Risk, capital markets and the future: a new generation of policy reform

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1. Introduction: Australia as a leader in government and economic reform

An Australian cliché stretching back at least to Donald Horne's 'Lucky Country' is that we excel at sports but fail to extend that excellence to other areas of national life.

Yet the list of things at which Australia excels keeps growing.

Despite the frustrations and compromises of government and politics in Australia you may be surprised to find that we are amongst the best in the world at government.

Of course politicians and bureaucrats can do all sorts of terrible things.

But like the ad with Ian Thorpe and seals, it is not really fair to compare human beings and seals at swimming.

Outside the fevered imagination of the ad agencies, and despite the heroic efforts of Ian Thorpe, the seals would win every time! So the only reasonable way to assess our performance is in comparison with other governments.

Individual policy programs have frequently been world leaders, studied and emulated around the world. They include:

- The Higher Education Contribution Scheme (HECs)
- The enforcement of family maintenance orders through the tax office and
- AIDS policy

Indeed, it would be hard to find any country that had managed to combine a talent for policy with its passion for sport as successfully as Australia. As the recent Commonwealth Games remind us when those things combine, extraordinary things happen.

These examples are part of a larger picture. Two Australian institutions at the apex of their respective areas of government, would be recognised by their peers as amongst the best in the world:

- the Reserve Bank of Australia and
- the High Court.

The best example of our broad policy prowess is the economic reform we have engineered over the last two decades. Few countries if any have done better than us, or achieved reforms more fairly.

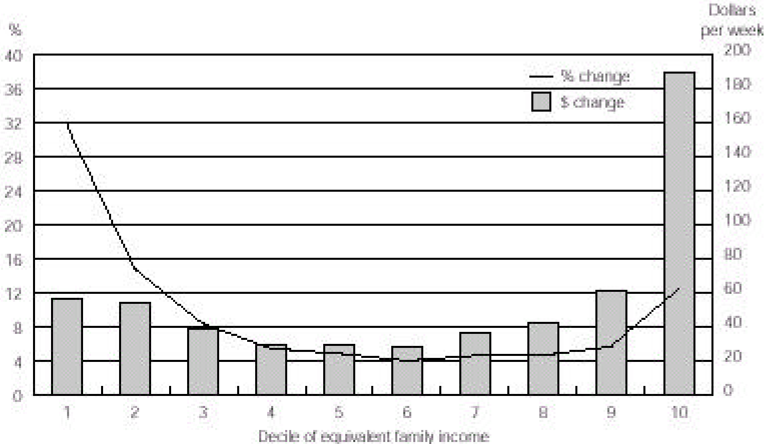
A critical part of the fairness of our own reform has been our uniquely targeted and means tested social security system. It has a unique blend of low US style cost and wide European coverage and security for beneficiaries. As a senior World Bank Official put it in 1998

> The Australian social security system . . . is one of the most cost effective in the OECD in terms of net expenditures as part of GDP; it has also . . . one of the most comprehensive coverages. Cost effective comprehensive coverage is a magic element in what we're looking for. . . . It also probably benefits the poorer parts of the population more than most other systems.[1]

Popular opinion notwithstanding, reforms actually worked actively against the increasing inequities being thrown up by the market. In other countries like the United States, important policy decisions greatly intensified inequality. By contrast, Australian tax and transfer policy meant that between 1982 and 1997 the real income of the poorest 10% of households grew by over 30% - the highest real percentage increase of any group of households.

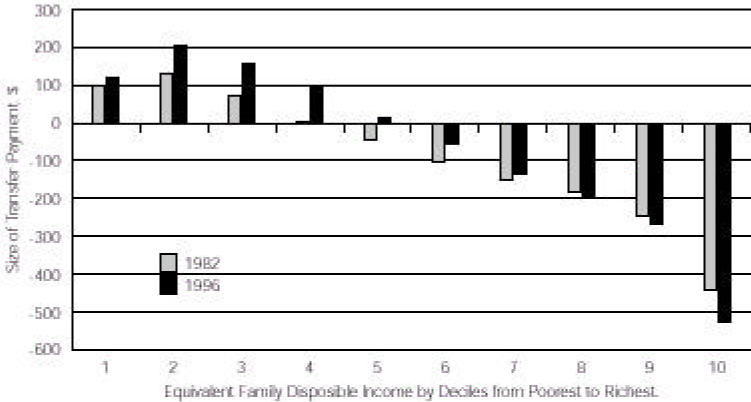
[1] Qaiser Khan, Senior World Bank official, ABC Background Briefing, 11/10/1998, at http://www.abc.net.au/rn/talks/bbing/stories/s13141.htm.

Figure One: Real dollar and per cent changes in equivalent family income 1982–97



Source: NATSEM.

