THE POWER OF SUPERANNUATION: ENHANCING AUSTRALIA'S RETIREMENT INCOME POLICY FOR THE 21ST CENTURY

Australia's retirement income policy has been a focus of the Commonwealth Government since Federation, evolving to consist of three main components or 'pillars': a taxpayer-provided Age Pension, a privately managed compulsory superannuation scheme through the superannuation guarantee charge (SGC), and a voluntary retirement savings system incentivized by concessionality in the taxation system.[1] As Australia's 'baby boom' generation, those born in the two decades following World War II, have moved into retirement, the Australian federal government has faced the challenge of shaping a retirement income policy that enables its ageing population to retain an adequate standard of living against the backdrop of appertaining structural economic changes in the labour market and its effect on fiscal policy in the 21st century for future generations.[2] The current government's retirement policy, characterized by its objectives of sustaining the Age Pension budget and limiting superannuation tax concessions[3], provides a short-term strategy to a multi-layered issue. A long-term approach that better deals with the intergenerational consequences of ageing would include a two-pronged solution that serves to strengthen the superannuation pillars of Australia's retirement income policy.

Australia's approach must be based on the values of adequacy, integrity and sustainability, the elements that have ranked Australia's retirement system as the third best in the world in 2015.[4] For adequacy, the federal government ought to raise the superannuation guarantee rate from 9.5 per cent to 15 per cent and manage the 80 to 100 year old superannuation cohort by introducing a Commonwealth Insurance Longevity Scheme – a proposal made by the architect of compulsory superannuation, Paul Keating. For integrity, tax-free superannuation for over 60s should be abolished and tax treatment for annuity payments should be incentivized over lump sums. These superannuation reforms would materialize to become gains in sustainability and thus, would secure Australia's retirement income policy for the 21st century.

However, such proposals have either been dismissed by the government in favour of short-term measures, or have not been raised. Moreover, such actions as delaying any increases in the 9.5% superannuation guarantee rate until 2021 have been shown to be detrimental, despite justification by Finance Minister Mathias Cormann that "workers would get a 2.5% pay cut" if the previously proposed increases went ahead and that as a result, "workers across Australia will keep more of their own money."[5] As ABC's Fact Check revealed, workers are unlikely to receive in wages what they lose in superannuation and even if workers did receive higher wages, many would pay tax at a higher rate than the tax applying to employer superannuation contributions.[6] Furthermore, the Financial Services Council calculated that due to the freeze in the SGC, Australians will have $128 billion less in their superannuation savings by 2025[7], which according to Industry Super Australia, will fall most heavily on Generations Y and Z who enter the workforce after receiving a tertiary education, with the delayed increase draining an estimated $100,000

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[1] Department of the Treasury, "The retirement income system: Report on strategic issues", May 2009
[2] The Productivity Commission, "An Ageing Australia: Preparing for the Future", 2013
[3] SuperGuide, "2016 Federal Election update: What superannuation and retirement policies can you expect?", June 2016
[4] Melbourne Mercer Global Pension Index Report, 2015
[5] The Australian, "Mathias Cormann hits back over union super rise demand", September 2014
[6] ABC Fact Check, "Fact check: Tony Abbott incorrect on impact of superannuation changes on workers", December 2014
[7] Financial Services Council, Media Release: "Super guarantee delay will mean $128 billion less in savings for working Australians", September 2014

in their lifetime retirement savings.[8] Thus, these policies have been counterproductive in solving the challenge of providing for an ageing population in the 21st century.

According to the Productivity Commission's 2013 report "An Ageing Australia: Preparing for the Future", the population aged 75 or more years is estimated to increase by 4 million from 2012 to 2060, rising from about 6.4 to 14.4 per cent of the population. This is expected to be coupled by a fall in the labour participation rate from approximately 65 to 60 per cent from 2012 to 2060. Consequently, it is projected that Australian governments will face additional budgetary pressures equivalent to around 6 per cent of national GDP by 2060, primarily reflecting the growth of outlays on health, aged care and the Age Pension.[9] Thus, the need to cope with Australia's shifting demographics require an urgent response from the federal government, but one that is focused on taking advantage of the opportunities brought about from these changes, predominantly with regards to boosting Australia's national savings and investment.

Australia's pool of superannuation savings is worth more than $2 trillion, which is larger than the size of the entire economy.[10] This vast pool of savings has revolutionised and turbocharged Australia's financial markets, lowered the cost of capital, increased productivity through a higher rate of gross fixed capital formation[11], lowered the infrastructure deficit, put downward pressure on interest rates, decreased the budgetary burden of the Age Pension to the tune of $6 billion[12] and lowered our reliance on foreign debt – one of the reasons Australia avoided the Global Financial Crisis. The benefits of higher savings and investment through superannuation has been a product of its universal component: a mandated, fully funded and privately managed occupational contribution scheme that has partially contributed in enabling Australians to have accumulated the second highest median wealth per adult in the world[13] through the effect of compound earnings on superannuation savings.

