THE IMPACT OF THE NEW SUPERANNUATION SCHEME ON LONG-TERM PERSONAL SAVING

Phil Gallagher

The views expressed in this paper are those of the author, and do not necessarily reflect those of the three Departments sponsoring the Retirement Income Modelling Task Force

Introduction

This paper presents an aggregate and a hypothetical analysis of the Government's policy for member superannuation contributions and matching Government co-contributions announced in the May 1995 Budget. The aggregate analysis contains some improvement on the Retirement Income Modelling Task Force estimates presented in *Saving for Our Future* (Willis, 1995) and gives a more comprehensive presentation of the analysis of the national savings effect of the policy. The hypothetical analysis addresses equity issues which have been raised by the Australian Council of Social Service (ACOSS) and the Consumers Federation of Australia.

The new member and co-contributions policy is an addition to the Government's policies of the Employer Superannuation Guarantee (SG) and Award Superannuation which were both additions to the system of voluntary superannuation. Prior to 1986, superannuation was encouraged by tax concessions. This voluntary system achieved coverage of 40% of employees by employer sponsored schemes and lower coverage of the self-employed. Covered employees were likely to be public sector workers and higher income and white collar private sector workers. Many of these schemes included contributions from employees.

In 1986, the Government encouraged the spread of superannuation among employees by agreeing with the Australian Council of Trade Unions to support 3% of wages being paid as new or improved superannuation as part of a productivity agreement. Award superannuation raised coverage from 40% to 80% of employees by 1992. However, employees not covered by awards were not included in the scheme and contributions of 3% of the award wage would not generate a substantial increase in retirement income.

In 1992, the then Treasurer, John Dawkins, announced the Employer Superannuation Guarantee which would:

- extend coverage beyond awards to employees earning over $450 per month;

- raise minimum employer contributions to 9% by 2002/03;

- count existing contributions towards the required level of contributions (with the value of contributions to defined benefit funds certified by actuaries); and

- involve new standards for preservation, vesting and prudential supervision.

At the time, the Government "envisaged" employee contribution of 3% and contributions from the self-employed (Dawkins, 1992, p3).

THE PROPOSED MEMBER & GOVERNMENT CO-CONTRIBUTIONS

The current Treasurer, Ralph Willis, announced the details of the member and government co-contributions policy in the May 1995 budget and tabled *Saving for Our Future*, an explanation of the policy backed by modelling results and costings.

The Government will support the phased introduction of employee contributions to employer sponsored superannuation schemes through industrial agreements, enterprise agreements and awards, where employee benefits are improved. The supported phasing timetable will be 1% of wages in 1997/98, 2% in 1998/99, and 3% in 1999/2000. In order to support the extension of member superannuation, the Government would match undeducted employee contributions to employer sponsored super funds and self-employed contributions subject to a cap and an income test from 1 July 1998. The cap would be 1% of AWOTE (Average Weekly Ordinary Time Earnings) in 1998, 2% in 1999 and 3% from 2000. The income test would phase out support from 1.4 times AWOTE at 5 cents in the dollar so that no matching co-contributions were payable for individuals with taxable incomes over twice AWOTE.

Contributions from the self-employed would be similarly supported. The self-employed could declare up to 25% of their contributions as undeducted and to be matched. The cap and income test would also apply to matched contributions from the self employed.

The government would finance its co-contribution by not implementing the second tranche of the tax cuts promised in the ONE NATION statement. These tax cuts would have benefitted taxpayers with incomes above $20,700 (see Table 1) whereas the co-contribution policy will direct the Government's matching co-contribution to those on lower incomes and ensure that those with taxable incomes in excess of twice AWOTE - about $66,000 - do not receive benefits.

TABLE 1 Scale For One Nation Tax Cuts Which Will Not Be Implemented
In Order To Fund The Government Co-Contribution

Bracket of Taxable Income	Old rate	Not Implemented
$0- 5400	0	0
$5401-20700	20%	20%
$20701-38000	34%	30%
$38000-40000	43%	30%
$40000-50000	43%	40%
Over $50000	47%	47%

On 2 November 1995, the Shadow Treasurer, Peter Costello, committed the Coalition to supporting total superannuation contributions being lifted to 15% of worker's salaries by 2002. In his speech to the Association of Superfunds Australia (ASFA) Conference the Shadow Treasurer supported:

- the continuation of the Employer SG on its current schedule;

- employee contributions of 3% by the year 2000; and,

- the redirection of tax cuts to superannuation or a like savings vehicle on the schedule set down.

The Coalition reserved the right to vary the mechanism for delivering the Government co-contribution. It also reconfirmed its support for Retirement Savings Accounts at the ASFA Conference.

Among the reasons for both the Government and the Opposition supporting the extension of superannuation is its capacity to add to national saving. The reasons for this view are explained below.

WHY COMPULSORY SUPERANNUATION ADDS TO NATIONAL SAVING

There are four main reasons for the view that compulsory superannuation adds to national saving:

1. The low existing financial saving in SG population means that they have a restricted capacity to offset compulsory superannuation saving by reducing other financial saving.

2. Economists believe or estimate that savings offset for compulsory superannuation is between 30% and 50%.

3. The design of the policy means that superannuation is a poor substitute for other forms of saving.

4. The design of the phase-in of the Employer SG and of the member contributions policy should ensure that existing real wages are not lowered so that existing saving can continue.

In addition, the Government co-contribution will add to saving more than the alternative tax cut.

It is worth examining these reasons in more detail.

