3 February 2020

Submission to the Retirement Income Review

Written by Dr John Humphreys[1]
On behalf of the Nurses Professional Association of Queensland

Executive Summary

Since the introduction of compulsory superannuation in 1992 there has been a ceaseless debate about the optimal rate of compulsory savings. The original rate of forced savings was 3%, which rose to 9% by 2002, and is scheduled to rise further to 12% by 2024; though there is a growing debate about the coming increase.

This report looks at the underlying issue of whether compulsory superannuation actually achieves a net benefit to Australia. The current system is often justified by pointing to benefits that accrue to some savers, and the long-term fiscal position of the government. We find that the most significant beneficiaries are actually fund managers, industry groups, and trade unions. In contrast, the main losers from compulsory superannuation are low- and middle-income workers, young families, and people wanting to buy a house, who are forced to save the wrong amount of money in the wrong way at the wrong time. The superannuation system is a good investment for some people, but it should be converted into a voluntary system where each worker has the freedom to choose.

Keywords: Compulsory superannuation; time preference; benefit-cost analysis

9/27 Evans Street, Maroochydore QLD 4558
PO Box 6279, Mooloolah QLD 4553

www.npaq.com.au
1300 CODE PH
hotline@npaq.com.au

[1] Sessional lecturer of economics, University of Queensland; john.humphreys@uq.edu.au

1. Introduction

Australia's system of compulsory superannuation is set to expand yet again, from the current level of 9.5% up to a target of 12% in 2024. The impending change has sparked a wide-ranging debate about the efficiency, effectiveness, and fairness of our superannuation system and retirement incomes more generally. In particular, the recent report from the Productivity Commission[2] highlighted some of the problems with the superannuation industry and recommended a Retirement Income Review, which is now being hosted by the Australian Treasury[3].

This working paper is written on behalf of the Nurses Professional Association of Queensland (NPAQ), as part of an ongoing research project into the effects of superannuation on workers. Additional working papers will be released in the coming months, but this paper is being released immediately (3-Feb-2020) as the NPAQ submission to the Retirement Incomes Review.

1.1 Nurses Professional Association of Queensland (NPAQ)

The Nurses Professional Association of Queensland is an independent (unregistered) trade union that provides high quality employment services at a low cost to members. As a truly independent union, the NPAQ is not associated with any political party and is not linked to any superannuation funds. This means that NPAQ is in the unique situation of being able to focus entirely on the welfare of members without the influence of vested interests or party politics.

While this working paper was initiated on behalf of NPAQ members, the arguments made herein apply to all Australian workers regardless of their profession or union membership.

1.2 Australia's retirement income system

Australia's retirement income system is mind-numbingly complex, which itself creates costs of administration, compliance, and inevitable mistakes. As a brief summary, retirement income is made up of a tripartite system of a government funded aged pension, compulsory superannuation savings paid by employers on behalf of workers, and additional voluntary savings.

At retirement age (currently increasing to 67), Australians who lack sufficient assets or income can access the aged pension at a rate of $926.20 per fortnight ($24,081 per year) for a single person[4]. For people who exceed the minimum assets and income thresholds, the

---

[2] Productivity Commission (2018), *Superannuation: Assessing Efficiency and Competitiveness*, PC Inquiry Report No. 91, 21 December 2018; https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf

[3] https://treasury.gov.au/review/retirement-income-review

[4] Overview of aged pension system: https://www.superguide.com.au/accessing-superannuation/age-pension-asset-test-thresholds and https://www.humanservices.gov.au/individuals/services/centrelink/age-pension/

aged pension is reduced (being paid as a part-pension), and people who exceed the maximum assets or income threshold are not eligible for the pension[5]. Despite the expansion of compulsory superannuation and the income test for the aged pension, 68% of retired people still receive the aged pension.

In addition to the aged pension, most workers are required by law to save a fixed percentage of their income into superannuation accounts. Australia's superannuation system started to take shape in 1985, when the Hawke/Keating government negotiated with the ACTU to quarantine 3% of workers' scheduled wage increase into superannuation savings (instead of receiving that money as a wage increase). In 1992 this was expanded by the Keating government to cover all workers, and then the rate was steadily increased up to 9% in 2002[6]. The rate has edged up further to 9.5%, and is legislated to increase further to 12% by 2024.

