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29 March 2023

The Director
Superannuation Insurance and Governance Unit
Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

Via email: superannuationobjective@treasury.gov.au

Dear Sir/Madam,

Re: Legislating the objective of superannuation

On 20 February 2023 the Treasury issued a consultation paper on legislating the objective of superannuation. The Government has invited stakeholder views about the issues raised in this paper.

The directors of Erebor Pty Ltd (Erebor) appreciate the opportunity to provide comments on the consultation paper. Erebor is a small family investment company, like many across Australia.

We support the objective set out in the Treasury consultation process of achieving clarity on the purpose of superannuation in Australia. The International Monetary Fund has noted 'Rational policy design begins by agreeing on objectives and then proceeds to discussion of instruments for achieving them.' [1] This can assist in shaping discussions on the policies that are best placed to achieve the proposed objective and measuring the effectiveness of these policies in achieving the desired outcomes.

However before agreeing on objectives, any discussion about the purpose of superannuation needs to start with a clear understanding of two fundamental and foundational questions.

Firstly what problem we are trying to solve and why this requires government intervention; and secondly, what form of government intervention is most effective in solving that problem.

In this submission, we have outlined our viewpoints on these matters and then commented on the proposed objectives for the Australian superannuation system set out in the consultation paper.

[1] Barr, Nicholas, *The Pension Puzzle: Prerequisites and Policy Choices in Pension Design*, International Monetary Fund Economic Issues, No 29, March 2002 (https://www.imf.org/external/pubs/ft/issues/issues29/index.htm, accessed 27 March 2023

What problem are we trying to solve?

Reports from the Productivity Commission[2], supported by the International Monetary Fund[3] highlight that superannuation is intended to solve two primary problems.[4]

Firstly, behavioural biases mean that people have a tendency to give a greater weight to payoffs closer to the present and a lower weight to those in the future. As a result, people tend to favour immediate consumption rather than saving for future consumption, including during their retirement. This is known as the present bias. Superannuation enables people to smooth the distribution of consumption spending over a life span, by deferring a portion of the income received while they are working and receiving this income when they have retired from paid work.

Secondly, how can we minimise the cost of the taxpayer-funded age pension provided by the government and avoid it becoming unsustainable particularly as the population ages. The age pension should be a welfare measure which provides security against destitution in old age and only available to those who have been unable to save for their own retirement.

A corollary of this issue, is that the cost of any government policies introduced to solve the 'present bias' (including compulsion to force people to save, tax incentives to encourage people to contribute to superannuation, and concessional taxation on earnings in superannuation) should not exceed the cost of the age pension.

There are a number of implications that flow from focusing on these two problems.

Superannuation is deferred income

Superannuation contributions are, in substance, deferred income. By making contributions to superannuation people are able to smooth their income, and their consumption, over their lives.

Behavioural economists have identified that because of the 'present bias' people don't adequately save for their own retirement and the government (i.e. taxpayers) are compelled to provide an income, the age pension, to these individuals. Ample evidence for this behavioural bias has been highlighted by the recent report on the adverse impact of the previous government's policy of allowing people early access to their superannuation and the significant cost this will impose on those individuals, as well as future taxpayers.[5]

Australia's superannuation system addresses the present bias through compulsion (the mandated SGC contributions) and tax concessions (deductibility of superannuation contributions and concessional rates of taxation on investment earnings), which provide incentives for people to take personal responsibility for funding their retirement.

Australia's taxation system taxes personal income using progressive income tax rates, with one glaring exception: it does not tax superannuation withdrawals when a person retires.

The failure to tax superannuation withdrawals is inconsistent with the principle of treating superannuation as deferred income.

[2] Productivity Commission, Superannuation: Assessing Efficiency and Competitiveness, Inquiry Report (2018) p92
[3] Barr (2002) op. cit.
[4] The Productivity Commission included a third objective of superannuation, to increase national savings. Productivity Commission (2018) p92
[5] See Australian Financial Review, Coalition's early super access scheme largely used to get cold hard cash, 16 March 2023 and The Age, Australians drained $38 billion of their super in the pandemic, 16 March 2023

In 2007 a previous Coalition government introduced a policy under which taxation on income earned by a superannuation fund was reduced to zero for an Australian over the age of 60 whose superannuation fund was in pension mode. This has been criticised by the IMF[6] and described as one of the five most profligate decisions of an Australian government.[7] More recently another Coalition government further compromised the principle of treating superannuation as deferred income by allowing people early access to their superannuation.

Currently, the superannuation pension a person receives is tax-free. In addition they can receive other income of up to the tax-free threshold of $18,200 without paying any tax. As a result a superannuation pensioner with a superannuation pension of, for example, $41,800 and other income of just under $18,200 has gross income of $60,000. On this income they pay no income tax and no medicare levy. By contrast a person earning $60,000 by working would pay $9,567 in income tax and medicare levy (after allowing for offsets).

A taxation system that results in different tax outcomes for people earning similar income levels depending on whether they are working or retired is inequitable and unfair.

Given that superannuation is inherently income that has been deferred, it follows that when this deferred income is withdrawn from superannuation and paid to a recipient it should be subject to income tax at marginal tax rates. This should apply whether it is withdrawn as a pension or as a lump sum.

To avoid double taxation a tax credit should be given for tax already paid by the superannuation fund on deductible contributions and investment earnings. This should operate in the same way as franking credits do today.