Low existing financial saving in SG population

Award superannuation and the employer SG have extended saving to groups who otherwise would have low financial saving for their retirement. Table 2 shows the imputed distribution of financial saving in the SG population - employees aged 18-64 who earn more than $5400. The imputation is based on the ABS 1990 Income Distribution Survey.

Table 2 shows that the 50% of the SG population had less than $454 in financial saving in 1990 and that 60% had less than $1,136. This lower income group is the

group to which award superannuation and the Employer SG have extended superannuation. Since they have very small savings, they have little capacity to offset superannuation saving by reducing other saving. Because superannuation assets cannot be borrowed against, they do not increase the borrowing capacity of the population affected by the SG.

Table 2: Distribution of Non-Superannuation, Non-Housing Savings in SG Population

Percentile	Imputed Value Financial Assets
25%	$0
50%	$454
60%	$1,136
70%	$2,272
75%	$3,598
80%	$5,522
90%	$18,939
95%	$50,136
Mean	$18,958

Table 3 confirms the view that the level of saving in financial form for retirement is low. Fifty per cent of wage earners aged 55-64 have less than $5000 saved in interest bearing accounts and equities. The predominant form of saving is in the family home where the median equity is around $70,000. However, given the resistance of Australains to home equity conversions, only the financial saving would be likely to generate a retirement income, and most people who have employer SG superannuation are very unlikely to have any other significant financial saving for retirement which they will reduce because of the employer SG. In the absence of the policy, most would have been full rate pensioners.

Table 3: Distribution of Wealth among Wage Earners Aged 55-64 Years.
(average asset holdings by wealth deciles, 1990 - $'000)

Wealth percentiles	Interest bearing assets	Equities	Home equity	Total wealth
0-9	1	0	0	1
10-19	6	1	9	16
20-29	5	0	34	39
30-39	3	0	48	51
40-49	4	1	61	66
50-59	8	0	70	78
60-69	9	0	85	94
70-79	15	3	104	122
80-89	16	7	148	171
90-94	39	38	178	255
95-98	51	190	210	451
99-100	90	554	515	1159

Estimates of the Savings Offset by Economists

Economists who have examined the likely saving offset to **compulsory** superannuation have concluded that it is between 30% and 50%, with 33% being the value preferred by those who have examined the issue empirically.

FitzGerald and Harper (1993) chose 50% as there preferred value. This was more a judgement than an empirical estimate. They reasoned that the offset could not be 100% and could not be 0%, so 50% was chosen as half way between 0 and 1.

Tulip & Stott (1994), then in Treasury's Policy Research Unit, reviewed US research and Australian savings data and concluded that offset would be 'about a third'.

Covick and Higgs (September 1995) estimated the extent of time smoothing of household consumption from Australian National Accounts data.   They concluded that their estimate of a savings offset of 36.7% was probably an overestimate, and that the Tulip and Stott value of about a third was reasonable.

The time series estimate **over the last 35 years** of the offset to superannuation of Moorling and Subbaraman (1995) is dominated by the period of voluntary superannuation for higher income earners. This estimate of a 75% offset factor is in fact smaller than the judgemental estimate of 100% used by the RIM Task Force for **voluntary** superanuation.

The current average household saving ratio is below 5%. If superannuation for those in SG schemes were paid as increased wages, it is hard to imagine more than 30% of the increase in take home pay being saved for retirement in financial form. On the basis of the empirical work of economists and on the basis of the saving behaviour of those likely to be in SG schemes, the RIM Task Force believes that the use of average saving offset for compulsory superannuation between 30% and 50% is justified, and that values closer to 30% should be preferred.

Superannuation Is A Poor Substitute For Other Forms Of Saving

Superannuation is a poor substitute for other forms of saving because people have to put in a fixed amount and because withdrawal of saving is regulated. Controlled entry, and preservation until age 55 (controlled exit except in hardship) mean that money stays in system and that abuse of tax concessions by funds movers is limited. It should be noted that the Insurance and Superannuation Commission's hardship system does give access to their savings for people in genuine need - a point often overlooked by many welfare and consumer commentators (eg Cox, 1995; Mack 1995). In fact, amounts under $5000 are released on establishing a prima facie case. However, the majority of those covered by superannuation do not apply for hardship release, and amounts in superannuation accounts are saved rather than consumed.

The Phase-in of the Policies has been designed not to decrease real wages

The Employer SG is effectively phased in at an average rate of 0.5% per year. This is well below the ABS estimate of compound growth in average productivity per worker of 1.29% pa since 1978/79. If the employees share of productivity were returned, average real wage rises could be around 1.0 to 1.3% per annum. If the employer SG diverts 0.5% of this rise to superannuation, this still leaves scope for real wage rises. If real wages do not fall, wage and salary earners should be able to afford the same standard of living as now, and achieve similar or better levels of home equity.

The member co-contributions, where they dont already exist, are likely to be implemented in the context of a wage rise - so other financial savings need not necessarily fall. Given that the spread of member superannuation is to be achieved by award agreements and enterprise bargaining, it is quite reasonable to expect that the policies actual implementation will reflect productivity rather than a drop in the real value of take home pay. The member coverage is expected to lift from 48% to 74% of employees. The costings assume that not all employees will be affected. The 74% assumption is based on the coverage achieved by the award and employer SG policies of 87% (74% is a bit less than 87% of 87%).

The RIM Task Force's policy costings of the co-contribution policy assume that coverage for the self-employed will only be small increase on the existing 23% coverage

In estimating the effects on national saving of the co-contributions policy the RIM Task Force assumed that:

- 30% of the increase in new employee and self-employed contributions would be offset by reduction in other savings or by borrowing by those without other saving; and

- 30% of the Government contribution to superannuation accounts would be offset by reduction in other savings or by borrowing by those without other saving.

