ACPSRO

Australian Council of Public Sector Retiree Organisations

Legislating the objective of superannuation

Submission from the

Australian Council of Public Sector Retiree Organisations

March 2023

Background

The Commonwealth Government has requested comment from interested stakeholders on the issues raised in its discussion paper on Legislating the objective of superannuation which was released on 20 February 2023.

The Australian Council of Public Sector Retiree Organisations (ACPSRO) has a strong interest in this topic and provides the following submission in relation to the questions raised in the discussion paper.

About ACPSRO

ACPSRO, formed in 1997, provides a united voice on the retirement issues relevant to Commonwealth, State and Territory public servants and Defence retirees who receive Defined Benefit Superannuation Pensions to which they had to compulsorily contribute from their after tax income. These issues impact upon the well-being of more than one million Australian households. The majority of these retirees provided front line services to the community including teaching, nursing, emergency services, transport services, energy, the provision of infrastructure, the needed administrative services to support these essential functions and the defence and security of our country.

Response to Consultation Questions

The discussion paper raises four consultation questions. Our response to each of these questions is provided below.

Before addressing the specific consultation questions raised by the Consultation Paper, ACPSRO would like to suggest that the discussion presented in the paper may be better termed the "purpose" of superannuation as opposed to its "objective".

Question 1: What do you see as the practical benefits or risks associated with legislating an objective of Australia's superannuation system?

ACPSRO supports the development of legislation to define the "objective" or "purpose" of superannuation. We consider that the lack of a clear "objective" or "purpose" for superannuation has resulted in the current confusion around the reason for Australia's compulsory superannuation savings arrangements. Is the system in place to boost retirement incomes? Is the system in place to reduce age pension costs? Are fund balances a source of capital to assist in meeting national goals beyond retirement incomes? What is the relationship of superannuation to the other two identified pillars of our retirement income system – the age pension and the family home? How should the costs of the system be managed, both from the point of view of foregone tax income and also from the perspective of administration costs incurred by the funds? How should risk be apportioned within the system? To what extent is superannuation a form of savings to be passed to future generations?

In legislating for an "objective" or "purpose", however, there is then a critical need to ensure that the objective is actually being met. As such ACPSRO considers that an essential aspect of any legislated objective is a mechanism for ensuring that the objective is assessed on a regular basis. We note that the Consultation Paper includes a section on accountability and we consider that, as a minimum, these accountability elements be included in the legislation.

As stated in that section, the "*objective would provide a guide for parliamentary scrutiny and debate in the context of superannuation legislation considered by Parliament*". However, without a legislative framework, the basis for applying Parliamentary scrutiny to superannuation and regular assessment as to the extent to which the "objective" or "purpose" is being met remains unclear.

Question 2: Does the proposed objective meet your understanding of the objective of the *superannuation system in Australia?*

The Consultation Paper considers the “objective” or “purpose” to have 5 elements:

1. Preserve savings;
2. Deliver income;
3. Deliver a dignified retirement;
4. Operates alongside Government support; and
5. Is equitable and sustainable.

ACPSRO considers that these five elements of the “objective” or “purpose” of superannuation are appropriate, and also manageable, in assessing the extent to which superannuation is meeting the retirement income needs of older Australians. We have specifically commented upon each of these elements in the following sections.

1. Preserve Savings

It is clear that the provision of a compulsory superannuation savings scheme has led to Australian wage and salary earners making regular contributions to their retirement income. To date around $3.3 trillion has been contributed to superannuation funds covered by the scheme. The total amount held in these funds is expected to increase considerably over the coming years and reach a peak of at least $7 trillion, or perhaps as high as $10 trillion. At this point the level of contributions by wage and salary earners is expected to stabilise and the drawings from funds by retired Australians will offset the flow of new savings into the scheme from those in the workforce.

What is not clear is to what extent the compulsory, and tax effective, nature of the scheme has increased the savings of wage and salary earners above the level which would otherwise have been achieved. It is also not clear to what extent the compulsory nature of the scheme has resulted in the under funding of the two other pillars of Australia’s retirement income system, particularly the purchase of an owner-occupied dwellings and the paying down of a person’s mortgage.