There are a number of additional advantages that flow from the treatment of superannuation as deferred income:

- Taxing withdrawals at marginal tax rates provides a simple incentive to draw down what is effectively an annuity. It does not require complex new financial products for deferred annuities or the associated costs of financial advice for some retirees.
- Taxation of lump sum withdrawals at marginal rates provides a disincentive for retirees to draw down their superannuation as a lump sum. Many who do this quickly spend these funds and then draw on the government age pension.
- Inclusion of withdrawals from superannuation as taxable income would result in other investment earnings from savings outside superannuation being taxed at marginal tax rates.

A corollary of defining superannuation as being deferred income is defining what it is not.

Superannuation should not be used for taxpayer subsidised estate planning.

One of the challenges that the Productivity Commission has noted is that retirees do not draw down on the capital in their superannuation. In 2019 about 20% of amounts paid from superannuation accounts were an inheritance or bequest. This percentage is expected to grow.

As a result, on death these balances are inherited by or bequeathed to the beneficiaries of their estate. The effect of this is that this deferred income is never taxed. This outcome is not equitable.

[6] Maurp, Paolo et al., A Modern History of Fiscal Prudence and Profligacy, IMF Working Paper WP/13/5, International Monetary Fund, January 2013, accessed 27 March 2023

[7] Denniss, Richard, Peter Costello's five most 'profligate' decisions as treasurer cost the budget $56bn a year, Australian Institute, 15 April 2015

As the Grattan Institute has noted, under our current system 'the [tax] concessions are basically subsidising inheritances.'[8] The Productivity Commission has noted that if this is not addressed the superannuation system's 'role in intergenerational wealth means it will play a growing role in wealth inequality.'[9]

To address this, any deferred income (i.e. concessional contributions and investment earnings, but excluding non-concessional contributions) retained in superannuation at death could be either (a) taxed in the hands of beneficiaries at their marginal tax rate or (b) subject to a flat tax rate, say 30%, in the same way as annual leave retirement benefits are taxed. This tax liability would be subject to tax credits for the tax already paid by the superannuation fund on investment earnings. A third alternative is that the balance of the superannuation fund could be transferred without tax to beneficiaries' superannuation funds.

Superannuation should also not primarily be a tax minimisation scheme. The Retirement Income Review found that 'large balances are held in the superannuation system mainly as a tax minimisation strategy, separate to any retirement income goals'[10] with 'At least half of the participants … using tax minimisation strategies'.[11]

Focusing on superannuation as deferred income highlights another issue that should be addressed – the role of self-managed super funds (SMSFs) in our superannuation system.

Given the objective of superannuation is to allow people to defer income until retirement, it is important that their investments are managed appropriately. Although SMSFs should have an investment strategy, it is not clear that this occurs in practice. SMSFs are not prohibited from carrying on a business, are allowed to negatively gear assets, can lack asset diversification, and can lack liquidity. These practices increase the risk that the SMSF will not have sufficient assets or liquidity to fund their members' retirements. Some of these practices are at risk of breaching the sole purpose test. Anecdotally, it would appear that some SMSF directors are ignoring, or not capable of fulfilling, their duties as trustees. This is compounded by inadequate compliance and supervision and a lack of appropriate consequences for breaches of SMSF trustee responsibilities.

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[8] The Age, Debate rises on super tax concessions, 25 February 2023
[9] Productivity Commission (2018) p3
[10] Australian Government, The Treasury, Retirement Income Review, Final Report, July 2020 p244
[11] Retirement Income Review (2020) p426

Reduce the cost to the Government

The second problem that the superannuation system is intended to address is the cost to taxpayers of providing an ageing population with a taxpayer funded pension.

Australia's superannuation policy should be designed to compel or encourage the majority of Australians to take personal responsibility for funding their retirement and not require age pension welfare payments to be provided by the government.

There are two elements to this.

- Firstly, ensuring that the value of the tax concessions provided for superannuation is less than the cost of an age pension. This test applies both at in relation to the cost to the government of the superannuation tax concessions in aggregate and to the benefits provided to an individual.
- Secondly, reducing the cost of the taxpayer funded pension by ensuring it is appropriately targeted at those who need it.

Cost of Tax Concessions

It is axiomatic that in addressing the second problem – the cost to taxpayers of providing the age pension –the cost of any taxation incentives implemented to encourage Australians to take personal responsibility for funding their retirement should be lower than the cost of the alternative of providing them with an age pension. This should be a key design principle reflected in the objective established for Australia's superannuation system.

The Treasurer has highlighted that 'we're on track to spend more on super tax concessions than the age pension by around 2050.'[12] This represents a failure in Australia's current policies for taxation of superannuation.

These tax concessions include:

- A 0% rate of income tax on withdrawals for superannuation funds in pension mode.
- A 0% rate of tax on income tax and CGT on investment earnings for superannuation funds in pension mode.
- Deductibility for superannuation contributions of up to $27,500 per annum (appropriate if this income is then taxed when withdrawn from superannuation).
- A flat 15% tax on contributions for people whose income is less than $250,000 (including the concessional superannuation contribution). This flat tax is concessional for all tax payers except those earning less than $18,200.
- A flat 30% tax on contributions for people whose income (including the concessional superannuation contribution) is greater than $250,000.
- A maximum rate of 15% on investment earnings from the investment of concessional and non-concessional contributions irrespective of a person's level of income or wealth.
- Contrary to the principles of our progressive income tax scale the benefit from these flat tax rates ***increases*** as a taxpayer's taxable income, and therefore marginal tax-rate, increases.

