The White Paper Task Force

The Treasury

Langton Crescent

PARKES ACT 2600

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I would like to thank you for giving us the opportunity to add to this important debate. The focus of this submission in on superannuation and its policy rationale in particular with minor comments on the family home and dividend imputation..

Australia is approaching a difficult period where demographic changes with present a real challenge both to the Budget and the economy. With a rapidly aging society we are going to have to look for long term policies to:

- Promote participation including a higher level of participation from traditionally working age people and to provide a system that allows workers to continue for longer, ideally with greater work flexibility and part time work;
- Policies to promote productivity and innovation;
- Ensure that there is sufficient aggregate demand to allow the economy to continue to grow and provide opportunities for employees and business which is also necessary ensure that adequate tax revenue is generated;
- Ensure that we have a layer of protection for the most vulnerable;

There is no doubt that Australia as a nation is one of compassion and we need a safety net in place. However, the leaders of any organisation including a country must as its primary objective run the organisation well. Companies making low profits cannot pay workers well or they will go broke and countries that are not performing well economically will have a reduced ability to assist the disadvantaged.

If policies are focused on our economic prosperity then we will have the most available to assist those in need. Therefore it is crucial to have an an overriding focus on economic policies. We then make adjustments to these for social and welfare considerations. It is not correct that every policy on a stand alone basis should be fairness based.

We already have a progressive tax system and a means tested welfare system. Corporates and higher income earners pay the overwhelming majority of tax and are the lowest welfare burden, yet the commentary are these are the groups that are receiving some unfair advantage. Inequality is a reality of all life and it is not of itself unfair.

We should work together, rather than demonise financial success. Self funded retirees have most likely paid considerable tax all of their lives and been of minimal burden on the welfare system. They are the people that make a Budget possible at all as they are the revenue side of the equation and this should be appreciated.

In this submission we certainly accept that we want a safety net, but our view is that a strong economy is the best way to be able to provide a safety net.

It is also a well understood relationship that higher tax can slow economic growth and therefore tax revenue over time.

The current and foreseeable reality is that the lower income earners in society this safety net will always come through the social security system. This is a group that simply does not have the income or savings capacity to ever be in a position to provide for themselves in retirement. If they do have the ability, then more social security is a disincentive to taking any opportunities available to them.

Superannuation is not a social fairness policy and should not attacked based on a particular view of fairness.

The debate around our superannuation system and its reason for being is an extremely complex topic which is of vital importance to our nation. As a finance professional with economics qualifications who is heavily involved on a day to day basis with assisting clients to achieve a self funded retirement I feel that I can provide some unique input into the policy debate around superannuation.

This area has become extremely confused by interest groups and emotion overriding economic realities. In policy design economic realities will be the drivers of success and simplistic policies based on popular misconceptions are likely to cause massive damage. With the never before seen demographic and environmental challenges that we have before us, the decisions we make now are crucial for the future of our great nation. We need the leadership to take the country in the right direction by making the right choices.

For the ultra wealthy superannuation is rarely a big issue. Our concern is what the view is of a personal that is wealthy or rich. We would see it as a person where money is of no concern as compared to someone who has a good lifestyle (spends a lot) and uses their retirement savings. This second group will be vital to the future economic success of Australia. There has been commentary from a range of people including Jeremy Cooper who said $1,000,000 was not a lot to retire on in today's world.

What should the policy rationale of superannuation be?

It is our view that superannuation has both budgetary and economic policy benefits and there is clearly significant cross over given the impact of the economy on the Budget. As a result we see the two main targets for superannuation to be:

1. To enable / encourage retirees who would have been part pensioners to become self-funded or less reliant on pension income (lower part pension);
2. To enable / encourage self funded retirees to get to a position where they will able to maintain their lifestyle in retirement.

You will have noticed that both these policy considerations are focused more on the top 50% of super balances rather than the large number of smaller balances. Superannuation should not be a viewed as core fairness based policy, but rather an fundamental policy to deal with the dramatically changing demographic situation and in particular that we will have a lot more people living longer, so more people in retirement relative to those working.

Our Age Pension structure allows an individual to have a certain level of assets / income before they lose any pension.

Low income workers have shown little ability to save anywhere near enough to build assets that would reduce their pensions at all. Increasing assets at retirement from zero up to these cut off thresholds has no benefit at all in terms of reducing the Age Pension support that needs to be funded from the Budget. So the argument that superannuation should be used to increase the wealth of our lowest income earners is not valid from a policy perspective. It may appear moral or fair, but it does not generate the stated policy benefits at all. Trying to target benefits to our lowest income earners will give us the lowest policy bang for our buck.

Where you have people that would have been on a part pension, but will be on a reduced pension you are getting a very powerful reduction in Age Pension payments. This is also a very large group of the population who actually have the means to make choices and react to incentives.

There is also a clear benefit from moving people on part pensions off the pension. As above these are people also have the means to make choices and react to incentives.

For individuals who would never have qualified for the pension there is clearly no Age Pension saving to be had, so one might suggest that they should not be offered superannuation at all. However this is missing the second, third, fourth, etc…. round effects that are of an economic nature. While these are difficult to model they cannot be ignored as so often is the case with reported figures. The second policy rationale of allowing people to maintain their standard of living in retirement is likely to have a significantly greater budgetary impact than the impact of superannuation on the Age Pension and certainly more impact on the Australian economy.