It is recognised that the contributions made to super, at the individual level, have been at the expense of increased wages. While for those on higher incomes this may have a limited impact on their ability to purchase a home and service a mortgage, for those on lower incomes the impact of foregone wage increases may well have impacted on their ability to enter the housing market and/or meet mortgage payments.

The effect of this is that for lower income cohorts the compulsory nature of superannuation and the accumulation of a saving fund for retirement may well impact of a person’s retirement income requirements if they are either forced into rental accommodation due to their lower income, or have a significant mortgage balance upon retirement.

In the case of those with an outstanding mortgage balance upon retirement, the ability to withdraw lump sums from super to pay off a mortgage is conflicting with this element of the objective which is to preserve savings.

For those who remain in rental accommodation, due to the reduced ability to purchase a home during their working life as a result of a lower income, the savings in super may be quickly consumed by high rental costs, especially while rental assistance remains limited and indexed at a rate which is not reflective of changing rental costs.

The tax concessions associated with compulsory superannuation make it a tax effective savings vehicle for wage and salary earners. However, the taxation benefit varies significantly and is dependent upon the marginal tax rate faced by a wage and salary earner. For those earning less than $45,000 per annum the savings incentive is just 4 cents for every dollar placed in super.

As wage and salary levels increase then the savings incentive increases dramatically. For those earning up to $120,000 the incentive increases to 17.5 cents in the dollar, or over 4 times the incentive provided to the lowest income earners. As wages and salaries increase to $180,000 so does the incentive, which is now 22 cents in the dollar. For those earning up to $250,000 the savings incentive becomes 30 cents in the dollar. Above $250,000 the incentive falls to just 15 cents in the dollar, an amount which is still nearly 4 times that offered to the lowest income cohorts.

It is unclear to what extent the high savings incentive applied to high income cohorts increases overall savings. However, what is clear is that the savings for this cohort come at a high cost to government via the tax concessions provided. As an example, for a wage and salary earner who has a superannuation balance of around $1.7 million at the point of retirement the accumulated tax concessions, on both the contributions to and the earnings from the fund, amount to around $600,000. This is analogous to the government not providing any tax concessions during the accumulation phase of the scheme and simply making a cash payment into a person's superannuation fund of around $600,000 at the point of retirement.

For those on low incomes, the actual benefit at the point of retirement from the compulsory nature of super is significantly less. For example, a person earning around $45,000 per annum at the point of retirement, their super balance may be as low as $150,000, of which only around $35,000 reflects accumulated tax savings.

This simple example reflects the extent to which the savings element of the scheme is highly regressive. As currently structured compulsory superannuation provides significant benefits to those who would have likely undertaken savings for their retirement in the absence of the current compulsory arrangements. This cohort of wage and salary earners are gaining a significant windfall advantage from the concessions available due to the compulsory nature of the scheme.

In relation to this objective ACPSRO concludes that while the scheme, as it is currently structured, encourages savings which can then be accessed to support a person's retirement, the cost of the concessional nature of the scheme is providing limited benefits for low income cohorts while offering significant support for high income earners, who would have likely undertaken significant savings in the absence of the scheme.

2. ***Deliver Income***

Clearly a fund which can only be accessed in retirement, and is compulsory during a person's working life, will deliver income in retirement. However, superannuation is only one part of a person's retirement income. As identified by the Retirement Incomes Review there are three planks to one's retirement income – superannuation, the age pension and the family home.

In order to assess the extent to which superannuation delivers income in retirement there is a need to consider the interaction between the age pension and the amount of superannuation that has been accumulated over a person's working life.

There are essentially 6 different categories when considering the extent to which superannuation contributes to a person's retirement income. These categories relate to the superannuation balance held at the point of retirement.

Category 1 – the superannuation balance is below the level where the income and/or assets test applies and the retiree is eligible for a full age pension. In this phase more superannuation savings will increase a person's retirement income to the full extent of those extra savings and will add directly to the age pension benefit received.