In keeping with the spirit of evidence-based policy the government should outline why tax concessions are required for compulsory contributions to superannuation. As has been noted by economist Chris Richardson 'You don't need to provide huge incentives for mandated saving.' [13]

Notwithstanding that superannuation contributions are compulsory, if it is accepted that taxpayers do need to be provided with a tax incentive as a result of the deferral of income, the tax benefit should be

[12] Australian Financial Review, 'One fact stands out': Chalmers targets tax breaks for super, 23 February 2023
[13] Australian Financial Review, Richardson, Chris, How to make prosperity and fairness the purpose of super, 23 February 2023

proportional to the age pension avoided. From 20 March 2023 the age pension is approximately $27,664 per year for a single or $41,700 per year for a couple ($20,850 per year for each person).

If policy is not designed with this objective in mind then taxpayers are worse off as the cost of the tax concessions for superannuation will exceed the cost of the age pension to the government. That is just dumb policy.

The Australian Institute[14] has reported that the annual cost of these superannuation tax concessions is $52.6 billion. Their report describes that in substance we have 'two classes of state-funded retirees in Australia, both costing the taxpayer roughly the same amount': those receiving the taxpayer funded age pension and those receiving taxpayer funded tax concessions for superannuation.[15]

The report concludes that 'The current system is not taking pressure off the budget to provide a dignified retirement for all Australians'.

The Association of Superannuation Funds of Australia (ASFA) has presented an alternative view.[16] Their report concludes that actual annual costs of superannuation tax concessions is about half the reported total, with about a quarter of the value of superannuation tax concession offset by a direct saving in the age pension expenditure and a further quarter which would 'leak' to other tax-advantaged vehicles (which includes negative gearing, and CGT-free housing).

However, even based on the results presented in the ASFA research, the cost of superannuation tax concessions are still almost 230% of the savings in age pension expenditure.

Neither the Australia Institute report nor the AFSA report highlight the key issue: the value of tax concessions provided to people during the 'decumulation' phase.

Treasury has noted that '46 per cent of the benefit of earnings concessions goes to people aged 60 or older'.[17]

Former Secretary to the Australian Treasury Ken Henry, expands on the consequences of this: 'this is going to become an increasingly big problem because as this population ages and the Baby Boomers move into retirement the earnings from superannuation funds will be more two-way with a … pension phase, rather than just an accumulation phase. … the cost of these concessions is going to increase very rapidly, [and it] should be removed.'[18]

We agree with Henry's conclusion: 'it's a complete nonsense'.

It is clear that the current failure to tax superannuation for retirees is financially unsustainable as well as inequitable. In addition the failure to tax superannuation withdrawals results in what Henry has described as an 'extraordinary intergenerational inequity'. [19]

Our superannuation system will only be fair, equitable and sustainable, where the cost to current taxpayers is lower than the cost of providing the age pension (a minimum basic income) to retirees.

These matters need to be reflected in the objective that is established for Australia's superannuation system.

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[14] Dennis, Richard and Richardson, David, Super Tax Concessions now on par with Entire Aged Pension, Greater than NDIS: Research, Australia Institute, 3 February 2023, accessed 27 March 2023

[15] Dennis, Richard and Richardson, David, Self-funded or State-funded Retirees? The cost of super tax concessions Australia Institute, February 2023, accessed 27 March 2023

[16] Clare, Ross, Mythbusting superannuation tax concessions, ASFA Research and Resource Centre, March 2016, accessed 27 March 2023

[17] Australian Financial Review, Chalmers won't find it easy to get his hands on $250b of tax breaks, 28 February 2003 and Capital gains tax breaks cost the most but Chalmers targets super, 28 February 2003

[18] Australian Financial Review, Not indexing super cap is tax jump by stealth: Henry, Friday 17 March 2003, p4

[19] ibid

Age pension

Operating alongside private savings and superannuation, the age pension is the third pillar of Australia's retirement income system.

In considering whether the superannuation system, including the tax concessions, provides sufficient incentive to encourage Australians to take personal responsibility for funding their retirement and not rely on the taxpayer funded age pension, it is necessary to consider the basis on which an age pension is paid to people.

There will always be circumstances where some taxpayers require government support in their retirement. The Retirement Income Review noted that 'Stakeholders widely endorsed equity as an important principle of the retirement income system.'[20] As a result, where despite compulsion and tax-concessions, people have not been able to save sufficient amounts to fund their own retirement, for social equity reasons Australians want to ensure that society, taxpayers collectively, provides them with a minimum standard of living.

The Review recommended that the age pension:

> 'should ensure a ***minimum standard of living*** for retirees with ***limited financial means*** that is consistent with prevailing community standards.'[21] (emphasis added)

The Department of Social Services notes that:

> 'The Age Pension is designed to support the ***basic living standards*** of older Australians. … It is targeted through the means test to ***those who need it most***.'[22] (emphasis added)

However currently the age pension is neither paid to 'those who need it most' or providing only a 'basic' or 'minimum standard of living' for retirees with 'limited financial means'.

A retiree household with up to $419,000 of non-housing assets and a house of unlimited value is entitled to a full age pension.[23] This level of assets would place this household in at least the top 40% of households by wealth in Australia.[24] Further a retiree household can have up to $954,000 of non-housing assets before they are cut off from the age pension.[25]

In addition, the value of a person's principal place of residence is excluded from the age pension asset test. With the average price of residential dwellings in Australia of $881,000 (at Dec 22), this means that Australian taxpayers are in many cases funding the payment of an age pension to millionaires.

