Department of Treasury Retirement Income Review - Submission of the Australian Taxpayers' Alliance (ATA)

3 February 2020

1 The Australian Taxpayers' Alliance thanks the Treasury Department for the opportunity to provide comments to the abovementioned review.

2 The ATA is the nation's largest grassroots advocacy group representing taxpayers. We are funded solely by civic-minded Australians passionate about the same issues for which we campaign: lower taxes, commonsense regulations, and no government waste.

3 The ATA notes the diverse set of views on the role of government in providing for the retirement needs of the Australian people. The Retirement Income Review consultation paper released on 22 November 2019 operated under the presumptions that:

a) Retirement is a net benefit to society;

b) At the prescribed age of retirement Australians should have 'adequate' funds to sustain a stipulated standard of living;

c) And it is the responsibility of the Australian government to ensure that standard of living is obtained and that it is equitable for different groups of Australians, is sustainable for the broader community over time, and is incentives are cohesive.

4 However, the Australian Taxpayers' Alliance questions those assumptions seeking first to recommend changes to the current system that value individual choice and responsibility, that reduce the burden on the taxpayer, that provide for those truly in need of assistance, and that will last regardless of economic fluctuations.

How the retirement income system supports Australians in retirement

5 Based on ABS Data the mean pension for Australians between the ages of 55 and 64 in 2017-18 was $241,000 for women and $332,700 for men,[1] and according to the Retirement Income Review, the median superannuation balances between the ages of 60 and 64 are $122,848 for women and $154,453 for men for the year 2016-17.[2]

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[1] Killian Plastow, "The pension rule leaving some retirees worse off for saving more," *The New Daily,* January 26, 2020, https://thenewdaily.com.au/finance/superannuation/2020/01/26/pension-super-income-backwards/.

[2],"Retirement Income Review," *Australian Department of Treasury*, Consultation Paper November 2019, https://treasury.gov.au/sites/default/files/2019-11/c2019-36292-v2.pdf.

6 A woman expecting to live until the age of 85 and attempting to live off of the interest on her low-risk superannuation fund would have only $7,880 per annum.[3] Under this scenario, she is not accounting for longevity risk, cannot dip into her super fund for medical emergencies, and has nothing to leave for posterity. A man under those same assumptions would have only $9,907 per annum. Currently, 50 per cent of Australians will have that much or less on which to retire.

7 If an individual wanted to receive what they would on the maximum age pension, that is $24,333 per annum, they would need to have $379,331saved in their superannuation fund.

8 However, workers with the median superannuation balance of $122,848 or $154,453 respectively would be able to retire with the equivalent of the age pension allotment should they delay retirement. If an individual did not contribute to their superannuation after achieving the age of 65 they would still be able to retire at 80 and 78 respectively. If they continued to contribute to their super they would be able to retire younger than 75.[4] Healthy individuals who find fulfilment in their job do not necessarily need to follow the modern proscribed formula for employment and retirement.

Means-tested Age Pension

9 Because 68 per cent of retirees depend on the Age Pension compared with 30 per cent in other OECD countries, young taxpayers carry a much heavier burden in caring for the older generation. Life expectancy in Australia is 82 years, meaning taxpayers are required to subsidise the majority of the elderly population for 15.5 years. This adds up to $377,000 for every single person receiving the maximum pension rate and $284,000 for each person living with their partner. Note these amounts outweigh both the mean and median superannuation funds approaching retirement (look to point 5). This assumes the pension rate remains the same for fifteen years, which is incredibly unlikely. [5] In June 2007, 1,952,700 Australians were receiving the age pension, a number which has only increased in the last 13 years.[6]

10 This is particularly relevant considering Australia's ageing population. While 13 per cent of Australians are now over 65 years, in 2047 censuses show 25 per cent of Australians will have reached the prescribed retirement age. The increasing number of people depending on the age pension in relation to the number of people funding the pension through their taxes is not sustainable. The United States faces a similar problem with Social Security which this year will begin dipping into its trust fund and is due to become insolvent by 2035.[7] Australia is at a point

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[3] This assumes a 2.5 per cent annual return on a low risk moderate superannuation fund found on the Queensland superannuation cite https://qsuper.qld.gov.au/investments/options/moderate. In general retirees should reduce the risk on their retirement portfolios as they age.