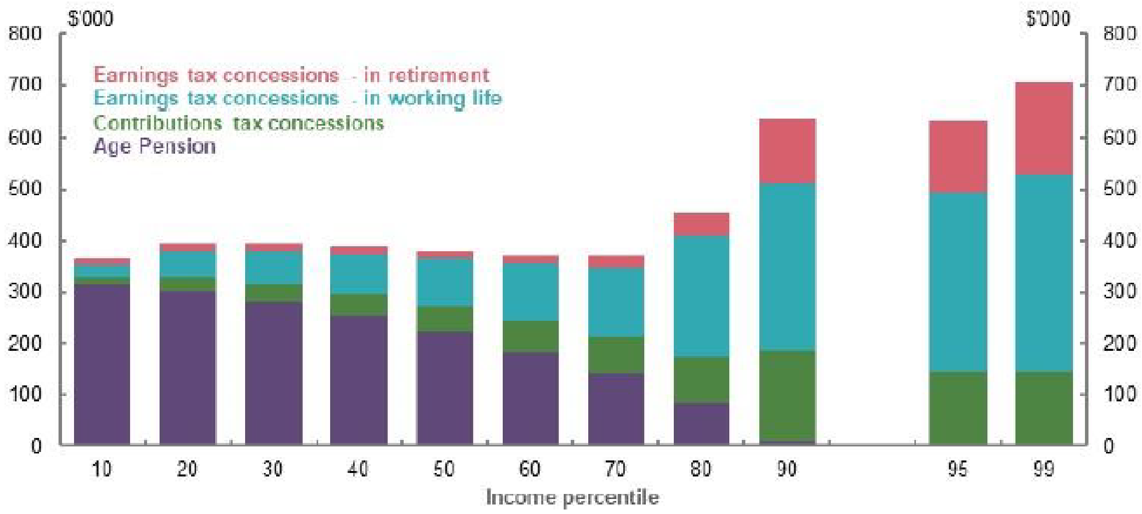
Category 2 – the superannuation balance reaches a level where the deemed income from that balance triggers the income test for the age pension. At this point additional superannuation savings will result in a lower age pension entitlement and a retiree will not benefit by the full extent of those additional savings. For every additional dollar of deemed income, with the superannuation fund assumed to be earning a marginal return 2.25%, a person's entitlement to the age pension is reduced by 50 cents. This reduction in the entitlement to the age pension reflects an effective marginal tax rate of 50 cents in the dollar, an amount in excess of the marginal tax rate applied to the highest cohort of wage and salary earners in Australia. This effective marginal tax rate applied to a person's age pension entitlement is additional to any income tax that may have already been levied upon a person's age pension payment.

As such it must be questioned as to the extent to which more superannuation in this phase is actually delivering additional income for retirees.

<u>Category 3 - the superannuation balance reaches a level where the balance triggers the assets test for the age pension</u>. At this point a person's age pension entitlement is reduced by $3 per fortnight for every additional $1,000 held in super. This is commonly referred to as the taper rate, and the wording does not appear to amount to a significant impost on a person's retirement income. However, the reduction in age pension entitlement reflects an effective marginal tax rate of 100% on an assumed earnings from super of 7.8%. Given that most retirees will hold either part or all their funds in a conservative account at this stage of their life, the impact of additional superannuation savings will, at best, result in their retirement income being effectively capped.

Chart 7 from the Retirement Incomes Review (shown below) clearly highlights this effect. As incomes reduce the composition of the support provided by government to a person's retirement income changes. At lower incomes support is provided primarily via the age pension. However, as incomes increase the support provided by the age pension declines and is replaced by support provided by the tax concessions related to superannuation. For those earning up to around $100,000 per annum (around the 75th percentile of incomes) the aggregate amount of retirement income support provided remains largely unchanged, and unless a person is drawing more than 7.5% of the funds balance each year their retirement income remains capped.