In some cases the age pension provides individuals with a higher income than they earned in their working years.

The government should review the amount of and eligibility for the age pension to ensure that they are consistent with the recommendation of the Retirement Income Review and the objective outlined by the Department of Social Services.

This review could also address gaps in the current age pension coverage. There are clearly some groups that could benefit from greater government assistance through the age pension. The Department of

[20] Retirement Income Review (2020) p29
[21] Retirement Income Review (2020) p28
[22] Australian Government, Department of Social Services , Age Pension Purpose of payment/benefit, accessed 27 March 2023
[23] Services Australia, Assets test, accessed 27 March 2023
[24] The average household net worth in 2019-20 (excluding residential dwelling and land) for the fourth equivalised net worth quintile was $318,713. Source: Australian Bureau of Statistics, 5204055011 Australian National Accounts: Distribution of Household Income, Consumption and Wealth, 2003-04 to 2021-22, Table 1.9. Household (excluding non-profit institutions serving households) Income, Consumption and Wealth, by household distributional indicator, $millions, current prices, 2019-20 (https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-distribution-household-income-consumption-and-wealth/latest-release)
[25] Services Australia, Assets test, accessed 27 March 2023

Social Services has noted that these include single people (disproportionately single women) and private renters.

The Retirement Income Review also highlighted that many people, including those on the age pension, are leaving substantial inheritances or bequests to their descendants. Axiomatically, a retiree who leaves an inheritance or bequest to descendants has not utilised their existing financial resources and if they received a taxpayer funded age pension, then the amount of the pension paid to them exceeded what they needed to have a basic or minimum standard of living.

It is also notable that age pensioners receive an inflation-indexed increase to their taxpayer funded pension every six months whereas for the last two years employees have experienced declining real wages.

It is not fair or equitable that age pensioners should be receiving an inflation-indexed pension funded by taxpayers whose real incomes are declining.

A government provided age pension also introduces a moral hazard. People are less likely to save for their own retirement if they are aware that the government will provide them with a basic income. Because of this moral hazard, many retirees have come to see a taxpayer funded age pension as an entitlement rather than welfare. This has resulted in a range of sub-optimal responses:

- Pensioners have been encouraged to draw down their assets as a lump sum and spend this to become eligible for the taxpayer funded age pension.
- As there is no financial cap on the asset test exemption for a pensioner's primary residence, pensioners have been encouraged to deliberately over-invest in their primary residence. This has had a secondary effect of reducing the supply of housing as pensioners are reluctant to downsize, as this would increase their financial assets and reduce the amount of age pension for which they are eligible.
- Product complexity has resulted from allowing some financial products to be fully or partially asset test exempt, enriching advisors but generating no value for society.

The cost of a government provided age pension is unsustainable, particularly as the population ages. The October 2022-23 Commonwealth budget papers highlight that assistance to the aged, including the age pension is the biggest component of social security. [26] A recent working paper by the ARC Centre of Excellence in Population Ageing Research has projected that the population aged 65+ will increase 54% over the next two decades. [27]

Of the total assistance to the aged, the value of the age pension program has been reported to be $55.3 billion. [28] This is still the case despite the superannuation system having been in place for over 30 years since it was established in 1992.

Some appropriate measures have been taken to address the growing cost of the age pension including restricting eligibility for the age pension by increasing the eligibility age to 67 and progressively tightening the means test.

However despite higher eligibility ages, tighter asset tests, income tests and deemed income from financial investments, assistance to the aged is forecast to grow by 34% over the period from FY22 to FY26.

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[26] The Treasury, Budget October 2022-23, Budget Paper No.1, Statement 6: Expenses and Net Capital Investment, Table 6.9: Summary of expenses – social security and welfare, p189, accessed 27 March 2023

[27] Wilson, Tom and Temple, Jeromey, New Population Projections for Australia and the States and Territories, with a Particular Focus on Population Ageing, ARC Centre of Excellence in Population Ageing Research, November 2022, accessed 27 March 2023

[28] Dennis, Richard and Richardson, David, Super Tax Concessions now on par with Entire Aged Pension, Greater than NDIS: Research, Australia Institute, 3 February 2023, accessed 27 March 2023

Retirees currently receive an inequitable level of tax concessions and benefits. These include:

- Tax-free withdrawals from superannuation
- Tax-free investment earnings on superannuation balances to $1.7 million ($1.9m from 1 July 2023)
- Inflation-indexed age pensions
- tax-free capital gains from housing
- fully refundable franked dividends
- exclusion of housing from the age pension asset test
- treatment of some financial assets as fully or partially exempt from the age pension asset test
- eligibility for a Commonwealth Seniors Health Card, without an asset test, for incomes up to $90,000 for a single or $144,000 for a couple
- concessions on health, prescriptions, dental and optometry
- Energy discounts

In addition, the over-65s incur a disproportionate amount of Australia's expenditure on health costs. The Productivity Commission has estimated that the average expenditure for those aged 65 and above is three times greater than that for those aged under 65.[29] The budgetary impact of this will only increase as Australia's population continues to age.

The age pension currently is not targeted to those in need and has become middle class welfare. It results in an inequitable distribution of income and wealth from those who are working to those who are retired.