I regard this last assumption as very conservative - if the Government put $1000 into a worker's superannuation account, why would the worker reduce other savings by $300 or borrow $300? The average household saving rate is 5%, so the amount of saving from the tax cuts would have been likely to be low. The 30% saving offset applied to the Government co-contribution more than covers the counterfactual saving rate.

The real fund earnings rate in RIM analysis are also conservative. RIM assumes a real fund earning rate of 4% whereas surveys of fund returns show real fund earning rates in excess of this for the last 5, 10 and 15 years.

AGGREGATE IMPACT OF THE CO-CONTRIBUTION SCHEME

The RIM Task Force currently estimates the effects of member superannuation policies using two medium term microsimulation models and a long term cohort model. The microsimulation models are MEMSUPER which estimates employee contributions using a database from the ABS Superanuation Survey 1994, and SEMSUPER which estimates self-employed contributions from a database summarising on all 1992/93 individual tax returns. The long term model is RIM's enhanced version of the National Mutual Retirement Income Policy (RIP) model.

MEMSUPER estimates that the the co-contribution policy will add about 1% of GDP per annum to National Saving by 2005/06. As shown in Figure 1, private saving rises quickly as the policy is phased in and then grows reasonably steadily. Public saving rises initially because the savings from not making the tax cut to employees exceeds the cost of the Government co-contribution to employees. However, once the policy is fully phased in the cost of the co-contribution to employees exceeds the savings from not implementing the tax cuts for employees.

Figure 1: Medium Term projections of Components of National Saving - Employees

EFFECTS OF MEMBER & GOVERNMENT CO-CONTRIBUTION
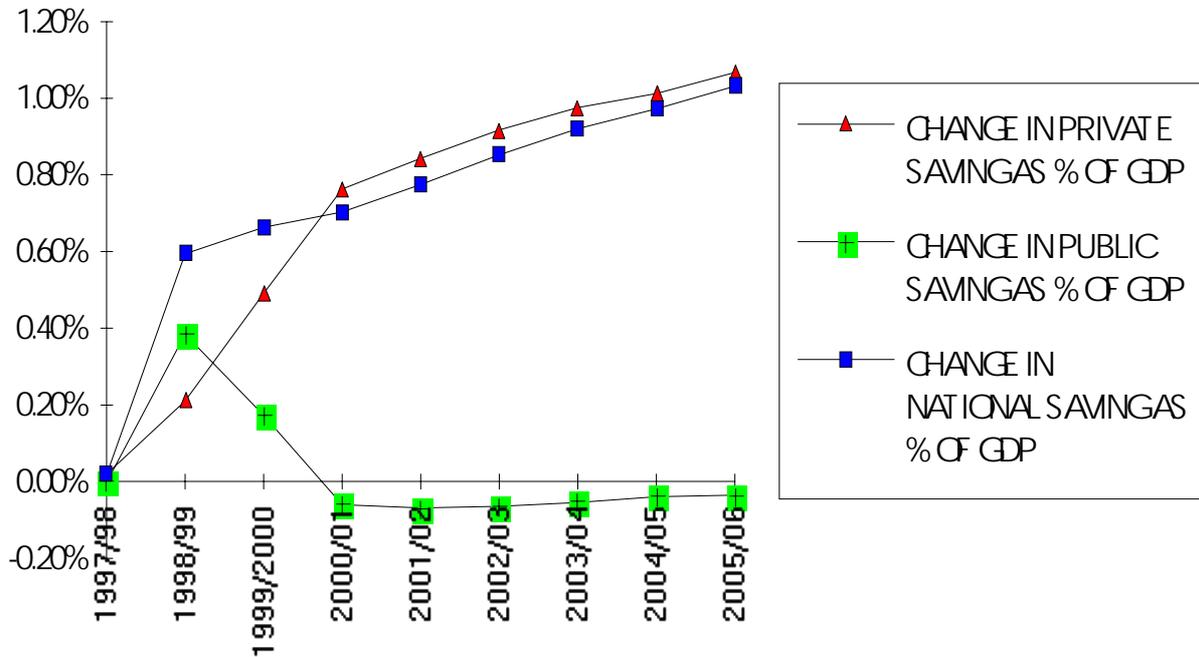PROPOSAL ON NATIONAL SAVINGS - MEMSUPER ESTIMATES

Figure 2 shows the results from SEMSUPER for the self-employed. Public saving for the self-employed is always positive because they would have gained more from the tax cuts than the projected cost of their co-contributions. The policy for the self-employed is expected to add about 0.1% of GDP per annum to national saving.

Figure 3 presents the full estimates of national saving for the policy which is projected to add 1.2% of GDP per annum to national saving by 2005/06. This estimate is higher than the combined microsimulation model estimates because not all taxpayers who would have received the tax cut are working.

Figure 3 shows that the cost of the Government co-contribution policy has been designed to balance the gain to revenue from not implementing the second tranche of the One Nation Tax Cuts. Several commentators have queried the inclusion of the legislated tax cuts in the estimates. The Government has always regarded their non-implementation as funding the policy. Even if they were not included, the policy would still add to national saving.