Chart 7. Projected lifetime Government support from the retirement income system



Note: Values are in 2019-20 dollars, deflated using the review's GDP deflator and uses review assumptions (see *Appendix 6A. Detailed modelling methods and assumptions*). Income percentiles are based on the incomes of individuals (whether they are single or in a couple). Source: Cameo modelling undertaken for the review.

For retirees with a superannuation balance in this category, additional superannuation savings will not necessarily lead to an improved retirement income, nor will it reduce the costs to government in supporting older Australians in retirement.

<u>Category 4 – the superannuation balance reaches a level where a retiree ceases to be eligible for even a part age pension</u>, <u>and is less than $1.7 million</u>. At this point more superannuation equates to

an increase in retirement income with any additional superannuation being fully passed on as additional retirement income. This outcome for those retirees with significant superannuation balances comes at a considerable cost for government. As shown in Chart 7, from the Retirement Income Review (above), the lifetime cost of retirement income support for these retirees, who are ineligible for even a part age pension, is considerably higher for the top 20% of wage and salary earners. This cohort reflects those earning in excess of around $115,000 per annum. For those in the top 10% of wage and salary earners, those earning above $145,000 per annum, the lifetime cost of retirement income support to government is shown as being about twice the cost of the full age pension.

Also, for retirees in this category the additional benefits provided by the generous nature of tax concessions for high income earners is not subject to any means testing. Means testing is restricted to those lower income earners who receive a cash payment from government via the age pension, as opposed to a benefit by way of a tax concession.

Category 5 – the superannuation balance is greater than $1.7 million, but less than $3.0 million. A retiree with a superannuation balance in this range is likely to be maximising the benefit of holding $1.7 million of their superannuation balance in a tax exempt account based pension fund and receiving the maximum retirement income benefit from that portion of their retirement savings. For the balance above $1.7 million, which remains held in an accumulation account, a 15 cents in the dollar marginal tax rate is applied to the fund's earnings. A retiree in this category is likely to be earning a considerable tax free income from their account based pension fund plus a lesser amount which is subject to the 15% tax marginal rate. As such, for retirees in this category more superannuation will deliver more income in retirement, but again the cost to government will be significant. As shown in the 95% and 99% income percentile bars from Chart 7 above the benefit received is more than twice the cost of the full age pension. For a person to be in this income percentile their income is likely to be well in excess $180,000 per annum.

Category 6 – the superannuation balance exceeds $3.0 million. Recent discussion has flagged that this cohort of retirees will have the earnings from superannuation balances in excess of $3.0 million taxed at a marginal tax rate of 30 cents in the dollar. While this rate is double that applying to funds held in excess of $1.7 million, it is still well below the marginal tax rate applied to incomes in excess of $180,000 per annum and considerably less than the effective marginal tax rates applied to those retirees eligible for a part age pension and subjected to either their deemed income triggering the income test , or the balance of their fund triggering the assets test.

Again, for retirees in this category more superannuation savings will deliver more income in retirement. However, this comes at a significant cost to the government. Like the benefits received by retirees in categories 4 and 5, no means testing is applied to the benefit received, unlike the case of those retirees in receipt of the age pension.

In conclusion, when considering this "objective" or "purpose" for superannuation the outcome will be dependent upon what category a retiree falls into at the point of retirement. However, what can be concluded is that for the vast majority of wage and salary earners superannuation will deliver a very limited income benefit in retirement due to the interaction between the means testing applied to the age pension and the level of a person's superannuation balance.

However, for those who receive the greatest benefit by way of the concessional tax treatment of superannuation, more funds will deliver significant income benefits in retirement, but at a cost to government which exceeds the cost of the age pension.

For the lowest income cohort, while additional superannuation will assist them in retirement, the benefit is quite limited, especially if the funds are held in a conservative superannuation account earning well below the level of return which a higher risk growth fund would be earning.

As such, this is a relevant "objective" or "purpose" for super, but one which is highly regressive in relation to the outcome achieved.