[4] These numbers continue to assume the very conservative interest rate of 2.5 per cent after the age of 65.

[5] "Age Pension," Industry Super Funds," accessed February 2, 2020, https://www.industrysuper.com/retirement-info/age-pension/.

[6] Harmer, Jeff. *Pension review background paper*. Canberra: Department of Families, Housing, Community Services and Indigenous Affairs, 2008.

[7] "Social Security Will Start Spending Trust Fund Reserves Next Year," *Committee for a Responsible Federal Budget*, April 25, 2019, http://www.crfb.org/blogs/social-security-will-start-spending-trust-fund-reserves-next-year.

where it can avoid this pitfall by implementing forward-thinking policies to address the ageing population.

11 The age pension-like other forms of welfare can serve as merely a safety net and so substantially reduce risk, specifically longevity risk.[8] The eligibility age for the age pension should continue to increase incrementally as life expectancy increases instead of stopping at 67 years on 1 July 2023. The Nation Commission of Audit recommends the age of eligibility increase to 70 by 2053. By increasing the age eligibility incrementally Australians, expecting the age pension to help them in retirement will not be forced to endure an unnecessary financial shock. When a system such as the American Social Security System reaches insolvency the people depending on that system will not receive the planning benefits of a gentler transition. While the age pension unlike social security is not expected to collapse in the near future, the aging population will strain the taxpayers and the government coffers. That strain can be alleviated by gradually increasing the age of the people drawing for the age pension.

12 There are two primary rationales for saving money: consumption smoothing and precautionary savings. When individuals expect to have a pension early they have little incentive to save either to mitigate risk or to smooth their consumption in old age.[9] Currently, Australians only save 3.51 percent of their disposable income.[10] Additionally, should the decreased spending on age pensions allow politicians to lower taxes without impacting the budget bottom line. This would give Australians more disposable income with which to save toward their retirement goals. Those with higher incomes and greater wealth tend to save more.[11]

13 The most ubiquitous objection to increasing the age of eligibility is that when individuals reach the age of 65 they will not have a livable retirement. According to psychologists and business professionals, people with rise to meet expectations. This is called the Pygmalion effect and it is used both in industry and in academics.[12] Many individuals when given the responsibility and personal agency to save for their own retirement with rise to that expectation as long as those individuals have been made aware of the age at which their age pension will become accessible. Under this type of policy, a chronic minority would fail to adapt and be forced to continue to work to sustain their lifestyle.

14 In general, most individuals over the age of 65 are healthy enough to continue working for an additional few years. It isn't until someone reaches the age of 85 that the NSW government requires them to take practical driving tests to maintain their unrestricted driver's licence.[13]

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[8] Cocco, Joao F., and Francisco J. Gomes. "Longevity risk, retirement savings, and financial innovation." *Journal of Financial Economics* 103, no. 3 (2012): 507-529.

[9] Parker, Jonathan A., and Bruce Preston. "Precautionary saving and consumption fluctuations." *American Economic Review* 95, no. 4 (2005): 1119-1143.

[10] "Household Savings," *OECD Data*, accessed February 2, 2019, https://data.oecd.org/hha/household-savings.htm.

[11] Dynan, Karen E., Jonathan Skinner, and Stephen P. Zeldes. "Do the rich save more?." *Journal of political economy* 112, no. 2 (2004): 397-444.

[12] Saha, Somrita. "Driving Performance Through Appreciative Inquiry: Role of Pygmalion Effect in Academics and Industry." In *Appreciative Inquiry Approaches to Organizational Transformation*, pp. 1-18. IGI Global, 2020.

