COMBINED PENSIONERS & SUPERANNUANTS ASSOCIATION

Submission

Retirement Income Review

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Combined Pensioners & Superannuants Association of NSW Inc (CPSA)
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CPSA receives funding support from the New South Wales and Australian Governments

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 88 branches and affiliated organisations with a combined membership of approximately 19,000 people living throughout NSW. CPSA's aim is to improve the standard of living and well-being of its members and constituents. CPSA receives funding support from the NSW Government Departments of Communities & Justice and Health and the Australian Government Department of Health.

Summary

Australia’s retirement system consists of five, not three pillars. Home ownership is the fourth pillar and, with more than 180,000 people on it, the Newstart Allowance is a short-ish fifth pillar. However, it is questionable if Australia has a retirement income system worthy of that descriptor. It is a hotch-potch and neither it nor its constituent parts have defined purposes. Given that lack of defined purpose, Australia’s retirement system has become an inequitable arrangement both while people are accumulating retirement savings and while they are spending those savings. This system or arrangement favours people on high income and or of high wealth at the expense of the public purse.

There is an urgent need to, first of all, define Australia’s retirement system and identify who it is meant to assist in achieving adequate retirement incomes. If this is done on the basis of socially equitable principles, a sustainable and cohesive retirement system will emerge.

The retirement income system

Most developed countries have contributory social insurance retirement income systems, which create an entitlement to an income stream in retirement. Australia is unique in having a social security ‘safety net’ Age Pension system, a system of tax-concessional treatment of the accumulation of retirement savings and a superannuation system proper.

These together are a bit bombastically referred to as the ‘three pillar system’. As Saul Eslake has pointed out in an excellent paper[1], owner-occupied housing is the ‘fourth pillar’. For most people owning their own home in retirement is key to an adequate standard of living, because most rely on the Age Pension for a substantial part, and in approximately two-thirds of cases solely[2]. Approximately 76 per cent of retirees own their own home. We should therefore speak of a four-pillar system, because without this fourth pillar the three-pillar system would not be stable.

The Age Pension is funded entirely from consolidated revenue. In the developed world, only New Zealand does the same and even pays a non-contributory flat-rate pension to anyone fulfilling residence requirements. Other developed countries[3] have built in safety-net features into their retirement systems. These are contributory but contributions do not cover all outgoings, which means consolidated revenue is used to supplement the cost of these safety-net features.

To refer to the hotch-potch of tax concessions available to those who accumulate and spend retirement savings outside superannuation as constituting a system or a pillar of the overall retirement system is perhaps misleading. The main concessions include: negative gearing of investments, dividend franking

[1] Eslake, Saul, 2017. *No place like home: the impact of declining home ownership on retirement*, p.15. Available here: https://www.aist.asn.au/getattachment/Media-and-News/News/2017/No-place-like-home-the-impact-of-declining-home-ow/AIST_Housing-affordability-and-retirement-incomes_FINAL-21032017.pdf.aspx

[2] 64 per cent of Age Pensioners receive the full rate Age Pension. https://data.gov.au/dataset/ds-dga-cff2ae8a-55e4-47db-a66d-e177fe0ac6a0/details

[3] For example, the Netherlands pays its residents a non-means tested pension based on years of residency, irrespective of years of employment, during which non-hypothecated contributions are made.

credits, capital gains concessions, family trust arrangements and the seniors tax offset. Only the seniors tax offset, and to some extent dividend franking credits, are targeted at low-income retirees. The other concessions, certainly family trust arrangements, favour those with high employment income and expectations of high retirement incomes and are not specifically or explicitly made available as part of retirement income policy.

The system of compulsory superannuation began in 1992 with a compulsory (employer) contribution rate of a mere 3 per cent. This has gradually risen to 9.5 per cent. This means that, even though compulsory super has been in place for nearly forty years (a working life), it is still not a mature system. Retail and industry superannuation funds are only now starting to come up with pension phase options. The very low number of super funds that offer lifetime indexed annuities is startling, with super pension accounts mostly providing income streams with unmanaged longevity risk[4]. The most striking thing about Australian superannuation is the extent of its income and capital gains tax-preferred nature, with an income tax rate of 15 percent and a capital gains tax rate of 10 per cent and with income streams and investment returns of pension accounts not taxed at all.

