SUBMISSION BY MAURICE KENNEDY TO THE SENATE ECONOMICS LEGISLATION COMMITTEE FOR ITS INQUIRY INTO THE PROVISIONS OF THE FUTURE FUND BILL 2005

Introduction

1. The Senate Economics Legislation Committee is inquiring into the provisions of the Future Fund Bill 2005. The Future Fund has been presented as an inter-generational strategy that, in coming decades, would take some of the pressure off the Commonwealth's financial resources by creating an income stream to the Consolidated Revenue Fund that would be hypothecated towards meeting the Commonwealth's future superannuation liabilities – principally for public servants, Defence Force personnel, Parliamentarians and judges.

2. In deliberating on the issues raised by the Bill, I believe that the Committee ought to address two threshold questions:

   (a) Is a Future Fund needed for this stated purpose?

   (b) If so, is the proposed manner and machinery of its operation consistent with the Commonwealth's inherent obligations for its trusteeship of public money?

3. This submission offers the following observations that may assist the Committee in considering these and other questions raised by the Bill.

This Parliament cannot commit future Parliaments

4. In being created as such a long-term strategy, the Future Fund would inevitably find itself under the stewardship of different future Governments and Parliaments with, perhaps, a vastly different make up to what we have come to expect, and for whom the policy agenda, and associated political and fiscal priorities, may profoundly differ from the present.

5. In other words, at some point, it is possible that an extant Future Fund – with its substantial accumulation of cash and investments – might be seen as an irresistible and expedient vehicle for a Government wishing to pursue, say, an interventionist development agenda. (Sadly, the examples of past WA and Victorian State Governments spring too readily to mind.) Thus, the Future Fund's currently proposed focus, its prudential underpinnings and its regime of Parliamentary and public transparency, will be enshrined in law only until a future Parliament changed the law to suit a different agenda.

The presumption of conservatism in Commonwealth financial stewardship

6. Perhaps the most disturbing aspect of the Future Fund, as presented, is its deliberate departure from the long-established principles of 'trusteeship' by which the Commonwealth has traditionally managed its surplus cash. The *Financial Management and Accountability Act 1997* (as did the *Audit Act 1901* before it) permits the Finance Minister and Treasurer to invest public money in "authorised investments" and establishes both Ministers as corporations for the purpose. Authorised investments are, essentially, akin to those that an ordinary trustee is permitted to make – Government bonds, deposits with a bank, etc. Conservative, but safe – since, unlike the stock market, there is no negative return on cash investments.

7. The Future Fund has been likened to 'any other superannuation fund' in which the Fund Managers seek to optimise, through a spread of investments, the returns on members' contributions. But this analogy is false – it is not **members'** contributions that are being managed: it is public money over which the Commonwealth has a primary duty of care to the Australian people as a whole, to exercise its trusteeship in a risk-averse way. The manner in which the Future Fund is to operate does not meet that criterion. Moreover, as shown in the recent past, even the best run superannuation funds can experience negative returns.

Depletion of the Commonwealth's Cash Balances

8. The Future Fund will convert the Commonwealth's cash into investments. There will be two opportunity costs to this. First, to the extent that the cash is so applied, there will be a reduction in the level of interest that the Commonwealth could potentially earn on its balances with the Reserve Bank. Secondly, the Reserve Bank, itself, will have access to a reduced level of Commonwealth cash to employ in generating its own profits. This, in turn, will affect the level of dividend it pays the Commonwealth.

The Future Fund's Influence on the Market

9. By any measure, the Future Fund will be a big player in the market, even among institutional investors. Its investment mandate is to pick winners. It will be monitored closely by other investors and its decisions – even allowing that it would have a broad spread of investments – will inevitably influence these other players' decisions. Notwithstanding the intended 'arm's length' relationship between the Board and Government, there will always be the suspicion within the market that the Board (for no other reason than because it is a *Government* investment body) is privy to proposed, but as yet unannounced, Government policy changes. This would create unwarranted, undesirable market distortions.

10. Worse than that, in the circumstances described in paragraph 5, above, the focus of the Board's investment mandate might have been changed from that of picking winners to one of 'saving losers'.