Figure 2: Medium Term Projections of Components of National Saving- Self Employed

CHANGE IN COMPONENTS OF NATIONAL SAVING FROM
SELF EMPLOYED SCHEME: SEMSUPER ESTIMATES
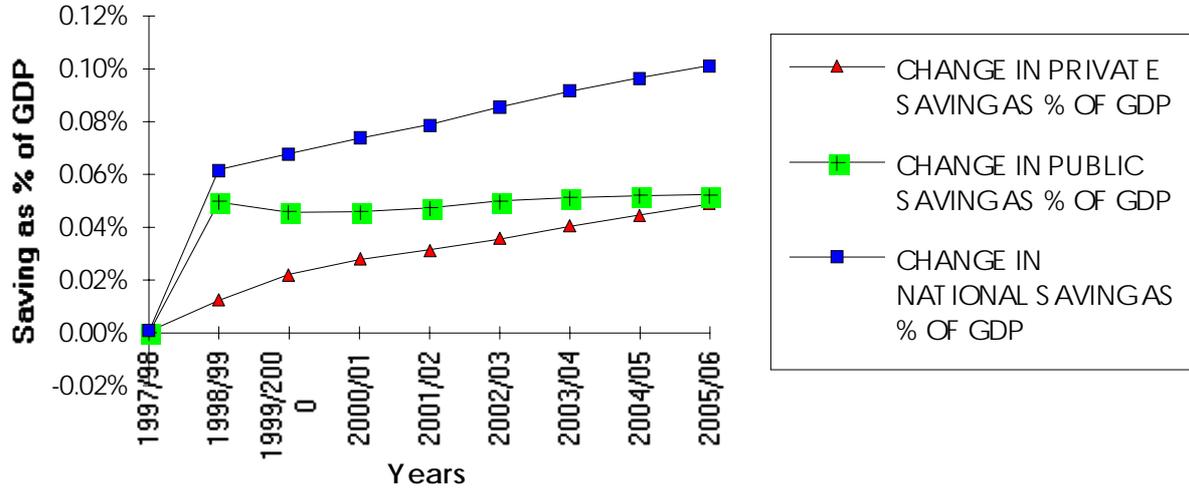
Figure 3: Medium Term Projections of Components of National Saving- All Taxpayers

CHANGE IN COMPONENTS OF NATIONAL SAVING FROM TOTAL
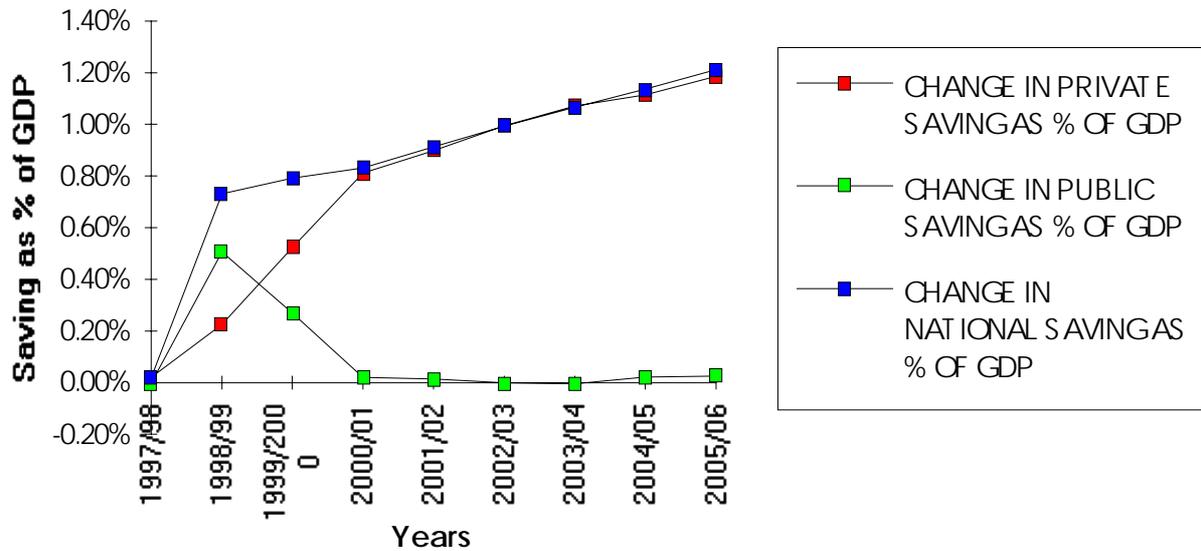MEMBER & SELF EMPLOYED SCHEME: FULL TAX CUT ESTIMATE