While the Treasurer has ruled out including owner-occupied housing in Age Pension means testing as an outcome of the current retirement income review, owner-occupied housing is still seen by some as a magic-pudding source of retirement income through equity release. However, such commentators forget that home equity release loans operate on loan-to-valuation ratios that do not exceed 25 per cent, even in the case of very elderly borrowers, underlining the financial risk to the lender associated with home equity release. It means a minimum of three-quarters of the value of owner-occupied housing is quarantined for interest payments and not available to generate a retirement income stream.

Although not generally thought of as retirement income, the Newstart/Jobseeker Allowance, re-baptised as Jobseeker Allowance, is an important source of income for people who are effectively retired. Over 180,000 people over 55 are on Newstart, more than a quarter of the total number. Most of these people will be unable to find employment again, something which is recognised to the extent that required job seeking activities are less onerous than for people aged under 55[5]. With the rate of Newstart 40 per cent below the Age Pension rate[6], it is obvious that as a single source of income Newstart is inadequate. A frequent scenario is a couple where one partner has reached pension age, stops working and draws a full partnered Age Pension, while the younger partner goes onto a Newstart Allowance. Given the inadequacy of Newstart, people on it tend to have depleted their superannuation savings by the time they reach Age Pension eligibility age. We might call Newstart/Jobseeker Allowance the fifth pillar of the

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[4] According to APRA annuities made up only 6 per cent of total pension member accounts as of June 2018. Account based pensions and allocated pensions accounted for 44 per cent and 32 per cent. respectively.
https://www.apra.gov.au/sites/default/files/annual_superannuation_bulletin_june_2018_reissued_3_july_2019.pdf , p.22.

[5] A Newstart recipient older than 55 can meet their mutual obligations by completing a mix of voluntary and paid work equivalent to 30 hours, significantly less than the 50 hours required for full time job seekers aged up to age 49.
https://www.humanservices.gov.au/individuals/topics/mutual-obligation-requirements/29751
https://guides.dss.gov.au/guide-social-security-law/3/2/10/30

[6] The full rate Age Pension (with supplement and energy supplement) for a single is currently $933.40 per fortnight (p.1), whilst the full Newstart rate (with supplement) for a single is $567.80 (p.3).
https://www.dss.gov.au/sites/default/files/documents/08_2019/indexation-rates-september-2019.pdf

Australian retirement income system and, extending the metaphor, note that the fifth pillar is rather shorter than the other four pillars.

While retirement income systems in other developed countries offer opportunities for comparison and can assist analysis of the Australian retirement income system, the Australian system should be judged on its domestic purpose and the extent to which it achieves that purpose.

Purpose of the system and role of the pillars

The Social Security Act 1991, under which the Age Pension and Newstart/Jobseeker Allowance are paid, does not offer a purpose or objectives for its operation. Perhaps this lack of objective has facilitated many beneficiaries viewing the Age Pension, effectively, as a contributory social insurance scheme, that is: as something that they have paid for while working and are entitled to. Because of the electoral sway held by retirees, politicians tend to talk about this system as though it is a contributory social insurance scheme, too. Conversely and perversely, the Newstart/Jobseeker Allowance, the purpose and objectives of which are also not defined under the same Act, is widely seen as a hand-out, often undeserved.

The purpose and objectives of the collection of tax concessions enabling wealth accumulation are also not formalised, certainly not collectively, as part of Australia's retirement income system. According to the Superannuation (Objective) Bill 2016, the objectives of the superannuation system should primarily be "to provide income in retirement to substitute or supplement the age pension." However, the Bill never made it into law, so Australia's superannuation system remains without formal objective. Also note, that the Bill only recognised the Age Pension as in need of supplantation or supplementation, not the Newstart/Jobseeker Allowance (which needs supplementation far more than the Age Pension) or the Disability Support Pension or Carer Payment, which are themselves without formal purpose or objective, as it is not defined in the Social Security Act 1991. These payments are relied on by people forced to retire because of loss of employment, for medical reasons or to be the carer for someone else.

