‘The Objective of Superannuation’ discussion paper

Submission to The Treasury

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CPSA is a non-profit, non-party-political membership association founded in 1931 which serves pensioners of all ages, superannuants and low-income retirees. CPSA has 117 branches and affiliated organisations with a combined membership of over 31,000 people living throughout NSW. CPSA's aim is to improve the standard of living and well-being of its members and constituents.

CPSA welcomes the opportunity to comment on The Treasury's 'the Objective of Superannuation' discussion paper.

Summary of recommendations:

- **Recommendation 1:** That the Australian Government adopt the proposed primary objective of superannuation 'to provide income in retirement to substitute or supplement the Age Pension'.
- **Recommendation 2:** That the Australian Government adopt the proposed subsidiary objectives of superannuation.
- **Recommendation 3:** That the Australian Government develops a longevity social insurance model.
- **Recommendation 4:** That the performance of default superannuation funds should ensure that those with little or no financial literacy are not disadvantaged.
- **Recommendation 5:** That the Australian Government establishes an upper limit on superannuation balances, beyond which tax concessions do not apply.
- **Recommendation 6:** That superannuation tax breaks and concessions be targeted towards low income earners and gradually tapered off as contributions increase.
- **Recommendation 7:** That the Australian Government adopt Recommendation 18 of the Henry Tax Review

Proposed primary objective of superannuation: to provide income in retirement to substitute or supplement the Age Pension

CPSA supports the proposed primary objective of superannuation being ‘to provide income in retirement to substitute or supplement the Age Pension’. Enshrining this objective in legislation is an important step in safeguarding Australia’s retirement income system. It is critical that the long term sustainability of the superannuation system is not undermined by shorter-term political objectives.

CPSA supports the clarification that superannuation should be used to supplement or substitute the Age Pension as this reinforces the notion that both individual savings and public pensions are integral to Australia’s robust retirement income system. It should be clarified that superannuation represents a supplement or substitute to the Age Pension on an individual level and that at a macro level the Age Pension will always be available to those who need it. The provision of the Age Pension recognises that the superannuation system does not work for all Australians, in particular low income earners, those who work part time or those who leave the workforce to provide care or due to health issues. Policy makers must understand that the superannuation system works alongside the safety net provided by the Age Pension and cannot be viewed in isolation or as an eventual replacement of direct transfers to retirees.

- **Recommendation 1:** That the Australian Government adopt the proposed primary objective of superannuation ‘to provide income in retirement to substitute or supplement the Age Pension’.

Proposed subsidiary objectives of superannuation

CPSA is of the view that that the proposed subsidiary objectives of superannuation can only be realised if there is strong support for the primary objective. Each of the subsidiary objectives assumes to some extent that the purpose of superannuation is to provide income in retirement. Assuming strong bi-partisan support for the primary objective, CPSA supports the proposed subsidiary objectives of superannuation. However, CPSA raises a number of concerns around themes raised in the discussion paper.

- **Recommendation 2:** That the Australian Government adopt the proposed subsidiary objectives of superannuation.

Longevity risk

CPSA is concerned that longevity risk has not been adequately addressed by Australia’s retirement income policies. It is impossible to know how long you will live and this makes planning for retirement difficult. The average life expectancy at birth in Australia is 80 for men and 84 for women[1]. However, once a person does reach their eighties, they can expect to live another ten years on average[2]. As life expectancy continues to rise, it is essential that mechanisms for mitigating longevity risk are incorporated into Australia's retirement income system as a matter of urgency. CPSA supports the idea of a compulsory social insurance scheme to cover people who outlive their retirement savings (in addition to the Age Pension) where benefits would only be paid to the very old.

CPSA supports Recommendation 21 of the 2009 Henry Tax Review, which recommends Australian Government support for the development of a longevity insurance system. The Government should pool risk and operate a universal social insurance scheme which is fully funded and available to people over the age of 80 and assist in the funding of aged care. For example, once the superannuation contribution guarantee reaches 12%, it should be increased again to 15%, with the additional 3% allocated to a Government-managed social insurance fund, used to cover the costs of payments to those who reach very old age.

- **Recommendation 3:** That the Australian Government develops a longevity social insurance model.

Financial risk and market volatility: safeguarding super

The global financial market has grown exponentially in the past thirty years. The compulsory nature of superannuation and the relatively high-risk investment patterns of superannuation funds in Australia mean that many Australians are more exposed to financial volatility than they know. Given the increase in adverse financial events in recent years, most notably the Global Financial Crisis (GFC), it is critical that safeguards are put in place to protect the superannuation savings of individuals.

It is important that individuals understand the concept of investment risk and are able to make decisions about how their superannuation is invested. Discussions of risk and investment often lead to the perceived need to improve financial literacy as a means of mitigating risk. While financial literacy does improve an individual's capacity to understand the nature of risk and make an investment decision accordingly, it does not actually address the extreme volatility that characterises participation in the global financial market. Given the compulsory nature of Australia's superannuation system, default funds must be designed so that an individual with no financial literacy is not penalised or disadvantaged compared to an individual with greater financial literacy.

