INFRASTRUCTURE INVESTMENT FOR FULL EMPLOYMENT: A SOCIAL DEMOCRATIC PROGRAM OF FUNDS REGULATION

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> *Where the rate of growth declines, whether because of internal or external forces, the future of social democracy will depend on its capacity to guarantee that adequate levels of investment are maintained, whether or not private capitalists are willing to accept the responsibility. It is doubtful that social democracy will be able to avoid, at one time or another, socialising the investment function (Esping-Andersen, 1985: 35-36).*

Since the election of the Rudd Government in 2007 and the Global Financial Crisis (GFC) from 2008, a new debate has begun in Australia that links social democratic socio-economic policy, infrastructure inadequacy, and retirement incomes.[1] These issues can indeed be re-examined together in the light of the quasi-Keynesian state activism that has erupted in response to the GFC. Residual Keynesianism has come to the fore again in the advanced western capitalist countries, in the forms of deficit financing, increased state regulation, and nationalisations in the banking sector. Politically, this suggests that Social Democracy remained alive (although driven into temporary retreat) as the alternative regulatory framework throughout its period of

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[1] These issues have been explicitly linked by Kevin Rudd (2009) and reiterated in Rudd Government policy announcements in April-May 2010 (*cf.* Rudd, 2010) regarding tax reforms, superannuation, and the National Broadband Network.

supposed eclipse by Self-Regulatory (or Neo-Liberal) Capitalism since the 1970s.[2] Perhaps we are now witnessing a significant shift in the dominant political economic regime in response to the GFC. This paper tries to make a contribution to this debate by examining the centrality of managed funds to the development of a social democratic strategy.

As Esping-Andersen (1985) understood, social democratic economies are in part a state-directed developmental project that rests, in the ideal form that is best (although imperfectly) approximated in the Nordic region, upon a high degree of national consensus around collective industrial relations, efficient markets, and generous state provision of welfare, health, education and public infrastructure. Such a structure, built in the 1940s-70s era, remains partially in place in the Anglo countries even if eroded and under pressure.

Recent policy responses to the GFC by the Obama, Rudd, and Brown governments (plus others), the new role of the G20, and many contributions to policy debates by leading scholars and commentators, could be seen as evidence of a move back towards a more social democratic regime. Nevertheless, such a move must be much more than a few tinkerings and rhetorical expressions. A well-developed social democracy has not yet re-emerged in the leading Anglo countries. Without adequate taxation, a fiscally capacious state, a strong program of both public and private investment in human, social, and physical capital, and state-co-ordinated national competitiveness, a SDWC regime, with its high degree of domestic co-operativeness and legitimacy around the enhanced role of the state, cannot easily develop

[2] Social Democracy or Social Democratic Welfare Capitalism (SDWC) remained central (although reformed) to the political economy of the Nordic states, the Low Countries, and Germany but was mercilessly attacked in the Anglosphere since the 1970s. But the GFC has transformed the context. For example, it has been argued that the British general election of 2010 was fought between three 'social democratic parties' (Labour, Conservative, and Liberal Democrat), none of whom wished to alienate the electorate by proposing major government spending cuts: see Hartcher (2010). It is interesting to compare the responses of states to the GFC this time with that of the 1930s and to see the widespread use of Keynesian and anti-free market rhetoric that has accompanied the state interventions in the face of the recession. SDWC is discussed in Hicks (1999) and Lloyd (2010). Self-Regulatory Capitalism is extensively examined in Braithwaite (2008).

and maintain economic strength within a capitalist world economy that has grown accustomed to lower taxes and less regulation in its heartlands. It is especially difficult in circumstance of severe recession and an unstable economic and geopolitical transition from West to East.

For social democracy to be viable as an economic alternative to neo-liberalism, the restoration and maintenance of full employment is fundamental. Without full employment there cannot be a meaningful claim to have established a foundation for social democracy. 'Full employment' in this context is defined as employment for all with a high rate of labour-force participation and with frictional unemployment as the only tolerable form of temporary joblessness.

The global nature of the current crisis and its social effects and the discrediting of free market solutions to economic, social, and environmental problems creates an opportunity to re-examine and re-defend social democratic/Keynesian policies. These policies centre on the socialisation of investment. Within such a framework, then, this article develops an argument about how the large and growing pool of pension and other managed funds that are now available in Australia can better be utilised for necessary infrastructure provision and to solve the persistent problem of unemployment, two of the fundamental tasks of any social democratic program, while at the same time providing adequate retirement incomes for an aging population.

The argument here, in short, is that a Keynesian 'socialisation of investment' strategy should be the core of this new regulatory framework. Of course, the politics of this transition to a new form of SDWC will be as crucial as the policy prescriptions. The politics will involve transcending both the old labourism that has always hindered the development of Social Democratic Welfare capitalism in Australia, as well as the ideologically-entrenched belief in 'unfettered free markets' in the political sphere and in the financial sector. That latter belief has been pervasive even among non-profit pension fund managers who are usually imbued with the prevailing ethos of 'the markets' in which they operate and which determine their competitively-calibrated salaries. [3]

The Continuing Significance of Keynes for an Investment Strategy

Keynes argued that:

> *[I]t seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment (1973:378).*

Central to Keynes' analysis is that full employment depends on the use of policy instruments capable of diminishing the oscillations in the level of economic output. Accordingly, throughout this article, it is argued that developed economies have the means to institute full employment via the application of an integrated and comprehensive socialised investment policy process. While superannuation and sovereign wealth funds provide the technical means, social democrats must provide the political will.

