

ACOSS supports a legislative purpose for superannuation. We believe this would help clarify the role of the superannuation guarantee and tax concessions for superannuation, and provide guidance for administrators of superannuation accounts.¹

Although it is now 25 years since the Superannuation Guarantee was introduced, there is much confusion over the goals of superannuation. Different people are using superannuation for different purposes, and advocating policy positions based on different, and often conflicting perceptions of the role of the superannuation guarantee and associated tax concessions.

The Financial System Review proposed the following legislative purpose:
'To provide income in retirement to substitute or supplement the Age Pension.'

While its emphasis on 'income in retirement' is welcome, this purpose has three weaknesses:

- (1) Full replacement of the Age Pension with superannuation should not be elevated to a policy goal. If this were achieved across the board, the resulting system would be highly inequitable and costly to government. For these reasons it is unlikely to happen in any event.
- (2) Supplementing the pension with superannuation for the majority of retirees makes more sense, but one implication of this is that the implied retirement income 'target' for superannuation is arbitrarily linked to the level of income where the pension cuts out completely. At almost \$50,000 for singles and over \$75,000 for couples, this would provide an relatively affluent living standard for a typical retired household living in owner-occupied housing. The vast majority of retirees live on much less.
- (3) It would be better to start with the underlying policy goal - adequacy of retirement incomes - and then turn to the contribution of each element of the retirement income system towards that goal.

Proposed purpose:

We propose that the following purpose and clarifying principles be inserted in relevant legislation:

'The purpose of superannuation is to ensure that as many people as possible can attain an adequate income in retirement, higher than the Age Pension, through an acceptable level of compulsory saving, and fair and sustainable taxation support.'

¹ For more information on our proposals for retirement income reform including superannuation, see http://www.acoss.org.au/wp-content/uploads/2015/08/ACOSS-submission-to-retirement-incomes-review_Tax-Talks-4_Final.pdf

Clarifying principles

The following 'clarifying principles' are also proposed. These need not be incorporated into the primary legislation. They could, for example, be included in the Explanatory Memorandum for the relevant Bill or in regulations.

1. Superannuation should be seen as a core component of Australia's retirement income system, together with the Age Pension. A key outcome of superannuation with a clear objective will be to maximise the ability for people to achieve an adequate retirement income with less reliance on the Age Pension.
2. Superannuation may assist in meeting other objectives including strengthening national saving, and providing a pool of savings to enhance financial stability but these are subsidiary to the purpose outlined above.²
3. The development of benchmarks for the adequacy of retirement incomes requires careful modelling of pre and post retirement living standards and how these are distributed among different households, including between men and women.

This should be carried out as part of a thorough and open public review of retirement incomes with input from experts, stakeholders and the general community.

4. An 'adequate retirement income' has different meanings according to the different *purposes* of the four components of the retirement income system, as shown in the table below³:

² It is unrealistic to suggest that superannuation would one day replace the Age Pension under current or similar policy settings since a majority of retirees will receive at least a part pension well into the future. Further, it is doubtful whether the superannuation guarantee and tax concessions significantly reduce the overall budgetary cost of public support for retirement incomes since the cost of tax concessions largely offsets any pension savings. A more appropriate goal would be to ensure that the overall cost to the Budget of support for retirement incomes is sustainable (discussed below).

³ These retirement income 'pillars' are similar to the 'five tier' model advocated by the World Bank, excluding in kind support for retirement and social insurance.

http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1121194657824/PRPNoteConcept_Sept2008.pdf

5. Proposed purpose of each tier of the retirement income system

| Retirement income 'tier' | Purpose | Suggested adequacy benchmark |
|--|---|--|
| Age Pension | Prevent poverty | Living standard above poverty level |
| Compulsory superannuation | 'Decent' retirement income 'worth saving for' | Living standard# between poverty level and (minimum) living standard of the vast majority of people of working age |
| Superannuation tax concessions | 'Average' retirement income 'worthy of public support through the tax system' | Living standard# between poverty level and living standard of median (middle income) household of working age |
| Voluntary saving not supported by government * | Income replacement according to individual choice | No common standard, determined by each individual |

Note that the same living standard can usually be obtained with a lower income after retirement, since the costs of children and housing costs are lower. These factors should be taken into account.

* Note that savings from non concessional contributions are still supported by government through the tax system to the extent that fund earnings and benefits are concessionally taxed.

(1) *The Age Pension and other income support payments including Newstart Allowance* should provide sufficient income (along with supplements such as Family Tax Benefit and Rent Assistance) to prevent poverty.

Since poverty is properly measured relative to community living standards, this implies that income support payments should be indexed to wage movements.

(2) *Compulsory retirement saving* (through the Superannuation Guarantee) should support a 'decent' living standard above pension levels that is 'worth saving for'.

This is the meaning of the reference in the proposed legislative purpose to an 'acceptable level of private saving', since the superannuation guarantee requires people to trade off a lower living standard in working life to improve their living standard in retirement.

This living standard 'target' should be set at an absolute level, rather than an income-replacement level.