Economics

Demand drives economic activity. If we have a large portion of our population moving into an older demographic and as a result they have to significantly reduce their lifestyle this would have disastrous economic consequences and would cause great damage to the Budget.

If we have a collapse in the spending capability of the biggest spenders we currently have (baby boomers) then we are likely to experience very difficult economic times. This also has a snow balling effect, so the magnitude is realistically impossible to quantify, but it would not take much modelling by Treasury to get a feel for how big an issue it is. A lack of demand in the economy will reduce taxes from:

- GST;
- Company profits;
- Personal income tax;

As well as many other sources of government income.

At the same time there will be more unemployment benefits and other costs associated with unemployment, underemployment and lack of opportunity.

While immigration could help right the balance of working to retired people, there is no way Australia has the capacity to keep the ratio anywhere near where it sits even today.

So other than the ultra wealthy we should be encouraging people to save as much as they can for retirement as well as educating more people on what they need to do.

Below is a simple example of a couple looking to maintain their lifestyle (they will not cause a decrease in aggregate demand in the economy)

The couple earns $100,000 and $60,000.

If they were looking to continue with this net after tax income in retirement, assuming:

1. They draw down all this capital in retirement over 30 years;
2. Drawdowns are indexed by 2.5% to maintain the real value of their expenditure (assumed 2.5% increase in cost of living);
3. They generate an average return of 6.0% per annum net of all taxes and costs.

They would need almost$2,260,000 in a tax free super system to provide that level of income for 30 years (running down the capital). If they were risk averse and only generated a 4% return (they could not even generate that at present) they would need over $2,900,000. With the current contribution rates, mortgages, kids and the like it is hard to envisage this couple ever getting a superannuation balance anything like the one required.

We accept that once you hit the $5,000,000 -$10,000,000 super balance stage it is not clear what additional expenditure would result from higher wealth. Below that point it is our personal experience that spending levels are highly sensitive to the wealth position.

The policy goal should be to get as many super funds as possible into the $500,000 - $5,000,000 range. It should not be considered a current tax loss. The concept of the aging population is that the Budget will be transformed by the huge increase in the older non working population. To try to plug current tax shortfall by attacking the very system that is in place to reduce the budgetary pressures of the future is clearly poor policy.

The idea that letting people build large balances is a bad thing is completely ignorant of the huge budgetary benefits for the future when they will be most needed. It is completely irresponsible to quote superannuation as simply a tax cost. You cannot tax your way to prosperity as high tax rates reduce economic activity and therefore the eventual tax revenue. We critically need our retirees to spend and this means in the vast majority of cases, the bigger their superannuation funds the better.

Policy options:

While there is a clear risk that constant change in superannuation may discourage super savings, there is some room for policy adjustment if it generates sufficient income.

- The current contribution limits are already so low that it is difficult for many people to use super to replace their pre retirement income. These limits actually need to be increased as younger people have limited ability to sacrifice income to super when they have mortgage and family costs.
- Some tax on higher income earners – The zero % tax should stay within the fund, however where amounts greater than a given amount are taken their marginal tax rate or a fixed tax rate could apply to the taxable proportion of withdrawals (not drawn for the tax free %). For example first $100,000 per individual is tax free and balance of withdrawals taxable at MTR or 15%. This is more equitable as taxing in the fund does not allow for what other income the individual has outside super. This would have the added benefit of ensuring that there would be plenty of death benefits tax collected as funds as there would be a lot of tax to pay if people tried to cash all their super prior to death.
- Maximum withdrawals limits should apply even on unpreserved pension funds. The idea is to fund retirement, not go on a big overseas trip and then go back onto the Age Pension. A limit of 10% seems appropriate.

When it is suggested superannuation is just being used to transfer wealth across generations it is so far from our experience it is extremely frustrating. We are certainly seeing it being used to build wealth and provide for lifestyle in retirement. If we have a tax applied to large withdrawals this will mean that money cannot be moved out of super and any taxable components on death will be subject to a 15% tax rate.

Negative gearing generally which often involves building up property portfolios that are never intended to be sold is far more a case of building wealth for inheritance. It starts from a negative gearing tax losses, builds up wealth in an illiquid form that is never drawn down and provides very low levels of income.

Dividend Imputation

This is a system developed to avoid double taxation. It is fair and reasonable and vital as a source of income in retirement in a world where income is so low.

As an adviser, if this was removed our companies would be robbed of capital as there would be a strong rationale to invest overseas.

One could consider capping the payout ratio that dividends of a company could be franked. However this should be done over a period of time (average over 5 years for example) and would need a lot of work to ensure that there are no unintended consequences for public and certainly private businesses.

Family Home

While politically sensitive there is no doubt that one of the great inequities in the Australian tax and social security system is the treatment of the home. Pensioners with no home, not only fail to benefit from the asset exempt treatment of the home, but are also given a meagre couple of hundred thousands of dollars headroom in the assets test and no advantage in the incomes test. A person can sit on a property and transfer all the wealth via inheritance to the next generation, rather than use that wealth to help fund their retirement and reduce the strain on the Budget.

The difference in financial options from selling and using proceeds to fund your lifestyle to reverse mortgages makes it highly inequitable to treat homeowners so similarly to non homeowners in the social security and age care rules. Treating people with the same wealth levels differently is what is really unfair.

All people should be treated equally and as much as possible be given opportunity, but they will never be equal at all things and should not be under a system to force people to be the same.

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