To address these challenges the government could:

- More closely target the age pension at those in the bottom quartile of income and wealth.
- Include the value of the family home in the asset test in full, or above a certain value (e.g. $600,000).
- Include dental costs in Medicare for those over 65. This appears to be one of the key contingencies causing people to be reluctant to draw on their assets.
- Phase out the pension supplement and energy supplement by incorporating them into any proposed future increases.
- Consider introducing a HECS style scheme where a portion of taxpayer funded age pension benefits (say 50%) are repayable from a person's estate.

The adverse impact of both the current eligibility criteria for the age pension and the amount of the age pension on people's incentives to take personal responsibility for funding their retirement, need to be considered in establishing an objective for Australia's superannuation system.

[29] Productivity Commission, Health costs and policy in an ageing Australia, 26 June 2008, accessed 27 March 2023

Measure and report the outcomes

It is an indictment on the transparency of our current superannuation policy (and the broader retirement income policy) that the government is not required to regularly report clear information on the cost to taxpayers of our superannuation and age pension policies.

It should not require the Australian Institute and the Association of Superannuation Funds of Australia to commission reports on this, and with open and transparent information it should not be possible for these two bodies to reach differing conclusions. There is no such thing as 'alternative facts'.

To prevent this, and to enable government, and taxpayers, to assess whether the superannuation system, and Australia's retirement income system of which it forms part, are operating effectively, the superannuation policy should have clear measures of what a successful outcome looks like.

These should include the following:

- The scale of the tax concessions provided should be measured against an alternative policy of paying every retiree a minimum basic income (i.e. a full age pension) with no tax concessions for superannuation contributions and earnings.
- The number of taxpayers receiving tax concessions in any year where the amount of the concession exceeds the cost of providing a full age pension.
- The policy of providing tax concessions when contributions to superannuation are compulsory should be supported by evidence both on why it is required, and the level of incentive that is needed.
- Targets and outcomes for the proportion of people who have taken personal responsibility for funding their retirement and do not rely on the taxpayer funded age pension.
- Targets to only provide the age pension to those who have been unable to save for their own retirement. For example, the age pension could be targeted so that it is only paid to those in the lowest quartile of income or wealth.

Recent policy measures

Since the release of the consultation paper, the government has announced that in addition to an income test for the 30% tax rate on superannuation earnings, it will also introduce a wealth test in which superannuation balances above $3 million will be taxed at 30%.

In principle we support this proposal.

As the AFR has noted '$3 million or more for an individual retirement is beyond any need for a taxpayer subsidy or incentive.'[30]

Whilst it is appropriate to include unrealised gains in calculating the $3 million balance, a contentious issue appears to be the method for calculating income and the inclusion of unrealised gains in taxable income. The current proposal is neither fair nor reasonable. In addition it adds complexity by introducing an inconsistent taxation treatment for unrealised capital gains.

A simpler approach would be to apply the same taxation rules for all income and then apportion the total income attributable to balances under and over the $3 million threshold.

Consideration could also be given to expanding the policy by requiring or allowing the withdrawal of previous non-concessional contributions where a superannuation balance exceeds $3 million.

[30] Australian Financial Review, Labor's super tax caps strike a fair balance, 1 March 2023

Consultation questions

1. **What do you see as the practical benefits or risks associated with legislating an objective of Australia's superannuation system?**

The consultation paper notes that the proposal to legislate an objective for Australia's superannuation system arose from Recommendation 9 in the 2014 Financial System Inquiry Report.

> *Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.*

Legislating an objective for Australia's superannuation system will only be effective if there is a clear articulation and understanding of what problem superannuation is solving. A focus on the problem to be solved is the only way to have a solid foundation for the policy responses.

As the Retirement Income Review noted 'A vague, ambiguous objective that is open to interpretation will not provide the guidance required'.[31]

In this submission we have outlined that there are two problems that the superannuation system is seeking to address.

Firstly, behavioural biases which result in people not saving sufficiently for their retirement. The superannuation framework addresses this by both withholding compulsory savings from income and concessional taxation of savings and investment earnings in superannuation. Implicit in this problem statement is the concept of 'sufficiency'. At a certain level either further compulsion and/or concessional tax treatment for superannuation withdrawals, investment earnings and contributions are no longer required.

The second problem is the growing cost to taxpayers, and the resulting inter-generational inequity, that results from tax concessions provided to superannuation particularly with an aging population. This is exacerbated when the proportion of the population still receiving the age pension and other government support remains high.

The consultation paper states that 'clarification of the objective of superannuation in law will provide a shared understanding of the role of the superannuation system…'. It is not clear why this would occur unless there was bipartisan support - *broad political agreement* - for the legislated objective.

Without broad political agreement there would appear to be little benefit from legislating an objective for superannuation as a subsequent government could simply amend the legislation to change the stated objective.

The consultation paper notes that the Retirement Income Review found that the objective 'has to be agreed and endorsed by the Australian community through the Government'. We do not believe it is correct to claim that an objective legislated by a government without bipartisan support – without *broad political agreement* –has been 'agreed and endorsed by the Australian community'.

[31] Retirement Income Review (2020) p90

2. **Does the proposed objective meet your understanding of the objective of the superannuation system in Australia?**

The consultation paper has requested feedback on the following proposed objective:

> *The objective of superannuation is to* ***preserve savings*** *to* ***deliver income*** *for a* ***dignified*** *retirement, alongside* ***government support****, in an* ***equitable and sustainable*** *way*.

While the wording rationale set out in the consultation paper is admirable, this definition unintentionally perpetuates some of the problems with the current system.