1.3 Focus on compulsory superannuation

This working paper does not attempt to answer all of the questions outlined in Treasury's consultation paper[7], but rather has a narrow focus on the benefits and costs of compulsory superannuation. The thesis of this paper is that compulsory superannuation has more costs than benefits, and so it represents bad public policy and should be reformed. The pivotal issue at the centre of this argument is that different people have different needs based on their circumstances, and for many people (especially low and middle-income earners) it can be optimal for workers to save a different amount, or save differently, or save at different times than currently mandated. Compulsory superannuation hurts these people.

Note that this paper does not argue against the general concept of superannuation, but rather against the idea that it should be compulsory. Superannuation is recognised useful system of savings, which may be appropriate in some circumstances.

---

[5] The aged pension income test has a very low threshold of $174/fortnight or $4524/year (boosted for labour income by $300/fn or $7800/year), with the pension then withdrawn at the high rate of 50%. This undermines the value of superannuation balances, by imposing high EMTRs on the returns on those balances for people caught in the income test. Income associated with assets is determined on a "deemed" rate of 1% for the first $51,800 and then 3% return for additional assets. By the time somebody is earning $2040.80/fn or $53,061/year, they are no longer eligible for the pension. The aged pension asset test has a threshold of $473,750 for a single person, with only the first $210,500 of your owner-occupier house counting towards that asset calculation (leaving a remainder of $263,250 for other assets of owner-occupiers). After reaching the threshold, the aged pension is withdrawn at a rate of $3/fortnight (or $78/year) for each $1000 in assets. If a hypothetical asset gives 5% return ($50/year) then the asset test represents a tax rate of 156% on the income from that asset. By the time a person has assets worth $785,000 (or $574,500 + $210,500 from owner-occupier house) they will no longer be eligible for the aged pension. This means that the entire aged pension is withdrawn over the relatively small asset range of $474k to $785k, which represents just $311k in assets. To put this another way, for each $100k in additional assets, the pension ($24,081/year) is decreased by $7800/year. Pensioners are not allowed to gift more than $10,000 per year (or $30,000 over five years) in order to reduce their assets for the asset test.

[6] Keating, P.J. (2007), The Story of Modern Superannuation, Australian Pensions and Investment Summit, 31 October 2007; http://www.keating.org.au/shop/item/the-story-of-modern-superannuation-31-october-2007

[7] Australian Tresaury (2019), Retirement Income Review Consultation Paper, November 2019; https://treasury.gov.au/sites/default/files/2019-11/c2019-36292-v2.pdf

2. The case for forced savings

Some people don't save enough for their own lifetime wellbeing[8], and this problem is exacerbated by Australia's tax-transfer system which discourages people from saving. The current solution has been to make it compulsory for people to save some of their income for retirement. The potential benefits are threefold:

1. Benefit to savers = the purpose of superannuation is to smooth lifetime consumption, by decreasing consumption during the working years (when you are earning an income), investing those savings, and then using that money to increase consumption during retirement (when you have low or no income). The correct amount of savings will balance the present cost with the future benefit in order to maximise lifetime wellbeing. A worker with perfect knowledge and self-control will choose the optimal personal savings rate, but in reality, some people will over-save or under-save, both of which creates a cost to the worker. For people who under-save, compulsory superannuation may help to remedy their mistake and improve their lifetime wellbeing.

2. Benefit to the budget = even if a person is saving the optimal amount for their personal situation, that may not be the socially optimal rate of savings. The existence of other government policies (specifically the aged pension and tax system) decreases the benefit from savings, and therefore creates an incentive for lower personal savings. This does not necessarily create a cost for the individual (indeed, they may benefit), but the lower savings and greater reliance on the aged pension does increase the budgetary cost to the government. Therefore, the second possible benefit from compulsory superannuation is that it may decrease the cost of aged pension payments to the government.