Figure 4 presents the breakdown of the total cost to Government of the co-contribution package on a scale of millions of dollars. As can be seen, the cost of the government co-contribution and the saving from not implementing the second tranche of the One Nation Tax Cuts dominate, with other costs and savings being comparitively insignificant.
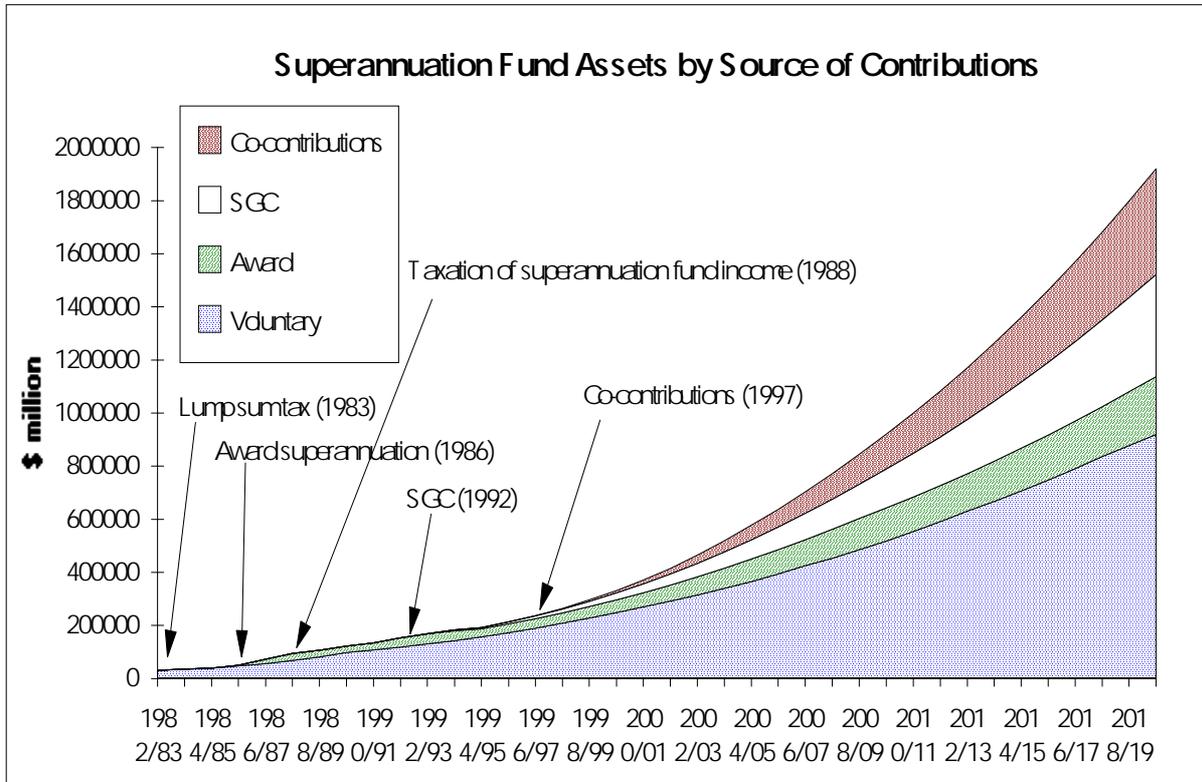
Figure 4:

Full Package Costs to Government
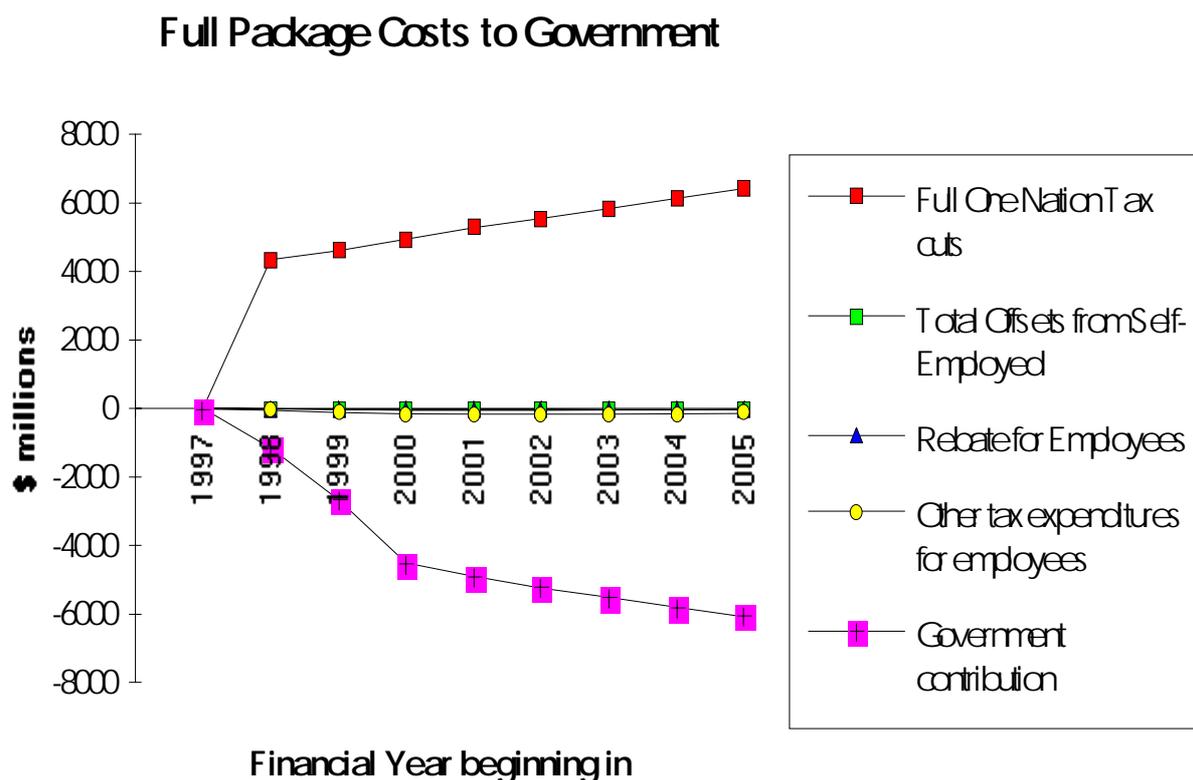
Long Term Projections Using RIP

Figure 5 shows a RIP projection of the growth of nominal superannuation assets according to the policy giving rise to the increase. The co-contribution policy is projected to make a significant difference to overall superannuation assets.

Figure 6 presents the RIP long term projections of components of national saving for the co-contribution policy effects on employee saving and related public saving. The RIP model projects national saving from the policy to reach 2% of GDP per year by 2020.