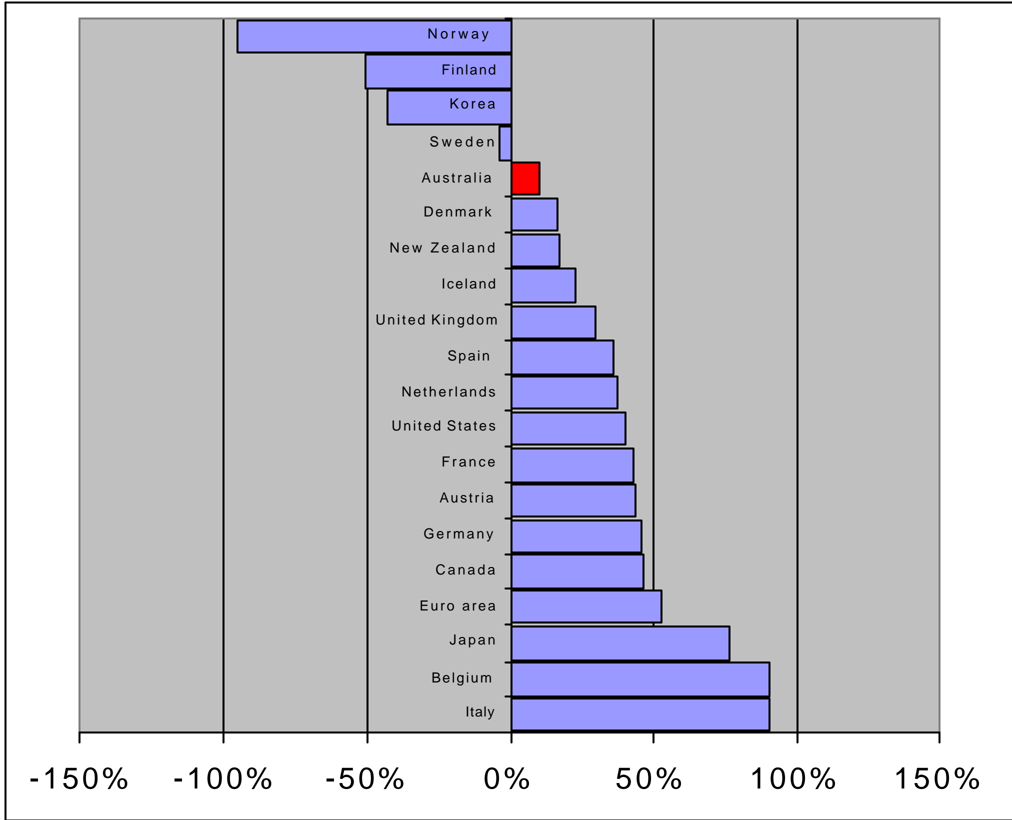
Figure Two: Weekly re-distributions through the tax and transfer systems ($ real, 1982-97)



Source: Private communication from Ann Harding, NATSEM.

We have one of the most fiscally responsible political systems in the world – with one of the best fiscal performances.

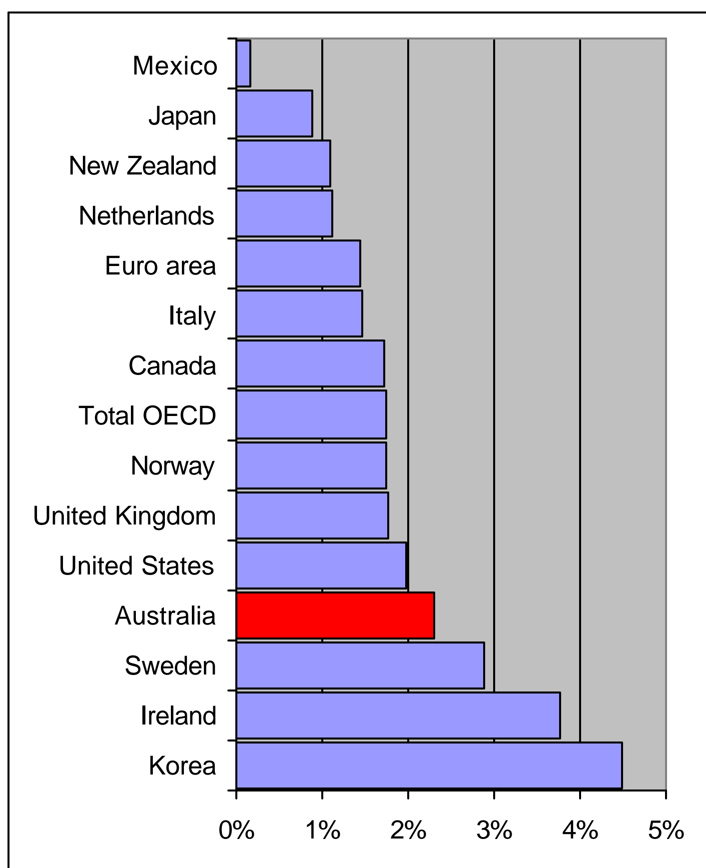
Figure Three: General government net financial liabilities



Source: OECD

And our productivity and output per capita, and so our living standards, have been steadily rising both absolutely and compared with other nations.

Figure Four: Labour productivity in the business sector 1992-2003 (forecast)



Source: OECD

Yet to stay ahead internationally we need to throw off two ingrained national characteristics.

One is our pessimism – our assumption that we're really not much good, that government in Australia is pretty mediocre and self serving.

I recall several taxi ride conversations I've had recently, in which the taxi driver said to me that it was "no wonder Australia was going down the economic tube". Informing the taxi driver that actually Australia had one of the healthiest economies of all the developed world was a real conversation stopper.

Related to this pessimism is a derivative kind of cultural conservatism. We might be in the process of throwing off the cultural cringe. But in my experience business people don't have much faith in our policy making ability. I recall conversations about policy with leading businesspeople at the BCA where the fact that a particular policy hadn't been tried elsewhere was – likewise a

conversation stopper. We don't really have confidence that something home grown might be the best, or even the best for us.

If our remarkable cultural achievements are leading us to dispense with our cultural cringe, its time our remarkable policy achievements put an end to our policy cringe. Quite obviously Australia cannot continue to define 'best practice' in policy without the confidence to build on the foundation we have already built.

2. Managing risk: a new field of reform

One important theme of reform since the 25% across the board tariff cut was a re-conceptualisation of the economy as going beyond the making of things and supply of services. Reform shifted the focus to something more abstract – the idea of the economy as a giant mechanism for regulating internal and external trade. And so we paid increasing attention to the efficiency with which we trade with the rest of the world, and the extent of competition in our internal markets.

A lot of the 'low hanging fruit' in the reform program we are on has already been picked in the past two decades. Today the trade agenda has run much of its course. The Productivity Commission recently conceded that reducing tariffs below 10% in the automotive industry would generate "very small" (indeed ambiguous) gains.