3. Benefit to capital markets = continuing from the 2nd point above, if government tax-transfer policy artificially decreases the savings rate, that will reduce the amount of money available in financial and capital markets. This may lead to higher interest rates and/or some businesses not being able to find funding for new investments. This point is mostly offset by the existence of foreign capital inflows, though there is arguably still a benefit from having more domestic investment instead of relying on foreign investment. A final possible benefit from compulsory superannuation is the boost to domestic investment.

There is some truth to all of the above arguments, but they are incomplete. A full reckoning of compulsory superannuation shows that the policy actually hurts most savers, damages the government budget, and distorts our capital markets. Like all government schemes, compulsory superannuation can only be justified if the benefits exceed the costs. This paper argues that compulsory superannuation fails any reasonable benefit-cost analysis, and therefore superannuation should not be compulsory.

[8] This may be due to a simple miscalculation, or it may be caused by time-inconsistent (hyperbolic) discount rates, which is another way of describing a person who lacks self-control in the heat of the moment.

3. Compulsory superannuation & savers: Different people are different

The core problem with the compulsory option is that it does not (and cannot) accommodate the different needs of people in different circumstances. It is true that some people should be saving 9% (or 12%) of their income for retirement, and yet might under-save, and compulsion pushes them into a situation they will later celebrate. However, it is also true that some people should be saving less than 9% (or even nothing) given their circumstances, while other people would benefit from different types of investments.

For most people, compulsory superannuation is either unnecessary (since they would choose to save anyway) or counterproductive. There are three ways that compulsory superannuation can hurt savers: (1) saving the wrong amount; (2) saving at the wrong time; and (3) investing in the wrong assets.

3.1 Saving the wrong amount

The optimal amount of savings depends on a number of different factors, but one of the most obvious issues is income level. Under the current system of compulsory superannuation, low-income and medium-income workers are being forced to save an inefficiently high amount, leading to lower lifetime wellbeing.

For many low-income earners, retiring onto the aged pension actually represents an *increase* in their income[9]. For these people, it makes no sense to reduce their wage during their working life (when they are already poor), only to boost their income in retirement (when they are less poor). This is the opposite of consumption smoothing. Investing in superannuation may be desirable in some specific situations, and the option should be available for people to choose if they wish, but for most low-income earners it doesn't make any sense. As explained by Dr Cameron Murray:

> *"For the bottom quarter of households, the age pension is a pay rise. It makes no sense to make these households poorer when they are working and poor, so they can be slightly richer when they are retired and rich. That is the opposite of what a pension system should do."*[10]

For most middle-income earners, investing in superannuation is a bad investment, causing a large drop in working-age income but only a marginal increase in retirement income. This is because middle-income people suffer from very high effective marginal tax rates (EMTRs) in retirement, caused by the application of the income and assets test on the aged pension. For these people, the increase in their superannuation income is significantly offset by the quick removal of the aged pension. The Grattan Institute modelled the impact of changes in

---

[9] Daley, J. and Coates, B. (2018), *Money in Retirement: More than Enough*, Grattan Institute Report No. 2018-17; https://grattan.edu.au/wp-content/uploads/2018/11/912-Money-in-retirement-re-issue-1.pdf

[10] The Guardian (2019), "The great superannuation debate: raise it, freeze it or do away with it altogether", *The Guardian*, 24 November 2019, https://www.theguardian.com/australia-news/2019/nov/24/the-great-superannuation-debate-raise-it-freeze-it-or-do-away-with-it-altogether

superannuation payments on lifetime wellbeing. Their conclusion was that the majority of people (including people on average incomes) are made worse off when forced to contribute more to superannuation[11]. Once again, superannuation may be desirable in specific situations, but most middle-income earners would get a higher lifetime benefit by decreasing their superannuation balance.

It is only high-income earners who clearly benefit from high levels of superannuation. This is because they will get the benefit from consumption smoothing (unlike low-income people) and they face relatively low EMTRS on their retirement income (unlike middle-income people). However, even in this case compulsory superannuation doesn't create a significant benefit, since high-income earners already overwhelmingly save enough for a comfortable retirement. The compulsion is either unnecessary or unhelpful.