The primary reason why compulsory superannuation was introduced was to increase national savings[7]. The secondary reason was related to retirement income, but no one is quite sure how.

The only formal purpose within the Australian Retirement income system is the sole purpose test for superannuation. This is a legal requirement that requires super funds to be maintained for the sole purpose of providing retirement benefits to their members. In other words, it is designed to guide the actions of superannuation trustees as to what they can and cannot do. By extension or implication, the purpose of superannuation is to provide retirement benefits. While the sole purpose test is of the greatest importance as part of the operation of superannuation funds, as a wider definition it is not useful.

[7] In 1992 Australia's gross national savings (GNS) was 19.1 per cent of GDP. In 2018 GNS was 21.8 per cent of GDP. International Monetary Fund World Economic Outlook, October 2019. https://www.imf.org/external/pubs/ft/weo/2019/02/weodata/index.aspx

The fourth pillar, owner-occupied housing, is not even commonly recognised as part of the Australian retirement system. As a result, no formal purpose or objectives in relation to retirement exist.

The conclusion is that the Australian retirement system (the three-pillar system, the four pillar system or the five-pillar system) has no formal purpose or objectives.

It is therefore no wonder that the purpose and objectives of particularly the Age Pension and superannuation are poorly understood. It is perhaps part of the explanation why the notion has gotten hold that the Age Pension is an entitlement and why engagement with superannuation generally is so poor[8].

Quite obviously, the Australian retirement system needs to be defined and its purpose and objectives formally identified in an Act of Parliament.

It goes without saying, almost, that the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes are not clear. Worse, older Australians are reliant on their own level of financial literacy to plan for their retirement and ensure retirement income adequacy: many don't plan and many start too late.

Given that the Panel has been asked to identify the role of each of the pillars (and CPSA argues there are five rather than three) of the retirement income system, the start is not to answer the question, what should each pillar seek to deliver and for whom?, but to define the purpose of the retirement income system as a whole. Secondarily, the Panel should identify how each (of the five) pillars should contribute in fulfilling that purpose . The principles identified by the Panel (adequacy, equity, sustainability and cohesion) are suitable to define the purpose and the contribution each pillar can make in the face of demographic, labour market, and home ownership trends.

Adequacy

The social security system places a strong emphasis on financial self-sufficiency. The pension-type payments (Age Pension, Disability Support Pension, Carer Payment) are subject to an asset test and a slightly more lenient income test[9]. Pension-type payments are substantively higher than the Newstart/Jobseeker Allowance, but the doubtful rationale here seems to be that there will only be

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[8] Cooper Review: Super System Review Final Report - Part 1: Overview and Recommendations, p.9
https://treasury.gov.au/sites/default/files/2019-03/R2009-001_Final_Report_Part_1_Consolidated.pdf

[9] Under the assets test a recipient may have assets worth up to the lower limit $263,250* and receive the full pension rate. For every $1000 over the lower limit a recipient will have their pension reduced by $3 per fortnight until the pension is cancelled at the upper limit of $574,500*.
The income test will reduce a pension payment by $0.50 for each dollar over $174* that is earned in income per fortnight. The pension will be cancelled if a recipient earns $2,040.80* in income per fortnight.
*Means tests are altered dependent on relationship status and homeowner status. The figures provided apply for a single homeowner.

temporary reliance on this payment and that people can tide themselves over using savings. What comes to the fore, however, is that the Government has a firm view that the full rate of pension-type payments is sufficient to keep the bodies and souls of recipients together.

