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SENATE

SELECT COMMITTEE ON SUPERANNUATION

Reference: Superannuation and standards of living in retirement

MONDAY, 1 JULY 2002

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SENATE

SELECT COMMITTEE ON SUPERANNUATION

Monday, 1 July 2002

Members: Senator Watson *(Chair)*, Senator Sherry *(Deputy Chair)*, Senators Allison, Buckland, Chapman, Hogg and Lightfoot

Senators in attendance: Senators Buckland, Sherry and Watson

Terms of reference for the inquiry:

To inquire into and report on:

The adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians.

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Committee met at 9.06 a.m.

CHAIR—I declare open the first public hearing of the Senate Select Committee on Superannuation's inquiry into superannuation and standards of living in retirement. Additional hearings are planned for 9 and 10 July in Sydney, 17 and 18 July in Melbourne and 19 July in Canberra. Under its terms of reference, the committee will inquire into 'the adequacy of the tax arrangements for superannuation and related policy to address the retirement income and aged and health care needs of Australians'. The inquiry is likely to be broad ranging and may consider such issues as how much money is enough for retirement, what it needs to cover, what superannuation contribution levels and other sources of income are required to meet retirement needs, the overall fairness of taxation of superannuation to ensure that individuals and groups are treated equitably in respect of end benefits, how to streamline the operation of the system to reduce costs and improve member understanding, and how to improve coordination of superannuation with the policy outcomes of other social security measures that concern the lives of older Australians, including health and aged care.

Today we will be taking evidence from organisations with an interest in these matters, including the Australian Bankers Association, Access Economics and a number of groups representing seniors and retirees, including the National Seniors Association, the Australian Council of Public Sector Retiree Organisations, the Superannuated Commonwealth Officers Association and the Society of Superannuants. All of the witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence that they shall give. This means that witnesses are given broad protection from action arising from what is said. The Senate has the power to protect them from any action which disadvantages them on account of evidence given before the committee.

BELL, Mr David, Chief Executive Officer, Australian Bankers Association

BLIGNAULT, Ms Ardele, Director, Australian Bankers Association

HEALEY, Mr Gary, Director, Australian Bankers Association

CHAIR—I welcome the Australian Bankers Association. The committee prefers to conduct its hearings in public. However, if there are any matters which you wish to discuss with the committee in private, we will consider your request. Thank you very much for your submission. We invite you to speak briefly to it. Following that, we will ask you some questions.

Mr Bell—I will briefly introduce my colleagues. Gary Healey is our director who specialises in superannuation, amongst other things. Ardele Blignault is our director of government relations. We are very pleased to be here today to discuss our submission. From our point of view, from the banks' point of view, this is a very important inquiry. It is dealing with issues that are fundamental to the wellbeing of all Australians when they retire. Despite the rise from today in the superannuation guarantee to nine per cent, many Australians are simply not saving enough for their retirement, and many unfortunately find the system far too complicated. Under the superannuation guarantee, a person on average weekly earnings who has saved for 30 years will only have $19,000 per annum. This includes a part pension. Yet ANOP research undertaken in May 2001 tells us that six out of 10 people feel they need $30,000 more in retirement. So it is quite clear that there is a gap.

The recent Intergenerational Report shows that mild budget surpluses will swing to chronic deficits in 2017-18 if existing policies, including in superannuation, are left unchanged. It is quite clear that, the longer we wait, the more expensive it will become to resolve these issues. As banks, we have a major stake in the superannuation system as providers of product in retail and wholesale markets and through over 200,000 employees. We consider ourselves a fairly major player in the superannuation issue, and that is why we have put together what we think is a fairly substantial submission.

I would now like to briefly summarise our proposals and, of course, Chair, I am very happy to take questions, as are my colleagues. Firstly, on adequacy, we believe that a national goal should be set for significantly increased retirement provisions. We believe that additional three per cent voluntary contributions are necessary across the board, on top of the nine per cent superannuation guarantee. For the broad middle-income group—that is, those people earning, say, between $30,000 and $60,000—we think a five per cent contribution will be needed on top of the nine per cent, because this is where the bulk of the adequacy problem lies. These additional contributions could be achieved through a combination of individual contributions, extended government co-contributions, reduced tax impacts on super and improved incentives for voluntary saving. We think this is necessary because compulsory superannuation contributions will not, in conjunction with the age pension, achieve fully satisfactory retirement incomes. We believe 'fully satisfactory' to be around 70 to 80 per cent of pre-retirement disposable income—that is, in the range of $22,000 to $25,000 per annum—which matches people's expectations in Australia and also brings us into line with OECD expectations.

The issue is: how big a gap is there in retirement income provision? We refer to the CPA report entitled *Superannuation—the right balance?*, which found that only in the most favourable circumstances will people relying on the nine per cent superannuation guarantee enjoy a standard of living in retirement close to that they enjoyed while working. To do so, someone on an income broadly around the average would need to, firstly, work on until the age of 65, for a long 40 years in the work force; secondly, achieve a minimum return on their funds in superannuation, after expenses, of 5.5 per cent in real terms each year; and, thirdly, take their superannuation divided equally between a lump sum and a pension. This, in all of those respects, is a best case scenario. But not factored into these figures is the impact on the standard of living and retirement of high health or aged care costs.

The findings of this study echo what has been understood by many experts who have looked at Australia's superannuation system over the past decade. Quite clearly, the very many Australians who came into superannuation in the past 15 years, whilst in mid-career, will not achieve such an outcome under the present system. Even those who are starting their working careers now may not achieve a good standard of living in retirement, not least because even males now on average retire at age 58, and only a minority spend even 35 years in the work force. Careers of 30 to 35 years are more common, both for males and for women who have unbroken years in the work force. Those who interrupt their careers will have even less time in full-time paid work. Unfortunately, significantly fewer women than men will have achieved good superannuation provision on their own account by the time they retire. Recent analysis suggests average super balances for women over 65 of only $26,000, which clearly is inadequate.