In addition, some people may simply prefer lower levels of savings because they have a high discount rate on their time. For example, people who expect to die relatively early will reasonably prefer to have higher levels of consumption earlier in life rather than saving for a retirement that might never arrive. Compulsory superannuation is a particularly cruel system for low-income people who die young. Other people may rationally decide that they are willing to accept a lower retirement income in order to achieve various goals and preferences while they are (relatively) young. There is no one correct attitude to life and time, but compulsory superannuation unreasonably punishes some people based on their approach to life.

3.2 Saving at the wrong time

In addition to forcing over-savings on many people, compulsory superannuation also forces people to save at the wrong times in their life. As explained in section #2 when introducing the argument for superannuation, the goal is to achieve a degree of consumption smoothing by saving during high-income years and then living off the savings during low-income. That idea makes sense, but the problem with our compulsory superannuation system is that it assumes people should be saving a fixed amount every year regardless of circumstances.

The optimal amount of savings at any point in time depends on your income and necessary expenses. Specifically, people should save more during their peak earning years and when they don't have large unavoidable costs. For many people this means saving relatively less during their 30s (when they are facing the main costs of raising a young family) and then saving relatively more during their 40s and 50s. Other people who would benefit from varying their level of savings are people with highly variable incomes, and people who are facing large one-off costs such as tuition fees or large medical costs. Australia's compulsory superannuation system does not take these changing circumstances into account, and instead forces people to save a fixed rate regardless of their situation, causing many people to save the wrong amount at the wrong time.

[11] Daley, J. and Coates, B. (2018)

In addition to changing life circumstance, there is also a rational reason why young people may have less focus on their retirement income. First, it makes sense on simple longevity grounds for young people to have a marginally higher time discount rate than middle-aged people. In addition, a person's time discount rate is likely to vary over time (being particularly high when they are young), and the optimal savings rate should change in line with those evolving attitudes.

On the other side of the life cycle, some people may end up amassing enough savings early in their working life, and make the rational choice that they don't need any further savings to achieve the sort of retirement they want. If a person does manage to save enough during the good years, they should not be forced to continue saving.

Optimal savings rate should vary based on life circumstances, but compulsory superannuation attempts to enforce a fixed rule on everybody. In response, many people attempt to escape the irrational restrictions of forced savings by either reducing other types of savings or going into debt. This can create counterproductive situations, such as people holding high-interest loans (including credit card debt) that they would like to repay, but their savings are trapped in a superannuation fund. In that situation, the forced saving may actually cause lower levels of long-term savings.

3.3 Investing in the wrong assets

Compulsory superannuation does not simply mandate a minimum level of saving, but it also mandates that the saving occur in a specific way. For most people, this means giving your money to either a retail or industry super fund, which then invests in a mix of shares, fixed-income securities, and cash. Given the relatively low return on fixed-income securities and cash, many super funds are heavily invested in the stock market.

Superannuation is a legitimate option for investing, and people should be free to choose that option if they want. However, there are a number of situations where compulsory superannuation causes people to end up with the wrong mix of investment assets (often with heavy exposure to the stock market), making them worse off in the long run.

The most obvious and important example of this is the impact on home ownership. For most people, their owner-occupied home will be the most important asset that they own, in addition to having a personal consumption value that should not be dismissed. There is a strong case to be made for home ownership as being a significantly better investment for lifetime wellbeing than superannuation, at yet the current system forces people to send their money to superannuation instead of saving for a house deposit[12]. Looking beyond the obvious example of the family home, depending on a person's personal preferences and risk attitude, there may be a range of other investments or business ideas that are preferable to the standard superannuation portfolio. People should be free to invest in superannuation if they want, but it is wrong to assume that super is the best investment option for everybody.

[12] Cowan, S. (2019), *Millennials and Super: The Case for Voluntary Superannuation*, Centre for Independent Studies, POLICY Paper 20.