Implicit in the settings for pension-type payments is that the cost of housing is substantially covered. Presumably to be better able to afford rented accommodation, those recipient households which don't own their own home have higher asset limits but are not preferentially treated under the income test.[10]

Current pension-type payments are low if they represent recipients' sole source of income. The full rate payment for a single is currently $933.40 per fortnight, or $24,268 per year and $1,407 per fortnight or $36,582 per year partnered combined. The poverty line for singles is $859.20 and for couples $1,217.06 per fortnight.[11]

In determining what adequate is in retirement income, the choice is between a single point of adequacy or an adequacy range (minimum and maximum). Adequacy in this context means the income level or income range where the state will assist the retiree financially either through a direct transfer or through tax concessions or a combination of both. The Social Security Act 19?? Identifies an adequacy range but it is set, particularly the full rate single Age Pension, only just above the poverty line. Is that adequate? Another important question is how the fourth pillar, housing security, is reflected in setting the adequacy level or levels of retirement income.

To date no Australian Government or Opposition has been game to propose that retirement income should cease to attract tax breaks at any level. Some action to reduce assistance has been taken. The current Government has, by doubling the asset test taper rate, (1) effectively taken away part-rate pension-type payments from a significant number of recipients and (2) reduced the part-rate pension-type payments from a further significant number of recipients and (3) has put a cap ($1.5 million per member) on how much money can be put into a (tax-free) superannuation pension account. However, there is no retiree in Australia, however wealthy, who has been banned from availing themselves of all tax-breaks[12].

The question of whether retirement incomes are adequate can also be examined from the point of view of what people should reasonably expect in retirement income and to what extent the Government should give them assistance. However, surely the limit of that Government assistance should not exceed the minimum adequate retirement income levels of $24,000 per year for single recipients of pension-

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[10] Asset limits are currently $210,500 higher for non-home owners. What is often forgotten in the debate about whether or not the family home should be included in pension means-testing is that owner-occupiers' ability to own assessable assets under pension-type payment arrangements is affected by the fact that they are owner-occupiers. In other words, the family home *is* included in pension means-testing. Commentators should take note.

[11] The Melbourne Institute: for June 2019 the poverty line for a single is $429.60 a week and for a couple $608.53 - https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0007/3207823/Poverty-Lines-Australia-June-2019-Final.pdf , p.2.

[12] Amounts in excess of $1.5 million can be put into accumulation accounts where they would be taxed preferentially at 15 per cent, while the pension account was permitted to hold more than $1.5 million if investment returns caused them to be. All this to publicly broadcast, amusing howls of distress by some multi-millionaires

type-payments and $36,000 per year for couples (and much lower for over-55s on Newstart/Jobseeker Allowance: ($15,000 per year for singles and $27,000 per year for couples).

The question of adequacy conflates to a large extent with equity.

Equity

As the tables below show, the retirement income system produces some starkly inequitable outcomes.

A retired couple of pension age without assets receives the full rate Age Pension of $36,582.

As savings increase within the pension system, the pension decreases. The value of breaks and transfers goes down steadily, until a savings level of $863,500 is reached, which is the upper asset limit of the Age Pension: at this point the Age Pension cuts out. The value of breaks and transfers at that point is $1,935 annually.

Then something happens which should not happen in an equitable retirement income system. As soon as the Age Pension cuts out as savings rise beyond $863,500, the value of breaks and transfers starts going up again. At $1 million of savings, that value is $3,334, going up to $34,094 when a level of $3 million is reached.

At that level of $3 million, assuming that each member of the couple has transferred the maximum total of $1.5 million into their super pension account, any excess is placed into an accumulation account, where earnings attract a 15 per cent income tax.

However, this tax on excess earnings does not reduce, or even contain the rising value of breaks and transfers, and means that a couple with $3,340,000 in savings receives the exact same value of tax breaks and transfers as a couple who own nothing but their own house annually!

Tax breaks/transfers continue to rise where somewhere in Australia live multi-millionaire couples in receipt of an annual value in tax breaks and transfers of double the full rate of the Age Pension.