So what can be done about this gap? Generally, we think there are four things. Firstly, we have talked about the need for increased super contributions by individuals, in the range of three to five per cent; secondly, the need for extended government co-contributions; thirdly, encouraging investment in super by reducing the tax impacts on super—and there are a number of things that we would like to suggest here: lowering upfront tax on contributions, removal of the superannuation surcharge, a much more progressive tax system, so transferring the tax burden from the front end to the benefit stage and, of course, improved incentives. The issue of simplicity is also very important and goes hand in hand with the issue of adequacy, and we really need to address the complexity of our super system, to try and make it simpler so that there is more incentive to save for our later years. I venture to say that the great majority of Australians simply do not understand how the superannuation system works. I must admit, before I got into this topic, I too was one of those many people.

We suggest two key directions for reform to restore simplicity: firstly, moving tax back to the benefit stage, ideally removing front-end contributions taxes altogether as we have previously referred to; and, secondly, removing unnecessary grandfathering, which litters our superannuation system. We think reform in these two areas would open the way to reducing complexity in a range of other areas in the system. For example, moving taxation fully back to the benefit stage would, if ordinary progressive taxation applied at that point, remove any connotation of concessions in tax treatment. That would also allow removal of both benefit and contribution limits, removal of restrictions on who may contribute and differences of treatment among different recipients of benefit.

We also recognise that there are significant budget issues to consider as a result of our proposals and others, particularly those that would shift taxation to the benefit stage. There is a need to manage these impacts either by phasing or judicial timing. Superannuation taxes in total earn the government around $7 billion per annum. Given these impacts, our submission puts forward a number of other reform proposals, which we believe offer considerable scope to manage short-term budget impacts. These would need to be developed in detail and consultation with government and industry but, essentially, they involve bringing forward for a transition period some of the future tax revenues from super. These proposals could not only provide us valuable time to deal with the short-term budget impacts but also buy us time to allow revenues for a benefits-only tax regime to grow. Thank you, Chairman. We welcome the debate on this very important matter and look forward to being able to answer any of your questions today.

CHAIR—Thank you, Mr Bell. You mentioned the forecast of chronic budget deficits. Given that environment, why do you suggest a number of measures which, firstly, will increase government expenditure and, secondly, will reduce taxation on superannuation?

Mr Bell—There is no doubt that, and I am happy to be helped out here by Mr Healey, if we do shift the tax burden from the front end to the back end, there will be short-term impacts upon government revenues. We think these can be managed in a number of ways. Fundamentally, what we would say is that, if you do shift the burden of taxation from front end to back end, you are actually encouraging people to contribute to superannuation, which in the long run or even in the medium term would smooth out those gaps in government tax revenue.

CHAIR—But we are not starting from a greenfield site, are we? We have an issue with us at the moment. How much revenue do the front-end taxes raise for government at the moment?

Mr Healey—At the moment, the figures vary a little but I think the surcharge is around $1.8 billion. I think the contributions taxes are around $2.5 billion. I think that by default benefit taxation is pretty well the rest. Contributions and surcharge together range between $2.6 billion and $3.6 billion, depending on how you cut the numbers.

CHAIR—We are looking at really significant amounts of dollars in tax revenue forgone, aren't we? How do you propose to make that up?

Mr Healey—We have talked about some proposals of phasing and transition. In particular, we have talked about how you may wish to think about bringing forward some future tax revenues, just for a period of time, to help overcome the transition arrangements and to overcome these budget issues. An example of that is in the 'long tail' grandfathering area where you could consider bringing forward the tax liability of all superannuants at a point in time, taking account of all of the grandfathered concessions that had been there, and that liability could then be calculated as if someone's accumulated benefit had been drawn at that time. You could then have that liability, or a portion of it, paid by superannuation funds to government over a number of years to help get over the revenue hump that you will have for a period of time. What you would also then end up doing is purging the system of the past set of tax arrangements, and from that date you could then apply benefit taxation. So there are some significant budget-in-transition issues that have to be worked through. We do not resile from that but they are, we believe, issues that can be worked through; they are not issues that are insurmountable.

CHAIR—Do you have any idea whether the government should either increase taxation or reduce expenditure?

Mr Bell—I do not think it is a case of increasing—

CHAIR—You are talking about chronic budget deficits for the future and cutting out the contributions tax, moving it to the other end. The committee has to find ways of balancing it.

Mr Bell—Again, I think we go back to the principle, which is that if we put in place a taxation system which encourages people to save, then over the medium to long term the overall tax impact will be mitigated. What we are also saying is that a way of dealing with that short-term gap that has appeared—which you are quite rightly asking about—is to look at the way that government accounts for its revenues. Currently, it really has a cash approach to its budgeting. If in some way we can deal with the way that government accounts for its revenues and understand that, in the medium to long term, by encouraging saving we are going to boost those tax revenues down the track, then I think that is one way of looking at it.

CHAIR—Yes, but at the end of the day cash is still cash, and this is one of the problems with your Enrons, isn't it?

Mr Bell—Correct.

CHAIR—They are accruing everything, they are deferring their expenditures—surely we cannot go down that track. The closer you keep your eye on the cash, the healthier you are going to be. Your big-city calculations worry me a little, because most people in the big cities pay about 25 to 30 per cent of their incomes in repaying their homes. Wouldn't you expect people to have repaid their home mortgage by that time so that you are looking for 70-odd per cent of pre-retirement incomes for income in retirement? And doesn't where you live have an effect? For example, if you have paid off your mortgage and you live in Dubbo or Devonport, Tasmania, and your income is $90,000, do you still need $60,000 plus? I can understand your calculations based on a Sydney scenario, where you are probably still paying off your mortgage, but what happens if you cash up your house and go live in a cheaper area? Demographics are going to play an important part. If we are going to base our calculations on everybody living on the North Shore, yes, we will need a very much higher standard of retirement income than if we are going to live in country Australia.