Another reason why people may want to invest outside of superannuation funds is the relatively high fees and mediocre rates of return. For a person forced into saving at age 20 and reclaiming their money at 60, they have been paying an average of 1.1% in fees for 40 years. This represents an annual bill twice the size of a household annual electricity bill[13], and yet the costs is largely unnoticed since most people don't pay close attention to their superannuation. The Productivity Commission completed a comprehensive review of the fees and returns on superannuation, leading to a raft of suggestions, but ultimately the performance of super funds will only be improved through the genuine competition that comes from giving people a free choice (discussed in section #5 below).

3.4 Who loses out from compulsory superannuation?

The previous three sections outlined the various ways that compulsory superannuation can lead to inefficient and counterproductive outcomes for savers. It should be stressed that superannuation can also be a good investment for some people in some situations. Many people benefit from some amount of superannuation, and it should remain as an investment option for those people; but the list of super-losers is far longer, including:

- Low-income earners
- Middle-income earners
- People with low life expectancy
- People with genuinely high time discount rates
- Young people
- People earning less than their usual income (e.g. students, part-time workers)
- People facing higher than usual expenses (e.g. young families, medical costs)
- People who want to pay off their credit cards and personal loans
- People who want to buy a house
- People who want to pay off their mortgage
- People who want to buy/start a small business
- People who want to actively manage their investment portfolio
- People who already have enough savings for their future needs

If we could rely on Laplace's Demon (or God) to set the rules, then perhaps we could legislate that people save exactly what is right for them in their own situation, but such policy making is not possible. More realistically, the person best able to balance the various different vagrancies of life is the person involved. In the case of superannuation, free choice is not just the best moral option, but it also the most efficient, effective, and rational option to give people to the highest level of lifetime wellbeing.

Making superannuation voluntary is good for most savers, allowing them to save different amounts at different times in different ways; but that is not the end of the story. The savings decisions of individuals may create a burden on the budget by driving up the cost of the aged pension. If that is true, then even if compulsory superannuation hurts savers it may still be appropriate to use compulsion. That is the topic of the next section.

---

[13] van Onselen, L. (2020), "Peter Costello: Superannuation system is inefficient", MacroBusiness, 29 January; https://www.macrobusiness.com.au/2020/01/peter-costello-superannuation-system-is-inefficient/

4. Government budget

One of the potential benefits from compulsory superannuation is that people will be better able to fund their own retirement, and so the fewer people will need the aged pension, and the cost to the government budget will be lower.

As noted by many commentators already, the problem with this argument is that compulsory superannuation also has a cost to the budget, due to the lower taxes paid on superannuation contributions and earnings[14]. According to Treasury's own estimates, the net impact of compulsory superannuation is a significant deterioration in the budget position[15]. Instead of being an argument for compulsory superannuation, the current budget impact is actually an argument for removing (or at least reducing) compulsory superannuation.

4.1 Ageing population and long-term budget pressures

It is appropriate for policy makers to worrying about future budget pressures. As the Australian population continues to get older, there will be relatively fewer people of working age paying taxes and relatively more people at retirement age drawing on government money. The Intergenerational Report is released by Treasury approximately every five years, and it makes for sobering reading[16]. Based on current trends (and assuming no new government projects), the ageing population will cause government spending to increase by about 3% of GDP. Funding this additional spending would require a massive increase in tax rates or decrease in other government programs.

The ageing population is a serious fiscal challenge, but that does not translate into an argument for compulsory superannuation. The problems with the ageing argument for compulsory superannuation are:

- As shown by the Grattan Institute[17], the net budget impact of the superannuation system is expected to remain negative until at least 2050;
- The budget cost of superannuation comes from the associated tax advantages, but the size of the budget cost is exaggerated by compulsion, which makes the superannuation system worse for savers and for the government;
- The largest single driver of budget pressures is not actually the aged pension, but rather the increase in government spending on healthcare, and compulsory superannuation does nothing to address this issue;
- If needed, there are other ways of making the aged pension more sustainable; and
- There are other ways of encouraging people to boost their private savings in the long run, which are better for savers.

