Join us in Setting the Public Policy Agenda

3 February 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Secretariat,

RETIREMENT INCOME REVIEW

We welcome the opportunity to make a submission to the *Retirement Income Review*.

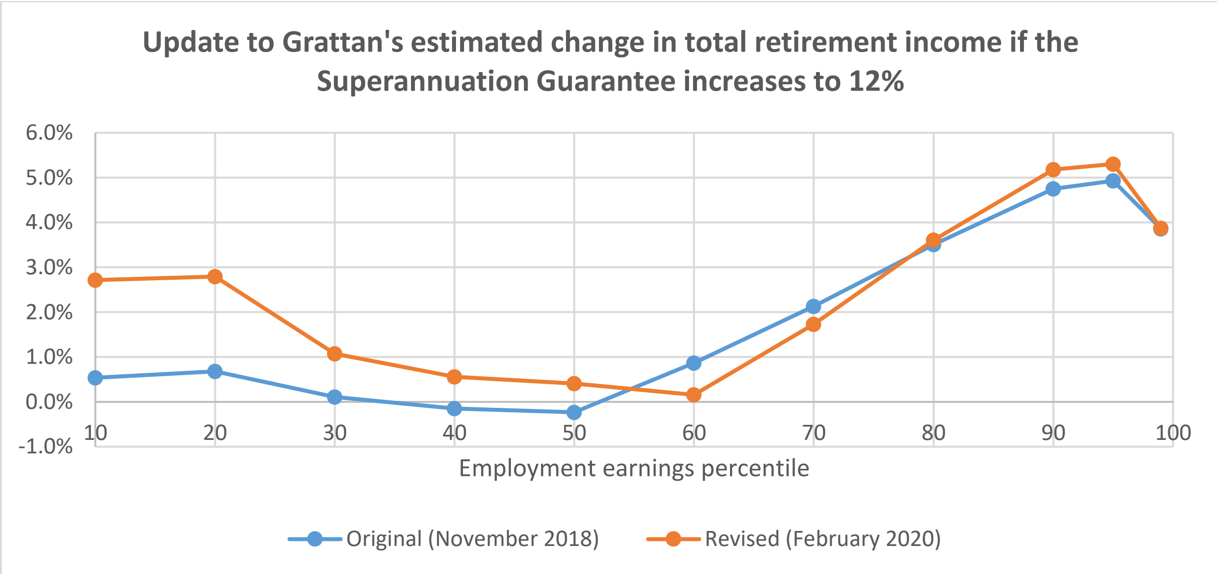
Given the short timeframe within which to prepare a submission we won't be in a position submitting any new evidence prepared specifically for the Review. Although we would like to flag our forthcoming report on *The Economic Benefits of Universal Superannuation* which explores the economic benefits that a well-designed superannuation system can deliver over and above the aim of maximizing retirement income for individual Australians (discussed further below).

Noting that many of the adequacy and equity issues will be covered in submissions made by other parties, we have dedicated the bulk of our submission to calling out a number of key principles that we think are critical for meeting the Panel's objective of establishing "a fact base of the current retirement income system that will improve understanding of its operation and the outcomes it is delivering for Australians." In no specific order, these are:

1. *The Review should make clear distinction between any conclusions drawn from hard evidence or data and those based on assumption or hypothetical cameos*

In recent years, public policy debates have become replete with cameos of hypothetical individuals designed to show how changes to policy settings will make them better or worse off. While such cameos can be a useful device for communicating the intended effects of a policy change in a practical or tangible sense, they can be less appropriate when used as inputs for informing a decision to change the policy in the first place, particularly if they aren't grounded in a real world case studies that are known to have occurred. In some situation the effects can be downright dangerous, should we end up making decisions based on individuals who don't exist that negatively impact people that do exist and whose circumstances we might have left out of hypothetical scenarios.

A recent example, of how this can play out negatively and causing the wrong conclusions to be drawn can be seen in the recent adjustments made by the Grattan Institute to their modeling of the impacts of an increase to the Superannuation Guarantee on retirement incomes by employment deciles. In the original modelling released in November 2018, the distributional impacts were based on hypothetical individuals that work uninterrupted from 30 to 67 years of age and whose employment arrangements ensured that any increase they receive in superannuation will be offset by a lower wage increase in that same year (the so-called 1-for-1 trade-off). Since being challenged on the latter assumption, the Grattan Institute can be commended for updating their modelling to reflect their best estimate of the actual trade-off that occurs in enterprise bargaining, which suggests for every dollar of increased superannuation contributions the wage increase will be lower by 80 cents (a 0.8-for-1 trade-off). For ease of comparison, both sets of results are combined into the one chart to show how changing just one hypothetical assumption can tell a vastly different story[1]:



Unfortunately, in the ensuing period the Grattan Institute's initial findings have been seized upon by some to argue, falsely, that the increase in the Super Guarantee will only benefit high income earners. Updating this one assumption has shown this not to be the case, and if included in the original report it could reasonably have led readers to forming different conclusions (e.g. that we'd be better off looking at reducing the asset taper rate and making the superannuation tax concessions more progressive).