As Keynesians have consistently argued, capitalist economies left unfettered are inherently demand deficient, giving rise to both under-investment and under-consumption, which, in turn, results in less than optimal employment growth. Given this theoretical starting point, the argument here is that any serious attempt to re-institutionalise full

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[3] This article concentrates on the social democratic investment strategy for employment and infrastructure and, although touched upon, there is no space for a detailed discussion of the following steps in the argument about rebuilding SDWC, regarding (a) the precise areas to which the socialised investment should be directed; (b) the building and strengthening of social democratic (rather than labourist) labour organisations; and (c) the construction of a counter-hegemonic intellectual framework for the future strategy of 'saving society and the environment', which of course is now widely discussed. These issues will be taken up in later work.

employment as well as solve the problem of deficient infrastructure must address the investment function. With OECD countries demonstrating their incapacity to garner sufficient investment to produce full employment over the last thirty years, a comprehensive socialisation of investment must be instituted, as Esping-Andersen understood.

The financial basis for this policy already exists. Australia's privatised compulsory superannuation scheme for retirement incomes that began in 1992, envisaged as eventually replacing the state-provided old-age pension system, has since grown to contain A$1.035 trillion (Australian Bureau of Statistics, 2010a:37). The figure rises to A$1.335 trillion when all accumulated managed funds (including life insurance) are taken into account (Australian Bureau of Statistics, 2010b:9). Most of these funds are in non-profit mutual trusts (so-called 'industry funds'), controlled and administered by boards that have union and staff representatives as well as professional managers. From 2006 the Australian Government also established a series of Sovereign Wealth (SW) funds to provide for civil service pensions and infrastructural investments. These now hold $A87 billion (Future Fund, 2010).

However, the investment strategies of private, mutual, and SW funds are currently determined by commercial decisions commensurate with the necessity to maximise capital growth, profits, and pension allocations, without regard to social or national economic considerations. There has always been an issue about the investment policy that should govern these funds but, due to the so called 'economic boom' since the early 1990s, little debate has occurred outside the scope of heterodox economic scholarship.[4]

The starting point of Keynesian analysis relating to investment is the notion that uncertainty plays a central role in private financial investment decisions. This is opposed to the rational expectation thesis (RET) that claims individuals have the ability to forecast accurately on average what the economy will do in the future and therefore respond to external events and act to nullify the effect of government intervention

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[4] See Ramsay (2004). On the millennial economic boom see Lloyd (2008).

in the economy (Barkley Rosser, 2001: 546). Keynes (1937: 214) argued that '…there is no scientific basis on which to form any calculable probability whatever. We simply do not know'. Rather, as argued in his *General Theory* (1973: 161), capital investment decisions are driven by subjective 'animal spirits'. Paraphrasing Keynes, Barkley Rosser (2001: 547) argues that 'real capital investment is not driven by long-run rational expectations, which are impossible, but rather by essentially subjective and ultimately 'animal spirits,' a spontaneous urge to action in the face of uncertainty.' Further, Keynes mounted a detailed case in the *General Theory* demonstrating the effects that speculation has on both productive investment and its relationship to uncertainty.

The important point is that uncertainty has destabilising effects on capital accumulation, as the preference for liquidity rises as confidence falls. As such, uncertainty has a tendency to transform an economy from one that is buoyant and dynamic to one that is stagnant (Driver, 1994: 234). More importantly, the notion of uncertainty can have self-perpetuating consequences, as private investors in a stagnant or recessionary economy liquidate stock and move their capital to short-term assets, further contributing to economic contraction (Poitras, 2002: 116). Keynes' insight as to why uncertainty restricts capital from investing sufficient surplus in productive infrastructure to meet labour demand has major ramifications relating to the need to socialise investment—a discussion that is advanced below.

Organised Labour and Labourism: beyond wage-centric activism

A major stumbling block to building a social democratic strategy in Australia has been labourism. Organised labour in Australia has rarely sought to move beyond the narrow confines of workplace struggle over wages and profits as its prime or only strategy.[5] While industrial disputation over the wage/profit share may seem a rational activity,

[5] In an Australian context, the disputation over the wage/profit share has operated within a number of institutional contexts, the most current being Enterprise Bargaining. On the history of Australian labourism and its connection with protectionism, see Lloyd (2003).

wage gains that are 'won' via industrial struggle are in many cases illusory because employers often pass on the higher labour costs in the form of higher prices (given that employees are also consumers). Wage rises that are met with price rises, in other words, do not 'liberate' workers in any meaningful way. A worse consequence of labourism, as Michal Kalecki has shown, is that unemployment is used by capital to discipline labour, thus ensuring that the rate of profits *vis-à-vis* wages remains within 'acceptable' levels (Kalecki 1943: 326-329). Accordingly, if full employment is again to be achieved, including additional social and economic benefits that derive from a SDWC economy, organised labour must move beyond a wage-centric activism that is met by higher prices and/or structural unemployment.