Mr Bell—Again, our calculations have been done in the aggregate. We have not got down to that level. I could counter by saying, yes, people in places like Dubbo and Devonport may be able to pay off their houses earlier. They would, without doubt, also have lower levels of income than, say, people in Sydney, who would have higher levels of income but also have higher mortgages to pay back. So these things would balance out. But we have not done those sorts of individual calculations; we have taken things in the aggregate.

CHAIR—The other thing that worried me was grandfathering. As the older people who are getting the pre-1983 tax-favoured treatment get older, why suddenly take that benefit away from them? Isn't it rather cruel that, just because there are fewer of them in society, we take away the benefit?

Mr Bell—I do not think we are talking about taking that benefit away from them.

CHAIR—You said 'taking away grandfathering' so that is effectively what it is.

Mr Bell—We should clarify that: we are talking about crystallising that. We are not talking about removing that benefit from them.

Senator SHERRY—So they only see it in a crystal ball, not in reality!

Mr Bell—No, we are talking about crystallising. We believe that benefit should not be removed from them—we believe that it should be crystallised—whilst the objective is to make the system simpler. Can you give the committee some more information about some of the things we have looked at, Gary?

Mr Healey—The aim is to make sure that, as you make the transition to the new set of arrangements, you calculate what is due to a person under those new arrangements and you ensure a smooth transition so you would not have a situation where people, say, on the pre-1983 set of arrangements would suddenly lose large amounts of their future retirement income. You would be very conscious that you preserved, as far as possible, the arrangements that people had before and that they knew that the benefit regime would apply for accumulation of contributions past a certain point. But prior to then the aim would be to maintain the sorts of concessions that had existed previously. You would need to do some calculations to work out how you would move from the old regime to the new regime in a way that was sufficiently smooth so that it did not disadvantage people who had been on the concession arrangements.

Mr Bell—In our submission we propose a couple of methods to do this. We are not saying this is the absolute answer but, again, I emphasise that we are not trying to remove concessions that people have built up—not at all. We have suggested a couple of methods. One proposal is to determine for every fund member the value of tax concession adjustment entitlements as at a certain date and to carry these amounts forward to be applied to their assessment when benefits are ultimately drawn. The second proposal is to determine the member's tax liability at a certain date, taking account of grandfather concessions—that is, as if their accumulated benefit were drawn at that date—and to pay that liability to government, possibly in instalments over a somewhat extended period. The new tax system would then apply cleanly to benefits accumulating from contributions after the set date.

CHAIR—Thanks for that clarification.

Senator SHERRY—I would like to come back to the issue of what is a reasonable level of retirement income, because I think everything else flows from that issue—what taxes, what level of contribution, all those sorts of things. I know it is not easy, because you have to look at the average person, but on page 14 of your submission you have used a figure of 35 years for a person on AWE to achieve 75 per cent to 80 per cent disposable income replacement. Should it be 75 per cent to 80 per cent? It seems to me the two critical factors to take into account are that, when you get to retirement age, your home is paid off and your children usually have left home. These are two major areas of expenditure that we take out and that is why you do not need 100 per cent replacement. So is 75 per cent to 80 per cent too high? The modelling I have seen and the theoretical discussion and debate seem to centre around 60 per cent to 65 per cent.

Mr Bell—It is a good question and it goes to the heart of what we are trying to do here. I guess there are a number of ways you can approach it. We have obviously looked at it from the aggregate and tried to draw from a couple of sources—one is the OECD findings, which indicate that what we have proposed is roughly what people in OECD countries expect. We have also looked at what is expected in Australia. Again, people's expectations showed—I think six out of every 10 in the ASFA survey—that they thought $30,000 was an adequate figure. Expectations are fine, of course, because you may argue that people's expectations may be higher than what they actually need. I think that is probably what you are suggesting.

Senator SHERRY—No, not necessarily.

Mr Bell—Okay. One might say that people's expectations—in this case, six out of 10 people saying $30,000 is what they want—may be too high. So we then have to look at some other model of working out whether $22,000 to $25,000, which is what we are suggesting, is excessive or not. I think that has to be a matter for debate. We have started from people's expectations.

Senator SHERRY—Do we not have a time problem here? The SG, for example, which came in in the late 1980s—the SG legislation came in later, but the three per cent started in the late 1980s for the majority of working Australians—hits nine per cent today—it has been a long 10 years—so effectively the majority of the baby boomer population have had SG only at partial rates since the late 1980s. The baby boomer generation are aged 40 to 55 at the moment; they are on the edge of retirement. How on earth do we reach the sorts of levels you are talking about, given the circumstances we are in at the moment?

Mr Bell—As I said in my opening statement, we acknowledge that there is that group of people who are in transition. There is no doubt about that. That is certainly an issue that we have to think about. Probably the only way we can deal with it is that—we cannot have a big bang approach to this, clearly; we simply cannot afford it—there has to be a transition to a point which is satisfactory.

Ms Blignault—Also in part our submission suggests encouraging voluntary contributions. So if you are in that baby boom age group and there was an attractiveness towards voluntary contributions that could help fill some of that hole.

Senator SHERRY—Just on that issue though, the 60 per cent of people who had no superannuation until the late 1980s had the greatest voluntary incentives in the world. Taxation was lower and they did not do it. This baby boom generation worries me because the expectation, as you have rightly said—I have seen the surveys—is $30,000. For the majority of them, it is going to be considerably less than that.

Ms Blignault—That is correct.