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[1] Australian Institute of Health and Welfare (2016) 'Life expectancy' [Accessed 31/03/2016] Available: http://www.aihw.gov.au/deaths/life-expectancy/

[2] Power, T (2015) 'Life Expectancy: Will you outlive your retirement savings?' [Accessed: 31/03/2016] Available: http://www.superguide.com.au/boost-your-superannuation/latest-data-find-out-how-long-you-can-expect-to-live

Accordingly, CPSA supports the development of a superannuation system that is simple and easy to understand for people with limited or no financial literacy.

- **Recommendation 4:** That the performance of default superannuation funds should ensure that those with little or no financial literacy are not disadvantaged.

Further discussion points

Issue: retirement income or standard of living in retirement, adequacy

Replacement rates offer a useful guide for personal wealth accumulation and help individuals to work out how much they need to have saved in order to fund the retirement lifestyle they desire. However, in the interests of fairness, CPSA rejects the use of replacement rates by policy makers to estimate the required level of retirement income for individuals based on the wages earned during working life. The public purse should not be expected to provide relatively more support to the wealthy (in the form of concessions and tax breaks) for the purposes of maintaining a higher standard of living in retirement.

The structure of the Age Pension provides some guidance on the question of cost-of-living versus standard-of-living in retirement and the level of support Australians should expect from Government. The full-rate Age Pension is intended to cover the cost of living in retirement, with the rate of payment tapered to ensure that it does not fund a standard of living beyond that defined in terms of income or assets. It is important to note that the Age Pension rate fails to cover the cost of essentials for many Australians, particularly those who are renting privately.

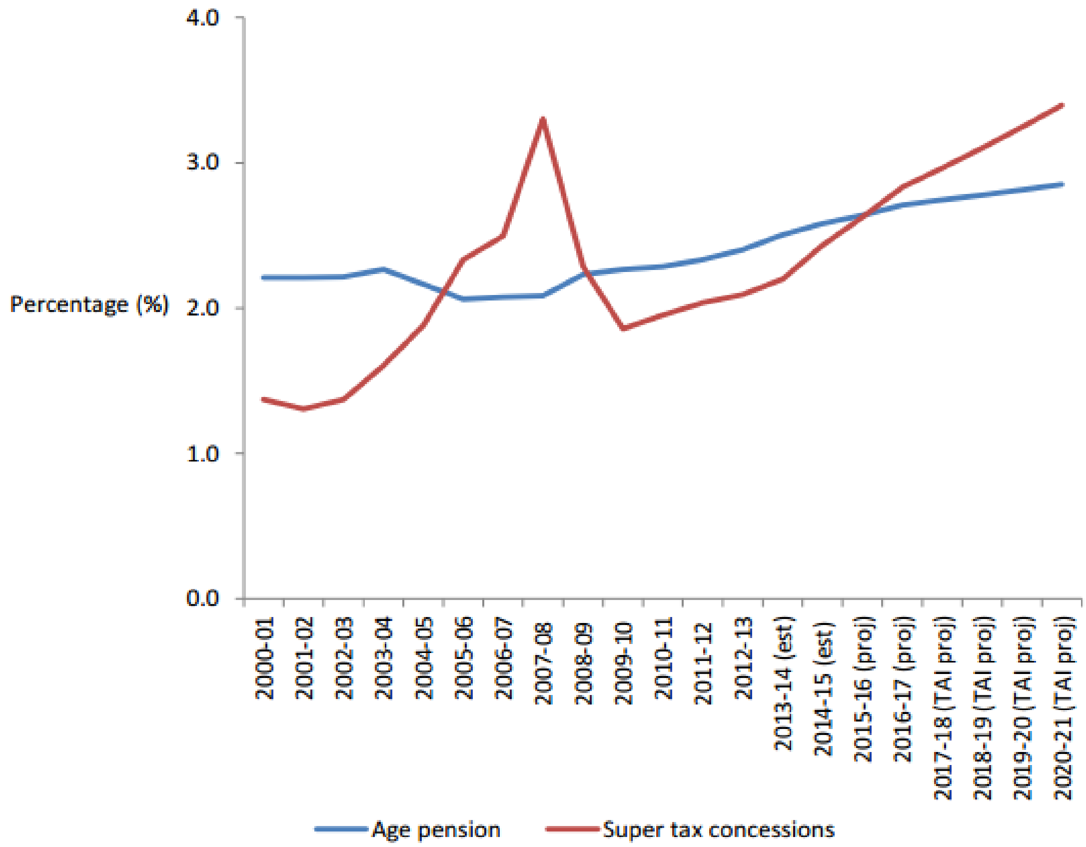
CPSA does not view it as necessary to develop an additional definition of an adequate standard of living in retirement for superannuants. Superannuation balances have no upper limit, with tax concessions becoming relatively more generous as the balance increases. In the interests of fairness and consistency, CPSA is of the view that these tax concessions must cut out at some point, in the same way that Age Pension benefits cut out once the income and asset limit is reached.

- **Recommendation 5:** That the Australian Government establishes an upper limit on superannuation balances, beyond which tax concessions do not apply.