I think there are many new reform frontiers where we could be making major gains – where the fruit is still hanging low to the ground.

I want to concentrate on some areas of importance for the property sector. Again the ideas are abstract, perhaps even more so than the trade agenda because in addition to being a giant mechanism to regulate internal and external trade, our economy is a giant risk management system.

Shining the light of economic thinking on the restrictions on trade and competition that had built up over the years revealed major gains to be made from reform. As we move to complete that agenda, so doing the same in the area of risk reveals plenty of existing arrangements which can be greatly improved.

If the economy is a giant risk management system, have we got the right risks with the right participants in the economy? How can we improve things?

The returns to managing risk

When one thinks about risk, diversification is a time honoured and incredibly powerful tool.

One can diversify to protect oneself from most specific risks – such as risk to a specific project or a specific sector. And if one could diversify away all risks, one would expect the cost of debt and equity to pretty much line up with each other. However one risk that largely defies diversification is the risk of recession. Some diversification can be provided by diversified asset allocation, but the more recession proof assets – bonds and cash – also lower average returns in a portfolio.

Our economy has become more stable and more supple as a result of natural maturation, reform and also the so far excellent judgement the Reserve Bank of Australia has exercised. But there are more things we could do to moderate the economic cycle. The benefits of so doing would be both economic – lower cost of capital, higher investment and faster economic growth – and social as employees enjoyed greater job security.

3. The BCA agenda for macro-economic reform

In 1999 the Business Council released a provocative discussion paper which explored ways to improve the way the economy as a system manages risk.

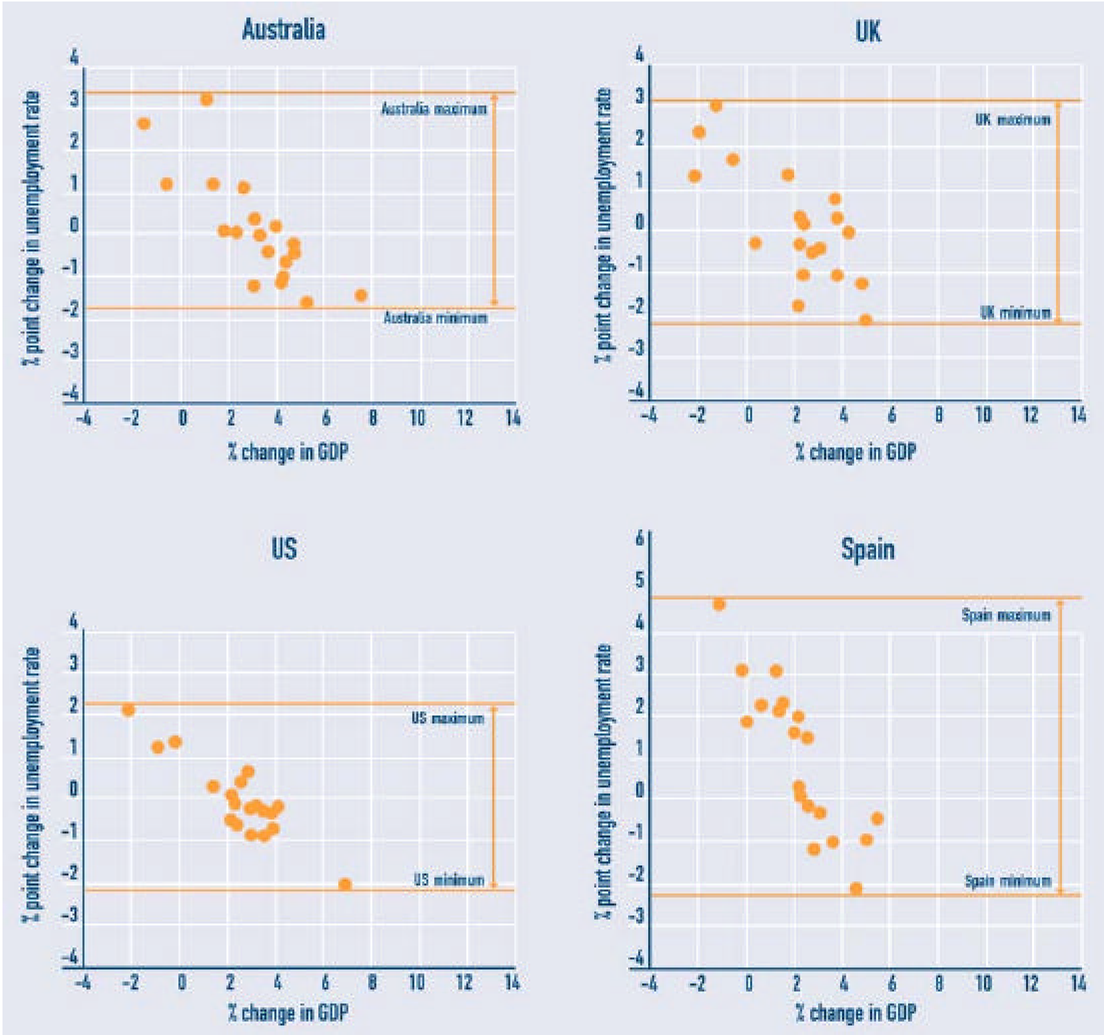
The logic of these reforms is similar to the logic of tax reform. You will recall the slogan "broaden the base – lower the rate". The BCA agenda for macro-economic reform involves broadening the base over which risks are shared in the economy. By doing so volatility would be lower for certain parts of the system that would otherwise by overloaded. And some risks would be traded for other more benign ones.

The BCA pointed out that we could build more automatic stabilisers into our economy by sharing risk just a little more with our workforce.

The wage share of the economy is so much larger than the profit share that one does not need to share risk much to have a strongly stabilising effect on capital returns and – perhaps more importantly, on employment and on the macro-economy more generally.