Mr Bell—Again you raise a very good point. All of us would like think that there is a different culture now in terms of saving for your retirement from the period we talked about, the 1980s to now. People perhaps have seen the benefits of saving superannuation but, notwithstanding that, there also has to be some form of education so that they do understand the benefits which will accrue to them if they save for their retirement. Again, we are suggesting

that the best starting point to do that is to encourage people to save. One of the methods is, of course, moving taxation back to the benefits stage.

Senator SHERRY—Having had some discussion within a limited time about what the final goal should be, I want to touch on this issue of taxation. Wouldn't one of the solutions to dealing with the baby boom issue—the majority have only had compulsory superannuation since the late 1980s—be to reduce their contributions tax? Let us look at priorities.

Mr Bell—Absolutely, we agree.

Ms Blignault—That is certainly our position.

Senator SHERRY—If we are looking at priorities, shouldn't the priority first and foremost be reducing the contributions tax for those people who are caught in this transitional problem?

Mr Bell—We agree. Our principle is to shift the tax back from the front end to the benefits stage. We also suggest that contributions tax should be reduced and the timing and transition of that is something that would have to be worked out. We would also like to have a look at the surcharge as well, but we absolutely agree with you.

Senator SHERRY—The surcharge is part of contributions tax.

Mr Bell—Yes.

Senator SHERRY—We look at the cost to revenue, and it is not an easy issue, and you are saying that the reduction in contributions tax should be the first priority?

Mr Bell—That would certainly be up there with one of our priorities, absolutely. But again, it would be dangerous just to pick something off in isolation.

Senator SHERRY—I understand that, but we have to look at the priorities here. We have the baby boom generation, who haven't had full SG, and all the voluntary incentives in the world are not going to make a huge difference to the bulk of them. If you were proposing compulsory higher employee contributions, again it would have to be very significant to get anywhere near the expectations for final income. So it seems to me that one of the solutions is dealing with the contributions tax issue for this group of people and making that a priority.

Mr Bell—That is correct. That would form a priority in terms of moving the taxation burden back to the benefit stage, yes.

Senator SHERRY—You might have a look at the Labor Party's options in terms of contributions tax reduction, and I would appreciate a written response at a later date. Just to finish on one other issue—I do not want do go into a long debate and question about it today because we will have an opportunity on another occasion—you acknowledge that fees and charges can have an impact on final retirement income?

Mr Bell—Yes, fees and charges can have an impact on final retirement income. That is clear. We have not dealt with that issue in our submission.

Senator SHERRY—We will have another occasion.

Mr Bell—But that is certainly the case, yes.

Senator SHERRY—Could you provide to the committee on behalf of the banks, who are your members—in anticipation of the so-called choice legislation coming to us—a copy of the fees and charges that are contained in the disclosure documentation under the Financial Services Reform Act for each bank? I would like it separately.

Mr Bell—We will certainly speak to our members about that, yes.

Mr Healey—Can I just pick up a point that both Nick and John were raising before? The circumstances of individuals often differ. One thing we are very keen to see is some quite careful modelling done by the retirement income modelling group in Treasury which picks up the differences in circumstances. As you have both pointed out, there are differences out there in the community. It is really important to design something that picks up those differences. We obviously have not had the facility to do that modelling, but it is a really important part of informing this debate going forward.

CHAIR—There are two questions I would like to ask. From your experience how can we best reduce the costs of superannuation? People are saying it is quite an industry. If we can reduce some of those costs it would increase returns. Have you thought about the way we can make it more efficient? Are we getting adequate value for money in terms of having asset consultants and all these intermediaries?

Mr Bell—That is something that we have not dealt with in our submission.

CHAIR—You might like to take it on notice.

Mr Bell—I certainly will take it on notice.

CHAIR—It is a big issue that we would like to look at. You said to Senator Sherry that you had used a lot of European data and experience. I would like you to rethink this because the Australian way of life is somewhat different to the European way of life. Europeans on average tend to pay a high proportion of their incomes in rent. Would it not be better, rather than have benefits for all, to perhaps continue to pay rent assistance to the very low-income earners if they are paying rent?

Mr Bell—I can see that point. Our starting point was looking at the expectations of Australians. To make sure that we were not completely out of the ballpark we referred back to the OECD study to make sure that what Australians were proposing and thinking was not completely awry.

CHAIR—I can understand that. I can see you applying too closely the European experience. It may not be 100 per cent lineball with Australian conditions.

Mr Bell—We accept that.

Senator BUCKLAND—I was going to ask a few questions about the surcharge and the percentage but it appears you have in fact answered what I wanted. You mentioned voluntary contributions. What do you feel would be an adequate voluntary contribution? How do you choose that and at what level do you set it?

Mr Bell—We have said in our submission at least three per cent and, for the broad middle-income group, up to five per cent.

Ms Blignault—In addition to the existing nine per cent.

Mr Bell—Yes, in addition, and we have done that on some fairly basic modelling of the aggregate situation. We think if you look at what people expect and what they are going to get with the nine per cent, that gap of three to five per cent provides for that cover.

Senator BUCKLAND—And if you determine that you will make a voluntary contribution, does that have to be a regular voluntary contribution or a top-up from time to time? I am thinking of one particular scheme that I was a member of at one stage.

Ms Blignault—We at this stage have not done any modelling to see how the two different approaches would go.

Mr Bell—Again, it is an aggregate response. The principle we are working from is that people have certain expectations. Currently at nine per cent those will not be met. To meet that gap we think anywhere between three and five per cent is the right figure.

Mr Healey—And certainly the little bit of calculation that we have done, in table 2.3, assumes the contributions are regular over that 35-year period.

Senator BUCKLAND—Going back to the surcharge, and I think Senator Watson addressed this question, why do you believe that the surcharge should be removed? What do you feel the repercussions of removing it could be? Have you gone as far as trying to examine that?