Figure 5: Long Term RIP Projection of Nominal Superannuation Assets with 3% CPI

Figure 6 RIP Long Term Projections for Components of National Saving for Employees
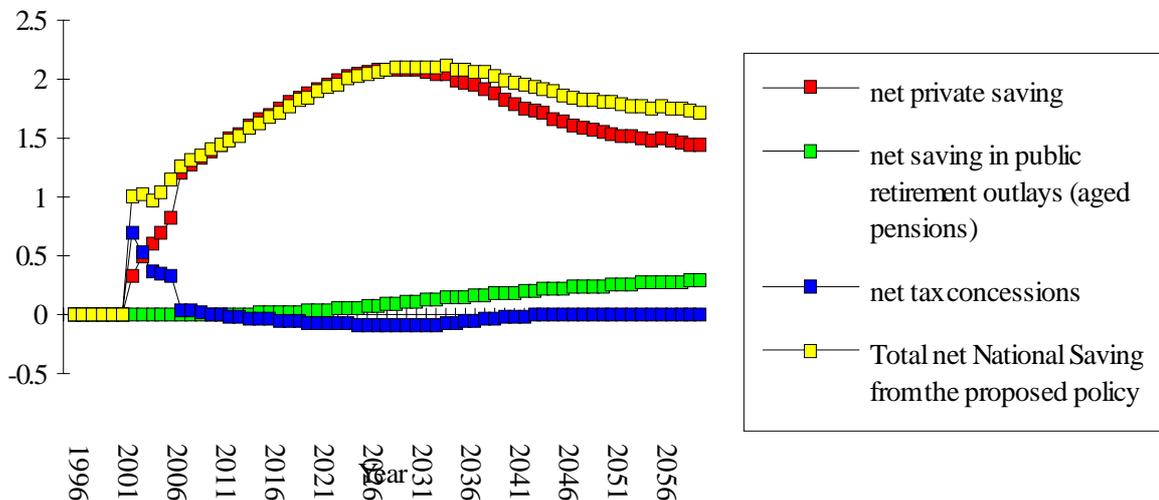
Independent Estimates of the Aggregate Effect of the Policy

The AMP Society have financed and worked on a macroeconomic model of the effects of superannuation policy - the AMP Savings Model. The model was predominantly developed and run by Access Economics. It predicts addition of 0.99% of GDP to national saving from co-contributions policy by 2002/03 which is the same as the MEMSUPER/SEMSUPER estimate of 0.99% by 2002/03.

Being a microsimulation model, the AMP Savings Model can be used to predict macroeconomic outcomes not predicted by RIM's micro models. For example, Access Economics estimates that the policy will cut the current account deficit by $6.2 billion a year. Chris Richardson of Access Economics estimates that the policy would regularly lower current account deficits and would cut foreign debt by $29.7 billion (Australian Financial Review, 19/10/95).

Clearly these macroeconomic effects, although desirable, are not the primary motivation of the policy. The major reason for the policy is to improve the overall adequacy and equity of retirement income policy. These effects are best demonstrated using hypothetical examples. Since 75% of people who retire are married, hypothetical couples provide more typical examples.

ILLUSTRATIVE IMPACT OF THE CO-CONTRIBUTION POLICY ON COUPLES

Hypothetical analysis is not a complete analysis of a policy. Hypothetical cases help us look at the theory of a policy, because we can vary a single characteristic or assumption at a time. Hypothetical analysis needs to be complemented by typical cases analysis and full population analysis. Typical cases and actual cases vary on many dimensions. Full population analysis is necessary to work out how many people are affected and by how much. Only full population analysis can do costings.

The following analysis is based on five sets of couples which differ in wage rate but are otherwise identical. In all sets, both partners commence Employer SG super in 1992/93 at age 25, retiring in 2032/33 at 65. The wife is out of the workforce between age 27 - 34 and works 17 hours per week between age 35-40 before returning to full-time work. The husband works continuously. Both partners have the same wage when working full-time and superannuation is the only financial saving. At retirement both convert all benefits to a lump sum and invest 100% of the net payment in an interest bearing account which they draw down in an annuity pattern.

Earnings of each partner are 50%, 100%, 150%, 200% and 250% of AWOTE (average weekly ordinary time earnings) when working full-time.

The economic and savings parameters are used in projection are 3% CPI, 4% AWOTE growth, 6% bond rate (used in present value calculations), 7% super and savings

account fund earning rate, and 40% of the counterfactual increase in take home pay is placed in a saving account.

Figure 7 shows the improvement in retirement income per year of retirement for each set of couples, comparing the results from the Employer SG and the full employer plus co-contributions policy with the results from the full rate age pension alone. The real value of the age pension has increased at 1% per annum over the 40 years of working life and during the couples retirement. As is typical of superannuation policies, those on higher incomes during working life have higher incomes in retirement. The important policy issue is whether those on higher incomes have received a larger subsidy from Government.
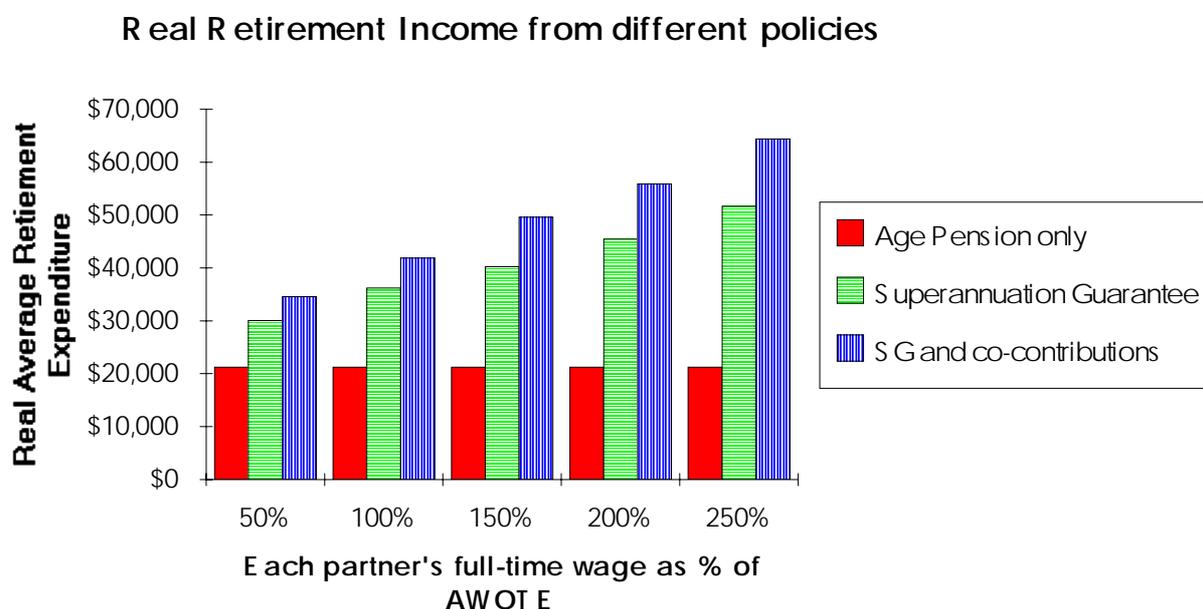
Figure 7