'to ***preserve savings****…'*

The consultation paper correctly notes that superannuation should not be accessed unless for the purpose of providing income in retirement, other than in exceptional circumstances. However, the inclusion of an objective to ***preserve savings*** perpetuates an issue highlighted in the Retirement Income Review which noted (in bold) that '**A common theme throughout this report is that the focus is on the accumulation phase of the retirement income system and insufficient attention is given to the retirement phase.'**[32]

The consultation paper makes this same mistake. An objective to ***preserve savings*** is only relevant in the accumulation phase of the superannuation system. During the decumulation phase post retirement preservation of savings should obviously not be an objective of the superannuation system.

The Retirement Income Review noted that 'retirees tend to hold on to their assets and leave significant bequests' [33] and 'tend to consume only the income derived from assets and not the assets themselves.'[34] The taxation at marginal tax rates of superannuation payments after retirement, as proposed in this submission, would encourage the drawdown of superannuation balances.

Given that the objective for the superannuation system should be relevant to both the accumulation and the decumulation phases of superannuation it does not seem appropriate for a legislated objective to include an objective *to* ***preserve savings***.

'to ***deliver income****…'*

The consultation paper correctly notes that 'deliver income' captures the purpose of the superannuation system.

The consultation paper further notes that '*The focus on delivering income makes clear that the purpose of superannuation is not for minimising tax on wealth accumulation or enabling retirees to leave tax-effective bequests.*'

However, these exclusions are implicit and do not necessarily follow from the objective to 'deliver income'. Whilst the consultation paper is looking for a succinct definition consideration could also be given to explicitly defining those activities which are specifically ***not*** the purpose of superannuation, including wealth accumulation and provision of tax-free inheritances or bequests to beneficiaries.

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[32] Retirement Income Review (2020), p56
[33] Retirement Income Review (2020), p56
[34] Retirement Income Review (2020), p432. These findings of the Retirement Income Review are consistent with personal experience, however they have been disputed by the Association of Superannuation Funds of Australia (ASFA) in its paper Superannuation balances prior to death (March 2021)

*'for a **dignified** retirement…'*

This element of the objective for superannuation attributes to the superannuation system something that is an objective of the total retirement income system.

The superannuation system can never, of itself, necessarily result in a *dignified retirement*. The adequacy of a person's superannuation savings will be dependent on a range of factors including the amount of time a person spends in the workforce, their rate of pay, the amount of time before retirement in which the work occurs, and the person's risk appetite and resultant investment choices.

Superannuation will never provide a sufficient balance for a *dignified retirement* for a person who works part-time, on basic wages, with career breaks, and invests in cash or conservative funds.

The consultation paper also proposes that 'individuals deserve a high-quality standard of living in retirement…'. The consultation paper further argues that this 'high-quality standard of living' should be provided 'by both the superannuation system and government support.'

It is not clear what is intended by these statements. Retired individuals are no more deserving of 'a high-quality standard of living' than any other Australians. It is not the responsibility of the superannuation system including its tax concessions, to fund a 'high-quality standard of living' for retirees. This is the responsibility of the individuals themselves.

It is certainly not the responsibility of taxpayers to fund a 'high-quality standard of living' for retirees. The age pension (alongside other government support) should be a welfare payment for those individuals who have been unable to save sufficient funds for their retirement.

This welfare payment is provided for social equity. But, as recommended by other reviews, taxpayers should only provide a 'basic' or 'minimal' standard of living for retirees who have been unable to adequately provide for their retirement, not a 'high-quality standard of living'.

Currently, in an environment in which real wages are declining, retirees receive an inflation-indexed age pension, tax-free superannuation, taxpayer funded health care (but pay no medicare levy), subsidised pharmaceuticals and reduced charges on many expenses including rates, telephone, energy, car registration and transport.

Delivering a *dignified retirement* should ***not*** be an objective of the superannuation system.

A better objective, but one for the retirement income system as a whole, would be a broader goal of 'reducing poverty in retirement'.[35]

*'alongside **government support**…'*

This element of the objective for superannuation also attributes something that is an objective of the total retirement income system to the superannuation system.

We have noted that one of the problems that superannuation ought to be trying to solve is the cost to taxpayers of the age pension, particularly with an aging population.

Our current system allows a person to receive a taxpayer funded age pension despite the fact that they have substantial balances in superannuation and choose to consume only the income derived from their assets and not the assets themselves. This also diminishes the perception that the age pension is welfare and reinforces the perception that it the age pension is an entitlement even though for some taxpayers it exceeds the 'taxes they've paid all their life'. A result of this is that, rather than utilising their

[35] A variation of this point was recently made by economist Chris Richardson in his article in the Australian Financial Review, How to make prosperity and fairness the purpose of super, 23 February 2023

own financial assets to fund their retirement, taxpayers are providing tax concessions (and an age pension) which have the effect of funding bequests to wealthy beneficiaries.

This is neither fair and equitable nor sustainable.

As a result delivering income *alongside government support* should not be an objective of the superannuation system. A better objective would be to deliver income to ***replace*** or ***minimise*** government support.

*'in an **equitable** … way*.'

The consultation paper correctly highlights the importance of delivering similar outcomes to people in similar situations. However equity does not apply just to the superannuation system, or even to the total retirement income system. An equitable outcome is only achieved if the taxation of retirees is equitable relative to the taxation of those who are working.

This should be an important element of the objective for superannuation and retirement income policy. But clearly this is not the situation currently.