[14] Creighton, A. (2018), "Scrap compulsory super, librerate Australians' wages", *The Australian*, 28 August 2018; also Murray, C. (2020), "Why Australia should scrap superannuation", *MacroBusiness*, 3 February 2020; https://www.macrobusiness.com.au/2020/02/why-australia-should-scrap-superannuation/

[15] Australian Treasury (2019)

[16] The most recent IGR is from 2015; https://treasury.gov.au/intergenerational-report

[17] Daley, J. and Coates, B. (2018)

The last point is an important but underappreciated issue that flows from compulsion. By forcing people to save regardless of whether it helps or hurts them individually, the government is able to avoid the responsibility of having good policies that promote private savings. As outlined in section #3 above, current superannuation policy forces some people to save even though that additional saving is reducing their lifetime wellbeing. By removing compulsion, the government would be forced to improve the quality of their policies to ensure that savings is good for everybody involved. One option would be to make use of the lessons of behavioural economics and choice architecture, as suggested in section #6 below.

Compulsory super is neither good for savers nor the government budget. However, there is one interest group that unambiguously benefits from compulsory superannuation, and the people involved have a strong incentive to lobby hard for the retention and expansion of the current system. The group is question is the superannuation industry (including an unholy alliance of big banks and unions), which has unprecedented access to money and power to defend their self-interest.

5. Super-industry and financial markets

Most people will end up with either a retail super fund (created by big banks) or an industry super fund (created by big unions). The two groups make a show of competing against each other, but both big banks and big unions eagerly agree that workers should be forced to send them an ever-increasing slice of their income through compulsory superannuation.

Big banks and big unions (along with specialist fund managers) are the big winners from compulsory superannuation, and they are the loudest cheer-leaders for the continuation and expansion of the scheme. These three groups make up the "super industry", which has expanded to now control a staggering $2.9 trillion in funds under management (over 150% of Australia's GDP), employing some 55,000 people, and charging $36 billion in fees annually[18]. The financial rewards to the super industry have been widely reported, but it is also important to recognise the unprecedented amount of power now concentrated in the hands of big banks, big unions, and fund managers.

5.1 Lack of competition

The concentration of money and power within the super industry would be less of a concern if there was genuine robust competition in the market. Effective competition would ensure that super funds maintained high performance with relatively low fees, and it would make it more difficult for them to abuse their positions of power. Unfortunately, the super funds lack this sort of competition, allowing super funds to charge relatively high fees (by OECD standards) and the freedom to pursue goals other than high returns. Productivity Commission reports:

> *"Muted competitive pressure from the demand side — members and their advisers — means that competition is not playing the corrective role that it does in other, less complex markets" (p22)*[19]

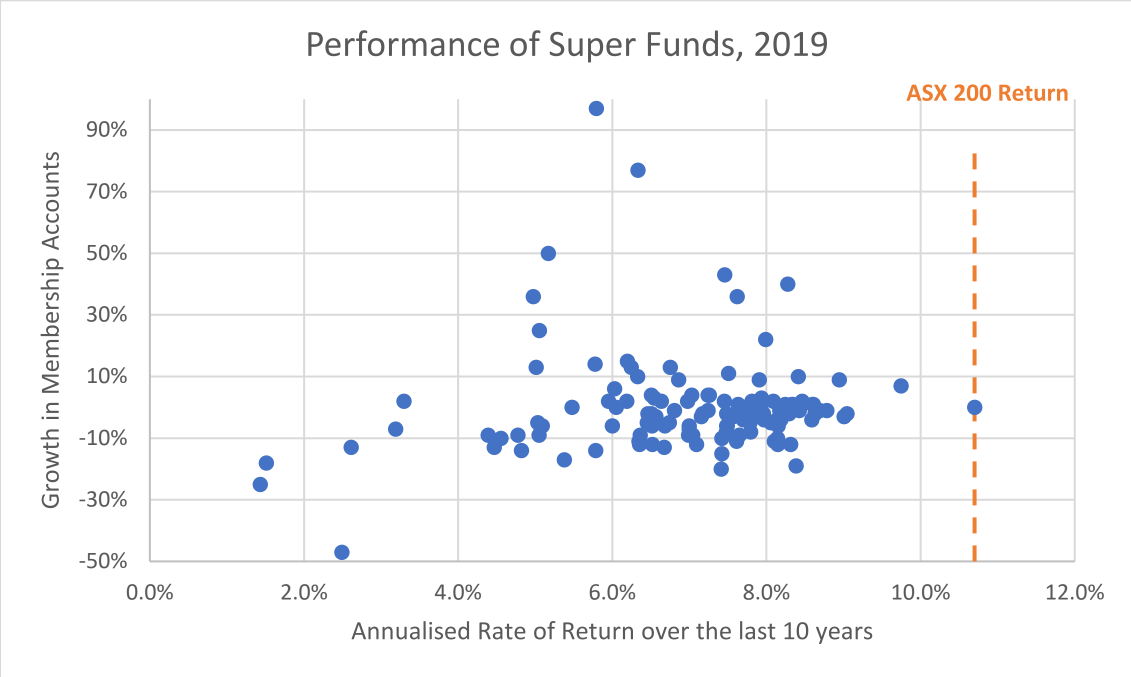
The lack of competition is directly caused by the compulsory nature of the system, where people are forced to contribute without having an interest or desire to invest. This results in passive customers who don't necessarily see their super balance as "their money", and who don't provide the sort of market feedback necessary for robust competition.