[13] "Find an older driver assessor," Service NSW, accessed February 2, 2019, https://www.service.nsw.gov.au/transaction/find-older-driver-assessor.

15 In 1909, when the means-test age pension was first implemented most jobs required high levels of manual labour. Since then we have seen both the Second Industrial Revolution, the introduction of the technology age, and growth of the gig economy. Older individuals have great ability than ever contribute meaningfully to the labour force. Even manual labour intensive jobs such as farming have become much more accessible to people as they age due to automation.

16 A health and retirement study found "retirement results in increased depressive symptoms," and the Institute for Economic Affairs discovered retirement increases depressive symptoms by 40 per cent.[14]

17 Many of the individuals receiving the means-tested age pension have the funds to sustain themselves without taxpayer assistance. Currently, 68 per cent of retirees receive the age pension adding up to over 2.5 million individuals. However, only 4.4 per cent of Australians are categorised as experiencing deep or persistent disadvantage and only 15 per cent are on income support. Assuming the deeply disadvantaged are receiving income support and that Australians disadvantaged during their working lives will also be disadvantaged at retirement, that leaves 53 per cent of Australians who are wealthy enough to not qualify for income support yet receive the age pension.[15]

18 The age pension takes into account both income and wealth. The Commission of Audit stated, "In the Commission's view the Age Pension should be regarded primarily as a social safety net, with the objective of providing security for older Australians who are unable to support themselves in their retirement. Older Australians with the resources to fund their own retirement should do so." An individual Australian with substantial income who chooses to spend those funds instead of saving for retirement should not be eligible for the age pension. Individuals with substantial wealth, also should not be eligible for the age pension.

19 In 2016, 6 per cent of pensioners owned a house worth more than $1 million. A million dollars is approximately 3-4 times the average superannuation fund. While property is an illiquid asset it can be used to generate income, and it exempts homeowners from paying rent. Individuals can also borrow against their homes when in need of liquid funds.

Compulsory Superannuation

20 The Australian Taxpayers' Alliance strongly opposes the legislated increase in compulsory superannuation from 9.5 per cent of an employee's income to 12 per cent. An individual who makes the median income, $65,577 per annum,[16] and contributes 9.5 per cent of their earnings from the ages of 25 to 65 will have the equivalent of the maximum means-tested age pension on which to retire. That is $24,333 per annum. If an individual wishes to have a larger retirement

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[14] Heller-Sahlgren, Gabriel. "Work longer, live healthier: The relationship between economic activity, health and government policy." *Live Healthier: The Relationship Between Economic Activity, Health and Government Policy (May 16, 2013)* (2013).

[15] "Australia's welfare 2017," *Australia Institute of Health and Welfare*, https://www.aihw.gov.au/reports/australias-welfare/australias-welfare-2017/contents/summary.

[16] Charis Chang, "How much do you need to earn to be rich in Australia?" *News.com.au*, February 2, 2020, https://www.news.com.au/finance/work/how-much-do-you-need-to-earn-to-be-rich-in-australia/news-story/cd7e6647199773c56ad5a9270c7aab87.

they can either work for an increased number of years or contribute more than the minimum to their superannuation fund.

21 The ATA recommends shifting the retirement savings system from compulsory superannuation to an opt-out super fund. Behavioural Economists in the United States have found that more individuals enrolled in 401(k) retirement funds when they were automatically enrolled than when they were merely given the option to enrol. Additionally, most of the individuals automatically enrolled in 401(k) retirement funds used the default contribution rate.[17] If Australia were to implement a similar opt-out system, it is likely only the individuals who needed the money most (for example in a medical emergency) or would like to take a more active role in investing that money whether in a home or other private means.