This standard should be *higher* than the living standard that can typically be achieved by people living on the maximum-rate pension (otherwise there would be no point in compulsory saving), but *no greater* than the average living

standard attained throughout working life by the vast majority of wage-earners, since it would not be reasonable to force a substantial number of people to save to achieve in retirement a higher living standard than they have in working life.

Since retirement living standards depend on more than people's incomes, when converting 'living standards' into benchmark incomes account should be taken of the typical costs of housing and children before and after retirement. For these two reasons a typical retiree household requires much less income to obtain the same living standard as a typical working-age household.

(3) *Superannuation tax concessions* should support an 'average' retirement living standard that is generally considered worthy of public support (since a tax concession for one taxpayer means that others must pay more to raise the same public revenue).⁴

In this case also, the living standard 'target' should be set at an absolute level, rather than an income-replacement level. This does not refer to 'average' in the statistical sense, but to indicate that it sits above a minimum level of adequacy but below what would generally be described as an 'affluent' or 'luxury' living standard⁵.

This standard should be *higher* than the living standard that can typically be achieved by people living on the maximum-rate pension (otherwise there would be no need for taxation support for retirement saving), but *no greater* than the living standard attained during working life by a middle-income (median) taxpayer, since it would not be reasonable to expect the majority of taxpayers of working age (at the median income level and below) to support a living standard in retirement for others that is greater than their own during working life.

⁴ We define 'tax concessions' against an income tax benchmark, under which wages, and returns to investment above inflation, are taxed at each individual's marginal rate. Some argue that an expenditure tax benchmark (under which investment income is not taxed) is more appropriate. However, exempting investment income from tax is unlikely to result in a higher overall higher level of saving. Lower tax rates for investment income mainly benefit individuals with high incomes, encouraging them to switch their savings to tax-preferred investments rather than increase their overall saving. In any event, the current superannuation system is closer to the income tax benchmark since benefit payments are not taxed, and it is unrealistic to expect that the system could be adjusted towards expenditure tax treatment. The real issues for debate are the degree to which income tax rates on superannuation savings are concessional, and who benefits from the concessions.

⁵ The 'comfortable' living standard benchmark developed by ASFA falls into this category. This living standard has greater relevance to the top 20% of wage earners and retirees rather than middle income households. It includes, for example, overseas travel every five years and weekly restaurant meals with quality wines. This standard of living is beyond the reach of most households. See Grattan Institute (2015), 'Super tax targeting.'

Otherwise, the result would be a compulsory transfer of resources from the lower half of the income distribution to people with much higher living standards than themselves. This is what the present inequitable tax concessions do.

Again, since retirement living standards depend on more than people's incomes, when converting 'living standards' into incomes account should be taken of the typical costs of housing and children before and after retirement. For example, a typical family with children and a mortgage should not be expected to support a living standard for a retired household that is higher than their own.

Contributions attracting tax concessions should be capped at an absolute level that is consistent with this retirement income benchmark.

Tax concessions should also support compulsory saving for retirement since it would not be reasonable to require people to save for retirement without any public support through the tax system. This applies especially to people with low incomes who are unlikely to save in the absence of compulsion and for whom saving for retirement involves greater financial sacrifice.

(4) *Unsubsidised private saving* through voluntary contributions supports the living standard chosen by each individual.

The superannuation system should also facilitate a higher living standard than the above through voluntary saving, where an individual has the capacity and desire to do so (otherwise, individuals would not be allowed to save through superannuation above the level of saving that attracts tax concessions).

There would be no standard retirement income target for this purpose since it is a matter of individual choice.

However, the community should not be expected to support such choices through the tax system or other retirement income subsidies. This implies that 'non-concessional' as well as 'concessional' contributions should be capped, since once income is invested in superannuation investment income and benefits are taxed at lower rates than would otherwise apply.

6. 'Fairness' has two dimensions: that as far as possible everyone should receive the same tax concession per dollar invested in superannuation and that those with lower incomes who need more help to save for an adequate retirement income (and are most likely to rely on the pension otherwise) should receive

more support.

While there is a tension between these goals, they both point towards a redistribution of the current concessions from high to low and middle income-earners. This tension can be partly resolved by capping the concessions, since caps are more likely to reduce concessions for high income earners.

7. 'Sustainability' refers to the fiscal cost of tax concessions, which based on the Tax Expenditure Statement's income tax benchmark is approximately equal to the annual cost of the Age Pension, and rising rapidly.

This leaves less room for expenditure on health and aged care services for an ageing population, which make a vital contribution to retirement living standards and security that is at least as important as an adequate income.⁶

Superannuation policy settings should not be based on an assumption that individuals should pay more for their health care from their own pockets, including from their superannuation benefits.

8. The purpose of superannuation is *not* wealth accumulation per se, or estate management.

Superannuation is only part of the mix of investment options available to people, and it has a particular purpose: to support retirement living standards.

This implies that the system should encourage or compel people to draw down their superannuation savings over the course of retirement, and that the use of superannuation to provide bequests (apart from transfers to support partners or dependent children) should be discouraged.

⁶ The World Bank's four tier retirement income model includes a health and care services tier for this reason. Currently less than one on five people over 64 years pays income tax, due in large part to tax concessions for superannuation including the non-taxation of fund earnings in the retirement phase. This is not sustainable if governments are to support decent health and aged care services.