If labourism is not sufficient to achieve social democratic goals (including the principal goal of full employment), what should be the overarching policy objectives of organised labour working within a social democratic program? While the underlying strategy must be collective action to achieve institutions that operate as countervailing forces to the (unequal) 'labour market', the de-marketisation of 'labour' (as a social democratic objective) can only be achieved under the condition of full employment.

The objective of undermining labour commodification is not a new task. Like Marx, Polanyi recognised the importance of countervailing forces to the labour market:

> For a century, the dynamics of modern society were governed by a double movement…one was the principle of economic liberalism, aiming at the establishment of a self-regulating market, relying on the support of the trading classes, and using largely laissez faire and free trade as its methods; the other was the principle of social protection aiming at the conservation of man and nature as well as productive organisation, relying on the varying support of those most immediately affected by the deleterious action of the market—primarily, but not exclusively, the working and the landed classes—using protective legislation, restrictive associations, and other instruments of intervention as its methods (Polanyi 1944: 132).

While social protection has reduced labour commodification, a more robust decommodification can only come about at the point of full employment. Only then is there the possibility of 'de-marketising' the 'labour market' because of the change in the balance of power towards organised labour and away from capital. As such, organised labour must pursue wider objectives than the wage/profit struggle. Central to this strategy is ensuring that part of labour's forgone wages drives the socialised investment function that is aimed at creating full employment.

Unemployment and the Long Stagnation

The view that unemployment arises from the deficiency of effective demand, and that this results from inadequate investment, can be demonstrated by the degree to which the full utilisation of labour has not been achieved throughout the 1974-2010 period.

While Esping-Andersen's (1985) argument is correct, especially his view that sustained full employment requires control of the business cycle, his analysis implies that social democratic governments may only need to stimulate the investment function when entrepreneurial outlays wane. In contrast, it is argued here that the socialisation of investment must operate in perpetuity. This stems from the fact that, between 1992 and 2008, when the economy 'enjoyed' 17 years of uninterrupted expansion, entrepreneurial investment operating within a neo-liberal regime was insufficient to generate a full employment economy.

Going back further still, a structural impediment to full employment throughout the 'long stagnation' since the mid-1970s[6] was the presumption that optimum investment facilitating full employment could not take place if organised labour elevated wages above

[6] The 'long stagnation' of 1975-2010, in which official unemployment has not fallen below 5% (except briefly in 2008) can be contrasted with the period commonly known as the 'long boom', 1947-74, in which official unemployment rarely arose above 2%.

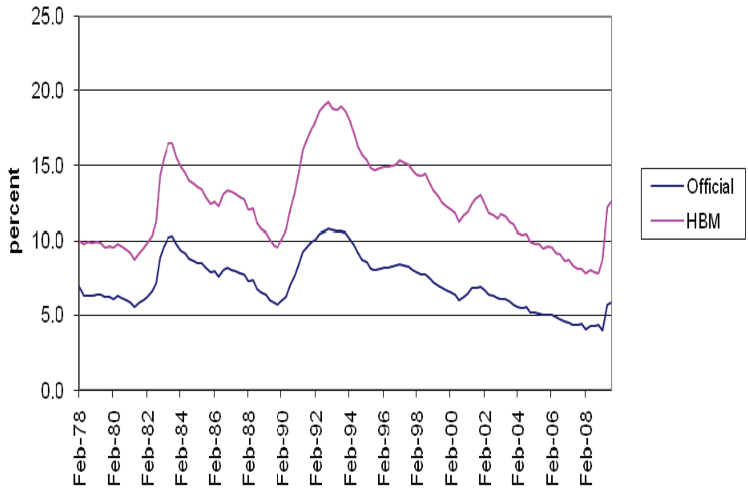
'equilibrium'. Accordingly, neo-liberal governments (including governments that were sometimes styled 'social democratic') sought to achieve the 'correct' level of investment to meet full employment by reducing the ratio of wages to profits. This, it was argued, would restore an efficient investment/wage/employment outcome. Moreover, it was argued that the interrelationship between low profit margins, low investment, and poor macroeconomic output had to be addressed by removing artificial impediments – trade unions and governments – from the exchange process.

After three decades of structural unemployment and with much of the world experiencing a severe recession, it is clear that these strategies have not facilitated enough investment to generate sufficiently robust output to achieve full employment. This outcome is consistent with the heterodox economic argument that high profit margins do not intrinsically lead to optimum macroeconomic outcomes.

Irrespective of the wage-profit ratio, capital in isolation does not reliably invest sufficient resources in productive investment to create labour demand equal to full employment. The stimulus to activity required to attain full employment is that which comes from planned investment. Full employment also depends on the use of policy instruments capable of diminishing oscillations in the level of economic output that 'lock in' a productive growth sequence – a point developed more fully later in the paper.

To appreciate the extent of labour under-utilsation throughout the period since 1974 (especially as it relates to Australia), it is helpful to draw on the extensive work of the Centre of Full Employment and Equity (CofFEE) at the University of Newcastle, Australia. Figure 1 on the following page represents the seriousness of unemployment in Australia since 1978. It compares the official unemployment rate published by the Australian Bureau of Statistics (ABS) with the Hours Based Measure (HBM) that charts official unemployment plus underemployment plus hidden unemployment (CofFEE, 2010).