If the Review's 'fact base' is to be viewed as credible across a broad spectrum of stakeholders and the public more generally, such discrepancies must be avoided in any modelling the Panel chooses to commission. The following simple measures could make a big difference here:

i. Ensure any modelling is significantly granular that it captures all meaningful cohorts of the population. In the aforementioned example, this would mean considering the impacts of low-income earners that are employed on awards or enterprise agreements whose wage increases are tied to awards, where the Fair Work Commission operates under the instructions legislated by Parliament in the of making its annual wage review.

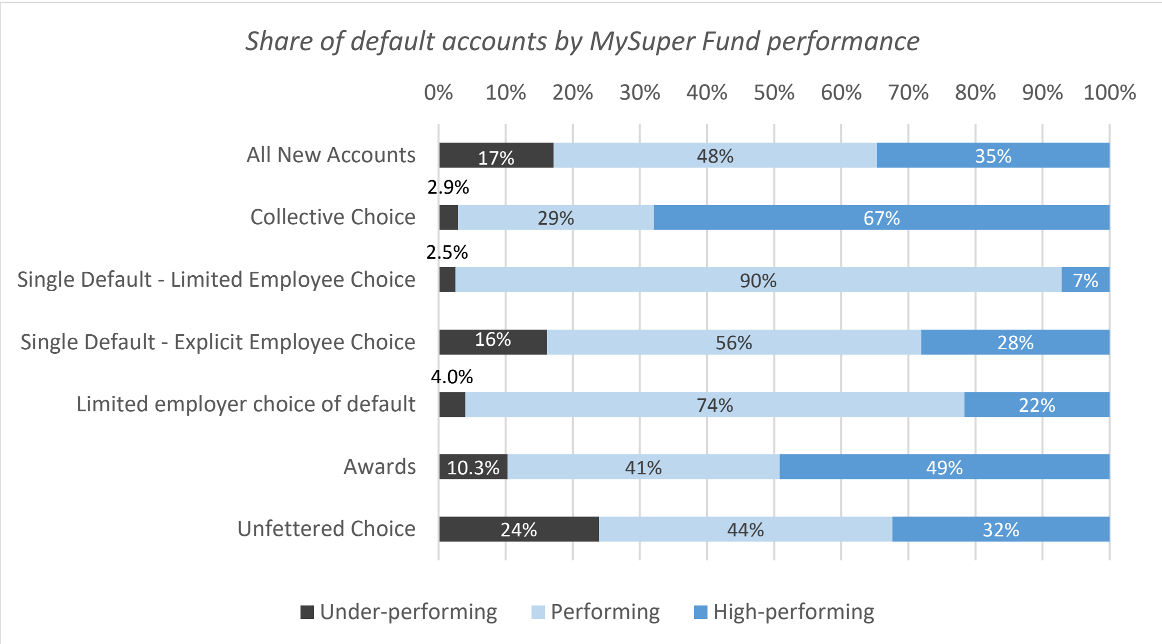
[1] *Grattan Institute. (2018). Money in retirement: more than enough. Accessed online:* https://grattan.edu.au/report/money-in-retirement/ *& Grattan Institute. (2020). No Free Lunch: higher super means lower wages. Accessed online:* https://grattan.edu.au/report/no-free-lunch/

ii. Make the Treasury's MARIA model along with relevant data and assumptions available to all interested stakeholders so that they can assist with iterating and refining the modelling and help build broader support for the model's effectiveness in the process.

2. *The Review should seek to fill the evidence gap on the actual 'causes' of inefficiencies or poor performance and explain clearly where it cannot*

The Productivity Commission's 2018 report on superannuation, which recommended this Review, did an excellent job of identifying and quantifying the various inefficiencies that adversely impact many Australians when it comes to how their superannuation is managed. It has proved a useful report for determining which problems need to be addressed and the potential benefit in addressing them. There is however still a gap when it comes having a comprehensive understanding of the underlying causes and drivers of many of those problems, let alone one that is backed by evidence and facts. This puts us at a disadvantage when it comes to selecting solutions that will actually make a difference and even puts us at risk of selecting policy responses that could make things worse.