Mr Bell—Again it goes back to the principle that we are supporting, which is to encourage people to save. We believe that gap exists of between three and five per cent. The best way to encourage people to save is to change the way that the system currently works in terms of taxation. That means shifting taxation back to the benefit stage, which, by definition, as we discussed before, means removing in some way contributions tax and also looking at the surcharge. In terms of the repercussions, Gary, do you have some comments on that?

Mr Healey—We have not at this stage done detailed work on precisely what the impact would be and on what sections of the community. That is certainly something that is part of the

next phase of the work that is needed to go forward, along with modelling all of the other proposals.

CHAIR—So on that proposal you would have a transition to make sure the current generation will not be caught twice?

Mr Bell—Yes, you would have to have a transition.

Ms Blignault—Yes.

Senator BUCKLAND—Have you looked at how it will improve the lifestyle of people in the future as far as their superannuation is concerned?

Mr Bell—I am not sure—

Senator BUCKLAND—If you remove the surcharge, have you considered or looked at how that will improve the lifestyle of people in the future?

Ms Blignault—Presumably if that encourages greater superannuation contributions and people end up with a larger benefit they would have further options in terms of lifestyle once they retire.

Mr Bell—To answer your specific question, no, we have not done that level of analysis at all. We have not asked people that question at all. For us this is work in progress and we are happy to consider that as part of work going forward.

Senator SHERRY—You mention in your submission getting rid of RBL limits. They are pretty generous—a million dollars for an annuity and half a million for a lump sum. Shouldn't there be a limit on the extent of tax concessionality; otherwise why should a person who is going to receive a couple of million dollars in an RBL under your proposition—and that would be a very high-income level—have the tax system give them a cross-transfer subsidy of that sort of generosity, because that is what will occur without an RBL limit?

Mr Healey—In short, we do not see a need for RBLs or contribution limits once you get to the benefit stage. The reason is that the system would not be one that has concessionality in it; in other words, you would be taxing people at income tax rates with a progressive scale at the benefit stage. However, prior to then, in the transition, there are some real issues about how you transition out of the RBL arrangements and the arrangements about who can contribute and on what terms. I think the question is a good one in that it does raise the need to make sure that you move very carefully. Indeed, RBLs and the existing contribution arrangements are part of the transition process as well.

Senator SHERRY—So you are saying that there has to be some sort of limit on the tax concessionality of superannuation?

Mr Healey—So long as the system has a concession in it, but our proposal is ultimately to move to a system that treats super at income tax rates once—only at the benefit stage.

Mr Bell—The objective of doing that is not to benefit millionaires; it is to make the system simpler, and obviously you have to pick up at the end—

Senator SHERRY—I understand the simplicity argument, but there is an equity issue too.

Mr Bell—Sure. And the way you can deal with that is to have a more progressive tax system at the benefits end.

Senator BUCKLAND—I suppose the primary concern for those on low incomes is the age pension rather than superannuation, because those on very low incomes fall outside the compulsory contributions. How do you deal with that?

Mr Healey—I think you are right, Senator: the issue for those people is the pension, given they are outside the superannuation system. Given that we are talking about coverage in this part of the inquiry, we have not thought about this in any detail. But I think it would be worth the committee considering whether you have the coverage of the community as wide as you can get it. That group may be an area where the committee could give some thought. There are other groups as well, such as the casual work force. I notice in some of the other submissions from people like, for example, the Association of Superannuation Funds of Australia, ASFA, that there are proposals to extend the coverage at the older end of the community as well, because there are clearly some gaps there also. I think your point is a valid one that would be worth the committee deliberating on. But at this stage we do not have a view on that.

Senator BUCKLAND—We need to address the casualisation of the work force and the part-time nature of it, where people may have two or three different jobs. But there is another aspect that is going to complicate this as far as equity at the time of receiving the benefits of superannuation, and that is women in the work force who interrupt their employment to have children and to rear them. What measures do you think need to be put in place to protect those people? Have you addressed that issue?

Mr Healey—We have not gone into that in any detail in our submission, but I do notice that quite a number of the other submissions to the committee have very detailed suggestions that pick up that issue and put forward the proposition that women should be allowed to contribute regardless of employment status and things of that sort to break the employment-superannuation nexus.

Senator SHERRY—I get concerned about this, Mr Healey. I understand the theory, but the reality is that it is generally women on a higher income or women with a higher income spouse who take advantage of those. In terms of equity we are talking here about low-income and middle-income women. All the stats show that, with respect to the spouse contribution that is available at the moment, there is a very low take-up rate. The issue that Senator Buckland raises is very important because there is a structural imbalance. Superannuation is fairer for women than it was 20 years ago but it is still not fair. The structural nature of women's employment has a much harsher impact than low or average incomes because of their periods outside the work force. I will put one suggestion to you. I know the banks are pretty good with this, because they have paid maternity leave. As part of the maternity leave for banks, does the maternity leave payment include the superannuation contribution?

Ms Blignault—I do not know, but we can certainly get back to you.

Mr Healey—We will find out for you.

Senator SHERRY—Wouldn't one way be to have in any model on paid maternity leave a provision for a superannuation contribution to be included as part of the package on paid maternity leave? Wouldn't that be one way? It is relatively small, but I think it is a constructive way of dealing with it.

Mr Bell—We will certainly check that for you and come back to you. I just do not know the answer.

Senator SHERRY—But what do you think about the issue—that, if you have a model of paid maternity and a person is receiving X amount when they are on paid maternity leave, they should also receive at least the SG equivalent during that period of time?

Mr Bell—I could not give you an answer to that, Senator. Individual banks have different approaches to these things.

Senator SHERRY—I would like to know what the banks do and how they deal with that issue—I suspect they deal with it more generously than most others in the community—but I would like to know what you think about this general approach; that is, that if we have paid maternity leave then there should be an SG component as well.