Figure 1: Australia: Official unemployment rate and HBM, 1978-2009



The CofFEE approach is the better way to determine the full extent of unemployment. As CofFEE observes:

> The ABS considers a person to be employed if they work one or more hours of paid work per week. However, it is clear...that there are many people working in part-time who desire more hours of employment but are unable to find employers offering the work. We consider these workers to be partly employed (the hours they work) and partly unemployed (the hours they want to work). [Accordingly] an hours-adjusted underutilisation rate is substantially higher than the official rate indicating that overall labour underutilisation remains a major problem despite the growth period that has just finished (2009: 2-3).

The application of an hours-based measure regarding total unemployment is not new, as similar studies for both Sweden and the USA have also been devised. The McKinsey Global Institute, for example, estimated that, in May 2006 (when the official unemployment rate in Sweden was 5.4%), real unemployment in Sweden was 15.7 percent. Applying the same methodology to the United States, John Schmitt demonstrated that the U.S. unemployment rate in 2007 rose from the official 5.5 percent to the *de facto* rate of 13.8 percent (Schmitt, 2007:2).

Socialising Investment

Having set out some reasons why recent employment outcomes have been inadequate and unacceptable, attention can now turn to how a socialised investment function directed by a planning authority could operate. The key concept is increased investment via pooled funds. This is not a new idea. The Australian Council of Trade Unions and the Trade Development Council released *Australia Reconstructed* in 1987, advocating the extensive use of superannuation funds as an investment resource (Australian Department of Trade, 1987). Following this failed attempt to transcend labourism, proposals for an investment function via pooled funds in Australia have, until recently, been met with either outright resistance or deep skepticism.[7] While it is no surprise that orthodox economists continue to reject pooled savings as an instrument for advanced capital formation, it is more surprising that social democrats, even after decades of less-than-full employment, continue to reject this investment instrument. Some argue that it is labour which is 'tapped' as a source of investment funds, and, thereby, labour which is required to carry the burden of national investment policies.[8] Others, nonetheless, have come to the conclusion that workers' funds can be used with a proviso that workers' investments must be subjected to the 'exclusive benefit rule'. That is to say, superannuation investment must be governed by the fiduciary duty to act for the sole and exclusive

[7] For a history of the early debate about socialised versus private superannuation schemes in Australia, see Gallery, Brown and Gallery (1996).
[8] For a discussion as to why some on the political left do not support such a policy, see Coates (2004).

benefit of the superannuate outside any wider economic or social criteria. Stated somewhat differently: workers are happy to have their money invested, though they expect optimum *financial* returns on their funds.

The 'exclusive benefit rule' is neither in the interests of labour as a class nor even in the interests of workers as individuals. As social democracy is not predicated on narrowly individual outcomes but on a wider societal interpretation of welfare, fiduciary duty (to the investor) should also incorporate what can be termed an 'Employment Generating Targeted Investment' that offsets the oscillations of private sector investment. This policy would not only assist to de-individualise workers' investments, it would, more importantly, help de-individualise unemployment. Moreover, tapping workers' forgone earnings is not a zero sum game, as some on the political left would have it, but, on the contrary, a positive sum game, as explained below. This, however, is getting ahead of the story, because it is important first to chart the changing nature of capital formation and accumulation, especially in relation to superannuation funds.

Australia's superannuation industry over the last decade has experienced two important changes: first, the rise in equities and units in trusts; second, the rise of superannuation assets held overseas.

While growth of total superannuation assets between 1995 and 2009 in Australia has quadrupled the asset size[9], what is important for this discussion is to chart the rise of equities and trusts that superannuation funds have held over the course of the decade or so. In 1995, equities and units in trusts represented 36.9 percent of total Australian superannuation assets (Australian Prudential Regulation Authority, 2002). By December 2008, equities and trusts rose to 45 percent of total superannuation assets (Watson Wyatt, 2009: 22).

On the other side of the coin, the allocation to fixed interest securities in Australian super funds fell from an average of 21 per cent in 1997 to 16

9 For a comprehensive analysis charting the rise of superannuation in Australia, refer to Australian Prudential Regulation Authority (2007).

per cent a decade later – which is the lowest allocation to defensive assets among the SP11.[10] Interestingly, the global average was an allocation to fixed interest securities of 28 per cent. The allocation to defensive assets is more than 50 per cent in France and Germany (Kavanagh, 2008). As a consequence, according to Watson Wyatt, Australia is one of the 'more risky' countries in which to invest in a superannuation or pension fund (2009: 3).