Thus workers might face a small increase in the variability of their income, yet for that they would have purchased higher real wages over time and less volatility in employment itself. They'd be less likely to be laid off.

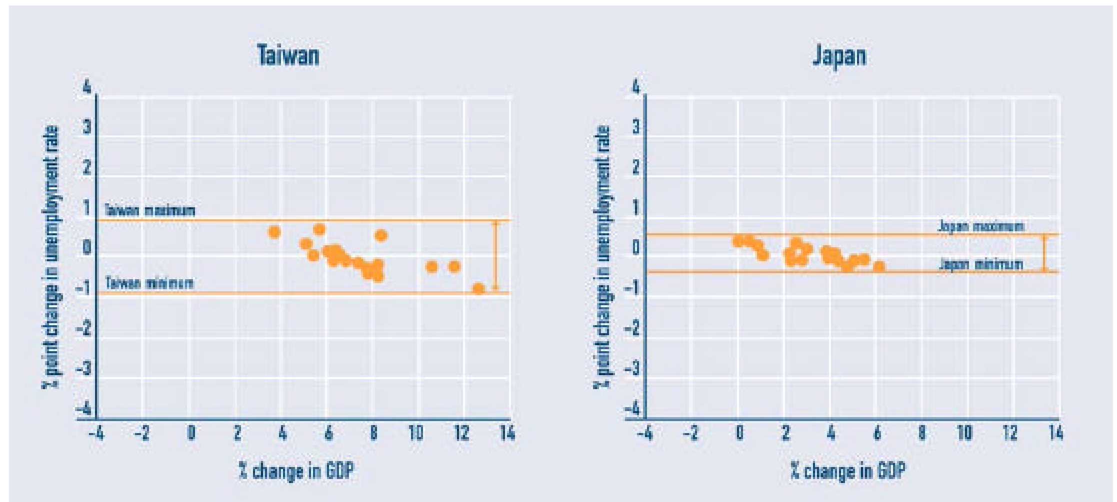
Figure Five: Annual % change in unemployment rate and rate of GDP growth



Source: *OECD, Main Economic Indicators*

In the Asian economies such as Taiwan and Japan, output volatility translates into far less volatility in the labour market. The BCA did not suggest that greater risk sharing be foisted upon workers. It proposed only that there were gains to be made from greater risk sharing and that accordingly we should explore the extent to which workers might wish themselves to negotiate away a small degree of wage stability for higher employment, greater job security and higher wages over time.

Figure Six: Annual % change in unemployment rate and rate of GDP growth



Source: OECD, Main Economic Indicators and Taiwan Statistical Data Book, Council for Economic Planning and Development, Republic of China.

Refashioning Fiscal Policy in the image of Monetary Policy

As I indicated earlier, we've been more successful than most other countries in turning away from the fiscal laxity of the 1970s. But it has become fairly clear that current political arrangements make it virtually impossible to sustain large surpluses during booms. The point of building large surpluses during these times of course is to increase public savings and to build government net worth or 'load the fiscal cannon' so that it can be fired – so that we can run substantial deficits – to moderate future downturns.

In Australia as in many other countries like the United States and New Zealand, politicians who follow a previous government that has run up large surpluses are invariably tempted to spend it. Thus in recent times governments which ran large surpluses in Victoria and New Zealand were seen to give a big free kick to their political opponents.

The fiscal discipline necessary to deliver large surpluses constrained their own political options, and to that extent assisted their demise. The surpluses were not only a handicap to the governments that ran them, but also a 'free kick' to their political opposition after the government had lost office. The surpluses they ran enabled incoming governments to spend a large portion of their predecessors' surplus on their own projects at the same time as staying sufficiently in the black to remain fiscally responsible in the eyes of the populace. The Commonwealth Government has taken the lesson to heart, running down its own surpluses to low levels having forecast substantial

surpluses in previous years. Elsewhere the Bush administration is demonstrating the fragility of popular support for fiscal responsibility. It is making a vigorous and so far extremely popular return to fiscal profligacy after the long haul back from the Reagan years.

The other problem with fiscal policy has been that it usually takes too long to alter in the face of changing economic circumstances as budgets are debated and negotiated through Parliaments.

We have largely ironed out these problems in the area of monetary policy as the Reserve Bank targets inflation through the cycle, is insulated to a substantial degree from day to day politics, and at the same time can act swiftly if necessary.

The Business Council paper suggested a mechanism whereby fiscal policy could be literally re-moulded in the image of monetary policy. A central agency independent of government could have a role in setting a general parameter that would affect income taxes by a very small amount. If it was felt that fiscal policy needed to be tighter for either long or short-term reasons, the parameter might be moved from 1.00 to 1.01. This would increase income tax rates by one per cent. Fiscal policy could be eased by reducing the parameter to .99 and so cutting taxes across the board by one per cent.[2]

Figure Seven: The Fiscal Parameter

Parameter Value	Tax Rate on Income below Threshold (%)	Tax Rate on Income above Threshold (%)	Company Tax Rate (%)	Change in Revenue (approx)
0.97	0	29.1	29.1	-$3 bn
0.98	0	29.4	29.4	-$2 bn
0.99	0	29.7	29.7	-$1 bn
1	0	30	30	0
1.01	0	30.3	30.3	+$1 bn
1.02	0	30.6	30.6	+$2 bn
1.03	0	30.9	30.9	+$3 bn

At the same time, the political decisions about who gets taxed, how much and how the revenue raised should be spent would remain where it belongs – with elected politicians.