Ms Blignault—It is certainly worth looking at. We would like to have a look at that in the context of our other suggestion to see how it fits and we could get back to you. Off the top of my head I could not say one way or the other.

Mr Bell—If we think through the logic of it, if there is paid maternity leave then compulsory superannuation contributions are made anyway. Is that the point you are trying to make, Senator?

Senator SHERRY—I suspect that is the case, but these are individual arrangements with some employers. If you are going to have a broader community paid maternity leave provision, however it is paid for—and we will not get into that debate—the logic is that, where a female is out of the work force for, say, three months and receives whatever the amount is, an SG component on top of that is paid into her super fund. It is relatively small in the context of the inequity, but it is a start.

Mr Bell—You are suggesting that this is on top of as opposed to part of that paid maternity leave package?

Senator SHERRY—It is part of the package.

Mr Bell—Can we come back to you on that. I cannot give you an answer off the top of my head.

Senator SHERRY—I would be interested to know what the banks do.

Mr Bell—Yes.

CHAIR—Mr Bell, given the huge growth in superannuation and its projected growth into the future, is the Australian Stock Exchange going to grow at a commensurate rate, given the very high proportion of superannuation moneys in equities?

Mr Bell—That is a good question. I am simply not an expert in that area. I could not give you an answer to that. I guess what you are—

CHAIR—But the banks would be in a position to try and work that out. I am worried about where all the money is going to be invested, because we have to look at all aspects of this in our inquiry. Given the growth of superannuation, I worry about whether the Australian equities market has the capacity to absorb that without substantially reducing the rate of return.

Mr Bell—I think you are probably referring to some sort of artificial bubble that might be created with the injection of these funds.

CHAIR—It is growing at a tremendous rate and continues to grow, particularly now it has gone to nine per cent et cetera. With the increasing proportion of the work force accessing superannuation, I think it is important. Will a lot of this money go overseas and not be invested in Australia?

Mr Bell—It is a good question.

CHAIR—I would like to get some of the best brains in Australia to look at that for us, because it is a very important question.

Mr Bell—Yes.

Senator BUCKLAND—I ask you to pardon my ignorance on this, because I am not an expert on superannuation like my colleagues Senator Sherry and Senator Watson—

Senator SHERRY—A junkie!

Senator BUCKLAND—They are superannuation junkies. They seem to live and breathe it. I have more interesting things to live with. Is there a scale or proportionate amount of investment from superannuation funds that must be invested in Australia in the industry, or is it just open slather and you go where you get the best bunk?

Mr Bell—As far as I know, there is no direction whatsoever that a super fund has to invest its funds anywhere other than where its prospectus determines it should.

Senator BUCKLAND—I think there are some funds that give you options as to how you do your investments.

Mr Bell—That is correct. For example, I recently shifted all my super into a master fund. I had thousands of options. I could go through and tick and flick, and it was quite clear where the moneys would be invested: in Australian equities, in overseas equities or in some other form.

Senator SHERRY—We will not ask you where you put it!

Senator BUCKLAND—That was the next question, but I will let that one go.

Senator SHERRY—I have one final request for information. I find the issue of reverse mortgages quite fascinating. I suspect that with the way the baby boomers are headed there is going to be little option. The reality will be that many people will exercise a draw down of their house asset into some sort of income stream to make up what they might consider a deficit in their retirement income. I do not know whether any banks in Australia offer this at the moment. Perhaps you could give us some further information on this: what is available and what is happening in the US. It is a fascinating area which I suspect could be of great significance in the near future.

Mr Bell—Yes.

CHAIR—Thank you very much for your presentation. I am sorry we have given you so much work.

Senator SHERRY—Chair, Senator Cherry is here. Putting aside the confusion between Cherry and Sherry, I know there is a technical problem if Senator Cherry wants to ask a question, but if he asks it then I will ask it as Senator Sherry. I think he can participate if someone picks up the questions verbally.

CHAIR—I understand from our secretary that if a person who is not a member, one way or another, of a committee asks a question, then the witness is not necessarily protected under parliamentary privilege. That is the problem.

Senator SHERRY—I understand. What I am suggesting is if Senator Cherry reads out a question or just says a question and then one of us takes it up, then I do not see a technical problem—as long as the question is asked by one of the members of the committee.

CHAIR—Unless Senator Cherry would like to write it out.

Senator CHERRY—I am happy to pass them to the chair. That is what has been suggested, so I will do that.

CHAIR—It would be a safer procedure to write it out.

[10.07 a.m.]

KINCAID, Mr Tony, Chairman, Supermaster Investments Pty Ltd

CHAIR—We particularly welcome you, Mr Kincaid, because you come as a retiree, which is important, and also as someone who has worked in retirement planning. Both are very significant because they mean you can bring a number of perspectives to the committee that other groups may not. Thank you very much for taking the time out in your retirement years and continuing to show your interest in superannuation by preparing a submission and coming to Canberra today to present to us. We really appreciate that. I invite you now to talk to your submission.

Mr Kincaid—Good morning. I have been asked to spend 15 minutes giving an outline of a couple of parts of our submission, particularly those relating to allocated pensions and their use and adequacy, which a lot of people do not understand. As the chairman has said, I retired last year from active service after 32 years of personal and continuous client advising. Since 1983 my organisation has specialised in retirement planning. In fact, in 1986 we were responsible for the first non-textbook on superannuation retirement and superannuation planning strategies, called *Superprofit*. I and my team have planned the retirement of thousands of people and also advised them—I do not, but the rest of the team does—on an ongoing basis. We have also been actively involved with allocated pensions from day one. My knowledge is therefore very practical and not just theory. As part of my submission relates, a lot of people in this industry are very good on theory and not so good on the rest of it. I would like to think I know retirees and pre-retirees and what is good, and even what is best, for them.