A recent survey of members of the Nurses Professional Association of Queensland showed that the majority of people did not pay attention to their superannuation[20]. Politicians have been pleading with Australians for 30 years to pay attention to their super balances, but the only effective solution will be to remove the compulsion. This would decrease the concentration of money and power within the super industry, and it would increase competitive pressure on the money that did remain.

---

[18] Murray, C. (2020)
[19] Productivity Commission (2018)
[20] Further details will be released in a coming working paper discussing the survey results.

Another indicator that customers are not engaged in the sort of consumer action that boosts competition is the relatively low level of switching between providers. As the graph shows below, there is no apparently correlation between fund performance and attracting new customers.



Source: Nicholas Umashev, NPAQ internal working paper

Suffice to say, big banks and big unions much prefer the status quo, where workers are forced to give a large chunk of their wages directly to them, and competitive pressures are weak. Big banks and big unions may play a pantomime of battling each other in public, but in the case of superannuation they are united in their believe that they should receive more of your money.

Removing compulsion would increase competition, and therefore put downward pressure on the fees and upward pressure on performance. If competitive pressures pushed average fees down from 1.1% to 1.0% (still high by OECD standards), that would be still represent a saving of nearly $4 billion every year.

5.2 Money, power, and self-interested lobbying

The concentration of money and power within the super industry has had a corrupting influence, as explained eloquently by Dr Cameron Murray:

> *"You can see this in the corrupting influence super has had on the Labor party, which now lobbies to have its members' wages given to the world's most expensive fund managers rather to their members. Imagine being a union member trying to support a family and having your political representatives tell you that you are too stupid to spend your own money: you don't deserve your wages. Instead, a fund manager*

downtown should look after the money you sweated for … and you have a one-in-six chance of dying before getting your hands on it."[21]

The super industry is not just getting rich, but they are also extraordinarily powerful, as owners of a large part of the economy. By some accounts, super funds control nearly 50% of the Australian stock market. We should always be sceptical of concentrated power, especially when those powerful people are lobbying for ever-more money and power. Listen carefully to the calls for compulsory superannuation, and you will quickly detect the unmistakable influence of the super industry arguing for more of your money.

5.3 Impact on capital markets and capital allocation

The concentration of capital within an uncompetitive super industry is not just a problem of high fees and low performance. Another problem is that the choices of the super industry create distortions within the capital markets, which has the potential to lead to a misallocation of capital and/or unsustainable asset bubbles.