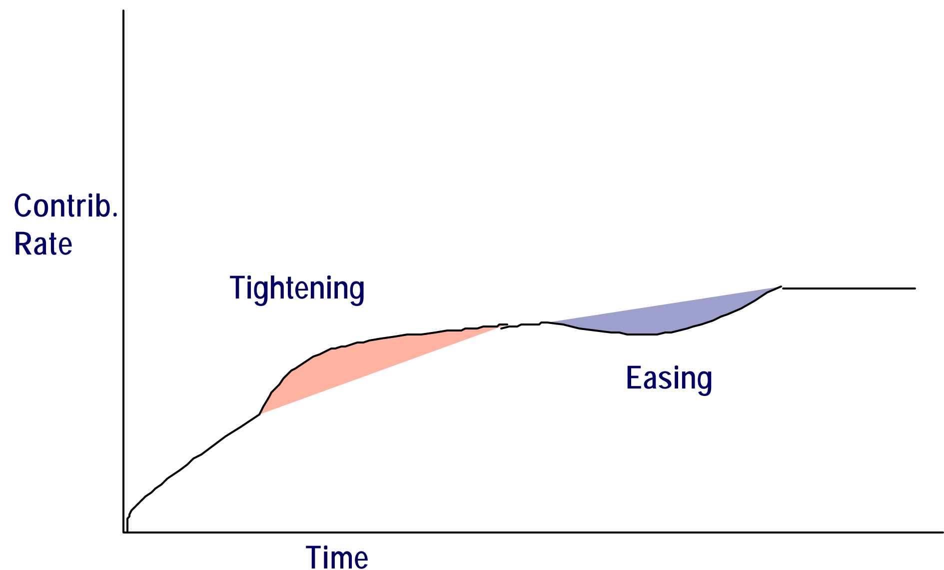
[2] The indicative table below makes an assumption that simplifies for the sake of illustration that tax rates are 30% above a threshold. Below the threshold tax rates are zero.

The mechanism would operate in close consultation with the government of the day as does monetary policy today. It would also operate 'in the background' as a kind of prudential architecture. That means that governments would be free to tighten and ease fiscal policy in whatever way they felt appropriate – that pressure would be brought to bear on governments for a change in the fiscal parameter only if the fiscal policy they were running went beyond the bounds of prudence.

Superannuation – about which I will have more to say shortly – also offers a potentially potent weapon for helping to stabilise the economy.

Something similar to what is proposed for fiscal policy could also be done with variations in compulsory contributions to superannuation. Indeed, this has been done on occasion in Singapore.

Figure Eight: Using compulsory super contributions to stabilise macro-economic stability



It will be noted from the diagram, that the intention is not to make short-term changes to compulsory superannuation which interfere with longer term objectives of substantially raising savings. In this context easing compulsory superannuation contributions may make sense at some time, but there would be some tension with the longer term goal. By contrast tightening for short-term reasons would 'kill two birds with one stone'. The instrument for delivering short-term stabilisation would also contribute to the longer-term goal.

4. A risk-based macro-economic reform agenda

If one thinks about the BCA agenda, all of the ideas seek to improve the way the economy as a system manages risk. Reform involved broadening the base over which risks are shared in the economy. Doing so would lower the level of volatility for certain parts of the system that would otherwise by overloaded. And some risks would be traded for other more benign ones. Thus workers might face a small increase in the variability of their income, yet for that they would have purchased higher real wages over time and less volatility in employment itself. They'd be less likely to be laid off.

This illustrates one of the critical things about risk. A risk avoided is a risk transformed. It may be passed onto others, but it may return to the party originally avoiding the risk in a more unpalatable form – particularly if the risk is passed on to a party who is not able to bear it efficiently.

Once we identify this issue of how the economy as a system manages risk it opens up plenty of other avenues of inquiry and opportunities for reform. I will go through just some of those opportunities below.

Some of the easy 'deregulatory' work is already done. Capital and goods market liberalisation has hugely improved risk management in the Australian economy, both in terms of the sophistication of systems in the market, but probably more importantly in terms of the massive increase in the depth of the market.

But this reform has left one critical issue largely unconsidered. The deregulatory phase of reform has seen government retreat to its core functions steadily pushing risks back onto the private sector. This is generally one of the advantages of privatisation, as it helps push risks back to that place in the market that can best mitigate them. Qantas shareholders now bear the demand risk when Qantas buys new planes – not government. Qantas is also able to make sophisticated arrangements with other market players to manage those risks.

But we should not forget that, though it is often not the right bearer of firm specific commercial risk, government – with its immense size, credibility in capital markets and its taxing power – is an excellent, least cost bearer of some kinds of risk.

As we have privatised state owned enterprises and property, government has been simply buying back its debt. Yet the issue of asset allocation is surely a separate issue from the one of whether government should run enterprises. So if it makes sense to sell the Commonwealth Bank and Qantas as I believe it did, if it makes sense to sell off Commonwealth office blocks (which I'm not sure it

does) it does not necessarily follow that the funds released from that transaction should simply retire debt. Apart from anything else this represents a sale of high yielding assets to fund the purchase of lower yielding assets.

If a well run firm in the private sector were to sell some of its businesses it would consider its appetite for risk (or rather the appetite of its owners – and prospective owners – in the market) and then seek an asset allocation that maximised its risk-adjusted return. If that meant retiring debt – well and good. But it is more likely to mean a more complex rebalancing of asset holdings.

Currently, by contrast, government asset allocation is largely by default. Government spends the revenue it raises and borrows – or lends – the rest. Government is too large, too important, and has too unique a role in the economy for it to handle its asset allocation by default. The Government has the health of the entire economy to consider, rather than simple returns to itself. But it should have an active asset allocation strategy that considers its role in handling the many risks that must be managed by the economic system.

If all this sounds fanciful or perhaps overly theoretical, these issues are actually pressing on government's attention right now. The sale of Telstra will move the Commonwealth from being a net debtor to being a net creditor. And the existence of a market in Australian government debt has clear utility in generating information and liquidity for Australian money markets. The Government is accordingly actively considering its options to maintain a substantial market in Commonwealth government debt in Australia notwithstanding the receipt of the Telstra sale proceeds.