The Market's Influence on the Future Fund

11. When the market experiences its downturns, whether from external factors or simply as a natural consequence of the economic cycle, the Future Fund may become a negative contributor to the Commonwealth's resources. Budget surpluses that are intended to feed the Future Fund are, of course, also jeopardised by the same external factors and economic downturns.

Why Superannuation?

12. Prudent financial management by anyone aiming to remain solvent demands that they make provision to meet their emerging liabilities – Current Liabilities. If I have a liability for a loan, I remain solvent provided I can continue to meet my periodical repayments – even if I don't have the resources to repay the whole of the loan (the Long-term Liability) in one hit. The Commonwealth operates similarly in formulating its annual Budget. It makes provision for the various liabilities, including superannuation, it will face during the Budget period.

13. To point out that the Commonwealth's total superannuation liability will be $140 billion **by** 2020 is disturbing, but it is misleading: the superannuation liabilities **for** 2020 and each of the subsequent years will not be anything of the sort.

14. It is also worth noting that these superannuation liabilities pale by comparison with the levels of the Commonwealth's ongoing statutory Health and Welfare Benefits liabilities. So why superannuation for public servants, Parliamentarians etc. should be singled out as the justification for a Future Fund is not clear. Perhaps the answer has more to do with politics than economics.

Hypothecation is bad Budget policy

15. The proposed Future Fund, at any point in time, will comprise two components – **cash**, which should be held in the Commonwealth's bank accounts with the Reserve Bank and which will make up the credit balance of the Future Fund Special Account (a sub-set of the Consolidated Revenue Fund); and **investments** which have either been acquired via cash spent from the Future Fund Special Account or investments (eg., Telstra shares) that have been transferred directly by the Commonwealth to the Future Fund.

16. It is intended that the Future Fund Special Account, to be applied to the Commonwealth's superannuation liabilities, will be fed by transfers of Budget cash surpluses (including an initial seed capital of $18 billion in 2005-06); proceeds of future asset sales; and dividends and realisations of the investments comprised in the Future Fund. Put another way, the specific revenues from asset sales and investment dividends and realisations are to be hypothecated to superannuation via the Future Fund Special Account, as augmented by any achieved Budget surpluses.

17. Successive Commonwealth Governments since Federation have come to recognise, time and time again, that hypothecating specific revenues to specific spending purposes are almost always ill-conceived and come to be regretted by the Executive – for two reasons. First, if the amounts being hypothecated are substantial (as is likely in this case) it constrains Budget flexibility by hampering rational resource allocation decisions of total revenues among total competing bids. The expenditure benefiting from the hypothecated revenue in practice receives an automatic 'priority'. That (and the unpopularity of the related income tax surcharge) was why the National Welfare Fund, as originally conceived, was abandoned as the means of hypothecating revenue to Health and Welfare Benefits. The second reason is that each instance of hypothecation creates a precedent for other areas of expenditure demanding similar treatment (often with equally valid grounds). This tends to undermine the integrity of Budget deliberations.

Hubris

18. Investment decisions for the Future Fund will be undertaken by a "Board of Guardians". This title seems to me, at least, unnecessarily grandiose (although it does prompt the inevitable question "Who guards the guardians?"). If the Committee recommends any changes at all in relation to the Bill, I hope one of them will be that the Board be titled simply as the "Board of the Future Fund".

CONCLUSION

19. I contend that the Future Fund has much less going for it than its proponents would have us believe. I suspect that they realise this. Consequently, I am led to wonder whether the Future Fund is being constructed as an elaborate device for one or both of the following reasons:

(a) To be the vehicle that allows the Government to unload its Telstra shares at arm's length via a body (the Board) that 'isn't the Government' thereby allowing it to wash its hands of any adverse PR and market consequences arising from their eventual sale.

(b) To 'earmark' Budget surpluses (that would otherwise lie unattached in the pool of the Consolidated Revenue Fund) and so forestall any claims by the States for the payment of that money to them, under the surplus revenue provisions of section 94 of the Constitution.

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