Most super funds are heavily exposed to equity through Australian and international shares. This makes sense for the super funds, given their need to achieve growth and the low returns on fixed-income securities. The consequence is that a growing proportion of capital is being funnelled towards companies that are listed on the stock exchange, with relatively less available for unlisted or start-up businesses. If capital is being biased towards listed companies, that has the potential to artificially inflate share prices, while imposing capital constraints on non-listed businesses (who become another set of losers from the compulsory superannuation system). These problems exist as a slow burn, hardly visible while the capital is still being allocated, but ultimately putting downward pressure on productivity, economic growth, and wages. Removing the compulsion in the superannuation system would help improve the allocation of capital, and hence productivity.

Advocates of compulsory super have claimed that the compulsion will benefit the capital markets by increase the supply of loanable funds and therefore putting downward pressure on interest rates. This argument is incomplete, as it doesn't factor in the role of international capital flows. For a country with open capital markets (such as Australia), any shortfall in domestic savings will be largely met with foreign savings available at the international interest rate, creating a capital account surplus.

[21] The Guardian (2019)

6. Conclusions and solutions

The argument for compulsory superannuation sounds compelling in the first instance. Some workers need more savings, and that will hopefully lead to fewer people relying on the aged pension. As shown above, neither of these arguments are sustained by the evidence, with low and middle-income workers losing out the most. Public policy can only be justified if the benefits exceed the costs, and that clearly isn't the case with compulsory superannuation.

Recommendation #1: First and foremost, superannuation should become voluntary, so that each worker has a choice about whether to contribute or not.

The main impediment to reforming our superannuation system are the significant vested interests of big banks, big unions, and fund managers. These groups benefit hugely from the money and power they wield. Their appeals for even greater money and power should be seen in this context. Instead of dancing to the tune of the powerful super industry, superannuation policy needs to be directed at what is best for workers.

Recommendation #2: Disregard the self-interested lobbying from the super industry, including appeals of big banks and big unions for ever more money and power, and focus primarily on the benefits and costs to savers.

The problem with compulsory superannuation is not that superannuation is a bad idea; the problem is the compulsion that results in some people saving the wrong amount, of the wrong assets, at the wrong time. The underlying concept of superannuation still deserves support, though now as a voluntary system. In addition, the switch to a voluntary system forces policymakers to more carefully consider the incentives they are creating, to ensure they are not discouraging people from savings. The assets and income test on the aged pension mean that the effective marginal tax rate (EMTR) on savings for middle-income people can be excessive (potentially over 100% in some instances), and this should be addressed. It may be worth removing the assets test entirely, and relying solely on the income test, which implicitly factors in the asset position through the use of deeming.

Recommendation #3: Retain the tax benefits of the superannuation system, and relax the assets and income test of the aged pension to decrease the EMTRs faced by savers.

The concessional nature of superannuation balances means that it would still be necessary to carefully set the rules about how super balances can be used, even after the system was made voluntary. The rules should be relaxed so that workers have the option of buying any sustainable financial asset that fits their life circumstances, and specifically including the purchase of an owner-occupied home. As a side note, if superannuation funds are used to buy an owner-occupied home, then it could be argued that the value of that house should subsequently be included in the asset test for the aged pension (if the asset test is retained).

Recommendation #4: Workers be given the freedom to use their superannuation balance to buy an owner-occupied home, and potential also to buy other wealth-generating assets such as investment properties or a businesses.

While people shouldn't be forced to save an amount that is against their individual interest, it is true that some people run the risk of under-saving. Compulsion is a poor solution to this problem because it harms most workers. An alternative approach is to utilise the lessons of behavioural economics, and specifically of "choice architecture" as promoted by Nobel laureate Richard Thaler and Harvard lawyer Cass Sunstein[22]. This would involve creating a default position of (for sake of argument) 9% savings that goes into a superannuation account, but then giving workers the freedom to opt-out of the system when needed, based on their personal circumstances. By setting superannuation savings as a default, this will increase people's likelihood of saving, without hurting those people who want to avoid superannuation.

Recommendation #5: Make use of behavioural economics and choice architecture, by setting up superannuation savings as a default, but then giving people the freedom to opt-out of superannuation. This ensures the system is voluntary, but decreases the risk of under-saving.

[22] Thaler, R. and Sustein, C. (2008), *Nudge: Improving Decisions about Health, Wealth, and Happiness*, New Haven, Yale University Press.