Should Australian super copy the Singapore model?

By Dr Tapen Sinha *

How should Australia's superannuation funds be invested? Many people are not happy with the existing arrangements. Chairman of Commonwealth Funds Management, Mr Ian Ferris, was quoted as saying: "The boom in superannuation funds may also concentrate super funds in the hands of fund managers of the 'Big Five' by the turn of century."

Some journalists are alarmed by all this: B A Santamaria notes: "The idea that a tiny handful of fund managers elected by nobody — responsible to nobody except the board of directors of their own life offices — should control almost the entire net household disposable savings of the community hardly commends itself." For some reason, a similar situation in banking did not seem to bother anyone before.

As an alternative, it has been suggested by many — including the recent report of the Commission for the Future, and quite a number of journalists — that the Australian superannuation industry should be run along the lines of the Central Provident Fund (CPF) of Singapore. Many Australian commentators now think that the CPF in Singapore is the source of all good things in Singapore.

In the interests of an informed debate, I shall highlight the important aspects of the Singapore CPF and contrast it with the Australian system. Then I shall discuss whether we should copy the Singaporean system.

Illustration by Mark Tremlett

History

The contribution rate to the Singaporean CPF was increased almost every year until 1984 when it reached a total of 50 per cent of wages. As a result, there has been a phenomenal growth in total CPF funds (see chart next page). One major use of the funds allowed by the CPF is the purchase of Government-built flats.

The current contribution rates are 17.5 per cent from the employers and 22.5 per cent from the employees.

Contrasts with Australian system

The Safety Net of Age Pension

The Singaporean CPF is simply the only system of old-age security. There is no age pension safety net if an individual happens to consume his/her financial resources before death. This conspicuous absence of the safety net of age pension is no accident. In 1959, the State of Singapore Development Plan for 1961-64 noted: "ambitious plans for immediate improvement of social services have to be

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SINGAPORE FUND CONTRIBUTION RATES

Contribution rate to the CPF as a % of wages			Contribution rate to the CPF as a % of wages		
starting date	by employer	by employee	starting date	by employer	by employee
September 1968	6.5	6.5	July 1979	20.5	16.5
January 1970	8.0	8.0	July 1980	20.5	18.0
January 1971	10.0	10.0	July 1981	20.5	22.0
July 1972	14.0	10.0	July 1982	22.0	23.0
July 1973	15.0	11.0	July 1983	23.0	23.0
July 1974	15.0	15.0	July 1984	25.0	25.0
July 1977	15.5	15.5	July 1987	10.0	25.0
July 1978	16.5	16.5			

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eschewed. Such a plan, can only be implemented by diverting much of the available capital resources from other even more pressing needs. The most pressing need is to increase employment and consequently national income to match the population growth." The present CPF was implemented in this spirit.

Proportion of Income Absorbed

The Singaporean system takes in a far larger proportion of income (currently 40 per cent) compared to Australia. This has important consequences in several dimensions as outlined in the following text.

Tax Revenue

The Australian system generates substantial tax revenues for the Federal Government. The money in the superannuation is taxed at three levels (with some exemptions): at the point of entry, earnings and exit. The Singapore system does not tax it at the point of entry or exit at all. Since most of the money is invested in government projects and the rate of return on these investments is not taxed, it may appear that there is no tax on the earnings either. However, the rate of return on CPF assets is lower than other forms of investment which amounts to an implicit tax on the CPF.

Performance Difference

One major tenet of the CPF is that the administration and investment management is centralised government.

Centralisation is explicit monopoly and, like any other monopoly, the absence of competition brings complacency. Has the Singaporean system suffered from lack of competition? Over 1975-1989, the real rate of return of the CPF was about 2.78 per cent per annum (the real rates of return in 1973 and 1974 were -11.6 per cent and -12.9 per cent respectively). At the same time, some private funds in Singapore provided over 6 per cent real rate. During the same time period, average real rate of return in Australia was 5.6 per cent.

