Should Britain look to Australia to solve its productivity puzzle?

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Among the many problems on the Chancellor's desk as she approaches the Budget is the UK pensions sector. Despite having the third-largest stock of pension assets in the world, there is a consensus that this capital is not working for the UK, and that it is insufficiently invested in the domestic infrastructure and equities that could support greater growth. Moreover, the growth of defined contribution pensions has generated concerns that pension pots in the UK are too small and fragmented. Lacking the heft and efficiency of larger funds, they cannot make the sorts of investments that would have a significant impact on the economy.

Those calling for reform regularly point to Australia as an example of what the UK should be aiming for instead. Before moving to the UK last year, I worked in the financial advice space in Australia for 10 years and dealt with the pension (or 'superannuation') system there on a daily basis. It is interesting to see it held up as an example here, and it does seem that there are lessons that can be learned from Australia's experience of reform.

The most obvious and immediate difference between Australia and the UK is that the Australian pension system is compulsory. While automatic enrolment has had an impact on behaviour, in the UK it is still possible to opt out. In Australia, like in the UK, there is a minimum contribution that employers must make, measured as a percentage of salary. However, this is much higher. From July this year, the minimum contribution rate in Australia was 11.5% of ordinary earnings, and next year this will rise to 12%.

To compensate for these more onerous requirements, successive governments have done a lot of work to ensure that pension investments are the most tax-advantageous investment to make. That incentive applies to both the employee and the employer, who gets a tax deduction for paying funds into the pension system. In this context, any move by the UK Government to raise taxes on employer pension contributions would go against the grain of Australian reforms.

Arguably, the Government will be less interested in individual contributions than it is in consolidating the sector, which leads to fewer, larger and more efficient funds, which can better support the UK economy through investment such as infrastructure. A stronger pension system also promotes self-funded retirement and reduces pressure on government finances. Australian regulations have supported greater consolidation in two important ways. The first is that they allow an employee to elect a fund and 'carry' it around with them, even as they change jobs. The result is that it is much easier to retire with one, larger fund, as opposed to multiple smaller ones, with all the benefits of compounding interest and fewer fees which a multiple single fund entails.

The second way regulations in Australia have supported consolidation is by being extremely tough on underperforming pensions, including banning them from accepting new members if they fail an annual performance test in two consecutive years. In the past this has forced mergers between funds, and overall has helped to 'tidy-up' the sector. Whilst the UK's recent value-for-money (VFM) framework is positive development, it may lack the teeth of the Australian reforms, which include stricter performance benchmarks and greater transparency requirements." All of this is done with a view to directing capital to the most effective, most productive investments.

Ultimately, the regulatory reform has worked. At USD$2.4 trillion, the Australian pension sector is remarkably close in size to the UK's (USD$3.2 trillion), considering that the country has a population of less than half of the UK. Can we work out the per capita amount? this would be a helpful metric to show to difference

That is not to say that the superannuation system in Australia is perfect. In particular, there is a long-running argument that the system does not always serve women well. Wage inequality means that women on average contribute significantly less to their pensions than men., and because they are more likely to take time out of work to care for children or elderly relatives, they often experience long periods where they are not making pension contributions. The Australian Government is looking at potential ways to fix this.

Nonetheless, there are clear lessons that the UK can take from Australia's experience, and there are practical reforms that the UK could emulate. For a government wanting to make an immediate impact, some quick wins could include: making it easier for individual consumers to consolidate their pension pots, and for workers to move their pots around with them as they change jobs. The FCA's Pensions Dashboard reform, which will allow users to see all of their pensions in one place, is an encouraging step in this regard. In addition, tougher regulation of funds that are underperforming, would increase transparency and encourage consumers to move their money to more productive funds. Can we link this back somehow to larger funds being able to invest in things like UK infrastructure which supports economic growth and development, which benefits the country and ultimately the retirement savings of the UK public?

Longer term, the Government may also want to look at making pension contributions compulsory and raising the minimum contribution limit. Reforms in this direction typically lead to concerns that salaries will be squeezed by employers looking to offset the rising cost of employee pensions. Ensuring that the tax system properly incentivises saving into pensions is therefore critical to making these changes work.