In my view, providing it is properly balanced, and specific investment decisions occur at arm's length from Government through a properly competitive process, we can all benefit from governments investing in equities both here and abroad. To the extent that such investment was within Australia this will make its own contribution to raising equity prices closer to their true value, reducing the debt equity premium.

Further it would make sense for government to manage the investment in a broadly 'contrarian' way – holding more equities when they are relatively cheap, with less exposure when equity prices are higher. This would generate several benefits. Firstly broad contrarianism is a time honoured way to make good returns over time (though of course it does not guarantee returns over any specific period). Secondly contrarian investment would be stabilising investment – at the same time as being likely to outperform the market over time (though this is not necessary to the wisdom of the proposals made here), government contrarianism would help reduce market volatility. This would improve the

efficiency of the market with its own benefits in sharing risk with other investors. It would also operate counter-cyclically – moderating the economic cycle.

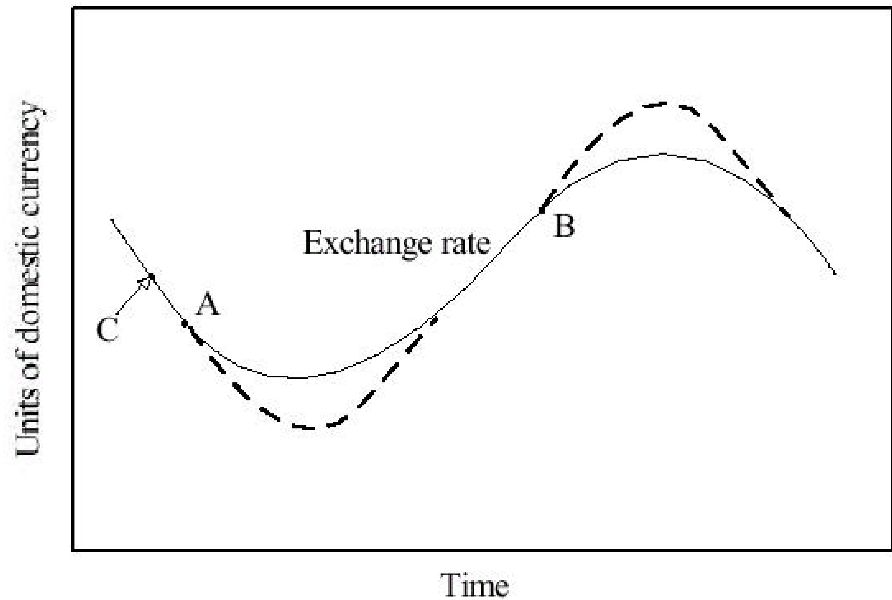
A possible institutional framework for such an approach would be a body or several government bodies – such as the Reserve Bank – taking responsibility for macro-economic stability and maximising economically sustainable growth. The body or bodies would play the lead role in managing interest rates, fiscal policy and asset allocation, with private managers competing for funds management contracts and managing stock selection.

As an example of the kind of thing that is possible, take the current unfunded Commonwealth superannuation liability of around $80 billion. Quite apart from the principles enunciated here, if it were simply funded transparently, the $80 billion odd unfunded liability would be acknowledged as a debt and the money raised from the debt could be invested in diversified assets yielding a higher return than the bonds that financed them. If we assume a cost of borrowing of 6% and an average return to the fund of 10% per annum, the gain would be over $3 billion per year. Net government debt would rise, but the more important measure, net government worth would rise also.[3]

Again, you may think all this is fanciful, but there are already precedents. This is pretty much what we do now in the foreign exchange market with the Reserve Bank intervening with the objective of reducing both short and longer term volatility and as a result adopting a broadly contrarian strategy. It has bought low and sold high. The result has been out of Milton Friedman's textbook for beneficial speculation – reducing market volatility at the same time as outperforming market returns. This is the diagram RBA researchers used to illustrate the ideal behind the strategy.

[3] This assumes the benefits accrue to the Commonwealth which seems a reasonable assumption for defined benefit schemes. If the scheme was converted to full funding, the benefits of the change in asset allocation would accrue to policy holders.

Figure Nine: Stabilising, contrarian investment



Source: "Reserve Bank Operations in The Foreign Exchange Market: Effectiveness and Profitability", Andrew, R and Broadbent, J, Research Discussion Paper 9406, November 1994, Reserve Bank of Australia, p. 5

Of course the government agency will not always be a winner. I expect the sustained fall in the Australian dollar has also tested the Reserve Bank's contrarian prowess. But over time I expect it will continue to beat the market and even if it did not, so long as it does not consistently lose money, the Reserve's intervention in the markets is a manifestation of its belief that its activity generates broader economy wide benefits beyond trading profits and losses.

Even if a government holding of higher yield assets did not beat the market it would enjoy a higher return at an acceptable level of risk. Instead of managing our asset allocation by default we should manage it according to the following principles. We should:

- increase government net worth through the cycle and beyond at least in line with the growth in our economy;[4] and

[4] My own preference is to aim for a gradual increase in government net worth as a percentage of GDP for some time as a prudential measure for a capital importer in a dangerous world in which markets can be capricious and as a means of raising national savings.

- manage government assets so as to improve economic efficiency and growth and contribute to an optimal management of risk by the economic system.

5. Risk and regulation

Finally, one agenda in micro-economic reform which has largely stalled is the issue of general regulatory reform. We have made great strides in de-regulation – the sweeping away of regulation that should not exist such as tariffs, airline regulation, prohibitions on competing with state monopolies and of course much regulation of the capital markets.

But with most regulation simply sweeping it away is not sensible, and is not a political option in a democracy, even if were desirable. We've known what regulation should ideally look like since at least 1972 when the Robins Report into Safety And Health at Work highlighted not just the inefficiency but downright counter-productiveness of what it called 'negative regulation' – what today we would call 'prescriptive regulation'. The best known simple illustration of 'negative regulation' is the requirement that a particular dangerous machine tool is not permitted without a mechanical guard. The way the regulation is written can thus preclude the use of an electronic guard which would not just be cheaper, but also more effective.