3. ***Deliver a Dignified Retirement***

As identified above, for the majority of older Australians, the level of retirement income provided as a result of Australia's compulsory superannuation arrangements will be capped at an amount roughly equal to the full age pension plus the earnings from a superannuation balance of around $225,000 to $265,000.

ACPSRO does not wish to comment on whether this is a sufficient amount to provide for a dignified retirement.

However, what we can say is that for the 70% to 75% of wage and salary earners, compulsory super plus the age pension, in full or in part, does provide a high degree of income security.

Any erosion of the balance held in super due to market downturns will be offset by increased eligibility for the age pension. However, should the converse occur, and the level of funds held in super increase due to an improved market environment, the means testing of the age pension will reduce their eligibility and effectively cap their retirement income.

For those ineligible, for even a part age pension, the operation of the superannuation arrangements during one's retirement will provide for a significantly greater retirement income than that available to others. This benefit, however, comes at a significant cost to government in terms of the support being provided as a result of the earnings of an account based pension fund being tax exempt. Similar benefits are also provided to those who purchase a lifetime income stream product in their retirement.

4. ***Operates alongside Government Support***

In the section above, where we have outlined the extent to which compulsory superannuation will deliver income in retirement, we have clearly shown how the superannuation arrangements operate in conjunction with the government's primary support mechanism for retired Australians – the age pension.

What this clearly shows is the interaction between compulsory superannuation and the age pension will for the vast majority of older Australians result in reduced age pension benefits being offset by increased benefits, by way of tax concessions, as a person's superannuation balance at retirement increases. However, this will not deliver any significant improvement in one's retirement income.

For those seeking to increase their retirement income there will be a need for them to accelerate the withdrawal of funds from their superannuation account and this will result in increasing demands on the age pension due to the highly regressive nature of the age pension assets test operating in reverse and a person's superannuation balance declines.

Once a retiree becomes ineligible for even a part age pension, due to the level of their superannuation balance, we have outlined how the means testing arrangements, which have been applied stringently to a retiree's entitlement for the age pension, no longer apply and the benefits available via tax concessions become open ended and costly for government.

5. ***Is equitable and sustainable***

ACPSRO does not consider the current superannuation arrangements to be equitable. Chart 7 from the Retirement Incomes Review clearly shows this. For the lower 75% of wage and salary earners the current arrangements provide a level of support from government for one's retirement income which is effectively capped at 15% to 20% more than the cost of the full age pension. Within this cohort of wage and salary earners a reducing entitlement to the age pension is offset by increasing support by way of tax concessions as one's superannuation fund balance increases.

Within this cohort the effective savings support provided by the tax concessions available during the accumulation phase of the scheme are regressive, with more support being provided to those at the higher income range within this cohort in terms of the percentage of the superannuation balance at retirement being related to the accumulated tax concessions received during a person's working life.

However, for those in the top 20% of wage and salary earners, compulsory superannuation will deliver considerable benefits. The open ended concessional tax arrangements, and the lack of means testing of the concessions available, make the system highly regressive and the effective benefits available are significantly greater in terms of both the total dollars of support provided by government, and also the level of that support as a percentage of a person's income during their working life and also in retirement.

Given that over time the aggregate balance of superannuation will significantly exceed the current $3.3 trillion held in superannuation funds, and wage and salary levels will increase, ACPSRO must question the sustainability of the current arrangements.

As the aggregate amount of superannuation held increases, the cost to the government's budget will increase. As the data in Chart 7 currently shows, and also as evidenced in the most recent taxation expenditure statements release by government, the aggregate cost of retirement income support provided through the compulsory superannuation arrangements is currently roughly equal to the expenditure of government on the age pension. As the aggregate balance held in superannuation increases towards its peak of between $7 and $10 trillion the tax expenditures associated with superannuation balances will further increase and soon exceed the cost of providing the age pension.

Given the regressive nature of the current arrangements the increasing cost of the tax expenditures associated with superannuation will more than offset any savings in the provision of the age pension. This will result in increasing total costs for government in supporting retirement incomes.