Owing to the decline in share prices worldwide during the GFC in the last two years, in conjunction with Australia's above-average allocation to equities, the net worth of Australian superannuation experienced a bigger decline in asset value than many other countries. Australian funds experienced a net loss of 16.2% throughout the 2008 calendar year. While the weighted average for the SP11 was -14.7%, some countries fared better. France, for example, experienced -6%, while Germany actually enjoyed a modest increase +1.1% (Watson Wyatt, 2009: 12). In highlighting Australia's exposure, John Kavanagh (2008) argues:

> The decline of fixed-interest assets, such as government bonds, as a component in super portfolios during the past decade has been marked…No longer dominated by government and semi-government bonds, these [Australian superannuation] portfolios are full of corporate credit securities, asset-backed securities such as mortgage notes, hybrids and hedge funds. Investors with more than A$900 billion in super have been the subject of an experiment in asset diversification. When it came to the crunch, many of the newer defensive assets did not work.

The increased holding of equities and trusts by superannuation funds is largely mirrored in relation to the increased proportion of assets held internationally by superannuation funds. In 1994/95 for example, 14 percent of total Australian superannuation assets were held internationally. By December 2007, international assets represented 22

[10] The SP11 consist of Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Netherlands, Switzerland, UK and USA. These countries together administer US$20418 billion in pension funds (Watson Wyatt, 2009: 3).

percent of total assets (Investment and Financial Services Association: 4).

The economic and financial crisis has seen Australian superannuation funds partially gravitate back to home soil—for example, in December 2009, offshore assets represented 19.7 percent of total assets (A$203.6 billion). However, there is little indication that fund managers will reverse the long-term trend of increasing their international portfolio investments (Australian Bureau of Statistics: 2010a: 37-38). While the development of the Australian Government's *Infrastructure Australia* investment policy may induce some off-shore money to return to Australia, it is likely to be insufficient without other concomitant incentives, including tax credits.

It has been shown that both the rise in equities and the rise in assets held internationally have changed the composition of domestic capital accumulation. International financial integration makes it increasingly difficult to compel capital to invest domestically, although some countries, such as Finland, do have tighter controls. Such regulation in Australia would convert more of labour's foregone income, derived from a factor of production that is primarily immobile rather than globally fluid, to being a domestic capital resource.

To reiterate, it is important to acknowledge that political impediments to the socialisation of investment will always be present. Capital, for the reasons offered by Kalecki, has little motive to support the implementation of socialised investment, as the maintenance of full employment shifts relative economic and political power from capital to labour. This is in spite of the fact that higher profits are associated with full employment (1943: 326-329). The debates in 2010 over a national maternity scheme and a resources super profits tax, as examples, show the power of capital to resist state direction in Australia. Such political barriers can only be overcome by a concerted campaign spearheaded by a social democratic political party that is prepared to take its case directly, coherently, and strongly to the electorate on the grounds of the national necessity for reform in the interests of social justice. There is evidence that the Australian electorate is responsive to such campaigns, given the very strong support in the community for greater government expenditure on public services and infrastructure.[11]

Political possibilities depend on contexts. It is conceivable that the following are achievable, with political will, in the current (2010) crisis climate, especially if the crisis continues or even worsens[12]:

- increased government capital investment expenditure;
- a full employment charter defended by the central bank;
- the establishment of full employment investment boards backed by a statutory authority to oversee full employment programs;
- a socialised bank that lends to private investors who meet productive investment criteria in conjunction with providing loans to individuals to offset overseas private household debt; and,
- significantly increased regulation of investment priorities and direction of pension funds.

To implement such a strategy a co-ordinated approach to investment and its relationship to effective demand and employment generation would be needed. Compared with the more *laissez faire* regime that has operated in Australia in recent decades, a somewhat radical strategy is implied. The GFC, the quasi-Keynesian responses, and the evolving global regulatory climate (possibly including a Tobin Tax[13]) have brought such thinking back to the fore.

Quantitative portfolio regulation, asset allocation and fund returns

Proposals for greater regulation of pension funds inevitably generate debate about their likely effectiveness and operation. Quantitative portfolio regulation can come in many forms, though the two most common features consist of limitations of equity to total assets held and

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[11] Gregory and Hetherington (2010), especially figure 9, page 13.

[12] In May 2010, at time of writing, it seems Australia has emerged from the GFC but the global crisis as a whole is not overcome. Australia, along with the rest of the world, is highly vulnerable to the remaining severe global financial instability.

[13] *Cf.* Sachs (2010).

a predetermined limit of foreign investments that fund managers can hold. Objections to these forms of regulation stem from research that suggests that returns are higher over the medium to long-term for funds that do not uphold these requirements. The World Bank's Pension Reform Primer, for example, is a comprehensive resource that has continually argued that investment restrictions (outside economies in transition) do compromise pension fund performance (World Bank Pension Reform Primer, 2010).

On this reasoning, if Australia were to implement quantitative portfolio regulation, total superannuation would be less than it would be under the present regime. Taking the ABS (2010b) figure of A$1.035 billion in superannuation funds and calculating a 5% compound interest rate over a ten year period, the total pool would grow to A$1686 billion. If, however, quantitative portfolio regulation were to limit growth to 2% (as the World Bank suggests it might) the pool would only grow to A$1261 billion. This is a 'shortfall' of A$425 billion over ten years.

This interpretation of the macro economic cost of quantitative portfolio regulation does not, however, take all relevant factors into account. First, the collapse in asset values in the current crisis has robbed funds of growth anyway. Second, there are wider social and economic benefits that regulation can provide - creating a fully employed, more productive and profitable economy. Accordingly, quantitative portfolio regulation should not be seen as an economic cost or potential loss to workers' savings but rather as an instrument that enhances the total pool due to the full employment of labour.