We need what is called 'output based' regulation, where the objectives of regulation are made clear and regulated firms are given the responsibility to use measurable, auditable business information and management systems to achieve those objectives in the most effective way. Some important strides have been made in this direction in some areas of our economy – for instance in occupational health and safety and environmental management. Yet it is amazing how much financial regulation remains crudely prescriptive.

Classic examples of relevance to the property industry are the widespread use of prohibition on various financial transactions – rather than the use of 'health warnings' for consumers. Thus retail foreign loans are all but prohibited, where it would surely meet the regulatory objective to ensure that anyone taking one out was clearly advised of the scope for risk and adverse outcomes. If this were not enough, some active education meeting specific requirements could be required.

If the prohibition on retail lending in foreign currencies sounds fairly small beer, ask a pensioner how easy it is to get a home loan to unwind the equity in their house to spend in their declining years. The Uniform Credit Code makes it heavy weather indeed. Major lenders have given it up as too much trouble. This restriction must already be the source of substantial real hardship in our

society as older people are forced into a situation where their asset riches cannot save them from their cash poverty. With the ageing of the baby boomers, the problem is growing worse.

There are plenty of other examples. Take the arbitrary prudential rules for safeguarding the value – soon to exceed Australia's GDP – in superannuation funds. In general, superannuation funds are not permitted to borrow or to invest in derivatives.

Of course they should not be permitted to do either of these things *imprudently*, but derivatives are a risk management *tool*. And of course fund managers should not be permitted to do either things against the will of those they manage funds for. But it is ridiculous that we impose huge restrictions on using debt and derivatives – as the latter were used by BT to protect their client's portfolios before the 1987 crash – to *reduce* portfolio risk. And as I expect all the delegates here know only too well, well managed debt exposure is central to building wealth efficiently and prudently. Indeed, debt will often enable a competent fund manager to achieve a lower risk for high yielding portfolios, because it can be used to increase the asset diversification from equities into property thus increasing asset diversification without sacrificing yield.

And – especially at a time when compulsory contributions to superannuation are still inadequate to fund retirement – it is also silly to prevent superannuation funds making prudent use of debt. Take the example of a working 20 year old. Are we really serious that preventing her super fund from accessing some gearing in her super especially early in her working life is not in her interest – or the community interest more generally?

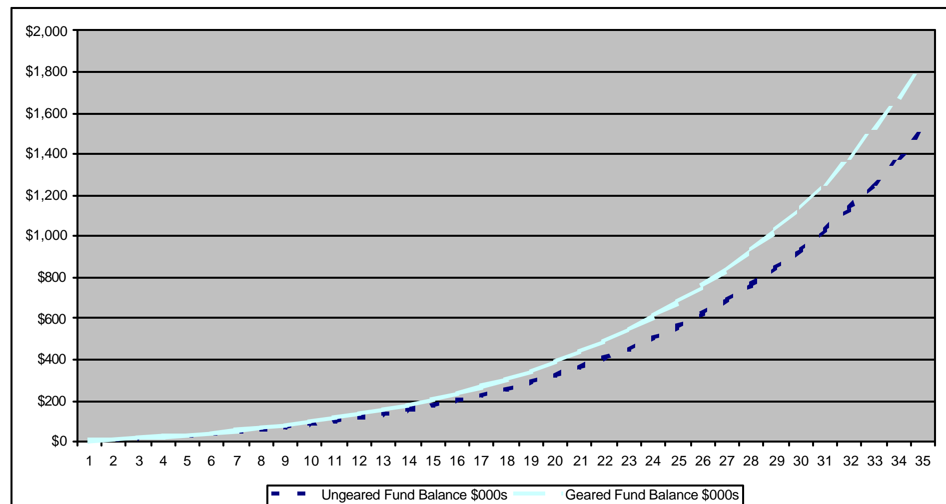
Here are the assumptions of a simulation we have done with a 20 year old professional on a salary of $65,000. In the base case there is no gearing. Then we construct a scenario by comparison in which we gear her super fund by 50% at the outset and this gearing ratio falls by 1.5 percentage points each year (reflecting declining appetite for risk) to be .5% geared after 35 years in the workforce. Pooled super funds have earned an average of 11.72% in all years since 1963 (including a forecast –4.1% for this year). We assume a return in the fund of 10.5%

Figure Ten

Investor's initial salary (p.a.)	$65,000
Growth rate of salary (p.a.)	3.5%
Tax rate on fund earnings	15%
SG employer contributions (% salary)	9%
Tax rate on contributions	15%
Initial level of gearing (%)	50%
Gearing reduction rate (p.a.)	1.5%
Interest rate on borrowing	6.50%
Superannuation fund average return (p.a.	10.50%

Our base case with no gearing generates a fund of $1,521,000 when she reaches 55. If she geared her commencing portfolio at 50% in the first five years, falling by 10% each five year period, she would end up with a fund of $1,847,000. This is a difference of 21% (it would be much more but for taxes on fund earnings).