Even a 1986 Report of the Central Provident Fund study group from the National University of Singapore criticised the government for not pursuing a more balanced portfolio to increase return on members' investments and will be discussed in greater detail later. Why has the performance of the CPF been so poor? The **nominal** interest rate paid on the CPF balance is set by the government. It bears practically no resemblance to actual earnings. For example, between 1974 and 1984, the **nominal** interest paid to the balance in the CPF was 6.5 per cent p.a. For 11 years, it did not change at all. During the same time, the financial world went through two oil crises, recessions and wildly fluctuating inflation.

Administration Cost

While the rate of return may be low, one would expect lower administration costs. That is indeed the case. Operating expenses of the CPF has steadily declined over the last 25 years. Currently, the operating expenses have stabilised at about 2.5 per cent of the revenue of the funds. This compares favourably with the figures for Australia, using the ASFA Fund Administration Cost Survey.

Investment Patterns

The CPF in Singapore does not publish details of its investment activities. Singapore Government Investment Corporation (SGIC) was formed in 1981 to oversee the foreign investment of the Singapore Government. It is believed that the first questions the sense of allocating of a large part of Singapore's foreign reserves come from the CPF. The local investment of the CPF is mainly in government paper. This is in marked contrast to Australia where investment management is based on competitive markets and diversification is regarded as a virtue.

Consequences of the Singaporean System

Residential Boom

A portion of an individual's savings in Singapore can be used to buy residential property. However, the purchase of such property is highly restrictive.

The Singapore Government owns more than 90 per cent of the land in Singapore. The Government has built apartment buildings for the citizens in huge blocks. The money from the CPF can only be used to buy these flats. As a result, over 95 per cent of all Singaporeans live in these flats built by the Government's Housing Development Board (HDB) — technically, Singaporeans only lease the HDB flats for 99 years. Singapore has the highest home ownership rates in the world: over 85 per cent. The Singapore Government is aiming at pushing the figure to 100 per cent by the year 2000.

There are two lines of criticism of the Singaporean system of home ownership through the CPF.

The first questions the sense of allocating such massive resources for infrastructure development.

Second, the resulting concentration of power of the Government can be phenomenal and therefore open to abuse.

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Take the example of the Singaporean Government's residential policy. The population of Singapore has the following racial composition: 77 per cent Chinese, 15 per cent Malays and 5 per cent Indians. The Government decided to maintain similar ratios in all areas of Singapore. This was simple to achieve given that Government had full control of allocation of HDB flats.

Singapore has been ruled by the People's Action Party (PAP) dominated by the Chinese. Malays have long been known to oppose the PAP rule. But, with the current system of population dispersion, it is hard for even one Opposition member to be elected to Parliament. In such circumstances, the CPF can be a powerful political weapon.

Australia already has the highest home ownership rate among the Organisation for Economic Co-operation & Development countries. Do we need another residential housing boom as a consequence of a centralised, compulsory superannuation scheme?

Foreign Exchange Reserves

One legacy of the CPF is the large foreign exchange reserves that Singapore has built up. It is the highest per capita foreign exchange reserve in the world. However, even the reserve has been used to political ends. Various politicians of the ruling PAP have eloquently spoken about the possibility that the Opposition might financially mismanage the funds and therefore put the adequate retirement of the elderly in jeopardy. Hardly a credible threat when the PAP has held at least 97 per cent of the Parliamentary seats over the last three decades.

High Per Capita Savings Rate

Singapore has the highest per capita savings rate in the world. High savings rates in general are considered a "good thing". However, whether forced saving is necessary or not is a debatable issue. In the case of Australia, a higher savings rate will certainly be in the long term benefit of the country.

Should we copy Singapore?

There are several preconditions for the Singaporean system that are simply absent in Australia. For example, Australia has long had a tradition of the age pension. It will be politically impossible to get rid of age pension. Singapore, on the other hand, practically started with a "clean slate" that came with its new nationhood.

Secondly, there is a well entrenched pluralistic political system in Australia. Any such mandatory directions would be likely to suffer a political backlash in a subsequent election. The Singaporean Government hardly has to worry about such things.

Thirdly, when per capita real Gross National Product (GNP) rises at the rate of 8-10 per cent per annum, a rise in CPF contribution rate does not lead to a reduction in living standards. However, Australia's per capita real GNP has been rising at the rate of 2-3 per cent per annum. Hence, a moderate postponement of consumption (by superannuation) diminishes current consumption.

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