As noted in the example above a retiree receiving a tax-free superannuation pension with investment income just below the tax free threshold pays no tax. By contrast a person working and earning the same level of income would pay almost $10,000 in income tax. This is simply not equitable.

The consultation paper is right to note that support, and particularly taxpayer funded support, should be targeted 'to those most in need.' However this is not achieved under current policies.

A retiree household whose wealth would place them in at least the top 40% of households by wealth in Australia is entitled to receive a full age pension.[36] With the exclusion of the family home from the asset test Australian taxpayers are in many cases paying an age pension to millionaires. Some reports have calculated, using Treasury information, that those in the 70th income percentile are still receiving an age pension.[37]

This is not an equitable allocation of taxpayer resources.

As a rule of thumb a taxpayer funded age pension could be limited to those whose income or wealth is in the bottom quartile of Australian households.

*'in [a] … **sustainable** way*.'

The consultation paper notes that 'the system should be robust to demographic, economic and social change, and should be cost-effective for taxpayers in achieving retirement outcomes.' It adds that 'Beyond a certain level of income, additional Government support through tax concessions is not necessary or appropriate.' We agree with this.

[36] A retiree household with up to $419,000 of non-housing assets and a house of unlimited value is entitled to a full age pension. A retiree household can have up to $954,000 of non-housing assets before they are cut off from the age pension (Source: Services Australia, Assets test, accessed 27 March 2023). The average household net worth in 2019-20 (excluding residential dwelling and land) for the fourth equivalised net worth quintile was $318,713. (Source: Australian Bureau of Statistics, 5204055011 Australian National Accounts: Distribution of Household Income, Consumption and Wealth, 2003-04 to 2021-22, Table 1.9. Household (excluding non-profit institutions serving households) Income, Consumption and Wealth, by household distributional indicator, $millions, current prices, 2019-20 (https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-distribution-household-income-consumption-and-wealth/latest-release), accessed 27 March 2023)

[37] Macrobusiness, Figure 4: Lifetime government support provided through the retirement income system, https://www.macrobusiness.com.au/2023/03/shed-a-tear-for-wealthy-boomers-hit-by-3m-superannuation-cap/, accessed 27 March 2023

This element of the objectives is linked to the question of what problem superannuation is trying to solve. Currently both the scale of the tax concessions provided for superannuation and the amount of the age pension and the breadth of eligibility mean that neither the superannuation system nor Australia's broader retirement income system are sustainable.

<u>Financial System Inquiry Superannuation Objective</u>

The FSI recommended that the objective of the superannuation system should be *'to provide income in retirement to substitute or supplement the Age Pension.'* [38]

This objective describes the primary purpose of the superannuation system. It partially addresses the question of 'what problem are we trying to solve' by noting that superannuation is intended to '*substitute or supplement the Age Pension'*.

However it does not go far enough to address ***adequacy***. This definition does not explicitly note that there should be a limit to the income that the concessionally taxed superannuation system provides and the value of the tax concessions provided.

It could go further in addressing ***sustainability*** by noting that superannuation should not just *substitute or supplement the Age Pension* but ultimately, along with private savings, replace the age pension and be the primary source of retirement income for the majority of the population.

<u>Retirement Income Review Superannuation Objective</u>

The consultation paper noted that the Retirement Income Review recommended the objective of the superannuation system should be *'to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way'*.[39]

This statement in the consultation paper is not accurate. The Review did ***not*** propose this as an objective for the superannuation system. It noted that delivering '*adequate standards of living in retirement'* should be an objective of the ***total retirement income system***[40] which includes private savings, the age pension and other government benefits, as well as superannuation.

This objective does ***not*** describe the primary purpose of the superannuation system.

It is not the purpose of superannuation alone to deliver an *adequate* (or alternatively a *basic* or *minimum*) *standard of living in retirement*. A defined contribution scheme cannot do this. The ability to generate a sufficient asset base to fund a *minimum* or *adequate* standard of living is dependent, as noted earlier, on a range of factors.

The focus on ***equity*** in this definition is admirable. But equity should not just be about providing similar outcomes for retirees in similar circumstances. Equity means that people with similar income – whether they be working or retired – should experience a similar incidence of taxation. That is clearly not the case currently, with large and inequitable differences between the tax paid by a superannuant and that paid by a working person earning a salary or wages.

The focus on ***sustainability*** in this definition is also valuable. It addresses the question of 'what problem are we trying to solve?' For a superannuation system to be sustainable (and equitable) the cost to taxpayers of concessions for superannuation should not exceed the cost for taxpayers of providing a basic income (the age pension).

[38] The Australian Government, The Treasury, Financial System Inquiry, Final Report, November 2014, p 95
[39] Australian Government, The Treasury, Legislating the objective of superannuation, Consultation paper, 20 February 2023, p8
[40] Retirement Income Review (2020) pp 17, 28 & 90

In this submission we have outlined that we believe the objective of the superannuation system should be to enable people, through compulsory contributions of earnings and concessional taxation of additional superannuation contributions and investment earnings, to defer taxable income earned during their working lives and receive this taxable income when they have retired.

A further objective should be to ensure that people have saved sufficient balances to fund their own retirement so as to minimise the obligation of taxpayers to provide people with an age pension, so that the taxpayer funded age pension is restricted only to those who need it to reduce poverty in retirement by providing a minimum standard of living when they lack sufficient superannuation or personal savings.