When addressing the element of adequacy in retirement incomes, it must be recognized that due to Australia's higher life expectancy, superannuation has been split into two different 'cohorts' – the first phase being from 60 to 80 years of age, and the second phase being from 80 to 100 years of age.[14] For the first cohort, raising the superannuation guarantee rate is vital to turbocharging retirement incomes during this phase. A 9 per cent SGC is not sufficient in aggregate to provide for a replacement rate of 70 to 75 per cent, that is, when one leaves the workforce and starts living off their superannuation capital sum, their annuity income should equal 70 to 75 per cent of the original annual income they earned prior to retirement – this replacement rate has been deemed 'adequate', but the current 9 per cent SGC does not provide this.[15] When Paul Keating first introduced compulsory superannuation in 1992, his intention was to raise the SGC to 15 per cent precisely because it was meant to provide an adequate replacement rate. The notion that increasing the SGC increases costs to employers and lowers the pay of employees may at first seem correct, but this ignores the long-term benefits that superannuation brings about in the areas of productivity and capital formation, both of which negate any short-term costs associated with raising the

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[8] The Herald Sun, "Superannuation freeze deal short-changes future savings, say critics", September 2014
[9] The Productivity Commission, "An Ageing Australia: Preparing for the Future", November 2013
[10] The Association of Superannuation Funds of Australia, "Superannuation Statistics", May 2016
[11] The Association of Superannuation Funds of Australia, Report prepared for ASFA by The Allen Consulting Group: "Enhancing financial stability and economic growth – the contribution of superannuation"
[12] Financial Services Council, Media Release: "Super guarantee delay will mean $128 billion less in savings for working Australians", September 2014
[13] Credit Suisse, "Global Wealth Report", 2015
[14] Paul Keating on ABC's Lateline: "Commonwealth insurance scheme needed for 80-100 year olds", May 2014
[15] Ibid

rate.[16] Thus, to provide adequacy for the first phase of superannuation, the SGC ought to be raised to 15 per cent.

The only systems that exist to provide adequacy for the second cohort of superannuants, those aged 80 to 100, is the first phase scheme and the Age Pension. Since it is not possible to work for 30 years and then live off those savings for another 30 years, the superannuation accumulation phase cannot simply increase to the life expectancy level. As a result, the government must create a scheme for the second cohort of superannuants, who will most likely not earn income or have the ability to manage money. Given that the Commonwealth government is the default insurer with the Age Pension and is the only institution that has the ability to insure across generations and pool resources, Paul Keating has suggested that a 'Commonwealth Insurance Longevity Scheme' should be introduced for those aged 80 to 100, whereby a calibrated and precise product is delivered which guarantees people income support, aged care and aged accommodation.[17] A scheme like this would work as an insurance model, where if one person dies earlier, their work and savings subsidises other people who last into their late 90s, with the system operating and investing in a similar style to the Future Fund.[18] Moreover, a 'longevity levy' equivalent to a certain percentage of one's wages could help fund such a scheme throughout the lifetime of generations.[19] For Australia's retirement system to truly reach a level of long-term adequacy, the government ought to consider managing the second cohort of superannuants through Keating's proposed Commonwealth insurance Longevity Scheme, given that 14.8 percent of seniors[20] and 36 per cent of pensioners[21] currently live in relative poverty, and that number is projected to increase without reform.

Another pillar of Australia's retirement system is that of voluntary savings incentivized by tax concessionality, with this component remaining central for the maintenance of the integrity of Australia's retirement system. Taxation of superannuation has been subject to recent political debate, with both of the major political parties outlining policies designed to make superannuation fairer through limiting tax concessions to higher income earners.[22]However, the focus of the debate has not been centred as much on the 'leakages' of the system than it should, given these 'outflows' corrupt the integrity, functionality and overall efficiency of Australia's retirement system. Policies in the past have degraded the superannuation system to such an extent that the actual purpose of superannuation – a system designed to provide for a secure retirement – has been put into question.[23] Perhaps the greatest flaw in the taxation of superannuation is the way in which the system provides no incentive to take out an annuity. This has enabled retirees to withdraw their superannuation savings as a lump sum, spend it on whatever they wish without being subject to any tax, and then become automatically entitled to the Age Pension, putting enormous strain on the government's finances and utterly defeating the purpose of superannuation as a retirement income system. To minimize this leakage, the government ought to reverse its policy of making superannuation tax-free for over 60s[24], and instead return to the system that existed before, which

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[16] The Australian, "Paul Keating vision proves a super saviour", August 2011
[17] Sydney Morning Herald, "Paul Keating calls for 'longevity levy' to support seniors", May 2014
[18] Ibid
[19] Ibid
[20] Australian Council of Social Service, Report: "Poverty in Australia", 2014
[21] OECD, "Pensions at a Glance", Report: 201
[22] ABC, Article: "Election 2016: Where the parties stand on the big issues", June 2016
[23] Paul Keating, Monte Carlo Global Pension and Investment Forum: "Superannuation: Turbocharging Retirement Incomes", February 2007
[24] Australian Parliament House website, Research paper 2013-14: "Major superannuation and retirement income changes in Australia: a chronology"

taxed superannuation annuities differently to lump sums, incentivizing people to pay less tax by drawing out annuities and thus, sustaining their superannuation savings for a long period of time.

Through enhancing adequacy and integrity in the superannuation system, flow-on effects will emerge in the area of the sustainability of Australia's overall retirement system, with the cost of the Age Pension, one of the three pillars of retirement income policy, being kept down in the long-term through retirees requiring less reliance on government support. Overall, in order to deal with the intergenerational consequences of ageing, Australia must look beyond short-term policies and build towards a long-term two-pronged solution that strengthens the superannuation pillars of Australia's retirement income policy and ensures every Australian can retire with dignity in the 21st century.

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Essay: 1992