The Relevance of Okun's 'Law'

Okun's Law relates to the decrease in output below potential output which generates an increase in unemployment above its 'equilibrium rate'. While the application of Okun's Law cannot be applied with precision, due to the fact that an equilibrium rate of unemployment has to be 'second guessed', it does, nonetheless, provide a good 'rule of thumb' in relation to the inter-connectedness of unemployment and lost GDP.[14]

Drawing on the work of Ben Bernanke and Andrew Abel, Okun's law suggests that for every 2% that output is below potential output, unemployment increases by 1% (Hussman, 2009). For the purpose of this exercise, the output/unemployment causality has been inverted. In doing so, it is assumed that every 1% deviation in unemployment from its 'equilibrium rate' is accompanied by a 2% reduction in GDP. On this basis, using Australia's official unemployment rate, the Okun output gap or GDP loss in 2010 would be 6.6% (5.3% official unemployment rate minus 2% frictional unemployment multiplied by 2). As indicated above, however, the official unemployment rate of 5.3% is too low as a measure of actual or *de facto* unemployment. Assuming that real unemployment is 12.6%, the output gap or GDP loss would be 21.2% (12.6 minus 2 multiplied by 2).

In 2008-09, Australia's GDP was A$1194 billion (Australian Bureau of Statistics, 2009:19). Taking the more conservative output gap of 6.6%, it is estimated that under a full employment economy Australia's GDP would be around A$79 billion per annum larger. With a 21.2% output gap, GDP would be A$253 billion per annum larger if there were full employment. This would be more than enough to offset the previously estimated reduction in the pension pool of A$425 billion over ten years that could result directly from quantitative portfolio regulation. In other words, the boost from having full employment much more than compensates for any loss of pension fund performance resulting from regulation. Thus it can seen by using even the most conservative estimates that a government presiding over a full employment economy

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[14] Throughout 1968 and 1969, Arthur Okun served as Chairman on President John F. Kennedy's Council of Economic Advisers (CEA). For a comprehensive analysis of his work, refer to Okun (1983). Frictional unemployment of 2% is used in the current article as the economic variable, not the Non-Accelerating Inflation Rate of Unemployment (NAIRU), when applying Okun's Law.

would have the capacity to ensure that fund-returns could be maintained at higher levels. A larger GDP enhances the tax base, which could then be directed, in part, to workers' super funds[15]. Budget forward estimates suggest that Australian government tax concessions to superannuants will cost the government A$33.9 billion in 2011-12 alone (Toohey, 2008).[16] There is no reason why forgone taxation to government could not be redirected to average wage earners via their super funds to fill any shortfall.

Furthermore, the World Bank model (as set out in its Primer) does not consider the lost revenue to pension funds that derive from unemployment. In the event of full employment an individual worker's superannuation earnings would be higher than under a neo-liberal regime, due to workers having higher total disposable income over the course of their employment life and not suffering monetary loss through unemployment. This is of extreme importance to Australia, as its superannuation system is predominately a Direct Contribution (DC) system stemming from workers' forgone earnings at a minimum rate of 9% of gross income, rising to 12% over the next decade. Accordingly, any employment loss that workers encounter (including under-employment) is a reduction of superannuation in real terms. Under a full employment scenario, there is no reason why these and other mechanisms would not ensure that future returns to workers would be comparable to current market benchmarks.

Australia's Sovereign Wealth Funds

Some elements of our proposal either already exist in Australia or have been earmarked by the Australian government to be introduced in the future. However, the existing government entities are uncoordinated, ad

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15 A similar strategy has been adopted by the Rudd Government's decision in May 2010 to use some of the proposed resource super profits tax to increase the superannuation accounts of low income people.

16 A major problem with the current pension taxation concession is that it is highly inequitable because it favours high income earners at the expense of average and lower wage earners.

hoc, and inadequate. Australia's principal sovereign wealth funds consist of the following (assets valued at April, 2010):

- Future Fund (includes Telstra shares valued at A$4.4 billion): A$66.2 billion;
- Building Australia infrastructure fund: A$10.14 billion;
- Education Investment Fund: A$5.99 billion;
- Health and Hospitals Fund: A$4.99 billion

The fiscal policy that generated these funds – massive budget surpluses that were diverted into SWFs rather than infrastructural investment – forced superannuation funds to diversify into equities because of the non-existence of new bond issues. This was poor policy for three reasons. First, it created an inadequate strategy to attract additional investment. Second, it reduced the capacity of superannuation funds to provide resources to the government via bonds. Third, it led to underinvestment in many necessary aspects of social infrastructure such as transport, hospitals, and education.

An Alternative Proposal

An integrated development fund that includes a highly prescribed bond market is required to consolidate public investment that will direct the socialised investment function. The large government borrowing requirement to fund counter cyclical measures during the crisis also opens the door to a much larger market for treasury bonds in Australia as elsewhere. As set out in Figure 3 at the end of this article, there are also important institutional innovations that would be required, particularly:

a. a degree of quantitative portfolio regulation, including investment in infrastructure bonds;
b. a national development fund;
c. a national development bank;
d. an enhanced role for a national planning council.