22 Additionally, the Australian Taxpayers' Alliance recommends the Australian government exempt both superannuation contributions and withdrawals for retirement from taxation. This will operate as a tax incentive. While tax incentives for retirement can be an expensive means of incentivising savings in the short run, in the long run, the government will likely save money as fewer pensioners will be burdening the taxpayers. By taxing superannuation at 15 per cent, the government reduces the amount retirees have come retirement thus reducing their per annum income below the level of the pension should these individuals consistently contribute the minimum mandated amount throughout their employment. Consequently, these Australians end up on the age pension costing the taxpayers.

23 High-income earners making over $250,000 and over per annum should receive the same tax offset as lower-income earners. Many labourers earn high salaries due to the rigours of their work. However, these individuals often need to retire sooner as their body breaks down. The same applies to executives in high-stress positions. Additionally, the increased pay is often a result of increased years of education which decreases the time a person has to save for retirement.

Voluntary Savings Including Homeownership

24 The Australian Taxpayers' Alliance recommends the government work to encourage voluntary saving and attempts to make homeownership more accessible to the average Australian.

25 Currently, voluntary superannuation funds are currently capped at $25,000 of pre-tax income and $100,000 of post-tax income. The ATA advises these caps be removed allowing Australians to save for the kind of retirement they so choose. However, allow for some level of taxation on voluntary superannuation fund so as to avoid incentivising Australians to invest solely in superannuation funds at the expense of other types of investment funds. This would create an unfair advantage among super fund managers and discourage competition.

26 A Morgan Stanley analysis on global property prices shows Sydney has the second least affordable housing, surpassed only by Hong Kong. Affordability takes into account median income. Sydney, Melbourne, Adelaide, Brisbane, and Perth all rank among the world's least affordable cities for housing.[18] Housing prices in Australia are much higher than the rest of the

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[17] Madrian, Brigitte C., and Dennis F. Shea. "The power of suggestion: Inertia in 401 (k) participation and savings behavior." *The Quarterly journal of economics* 116, no. 4 (2001): 1149-1187.

[18] Duncan Hughes, "Australian property still world's most expensive despite sharp falls," *Australian Financial Review*, May 10, 2019, https://www.afr.com/companies/financial-services/australian-property-still-world-s-most-expensive-despite-sharp-falls-20190508-p51l5x.

world due to a lack of supply despite high demand. By streamlining and minimising land-use regulation, the Australian government could promote building and help mitigate the current supply shortage. When Tokyo reduced their land-use regulation in the 1990s, the subsequently allowed for increased building which decreased rents and mortgages thus reducing homelessness by 80 per cent.[19] Mortgage and rent payments in retirement strain savings and a retirees ability to maintain a reasonable standard of living.

Conclusion

27 The Australian Taxpayers' Alliance's recommendations on the means-test age pensions are as follows:

a) Incrementally increase the age of eligibility upwards from 67

b) Increase the income requirements to receive the means-tested age pension

c) Increase the wealth requirements to receive means-tested age pension, including accounting for owner-occupied homes

28 The ATA's recommendations on compulsory superannuation are as follows:

a) Repeal the legislated increase in compulsory superannuation from 9.5 per cent to 12 per cent

b) Trade the compulsory superannuation system for an opt-out system

c) Exempt both contributions and withdrawals for retirement from taxation. Include high income ($250,000 per annum and above) in the tax exemption

29 The ATA's recommendations on voluntary saving including housing are as follows:

a) Remove the $25,000 cap on pre-tax income and the $100,000 cap on post-tax income for voluntary superannuation contributions but allow super to be tax similar to other investment funds.

b) Reduce land-use regulation to improve housing affordability

Prepared by Emilie Dye on behalf of the Australian Taxpayers' Alliance.

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[19] "Homeownership is the West's biggest economic-policy mistake," *The Economist*, January 16, 2020, https://www.economist.com/leaders/2020/01/16/home-ownership-is-the-wests-biggest-economic-policy-mistake.

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