3. Is the proposed approach to enshrining the objective in legislation appropriate? Are there any alternative ways the objective could be enshrined?

As the consultation paper has noted, repeated reviews of Australia's superannuation system have recommended that the objective of superannuation should be clearly stated. The only thing that is surprising is that this is still outstanding in 2023.

The proposal to locate the objective in existing superannuation legislation (such as the *Superannuation Industry (Supervision) Act 1993*) is appropriate. Including a clear statement of the objective of the superannuation system in legislation would be more effective if the legislative objective is also clearly framed in terms of the problem that the legislation is trying to address.

However a clear statement of objective, even if clearly linked to the problem being addressed, is not sufficient. There also needs to be a clear statement of what specific measures will be used to assess the success of the legislation in solving the problem identified.

The consultation paper claims that a legislated objective will provide 'stability', 'confidence', 'certainty' and a 'shared understanding'. It also claims that it will be 'forward-looking' and provide 'greater focus' and 'encourage individuals to think…'.

The only thing that these benefits have in common is that none of them are measureable.

The Australian Bureau of Statistics has noted that 'The impact of policy can be measured with good statistics. If policy cannot be measured it is not good policy.'[41]

Paraphrasing this principle, if the achievement of the legislated objective of superannuation cannot be measured, it is not a good objective.

4. What are the practical costs and benefits of any alternative accountability mechanisms to the one proposed?

Recommendation 9 in the FSI Report included a proposal to '*report publicly on how policy proposals are consistent with achieving these objectives over the long term.*'[42]

The consultation paper proposes that the legislated objective for the superannuation system would be assessed using 'existing policy development and parliamentary scrutiny processes' to provide the checks and balances. This is the only practical process that can be adopted.

However the consultation paper appears to suggest that this would only be used for proposed future changes to the superannuation system.

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[41] Othman, A 2005, 'The Role of Statistics in Factual-Based Policy-Making', *Journal of the Department of Statistics, Malaysia*, Vol. 1, pp 1-16 as cited at Australian Bureau of Statistics, 1500.0 A guide for using statistics for evidence based policy, 2010, accessed 27 March 2023

[42] Financial System Inquiry (2014), pp xxiii, 95, 98

Based on the paraphrased ABS principle, that 'if the achievement of the legislated objective of superannuation cannot be measured, it is not a good objective', there is an opportunity to enhance the accountability and assessment mechanisms and include a regular report to the parliament and the people on the current superannuation system and not just future changes.

Unless there is clarity that the two problems outlined in this paper are the problems being solved it will not be possible to have meaningful reporting on how the policies are addressing these problems.

A key measure for the first problem (addressing the present bias), particularly given compulsory savings through the SGC, is the economic cost of the concessional tax treatment of contributions to superannuation and investment earnings in superannuation compared with the economic cost of the age pension payments avoided.

Key measures for the second problem (reducing the cost to the government of age pension payments) are a reduction in the proportion of the population receiving the age pension, and clarity that, in the context of the total retirement income system, the age pension is only going to those who most need it – say, the lowest quartile of the aged population by income or wealth.

While the headline numbers of the cost of the age pension and the cost of the tax concessions for superannuation are of some value, they are not sufficiently detailed to inform taxpayers on how their taxes are being spent and to who the tax concessions are provided.

The relative cost of superannuation tax concessions compared with the age pension is central to a determination of the fairness and effectiveness of Australia's superannuation system. An effective accountability and assessment mechanism should include detailed information on this.

More granular information could be provided, for example, on the number of taxpayers who receive a superannuation tax concession on contributions, earnings and / or tax-free withdrawals which is greater than the cost of the age pension ($27,664 as at 20 March 2023).[43]

The introduction of an asset test ($3 million) alongside the income test ($250,000) at which a 30% tax rate applies to superannuation has been widely recognised as a sensible reform. This change supports the creation of a sustainable superannuation system. Together these measures, in addition to lifting the age at which people are entitled to the age pension, ensure that for the majority of people, the cost of the tax concession for superannuation is less than or reasonable relative to the age pension.

There are three exceptions.

The largest inequity arises for retirees with superannuation funds greater than $5 million for whom the tax foregone on the superannuation investment earnings significantly exceeds the cost of an age pension for that person, making tax payers significantly worse off as a result of the revenue foregone.

A second is the 'extraordinary intergenerational inequity'[44] which results from the failure to tax superannuation payments to and earnings of retirees. This is financially unsustainable as well as inequitable. It should be measured and reported on annually.

The third is defined benefit schemes. It is important that, in order to both be and be seen to be fair, that restrictions on tax concessions for defined contribution superannuation funds are applied to defined benefit schemes, such as those of which members of parliament, judges and others are members. Reports that the current and former prime ministers receive a superannuation benefit of $10 million completely undermine the government's credibility. It should not have taken a television interview for the government to commit to review this excessively generous scheme. It is also notable that a

[43] Calculated as 26 fortnights of the total fortnightly payment for a single of $1064 (including the maximum basis rate, pension supplement and energy supplement) as reported by Services Australia, How much you can get, accessed 27 March 2023

[44] Australian Financial Review, Not indexing super cap is tax jump by stealth: Henry, Friday 17 March 2003

commitment to *review* the scheme is not the same as a commitment to *change* the scheme so that it operates in a way that is consistent with defined contribution superannuation schemes.

Thank you for the opportunity to provide our views on the proposal to legislate an objective for superannuation.

We would be pleased to discuss any of the matters noted in this submission.

Yours sincerely

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