There is a lot to criticise in our system. It has grown in 19 short years—today, in fact, it has turned 19—from the world's worst into what I believe is the world's best. Too much criticism in the industry is ill-founded and does not understand where we sit. Our approach today and always is to be constructive and positive to try and make the system better.

These are the main points of our submission, in simplified form. One: the system is way better than most, even than the industry realises, so, please, no radical changes, no complete reviews of the system. Please do not do anything except simplify, and reduce confusion. Just keep improving it. Two: remove all work and age barriers for superannuation contributions, at least those used to fund pensions. You can enable everybody to fund their own pension. Today there are too many artificial barriers, as I will illustrate. Three: eliminate the surcharge. It is the worst legislation ever, very inefficient and costs more than it collects probably, so enough said. Four: encourage everybody to contribute into superannuation or pensions. To do that I propose a simple option: as well as keeping the very valuable undeducted contributions system, make tax deductibility a uniform 30 per cent.

The first of those items is allocated pensions, which I have been asked to talk about. Time is limited so I thought the best way I could do that is to try and help the committee understand how allocated pensions really work. Maybe I am presuming you do not really know—

CHAIR—It was the work of this committee that got them established.

Mr Kincaid—I realise that. But whether you actually understand how they are implemented and used by people is the point I would bring to the debate. If you look at so much of the literature put out by friends like the previous people, they do not understand how they work. If you do not understand how they work you do not maximise the benefits. Most people think that when they start a pension the account balance just decreases continuously. That is only true if you take out more in pension than you earn. To explain that let me simplify it. The minimum pension valuation factor at age 55 is 19.8. What does that mean to people? They have no idea. We simplify that and say five per cent, because 19.8 divided into 100 is five per cent. Now people can say, 'Right, the pension is about five per cent of my capital.' That is the minimum, and the maximum is double that. Now you start to get a level of understanding that those who are going to use the product can benefit from. Then you explain how the percentage grows to, say, 5½ per cent at 60 and six per cent at 65.

I would like to hand out a paper that addresses this issue. There is a little graph on page 3. Time is short so I will ask you to look at just the sections that suit my purposes for the moment. That graph on page 3 is based on an earnings assumption that we have used since 1978—unchanged since then—of nine per cent. For a pension commencing at 55, a minimum pension on, say, an amount of $400,000—and it is true regardless of the amount—is about $20,000. The $400,000 is the top line on that graph; the $20,000 is the bottom. If we stay with the pension, the lower line continues to grow as a function of the growing account balance and the age. You will see that at age 60 that has grown to $60,000 and stays that way even at age 90. As far as adequacy, that is one point. Interestingly, though, the capital is projected to grow significantly. You see at age 74 that the break-even point of $615,000: it has grown more than 50 per cent. If you earn nine per cent and draw five, the account grows by four. It is only at age 74 in this projection that you earn nine per cent and draw nine per cent, so the balance changes.

We emphasise with all of our clients, leading up to retirement and beyond, the need, wherever possible, to live on minimum pensions. Our experience is that if we take that approach and do not use the opposite, which I will demonstrate in a minute, that probably 95 per cent or more of people actually use these minimum pension payments and therefore their capital arrangements follow somewhat that line on the graph. In a word, they have enough cash to last them through their retirement and handle things like emergencies, travel, health and the replacement of motor vehicles because the pension allows them to take lump sums.

The maximum pension, however, presents an entirely different scenario. The graph on the last page shows the effect of a maximum pension that is very similar to what happens with an annuity as far as capital goes. You will see that at age 80 the capital is virtually exhausted and now that person is dependent on the social service pension whereas the minimum pensioner is not.

To show the importance of this, the committee recently released some figures about private pensioners. There were 20,000 of them in 1992 when the allocated pension was released: there were other products then. Funds under management were only $1 billion. In nine short years to June last year, the private pensioners went from 20,000 to 584,000, and funds under management went to $47 billion, a 47 times increase in funds and a bigger increase in the number of pensions.

Most of that comes from the allocated pension, as evidenced by recent figures which show $180 million per quarter is invested in complying pensions, managed products, whereas there is $2.5 billion in allocated pensions. So over 93 per cent of the money going into private pensions is going into allocated pensions, and I ask the question: why? Very simply it is because, in my view, allocated pensions are the world's best product: they are the most efficient retirement product and are best able to look after retirees. We think they make a fantastic contribution to the self-funding of an adequate retirement, and we would like to see everybody have access to them.

I come to the most important issue in the submission, one that I think is most easily implemented at virtually no cost. It is to remove the disadvantage which hundreds of thousands—maybe millions—of older Australians face because of the discrimination of what I think are silly and arbitrary entry rules. So what happens is that they generally place the bulk of their cash in term deposits with their friendly banks. Their friends rub their hands in glee and pay out a pittance in income. But, worse, there is absolutely no asset growth, and therefore the retiree's income is subject to the vagaries of interest rates and quickly dissipates.

I have prepared a set of numbers. This graph shows the drawdown that would typically be made from the same amount of money but invested in a term deposit. Compare that with the allocated pension. I will rephrase that: we take the amount that is drawn down in my example from the allocated pension and take that out of the term deposit and, as you see, the term deposit, paying the same amount, runs out at age 75 when the capital in the allocated pension is over $600,000.

Senator SHERRY—That is not good news for the banks, is it?

Mr Kincaid—It is not good news for the banks, but it is worse in that it is not good news for the retiree—that is the problem that they get sucked into.

Senator SHERRY—Maybe that is why the banks want to get hold of super before people retire.