Assets: Super balance	Investment income - annual	Age Pension payment – annual	Tax on excess transfer balance	Nett value of tax breaks and transfers
$ -	$ -	$ 36,582	$ -	$ 36,582
$ 200,000	$ 10,000	$ 36,582	$ -	$ 36,582
$ 320,000	$ 16,000	$ 36,582	$ -	$ 36,582
$ 330,000	$ 16,500	$ 32,410	$ -	$ 32,410
$ 394,500	$ 19,725	$ 30,475	$ -	$ 30,475
$ 600,000	$ 30,000	$ 20,553	$ -	$ 20,533
$ 863,500	$ 43,175	$ -	$ -	$ 1,935
$ 1,000,000	$ 50,000	$ -	$ -	$ 3,334
$ 2,000,000	$ 100,000	$ -	$ -	$ 17,094
$ 3,000,000	$ 150,000	$ -	$ -	$ 34,094
$ 3,340,000	$ 167,000	$ -	$ 2,505	$ 37,165
$ 4,000,000	$ 200,000	$ -	$ 7,500	$ 46,294
$ 5,000,000	$ 250,000	$ -	$ 15,000	$ 58,044
$ 6,000,000	$ 300,000	$ -	$ 22,500	$ 69,794

The gentle decline of the nett value of tax breaks and transfers within the Age Pension system makes sense. However, for retirees who have wealth beyond the upper asset limit applicable in the case of the Age Pension, the nett value of tax breaks and transfers simply keeps rising with wealth and is not materially checked by the tax on excess transfer balance amounts in superannuation.

The creation of the tax on excess transfer balance amounts was a feeble attempt to address the very obvious inequity in Australia's retirement income system where very wealthy retirees pay no tax and, as a consequence, receive tax benefits that can add up to multiples of the full rate Age Pension paid to people who have no wealth at all.

A similar story can be told about the accumulation phase, where a person on an income equal to the tax-free threshold ($18,200) receives an income tax reduction of 27 per cent when comparing tax paid over the Superannuation Guarantee (SG) contributions with tax applicable if the SG contributions had been paid out as salary, but a person with a wage attracting the highest marginal tax rate of 45 per cent plus 2.5 per cent in Medicare levy and surcharge gets an income tax reduction of 68 per cent. Clearly, there is a case to be made for progressive income tax rates applying to SG contributions.

Income	SG contribution (9.5%)	Concessional tax on SG (15%)	Non-concessional tax on SG	Tax break in $$$	Tax break in %
$ 18,200	$ 1,729	$ 259	$ 354	$ 95	27%
$ 37,000	$ 3,515	$ 527	$ 1,195	$ 668	56%
$ 90,000	$ 8,550	$1,238	$ 3,292	$2,009	61%
$180,000	$17,100	$2,565	$ 8,123	$5,558	68%
$181,000	$17,100	$2,579	$ 8,168	$5,588	68%
$300,000	$25,000	$3,750	$11,875	$8,125	68%
$500,000	$25,000	$3,750	$11,875	$8,125	68%

A current annual limit of non-concessional contributions means that a person on a high income can accumulate more tax benefits through super. Clearly, there's a case for rendering the ability to make non-concessional contributions fully conditional upon a person's need to achieve income security.

The rampant inequity of the retirement income system during both the accumulation and pension phase highlights the lack of policy on retirement adequacy and the lack of a defined purpose of superannuation and the retirement income system generally. It is noted that in practice this lack of policy benefits high-income and high-wealth individuals (and couples).

Sustainability

It is unfortunate that much of the debate about the sustainability of retirement income concessions focusses on the Age Pension system. It is also unfortunate that the 185,000 people over 55 on Newstart are ignored as part of this debate even though the majority of them have no chance of finding work and even though there is broad consensus that this unemployment benefit is grossly inadequate even for those for whom it is meant to be a temporary payment.

The question about the sustainability of the retirement income system cannot be meaningfully answered without first answering the question what its purpose is. Part of the answer to that question is doubtlessly that it should produce adequate retirement incomes for all.

Also, part of that answer should be an acceptance that anyone unable to find work for reasons of age or incapacity is retired and should be included in Australia's retirement income system and be able to access an adequate income.

Only then should the question of sustainability of the retirement income system be examined from the point of view of funding allocation. Given that funding is always scarce, the application of the principle of social equity demands that the rich don't get more than the poor either as a transfer payment or as a tax concession.