As incomes rise into the future, and wage and salary earners move into higher marginal income tax bands, the cost to government of the current arrangements will also increase as shown by the significantly higher lifetime costs for government for those earning more than around $115,000 per annum.

As such the current superannuation arrangements represent an increasing and potentially unsustainable cost for government.

Question 3: Is the proposed approach to enshrining the objective in legislation appropriate? Are there any alternative ways the objective could be enshrined?

Given the current maturity of our compulsory superannuation system, ACPSRO considers that the lack of a legislated "objective" or "purpose" for the system is a substantial weakness. The lack of a clear and legislated "objective" or "purpose" permits superannuation to be many things to many people. It has permitted the system to reach the point it has today where making any changes is extremely difficult for any government.

By having a clear and legislated "objective" or "purpose" it will become very clear to all that compulsory superannuation and the various elements of the arrangements have a clear policy outcome for government and that the operation of the system will and can be assessed in regard to those policy "objectives" or "purpose". Where the system is failing to meet those "objectives" or its "purpose", or where it is identified other outcomes are dominating the specified "objective" or "purpose" of the compulsory superannuation arrangements, a legislated "objective" or "purpose" gives the government a clear mandate to undertake action to address such inadequacies within the superannuation system.

The Government has recently instituted an Economic Inclusion Advisory Committee to annually assess the adequacy of support payments provided by the Australian Government. A critical element of the compulsory superannuation arrangements is the provision of tax concessions to support both the accumulation of funds over a person's working life and an exemption from taxation for funds used to provide income in retirement and on-going concessional tax arrangements for funds remaining in an accumulation fund.

ACPSRO considers that such concessional arrangements are no different to the direct payment of support provided via programs such as the age pension. We consider that in the same way the adequacy of direct payments from the budget will now be assessed annually to ensure they are meeting their defined policy objectives, the provision of a legislated "objective" or "purpose" for superannuation would permit the Economic Inclusion Advisory Committee to regularly assess superannuation and make recommendations as to the extent its "objectives" or "purpose" are being met, particularly within the context of the "expenditure" being undertaken by government to support those superannuation arrangements.

Question 4: What are the practical costs and benefits of any alternative accountability mechanisms to the one proposed?

ACPSRO does not wish to comment in relation to this consultation question, other than to re-state that the absence of a legislated "objective" or "purpose" for superannuation has resulted in superannuation becoming a scheme with many competing and contradictory facets which has an exponentially growing cost for the government. We would also note that the lack of scrutiny around this cost does not assist the government in addressing the sustainability of the current arrangements and has led to the system becoming increasingly politicised.

Final Comments

In addition to the comments outlined above ACPSRO also considers that there may be value in also having a statement which outlines those things which are not the "objective" or "purpose" of superannuation. In this regard, and as an example, we note that the Consultation Paper states "*The focus on delivering income makes clear that the purpose of superannuation is not for minimising tax on wealth accumulation or enabling retirees to leave tax-effective bequests*" (page 10). We consider that an explicit statement which outlines those elements which are not specifically the part of the "objective" or "purpose" of superannuation would certainly assist current and future Parliaments when they are applying the accountability elements which are outlined on page 12 of the Paper.

Such a statement also reinforces the "objective" or "purpose" of super as being the delivery of income in retirement through both the returns achieved by a superannuation fund and by the drawing down of the balance of that fund.

Finally, while ACPSRO represents those retirees on a defined benefit pension, and recognises many of our members also receive a part age pension due to the limited value of the defined benefit pension received, we also note that we reflect a declining cohort of retirees as most defined benefit schemes have been closed for many years. These retirees, while outside the current compulsory superannuation arrangements, were required to make compulsory after tax payments into their superannuation while employed as part of their employment arrangements. In retirement they become captured by the current progressive taxation arrangements, and as such, do not enjoy most of the benefits which flow to those covered by the compulsory superannuation arrangements, particularly the benefits flowing to the highest cohort of wage and salary earners who receive substantial taxation concessions during retirement.