Figure 8 shows the components of real present value of the cost to Government of the Employer SG policy. The important feature of the graph is that the regressive tax expenditures are more than clawed back by loss of age pension and by income tax in retirement with the net result (shown by the line and the right hand scale) that the overall cost of the policy change is negative for all groups, and more strongly negative for higher income groups. That is, retirement income policy is progressive when the effect of all components is included. Many commentators make the mistake of looking at the regressive nature of the tax expenditures without looking at retirement income policy as a whole.

Figure 8

Components of Net Cost to government: S G policy
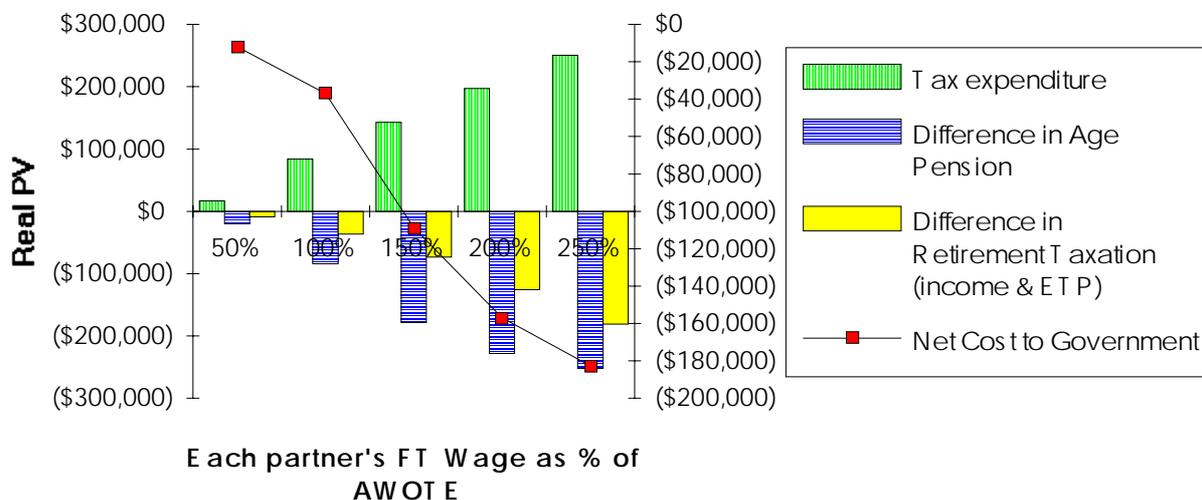

Each partner's FT Wage as % of AWOTE

Figure 9 shows that the superanuation guarantee and the co-contributions policy have the potential to improve the equity and the total cost to Government of retirement income policy. As incomes rise, the real cost of the SG and co-contributions policy drop. Figure 9 also shows that the real present value of the cost to Government of the co-contributions policy is higher than the Employer SG cost for the low income couple earning 50% of AWOTE. This is further evidence for the more progressive nature of the co-contributions policy.

Figure 9

Real PV of total cost to Government of different policies
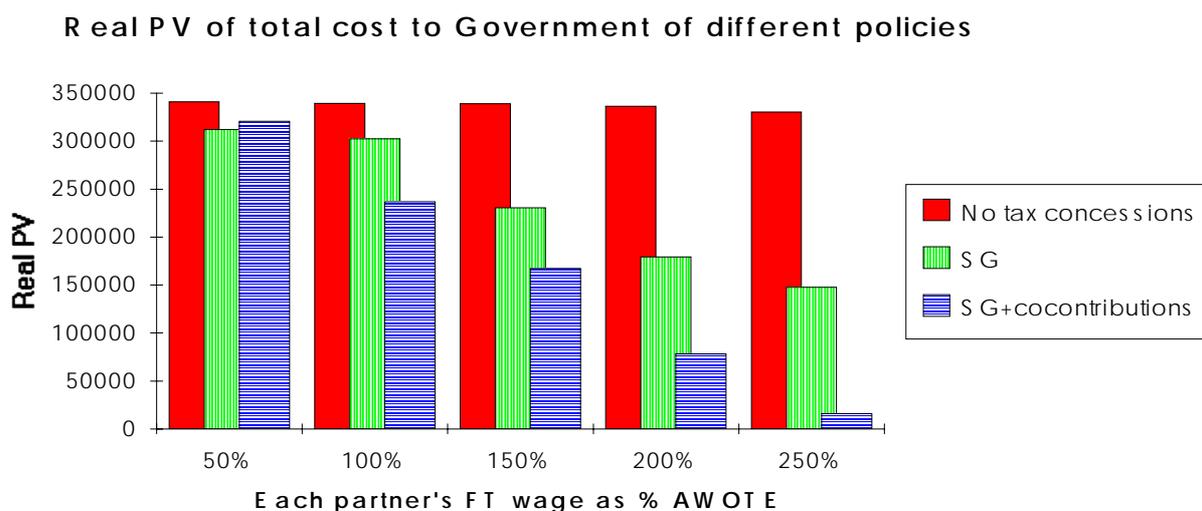