One example of this is how the Productivity Commission describes the existing default settings as an "unlucky lottery" that places too many workers into funds that are consistently underperforming[2]. As one of its responses to this, the Government has introduced its *Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019* but it appears that this legislation may have been misguided by the concept of the lottery or at least by the lack of evidence as to how people end up in under-performing funds. In our submission to the Senate Inquiry examining this Bill[3], we sought to shed some light on the causes of this 'bad luck' by analysing the funds named in enterprise agreements and the types of clauses governing their selection. Our results, summarized in the following chart show how the outcomes of the "lottery" vary according the clauses in an agreement.



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[2] *Productivity Commission. (2018). Superannuation: Assessing Efficiency and Competitiveness, Inquiry Report. Accessed Online:* https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf

[3] *McKell Institute Victoria. (2020). Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019 Submission. Available online:* *https://www.aph.gov.au/DocumentStore.ashx?id=60ffe073-59f7-4ebe-beb3-6d6974c26b06&subId=676771*

Critically, it shows that the type of clause that the Bill seeks to prohibit ("collective choice" clauses that restrict individual choice) currently deliver significantly better outcomes for workers than any other arrangements when to comes to allocating workers into high performing funds and not into underperforming funds (based on the MySuper Heatmaps).

This would suggest we are effectively flying blind when it comes to developing policy on default fund selection. Given the Government has flagged its desire to significantly overhaul the default arrangements it would seem critical that the Review help address this blindspot. Especially before we embark on further changes that could have adverse impacts spanning multiple generations. Two critical questions the Review should seek to investigate are:

i. Why do employer or individual choice selection of funds seem to consistently deliver poorer outcomes than arrangements that have been struck via collective bargaining or centralised arbitration?
ii. What factors about superannuation funds (e.g. governance, size, membership demographics) can explain sustained material underperformance?

3. *The Review should develop a hierarchy of importance for tackling issues based on the people they adversely affect*

It is reasonable to expect policymakers to be able to address more than one problem at a time, but it is sometimes the case in a complex policy area that overlapping impacts could mean a fix for a small issue might have unintended consequences that are negative and far outweigh them.

The *Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019* provides another good example of this. One of the other rationales provided for the Bill is to reduce people's exposure to multiple accounts. Now the Productivity Commission provided compelling analysis as to why multiple accounts need to be eradicated, including the example of a full-time worker with a starting salary of $51,000 the equivalent of one-years' lost pay or 6% less to spend in retirement. But they also established that being in an underperforming fund could cost that same worker up to 13 years of lost pay or mean they have 54% less to spend in retirement. If the proposed Bill helps address the exposure to multiple accounts, avoiding a risk to 6% of potential retirement income, by exposing them to the an increased chance of being in an underperforming fund, creating a risk to 54% of the potential retirement income, is that a sensible change in policy?

Establishing a clear hierarchy of importance for tackling these problems would assist policymakers and legislators in setting the right priorities, particularly if it also identified any intersections or cross-over between them. Achieving this requires a better understanding of the costs that problems such as multiple accounts, fund underperformance and underpayment of superannuation have not just at a national level, but for individual cohorts of workers or fund members.

The Economic Benefits of Universal Superannuation Report

As flagged earlier, our forthcoming report seeks to identify the various economic benefits that have accrued for Australia as a result of the design of our superannuation system. This includes: boosting the domestic savings pool; reducing our reliance on foreign sources of finance; improving the budget's long-term sustainability and further diversifying the tax base; helping to support our infrastructure needs; shifting capital towards longer-term investment horizons; facilitating workforce mobility; helping households diversify their balance sheets.

Critically, the funds through which these benefits have been achieved have done so in conjunction with enhancing retirement incomes for individual workers rather than compromising them. What this means is that even when the primary objective of the superannuation savings system is to maximise retirement outcomes for members, it can possible to design a system that creates broader economic benefits at the same time.

We would be pleased to make a copy of this report available to the Panel once it has been finalised and in the meantime encourage the Panel to include the broader economic benefits in its fact base and to think about how key design elements of our retirement income system, such as superannuation's compulsory and universal nature, the default fund selection process have played a role in enhancing all outcomes.

Should you have any questions about the issues raised in in this submission, please do not hesitate to make contact via (02) 9113 0944 or melbourne@mckellinstitute.org.au.

Yours faithfully,

James Pawluk
Executive Director
The McKell Institute Victoria