Quantitative Portfolio Regulation in Practice

The first step would be to cap investments in overseas ventures. To reiterate, the amount of assets held offshore limits the capacity for domestic private investment in productive plant, machinery, infrastructure, and services. Figure 2 shows a number of examples of the extent to which other countries currently restrict overseas investment (OECD, 2008).

Figure 2: Foreign Investment Caps

Austria	30%
Finland Voluntary Pension Plans	10% in assets only in OECD countries other than EEA Countries
Finland Statutory Pension Plans	20% in assets in countries other than OECD countries
Germany	30%
Switzerland	30%

With tightened domestic prudential legislation, capital controls of this nature could be enforced in Australia, notwithstanding the more general process of financial liberalisation that has occurred. The reason is that, unlike other forms of capital accumulation that are subjected to both domestic and international inputs, capital accumulation derived from domestic pooled savings is inherently 'home based'. Pooled wage earnings, in other words, only become internationalised after, and not before, the accumulation process.

As previously indicated, Australian assets held internationally by superannuation funds amount to A$203.6 billion, comprising 19.7% of total assets held (A$1.035t). If international investments were capped at 15% of total investments, it is estimated that A$49 billon would immediately return to Australia's domestic economy. Moreover, if, on an annual basis, superannuation fund managers were required to make 5% of their total resources available to the National Development Fund (NDF) for investment in new capacity (a Compulsory Appropriation

Provision or CAP), the government could plan investment to meet effective demand equal to full employment and also reimburse superannuation funds by issuing annualised government bonds.

If, for example, superannuation fund managers allocated this percentage of their total assets to the NDF over a ten-year period, the NDF would grow to A$515 billion. This is a conservative figure as it is based on the following assumptions:

- one-off capital injection derived from 15% overseas cap – A$49 billion (year 1);
- total asset pool remains constant at A$1.035 trillion;
- annual appropriation stemming from 5% CAP – A$51.75 billion (years 2-10).

When a less conservative approach is taken by factoring in long term forecasts in relation to growth, in conjunction with the compulsory contributions that Australian workers make to the pool, it is expected that a sum in excess of A$515 billion would develop over the course of a ten year period. For example, assuming that superannuation grows over a ten year period by 5% per annum, the total superannuation pool would rise to A$1.605 trillion (1.035 trillion at 5% compound interest over ten years).[17] Factoring in a further A$500 billion over the course of the ten years for annual contributions to super funds, the pool rise would rise to A$2.15 trillion at the end of year 10.[18] At the end of the tenth year, the 5% CAP for investment would be around A$105 billion. The purchasing of bonds by superannuation funds is already standard industry practice. At the end of the December 2009 quarter, for example, the existing superannuation funds held 5.5% of their total

[17] Not discounting the degree to which pooled savings have been reduced due to the stock market meltdown, this figure is comparable with long term growth forecasts. For example, for the decade ending January 2007, pension assets in Canada, the United States, Japan, the United Kingdom, the Netherlands, Australia, Switzerland, Germany, France, Ireland and Hong Kong grew at a compound annual rate of 7.5%. Source: *http://www.benefitscanada.com/news/article.jsp?content=20070124_121221_5684*.

[18] Members contributed A$49.8 billion throughout the year to June 2008 (APRA 2008, p.7).

assets in long-term securities and bonds, one quarter of which were Commonwealth government bonds (Australian Bureau of Statistics, 2010b:9).

This proposed system, then, would do two simple things – restrict overseas investments to 15% of total investments (down from the current 19.7%) and raise the proportion of long-term government bonds that superannuation funds must hold (up from the non-compulsory 1.4% to a compulsory 5%).

Other mechanisms that could be employed to induce superannuation funds to invest in Australian infrastructure include concessional tax treatment. The tax could operate on a sliding scale and vary depending upon the degree to which fund managers voluntarily hold assets in government securities over and above the compulsory 5%. Government bond holders would need to be compensated for their investment. However, these costs to the government of bond issuing could be expected to be met by additional taxation revenue generated by full employment, in conjunction with GDP growth and savings associated with a reduction in welfare costs. The socialised investment function, in other words, would stimulate the additional economic activity to more than meet the debt repayments.

A National Development Bank

The proposed National Development Fund is a crucial instrument for facilitating planned investment to meet effective demand. It could be expected to generate sufficient funds over time to finance a socialised bank. The socialised bank could operate within a deregulated financial banking system.[19] The purpose of a socialised bank would be to offer low interest rate loans for socially productive infrastructure, in conjunction with reducing pressure on net foreign debt. In Australia, for

[19] The NZ PostBank has moved in this direction and a similar model has been canvassed in Australia. Moreover, in the present GFC environment, such socialisation measures have become potentially feasible, as debates in various western European countries reveal. Nationalising banks, in other words, is very much back on the political agenda.

example, net foreign debt has risen from A$332 billion in 2002 to A$648b in December 2009 (Australian Bureau of Statistics, 2010c). Most of this debt is private and much of it is household. Furthermore, with Australian banks possessing a low domestic deposit base because of low domestic savings (apart from pension savings), a number of banks have raised interest rates higher than the Reserve Bank's base rate in order to attract international funds (which has the capacity to dampen domestic investment and effective demand).

