becomes how quickly the Commonwealth can adopt the requirements it has imposed on others, and the flexibility it has or may extend to others. The targets could be:

1. to allow existing defined contributions employees to have their superannuation contributions invested in a fund of their own choice. This would mean the full funding of the existing superannuation liability of those individuals;
2. the Commonwealth arrange for the superannuation of other defined contribution employees to be conducted for the individual by private sector funds. This would mean the full funding of the existing superannuation liability of those individuals;
3. the Commonwealth close defined benefit arrangements to new entrants (if this has not already been done) and arrange for the superannuation of defined benefit employees and retirees to be conducted by private sector fund(s) with the Commonwealth funding any shortfalls or benefiting from any surpluses arising from the private sector fund(s)' actual performance. This also would mean the full funding of the existing superannuation liability of those individuals

Under this approach, the Commonwealth could need to borrow. This would be at the CGS rate. Defined contributions employees would earn private sector superannuation rate returns on their defined contributions. The Commonwealth would have no exposure to any difference between the CGS rate and the private sector superannuation rate.

With defined benefits employees and retirees the Commonwealth would be exposed to any difference between the CGS rate and the rate earned by one or more private sector superannuation funds. If the Commonwealth is not yet comfortable with tolerating this risk it may wish to defer this (third) target to some later date.

This approach removes any issues of interfaces between the Commonwealth and borrowers or equity issuers resulting from the investment of Commonwealth employees' and retirees' superannuation. It also has the additional benefit of the Commonwealth having some interest in the performance issues faced by private sector superannuation funds and private sector employees. Any concern as to the likelihood of the quantum of the investment of the current unfunded superannuation liability distorting asset prices is even more applicable to the growth in superannuation investments generally and both should be carefully considered.

It also eliminates any need to address special governance arrangements for hypothecated asset funds or a Commonwealth internal superannuation fund.

When reading the section on budget impacts [page 101] I found myself asking what is offensive in reporting the full extent of the Commonwealth's liabilities and Government's expropriation of taxpayers' future earnings? This contrasts with focusing on the lesser draws today on taxpayers' cash resources and only the (general government?) net debt component of the Commonwealth's liabilities. I also found myself asking whether the discussion on what is classified inside or outside the general government sector [page 102] tends to suggest that honouring the fiscal policy really turns on finding classifications that meet the circumstances.

The cash measures advanced in the Paper may be of interest to economists. But the unfunded superannuation liability is massive, both in absolute terms and relative to the projected future net debt. As a taxpayer I, at least, am also interested in the Commonwealth's and hence my liabilities for payments into the future. Funding the superannuation liability and thus including any liability within the reported net debt gives transparency to a very significant impost on future generations.

The Commonwealth's unfunded superannuation liability has the potential of being a very substantial problem for future taxpayers and is worthy of much more serious consideration than the limited consideration evident in Chapter 5. To me, the unfunded superannuation liability dwarfs the question of whether or not Government closes down the Commonwealth Government Securities market for some few years. The market can be reopened at an extra (unnecessary) cost to the Commonwealth.

But there will prove to be a limit to even future taxpayers' resources to meet the unfunded superannuation liabilities; $84 billion today is a significant sum, and it is still growing. And does anybody seriously expect future taxpayers and business owners who have funded their superannuation to be happy to find themselves paying this bill in the future because of differences in public sector and private sector funding requirements and reporting practices today.

I would urge the Government to very, very seriously reconsider the priorities being given to solving the unfunded superannuation liability, as evidenced in the Discussion Paper.

I would be pleased to elaborate on any aspect at your request.

I will separately email a copy of these comments to you at < debtreview@treasury.gov.au >

Yours faithfully

Neville Smith

4 December 2002