Issue: fiscal sustainability

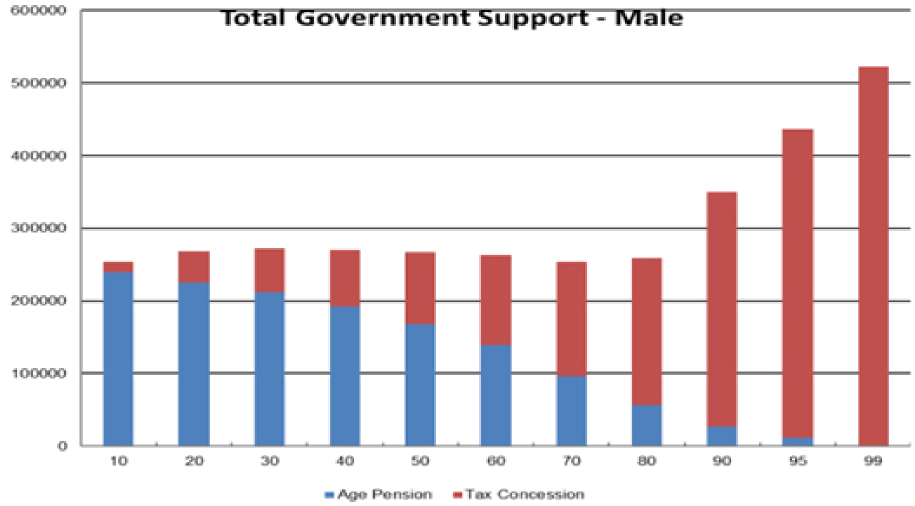
The topic of fiscal sustainability, particularly as it relates to Australia's retirement income system tends to focus on spending, specifically the amount spent on the Age Pension. However, the cost of superannuation tax breaks and concessions is projected to exceed the cost of the Age Pension by 2016-17 (see Figure 1). The tapered structure of the Age Pension clearly defines the level of Government support available to meet the costs of living in retirement. Thus it logically follows that superannuation tax breaks and concessions should be structured so that those with the least means receive the greatest support. This is not currently the case. Figure 2 illustrates that the top 10 percent of income earners receive by far the greatest support from government to grow their retirement income through generous tax breaks and concessions.

Figure 1: Relative cost of the Age Pension and superannuation tax concessions as a percentage of Gross Domestic Product (GDP)



Source: Ingles, D. Denniss, R. (2014) 'Sustaining us all in retirement: the case for a universal age pension' The Australia Institute, Policy Brief No. 60, pp.3. [Accessed: 30/03/2016] Available: http://www.tai.org.au/sites/defualt/files/PB%2060%20Sustaining%20us%20all%20in%20retirement.pdf

Figure 2: government support provided through the Age Pension and Superannuation



Source: The Treasury (2012) 'Distributional Analysis of Superannuation Taxation Concessions' [Accessed: 30/03/2016] Available: http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/Distributional-analysis-of-superannuation-taxation-concessions

As it stands, superannuation tax concessions are incredibly regressive, with the bottom 60% of income earners receiving 27.2% of concessions while the top 10% of earners receive 31.8% of the benefits of these tax breaks[3]. This is due to the fact that superannuation contributions are taxed at a flat rate of 15%, thereby allowing high income earners to avoid paying up to 47% in tax, while simultaneously taxing low income earners at a higher rate than they would otherwise be paying (because the tax free threshold of $18,200 does not apply). The Low Income Superannuation Contribution (LISC) is one of the few equalising aspects of the superannuation system, effectively providing low income workers with a tax refund on the additional tax they have paid on their superannuation contributions. It provides people earning up to $37,000 with up to $500 into their superannuation account. It is most concerning that the LISC is only in place until 2016/17.

- **Recommendation 6:** That superannuation tax breaks and concessions be targeted towards low income earners and gradually tapered off as contributions increase.

At its inception, one of the key purposes of Australia's superannuation system was to boost national savings. This likely contributed to the lack of concern regarding the excessive tax benefits available to the wealthy and sub wealthy. Given that this objective

[3] Ingles, D. Denniss, R. (2014) 'Sustaining us all in retirement: the case for a universal age pension' The Australia Institute, Policy Brief No. 60, pp.5. [Accessed: 30/03/2016] Available: http://www.tai.org.au/sites/defualt/files/PB%2060%20Sustaining%20us%20all%20in%20retirement.pdf

of increasing national savings is no longer a priority, the inequitable nature of Australia's superannuation concessions must be corrected.

CPSA is a strong supporter of the superannuation tax concession reforms recommended in the Henry Tax Review. In particular, CPSA supports Recommendation 18, that superannuation contributions should be taxed at marginal personal income tax rates and that an offset should be provided for superannuation contributions up to an annual cap of $25,000. This is in contrast to the current system where all contributions are taxed at a flat rate of 15%, meaning that Australia's low income earners and Australia's highest income earners are taxed at the same rate. CPSA views the introduction of marginal tax rates on superannuation contributions as a critical step in ensuring both the equity and the fiscal sustainability of Australia's superannuation system.

- **Recommendation 7:** That the Australian Government adopt Recommendation 18 of the Henry Tax Review