Reform of Australian superannuation taxation and regulation

Submission to The Treasury's Retirement Income Review

Dr. David C. Thorp, 13 February 2020

The current superannuation system is inflexible and complex, which explains why despite its very expensive tax concessions, the average Australian has as much in savings outside super as they do inside it. It doesn't meet the needs of a modern, flexible and ageing population. It needs fundamental reform.

My 2012 paper, "supertaxreform-final updated2012.pdf", attached here presents a vision for simple, flexible, customer-focussed superannuation (to support flexible careers and retirement) that is fair and sustainable in its tax treatment. The paper has evolved over the years through various submissions (initially to ASFA's 2005 competition and to the 2006-07 Budget, which Costello & Dutton failed to grasp). Here is an initial draft of a news article about my long-standing campaign (which was posted here).

Also Also see here on Global Access Partners' Open Forum blog site and attached here my one-page paper, "AgeingSuperTaxReformJan2017.pdf", on the *inevitable* need for such tax reforms due to an ageing population.

The following are the key points of my proposed superannuation reforms:

1. An initially voluntary new "*Flexi-Super*" scheme (voluntary for at least older workers, over, say 45), with the following features:
    a. **No tax on contributions** (i.e. made from pre-tax income, or with tax credits granted for post-tax income contributions).
    b. **A small tax on earnings (say 10-15%)** for funds below a defined maximum balance (where the maximum provides for "comfortable" retirement).
    This tax applies at all ages (including in "retirement"). Earnings on funds above the maximum balance would incur full income tax rates.
    c. **Full income tax rates on withdrawals**.
    d. **Funds could be withdrawn at any age** (e.g. for a mid-career break or unemployment period), **as long as the balance exceeds a regulated minimum amount that would rise with age** (this minimum, specified by age, would be based on the savings required to retire with a basic '*minimum'* standard of living, i.e. less than "comfortable")
    - this flexibility addresses probably the biggest barrier to voluntary contributions under the current superannuation regime.
    e. **10% of wages must only be contributed if the fund balance is below the regulated minimum** (for the person's age) - noting the arguments for more than 10% (made by the self-interested super industry) are not strong.

Besides being simple, having all tax benefits on earnings automatically rewards people for saving longer and thus avoids the need for complex regulations limiting annual contributions and withdrawals. And with progressive income tax rates applied to withdrawals, the more that's withdrawn in any single year, the higher the % rate of income tax that will apply - so *there's an incentive to withdraw funds gradually*.

The proposed tax treatment would also benefit people taking a voluntary or forced career break, because the marginal tax on withdrawal could be at a lower rate than during prior high-income periods of their career. For example, year 2 (when out of work) would be taxed the same as someone who worked two years at $50k p.a. - unlike the current income tax system, which taxes you at a higher % rate for earning a given amount if it is concentrated into one year rather than two, unlike the current income tax system, which taxes you at a higher % rate for earning a given amount if it is concentrated into one year rather than two, thus actively discouraging employment contracts that respond faster (more efficiently) to varying demand. Hence these proposals could encourage greater job mobility - with more frequent vacancies and more opportunities for those looking for work - thus potentially reducing unemployment.

There may also be other 'externality' (society-wide) benefits arising from people taking more career breaks to focus on their families or other aspects of life.

2. Pragmatic implementation could be assisted by:

   a. An extended phased implementation, with voluntary participation from people currently over, say, age 45. Those people that valued the flexibility (especially younger people) would voluntarily switch to the new scheme, even if it had somewhat lower tax benefits. Over time, the current Australian superannuation scheme would be phased out.

   b. Pre-paying of withdrawal tax credits (perhaps encouraged by incentives) in order to manage any short-term government budget constraints.

   c. The Australian Superannuation Funds Association (ASFA) should support it as it's based on a concept that they awarded first prize to in their 2005 "Simply Super" competition, and it also has similarities to their 2013 reform proposals.

3. These superannuation reforms would also facilitate the following further policy options, including **welfare-system reforms to better support (life-long) employment** (**as attached here** and also more concisely covered in **my more recent paper on a "UBI"**), as well as **broader, comprehensive reform of income, company & consumption taxes**:

   - **Merging the pension with superannuation** to form one integrated system, with the pension being replaced by government contributions to private super accounts that are below the minimum balance.
     - Measures to address inequality need to consider both income and wealth, because only when people have more income than their basic living expenses can they save & invest any surplus so as to build their future wealth. This is why the ABS charts here show that wealth inequality is starker than income equality (and conversely, a small improvement in income equality will deliver a bigger improvement to wealth equality). In 2015–16, ABS data reveals that the mean Australian disposable equivalised-household income (after tax & Medicare levies), at $1009 per week, was 18% higher than the median (which 50% of households have less than), but the large wealth accumulated by a small fraction of households (the top 1% own as much as the bottom 70%) made the mean household wealth 76% higher than the median and the wealthiest 20% of Australian households owned 63% of total household wealth, which was 80 times more than the less-than-1% owned by the lowest 20% of households. By 2018, the Credit-Suisse Global Wealth report indicated the ratio of mean to median Australian wealth had risen to over 2x, while in the UK & USA it was nearly 3x & more than 6x respectively. This concentration of wealth through the ownership of land & corporations then gives the "elite few" disproportionate power & control over society. Moreover, people on low incomes tend to have low bargaining power, which means their wages can be pushed down to the bare minimum needed for current living costs. This is why welfare support should ensure minimum incomes include a protected component for savings, i.e. mandatory superannuation.
   - **Mandating the purchase of lifetime annuities** to provide an indefinite minimum income beyond "retirement age" (to the extent a specific "retirement age" has much meaning in future).
     - *Note if lifetime annuities aren't compulsory then demand will be biased towards those that expect to have a higher than average life expectancy, which will cause premiums to rise and be poor value-for-money for a person with average life expectancy, thus causing a spiral of low demand and higher premiums. This market failure justifies mandating minimum annuities.*
   - **Replacing most tax allowances and welfare payments (but not disability support) with one, simpler Universal Basic-Income** (UBI) paid into super accounts, as described in my paper here or here on GAP's blog forum):
     - A Universal-Basic-Income can provide a basic, bare-minimum income to live, without complex & costly eligibility tests, and would be gradually repaid through the progressive income tax system as people earn additional income, so as to reduce the otherwise **punishingly-high effective marginal tax rates (sometimes over 100%) currently experienced by the unemployed as their benefits are withdrawn when they gain paid work**. A UBI also has the potential to promote innovation by moderating the impact of failure, and is supported by a number of high-profile entrepreneurs at least partly for this reason (although perhaps also out of guilt at their extreme wealth!).
       Furthermore, **with a UBI in place there would be no need for a minimum wage** (although whether that is socially acceptable depends very critically on how high the UBI is), which should then create new employment opportunities, as it would be less costly for businesses to employ someone. In effect, it would introduce a more efficient form of "access pricing" for labour, analogous to utility bills, where the UBI (paid by government) forms the fixed-cost component for

the minimum cost of living and the variable cost (paid by consumers, including taxes) of what is then genuinely voluntary labour only needs to compensate for the "marginal cost" (disinclination) of the person undertaking that labour. This would have cascading effects throughout the economy; for example, lower marginal labour costs (in isolation) would make it cheaper to eat in restaurants, but as the cost of food ingredients would then form a bigger proportion of meal costs, smaller (more healthy) meals would be relatively even cheaper (unlike at present where customers are encouraged to eat in excess because fixed, high service costs mean a larger meal incurs a relatively small premium).

    - The idea of a UBI is attracting growing interest from around the world, even from the IMF, with schemes being implemented or trialed in Scotland, Canada (see here for more details), Alaska, Holland, Africa & other countries. Some advocates, such as Elon Musk and US Presidential candidate Andrew Yang, argue the need for a UBI may be inevitable soon, as technology automates more and more of society's needs - otherwise we will all be forced to do ever more useless jobs producing more stuff that we don't especially want or need (mainly so we can outbid each other for the best bit of land to live on), instead of just chillin' out in utopia! The challenge is to achieve the potential benefits of reduced administration costs & complexity and improved employment incentives, with acceptable changes to income tax (& sustainable budget impacts). Initial results from a trial in Finland indicate a UBI may not discourage people from working, but it's not clear-cut how to design it optimally for overall benefits.
      Ideally, I suggest a UBI could be administered through the employment-agency services of "capitalist co-ops", who would compete to design the optimal combination of efficient, client-focussed services that encourage people to gain additional employment (subject to regulatory oversight to ensure no-one could be unfairly denied their UBI). They would aim to change the current culture that is biased against welfare recipients (though perhaps finally changing) towards one of actually helping disadvantaged people gain productive employment! As I discuss in my paper on supporting employment & reforming welfare, there may still be some requirement for UBI recipients to accept work offered to them, but the onus would be on these employment agencies to find suitable employment, rather than forcing those struggling to find work to make umpteen, ineffective "compliance" job applications (which only makes companies' recruiting task more onerous & inefficient).
    - In Australia, the level of universal-basic-income could be based on the cost of housing in regional areas and thus cost taxpayers significantly less than the rent-assistance currently required for unemployed residents in urban Sydney struggling with unaffordable housing. The implication is that Sydney's unemployed population may have to move to non-urban areas where they could afford rent, and although these areas may have few current job opportunities, a UBI makes this a feasible option as recipients would not have to provide evidence of job applications (as required with current welfare benefits). Over time, the growing regional population (supported by a planning & transport strategy connecting regions to cities with fast rail links) would improve the economic viability of local businesses and thus facilitate new residents on UBI gaining employment or creating new businesses and contributing to increased local economic activity (as occurred in trials of a universal basic income in Uganda and as might be expected when people no longer have to worry about their most basic, immediate needs and can afford to take risks & innovate).
  - **Supporting more affordable housing** by, for example, allowing low-wealth first-home buyers to use superannuation funds for a deposit or mortgage repayments (subject to constraints). This could be enabled if APRA helped manage excessive investor demand for housing through lending controls as suggested here (noting that as a matter of principle low-wealth households should be able to use their limited savings for a home deposit, but allowing the wider population to access superannuation for this purpose will simply bid up the price of housing). However, this is not a substitute for having a progressive tax & welfare system to redistribute wealth, since increasing inequality is the fundamental cause of declining home ownership.
    - *Note the proposed low tax rate of 10-15% on superannuation earnings could also address the economy's current distortion towards housing investment without requiring changes to negative gearing policy, which is mainly a problem because of its interaction with the discounted tax rate currently applying to capital gains (which the over-rated Treasurer Costello introduced along with unsustainable superannuation tax changes, although maybe his adviser is to blame).*
  - **Enabling comprehensive rationalisation & reform of the broader tax system**, including GST, income tax and company tax, as discussed in section 2 at: http://davidthorp.net/economics/super-tax.