David Love (2008:93) argues that, had the mandatory superannuation contribution been raised from the current 9% to 15% throughout 1997, 1998 and 1999 (as was the Keating government's policy prior to 1996), superannuation savings would now be around A$1500 billion.[20] While this would be of little socialised benefit without the prudential controls that have been proposed here, the important point is that a phased increase of compulsory superannuation to 15% of gross total earnings would help close the savings/spending/debt gap that currently exists.

A further function of a socialised bank would be to discount official interest rates with the purpose of providing domestic liquidity for productive investment. A different institution, such as an Economic Planning Council would be needed to determine the criteria by which a loan is deemed to be 'investment friendly'. As Harcourt (2001: 253) has argued:

> We need also to think of measures which will eliminate harmful speculation in finance and property markets so that prices and rewards there may more fully and fruitfully reflect useful economic activity. In this way present and past savings will be gathered together in a more socially useful way. On the side of real investment the government should take the lead in designing investment incentives which persuade business people

[20] The Rudd government announcement in May 2010 of a move to 12 percent employer contributions over the next decade goes some way towards making retirement accounts adequate; nevertheless the issue of socialisation of investment remains.

> to invest in those areas which, overall, the government has decided most need to be developed.

While individuals would continue to be free to 'shop around' for loans on the open market, there would be a large incentive to borrow at less than private market rates for productive investment. While it is inherently difficult to determine what constitutes 'good debt' and 'bad debt' there is little doubt that if a proportion of Australian debt were funded from the NDB, debt servicing of international loans would moderate to more sustainable levels.

Public Sector Investment Initiatives

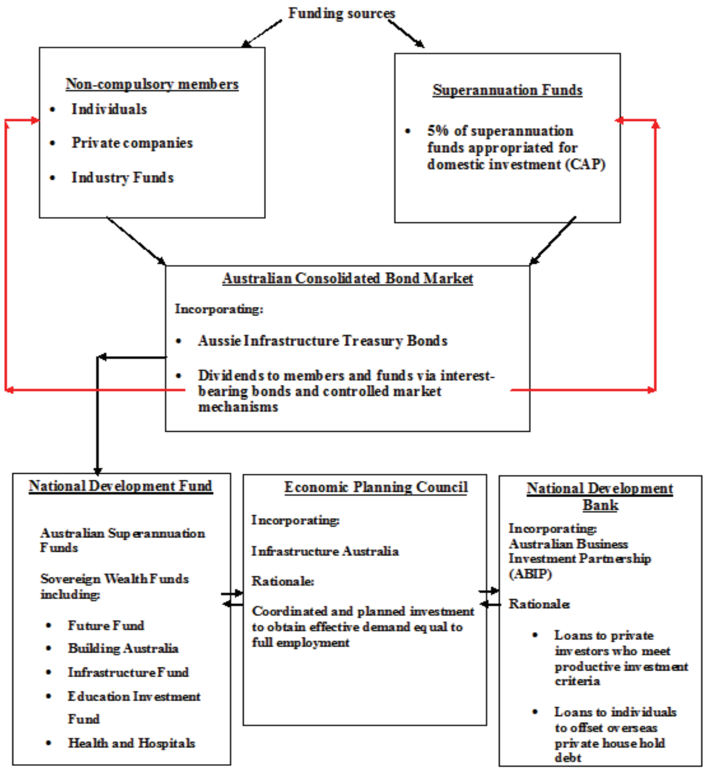
Given that many countries are now finding it difficult to obtain funds for domestic stimulus programs and investments, some governments are starting to use bonds as a way to stimulate output. The Irish government, for example, has introduced a bond scheme using pension funds to pay for the construction of roads, schools and hospitals. This is expected to raise up to 3 billion Euro (McDonald, 2009, *Sydney Morning Herald*, April 8: 12). Similarly, the Australian government in April 2009 began issuing infrastructure bonds to fund the nation's largest ever infrastructure project: a A$43 billion national broadband network. As Adele Ferguson stated, 'the Government's decision to take control of the project is the latest example of the private sector's inability to get enough funding for infrastructure deals' (2009, *The Australian*, April 8).

Another positive development in Australia is the recent announcement by the Rudd government to institute *Infrastructure Australia*. Yet to be fully operational, *Infrastructure Australia* as a statutory body has the responsibility of auditing Australia's infrastructure needs, providing a nation-building program and working out ways to fund A$90 billion of infrastructure that is needed to start to modernise Australia's roads, ports, aviation, education, and telecommunication sectors. With barely 3 percent of superannuation money invested in infrastructure (Ferguson, 2008, *The Australian*, January *26*) (and much of that is directed overseas), this ambition is highly constrained. The model put forward in this article would provide much of the financial resources needed for

Infrastructure Australia to succeed, while at the same time building a strategy for achieving full employment.

The figure presented below summarises these proposals about the systemic interconnections between the socialisation of investment function and the institutions needed in practice to implement the policy.

Appendix: The 'Socialisation of Investment' Strategy



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