

CAPITAL IDEA BRIAN TOOHEY

Paternalism on super destined to fail

The government is still trying to tell people what to do with their money.

Chris Bowen will soon have to decide if he wants to be a "libertarian paternalist" who thinks it's possible to calculate the risks other people face in a radically uncertain world. There's no doubt Bowen, as Minister for Financial Services and Superannuation, often takes a paternalistic approach. Before the last budget he championed the decision to compel people to lift the proportion of their salaries they must hand over to the nation's superannuation funds managers from 9 per cent to 12 per cent. You can't get much more paternalistic than that.

Now Bowen has to respond to Jeremy Cooper's review of Australia's superannuation system. Cooper says "libertarian paternalism" is the key tenet of his recommendations. The phrase sounds like a clever attempt to use a paradox to illuminate an underlying truth. In this case, the attempt fails miserably. Any libertarian element in Cooper's



Illustration Ward O'Neill

present to its eyes". The risk calculations may have been plausibly low, but this did not stop BP suffering a massive oil leak in the Gulf of Mexico. Now the owners of BP shares in British pension funds are demanding that the Obama administration does not make the company pay for the damage. Why the owners should not have to pay is unclear. But it is doubtful if Cooper's "dashboard" data would have done a better job of warning of the risks.

Cooper's desire to forecast how much money fund members will end up with is understandable. But these forecasts can never be more than a rough guess in most cases and could turn out to be badly wrong. No amount of risk control can foretell if, and when, a huge financial collapse will occur.

Cooper is on firmer ground in trying to increase members' returns by reducing the fees paid to fund managers. Unhappily, a leading actuary, Michael Rice, told this column that he does not expect Cooper's support for fund mergers and MySuper will cut costs, noting that, after a merger, Australian Super increased its administration fee by 50 per cent. But he says streamlining the handling of contributions should

review is almost entirely suffocated by its paternalism.

In Cooper's stilted definition, libertarian paternalism is "the idea that outcomes experienced by inert or disengaged consumers should have inbuilt settings that most closely suit those consumers' objective needs, as assessed by the expert providers of the product or service in question". Although individuals can opt out of his proposed MySuper product, he says its default setting must always reflect the "positive judgement about the most appropriate outcome for a [fund] member" the product provider makes.

One paternalistic element of his overall recommendations involves banning self-managed super funds from owning collectables such as coins or art, no matter how much more the trustees know about these investment categories than shares or property. The ban would

channel people into the financial services industry, where Cooper assumes they will be safer with shares, collateralised debt obligations, contracts for difference, speculative foreign exchange positions, hedge funds, derivatives, pork belly futures and so on. Self-managed funds can't have more than four members. Most are usually in the same family. All must be trustees. If they buy paintings that don't gain in value, they only hurt themselves.

The sharp decline in prices for many asset classes during the global financial crisis highlights the flaws in Cooper's paternalistic belief that governments can lay down guidelines allowing super fund trustees to successfully calculate the long-term risks for a vast range of financial products. He wants data about risks and volatility of the various components of all funds' portfolios

to be displayed on a "dashboard" in reports to members that also include forecasts of likely retirement balances.

The analogy is ill-chosen. Those looking at a car's electronic dashboard display of a road map can get an accurate picture of destination and route. As the financial crisis showed, this can't be done with financial products. But Cooper insists his "forward-looking, risk-targeting framework" will "provide members with a proper indication of expected future returns".

In considering these recommendations, perhaps Bowen should look at his own record. In assessing the performance of one asset class during a speech to a financial services conference in August 2007, Bowen said: "You don't need me to tell you how Australia's innovative property trusts are transforming the way

property is securitised around the world." At the time Centro, the most celebrated example of an Australian firm which had developed "innovative" financial engineering practices, had begun its slide to near oblivion.

As many researchers have explained for decades, it's not possible to achieve a high level of confidence with calculations of financial risks and volatility. The reason is that the behaviour of many of the relevant factors in an immensely complex future doesn't meet the requirements of probability theory. Contrary to the assumptions underpinning many risk management models, no system possesses the perfect foresight that the French mathematician Pierre-Simon de Laplace envisaged for a being of such vastly superior intellect that "nothing would be uncertain and the future, as the past, would be

create savings.

Nothing can resolve the government's core predicament on superannuation. It forces people to put their money into inherently risky financial markets on the implicit promise that this will deliver handsome returns in retirement. However, when markets go backwards there's nothing governments can do to boost the returns to angry fund members short of injecting large subsidies on top of the projected \$35 billion cost for the tax concessions on super in 2013-14.

Politicians love the paradoxical thought that returns can be lifted with lower risks. Which is why Bowen will accept most of Cooper's recommendations. But this won't make him a "libertarian paternalist". He will remain an old-fashioned paternalist who tells people what they must do with their money.