Figure Eleven: Superannuation with and without gearing

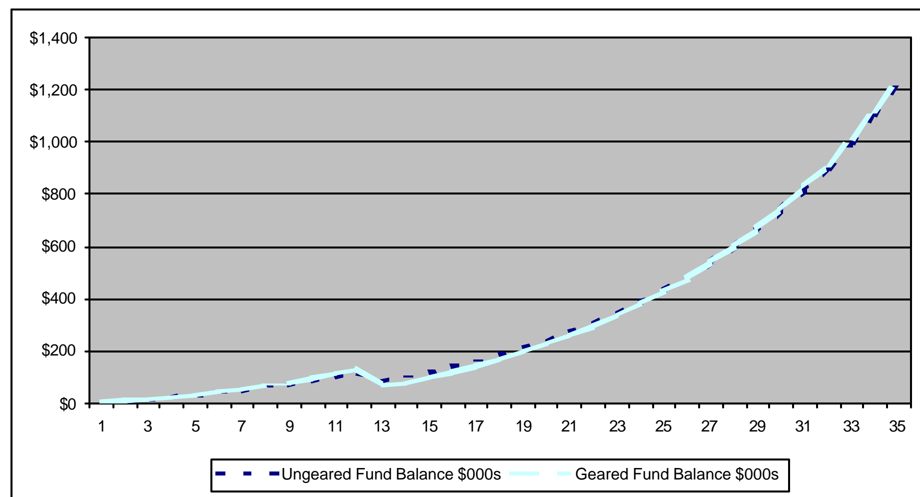


Yet the risk is exceptionally modest. The structure of the gearing is such that it would easily absorb the kind of volatility which has characterised the market in the last thirty years. The largest fall in average returns to superannuation funds in the last thirty years has been 14.5%. Our simulation already has a return which is one percentage point lower than the average return over this period. We also simulate a thirty year period during which there is a year in which returns are –35%. (Remember the portfolio held by the superannuation fund is taken to be an aggressive but diversified portfolio containing domestic,

international shares and property and some bonds.). There are no compensating increases in yields in the years leading up to or following this crash – so the simulation does not just model higher volatility but also lower returns. Average returns here are 8.68%.[5]

It turns out that the superannuation portfolio can absorb a shock of this magnitude in *any of the year* of its existence and still outperform the ungeared portfolio when our superannuant reaches 55. Year 13 is the most unlucky, leaving the geared superannuant only a little more than $16,000 richer than the control.

Figure 11: Superannuation with and without gearing with –35% returns in year 13



Simple rules like 'no debt or derivatives' might make sense for self managed funds for instance, but for funds managing billions of dollars of funds with elaborate trustee and audit safeguards, such a simple rule is hugely wasteful and inefficient. The appropriate regulation should be like some of the more advanced occupational health and safety regimes where virtually everything is allowed where it is done within the context of a well-documented measurable and auditable safety plan. Anyone who can demonstrate that kind of system should be allowed to access a more sophisticated kind of regulation.

[5] This is a simple average not allowing for the time value of money as we have not specified the year in which the shock occurs.

'Minimum Effective Regulation'

Over fifteen years ago the Commonwealth Government committed itself to what is effectively a bipartisan policy of 'minimum effective regulation'. Apart from the various mostly sensible ways in which we've deregulated, we have not gone far down the track of embracing output-based regulation.

This is another area in which large gains could be made and the property and financial markets could become more prosperous and more competitive, leading to greater economic prosperity and security for all Australians.

Unfortunately although Oppositions from time to time promise to 'cut red tape' our political system – like everyone else's political system – does not hand out rewards for the kind of high quality processes that are necessary for effective regulation. The various regulation review mechanisms impose apparent scrutiny but are not taken seriously within government or – it has to be said – by business. Lateral Economics has developed a project which would help address this situation. As the examples suggest, the gains from getting our system to actually deliver higher quality regulation would be huge.

6. Conclusion

Finally what would the world I have pictured look like?

An independent body or several independent bodies would have responsibility for macro-economic stability and maximising economically sustainable growth.

That body or bodies would play the lead role in managing interest rates, fiscal policy and asset allocation, with managers competing at arms length for funds management contracts and managing stock selection.

Some of the burden of aging would be lifted from Government, as it would be earning higher returns as a result of sharing more risk in the economy. Over time it this would make a substantial difference.

Equity prices would be higher and so hurdle rates for projects would fall and investment would rise. In the long run, a fall in the price of equity driven partly by an increase in indebtedness could be expected to increase interest rates and returns to debt.[6]

In fact it might not end up that way.

[6] The issue of foreign borrowing and the investment in foreign assets has not been separately treated here. Suffice it to say here that, to the extent that borrowing came from, or investment was placed in, foreign markets, the effects on the Australian market would be diluted.

With rising stock prices, increasing investment and lower levels of market volatility we would very likely become a more attractive place to invest. A virtuous cycle would have been established.

Of course nothing in what is here proposed is a panacea.

It won't end the cycle, or prevent all recessions. It won't abolish risk for anyone, though it will improve the form some of the risks take and the way they are managed and shared within our economic system.

It won't change the fact that hard work and attention to the fundamentals of good governance and prudent financial management at all levels within an economy is the foundation of prosperity as it always has been.

But it would ensure that as well as working hard, we worked a little smarter, and got a little richer, and a little further out in front as we continued to set the benchmark in world's best policy practice.

7. Appendix

Average Returns to Pooled Superannuation funds from 1963.

Year	Return (%)	Year	Return (%)	Year	Return (%)	Year	Return (%)	Year	Return (%)
1963	11.3	1971	2.4	1979	13.9	1987	31.5	1995	7.9
1964	13.6	1972	20.6	1980	37.5	1988	1.0	1996	10.5
1965	-8.7	1973	0.1	1981	17.1	1989	10.0	1997	18.9
1966	8.4	1974	-14.5	1982	-2.8	1990	11.2	1998	8.7
1967	12.0	1975	8.7	1983	26.4	1991	9.4	1999	8.6
1968	41.1	1976	21.3	1984	14.2	1992	10.6	2000	13.3
1969	8.3	1977	7.3	1985	21.5	1993	11.5	2001	5.3
1970	-1.5	1978	15.5	1986	32.0	1994	8.8	2002*	-4.1

*Source: Towers Perrin survey of pooled superannuation funds (Except for *) Cited in ASFA, "Superannuation Fund Investment Returns in 2001-02, Sydney, 2002, p. 7.*