Each partner's FT wage as % AWOTE

Figure 10 examines the equity of retirement incomes policy as a whole, using the criterion that an equitable policy is one in which those on high incomes receive far less of their taxes back as benefits. This is the case if the age pension, and retirement

taxation, claw back superannuation tax expenditures. One implication is that tax expenditures are largely inter-temporal transfers - not intra-generational transfers. The major threat to the equity of the of superannuation policy is not tax expenditures but dissipation of benefits so that the claw back cannot occur.

Figure 10

Total cost to Government as % PV tax paid in working life
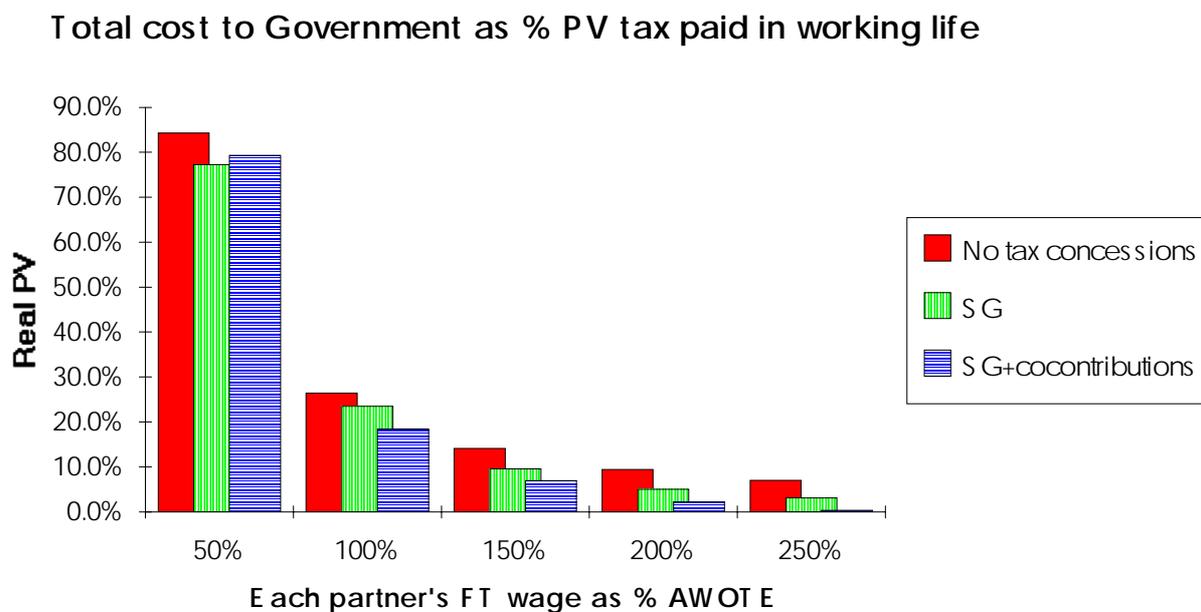
The issue of dissipation has been investigated using a highly disaggregated file from the ABS Retirement Survey of November 1994. Dissipation of superannuation lump sums is only important if the lump sum was large enough to affect benefits. As shown in Table 4, only 3% of retirees with lump sums large enough to affect pensions do not use them mainly for investment purposes.

Table 4: Summary of Disbursement of Lump Sums Which Would Affect Pension, from ABS Retirement Survey, November 1994

Subset: Potential Effect of Lump Sum on payment: Would affect pension					
	Summary of Main use of Lump Sum				
	Rolled over	Invested	Pay bills	Holiday family other	ALL
Use of social security as main income source					
Social Security used as main income source	10,089	4,755	5,120	1,025	20,989
Never had social security as main income source	31,539	10,685	4,008	1,152	47,384
ALL	41,628	15,440	9,128	2,177	68,373
Distribution of Percentages					
Social Security used as main income source	48.1%	22.7%	24.4%	4.9%	100.0%
Never had social security as main income source	66.6%	22.5%	8.5%	2.4%	100.0%
ALL	60.9%	22.6%	13.4%	3.2%	100.0%

Summary

The main points arising from the paper on the Government's new member and Government co-contributions policies are:

- Retirement expenditure should be increasingly financed from invested superannuation benefits arising from the policy.

- There are sound microeconmic reasons for believing that the savings offset for the policy is around a third.

- The member and government co-contributions policy has the potential to add 1.2% of GDP to national saving over the next ten years.

- The member contributions are likely to be to funded from productivity rather than from a decrease in real take home pay.

Although the theoretical analysis of the equity of long term costs to government is very encouraging, this is critically dependent on savings in age pension being achieved. Available evidence suggests low dissipation which would imply that the social security clawback of tax expenditures occurs in most cases, which implies that the retirement income system **as a whole** is equitable. Further research on this issue is necessary, but it should not restrict itself to tax expenditures or co-contributions alone - the effect of the social security system must be included.

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