Mr Kincaid—I would love to make some comments on some of the things they said. They were very impractical. In one case shown here we have here a citizen who has money in the bank. Even if you look at the poorest people and take the noughts off, they have money in the bank to live on and it is invested in growth assets; the other one is totally dependent on the government and has been for years. I have here another graph that also would not be recognised by most people. Not only does the capital balance in the account last much longer but, staggeringly, the allocated pension pays the pensioner three times the amount of money that they would receive from the term deposit under the name of the game that I have said. Not only does it cease at age 75 under the term deposit while the allocated pension keeps going, but the allocated pension is paying money at age 90 and has churned out $1.7 million from the original $400,000. That is a very important growth factor of which most people have no idea.

To me the inferences of the government's liability for age pensions and adequacy are fairly obvious from those sorts of examples. They give an entirely different view of adequacy, because not only are we looking at having sufficient money in the pot to retire on but also we are looking at making the most of what we have in the jar to live on; there are two sides to the coin.

Most people invest outside of super simply because they are denied entry through age or they are not working 10 hours or they are single—and probably women—or they are denied entry for what I call spurious reasons. The question is: what has 10 hours or any other work measure got to do with funding an adequate retirement? It is an antiquity.

We agree with the CPA submission that there should be no nexus because, if people and their advisers really understood and if they all had access to allocated pensions, their investment horizons would increase from 90 days to 10, 20 or 30 years or more; investments would be largely growth oriented, not cash; they would probably earn nine per cent, not six; and the capital would be significantly greater. The committee is concerned with adequacy; here is a large part of the answer. The additional retirement capital potentially generated from the use of minimum allocated pensions is way more than most other measures could put together. So in our book the solution is, very simply, to remove all entry barriers for contribution as an absolute minimum for undeducted contributions where nobody is claiming a tax deduction. I would like to go on with other comments, but time is limited and I undertook to address those issues.

CHAIR—Is it the wish of the committee that the three documents be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The documents read as follows—

CHAIR—We have read your submission. To enable all of us to ask you questions, which is very valuable, we are wondering whether you could wind up very quickly—

Mr Kincaid—I have.

CHAIR—Firstly, thank you for your very clear exposition of allocated pensions. I think that is very useful. However, there are some warnings. I am not sure whether we should be putting quite as much in allocated pensions as you probably suggest. I put it to you—you are just assuming that the downturns are going to be temporary—how do we know that what is going on now may not last for three, four or five years? And, if people had put their money into a long-term annuity when interest rates were higher or when they could get better returns, wouldn't they be better off than in an allocated pension at the moment, where we are seeing a lot of funds showing negative returns? Therefore, in the environment in which we see ourselves at the moment, do you think we are going to see the sorts of rises between $400 and $615, as you are suggesting?

Mr Kincaid—I will answer the last part first. Yes, I have got ultimate faith in that. Over my 30-odd years, I have seen markets go up and down. In negative times like we have today, just like the sun rises in the morning, it will rise tomorrow. I have that blind faith—but that is a bit glib. The alternative question is this: if markets are going to stay down for quite a while, what does the term deposit or other non-superannuation alternative offer? All it does is offer lower and lower interest rates.

CHAIR—What I am saying is that it is really a question of timing.

Mr Kincaid—Yes.

CHAIR—If people, three years ago, went into a term annuity or one of those other products that are favoured by social security, then certainly it would favour them vis-a-vis the allocated pension—and I am a fan of allocated pensions, mind you, but of not too much of it. I am just worried; you say 'in the long term', but will markets continue to behave in the future as they have in the past? That is the issue that we have got to look at answering.

Mr Kincaid—There are several answers. One of those is this blind faith that, yes, it will. The second one is that the alternative will not offer any better. Senator, you are talking about the 14 per cent underlying earnings rate that we could provide in a combined pension back in 1990. But we had interest rates of 18 per cent on 90-day bank bills and, if anybody could have locked into those pensions at that time—as lots of our clients did—that was fine. But you try putting people into a complying pension today, where the underlying rates are three and 3½ per cent! I have done a calculation of what would be the equivalent of that $400,000 invested, as of Friday, into exactly that sort of pension and making certain assumptions. The starting annuity is $17,000, not $20,000.

There is another answer. On one of the pages of that handout we go through an explanation of what happens if next year your capital is in fact down, like it is today, and your allocated pension started last year at $20,000 and the minimum is now, say, $18,000. Simply increase it to $20,000 or $21,000 for this year. You can increase it anywhere from $20,000 to $40,000 this year; that is your choice. So you increase it back up to $20,000 or $21,000. Next year if rates

have gone up you go back to the minimum. If you do not and it is still $18,000, push it up to $20,000 or $21,000. Every pensioner has the right to set that rate, and it happens hundreds of times. This is not new; we do it every year with people so that their actual income line is still steady. The drawing level can still go up by last year’s amount plus inflation or whatever. The principle is to stay around about the minimum pension, not the maximum.

CHAIR—How do you get more people into income streams like allocated pensions, given that you propose to maintain the current end benefit tax arrangements that at the moment tend to favour lump sums?

Mr Kincaid—There are about three or four answers again. First of all, most of the figures that are put out about the withdrawal of money from superannuation are simply not correct, in my view. One of the submissions—I think it is the CPA study—is based on taking 50 per cent out as a result of a survey. Our clients take out money, a lot of money, as lump sums, pay the tax or pay no tax up to the threshold, to create a pension for their spouse. It is staying in pensions but it has not been rolled over in the name of the superannuant. It has been taken out and split or recontributed back for another person or for themselves.

CHAIR—So you are saying the statistics are meaningless?

Mr Kincaid—Yes. It is a bit like our friends here before quoting the OECD. One of the biggest fallacies in that is that most of the systems overseas do not have undeducted contributions and rely on what we would call complying pension mentality. Every time you put money into super, it is basically paying out another dollar at retirement. It is a fixed end product; they do not have any of the flexibility that the Australian system has got. With that, for people that do not have great assets, people with $100,000 or something, maybe even less than that, you can generate all sorts of things. Senator Sherry was on about this, about drawing down from their houses. We have used that a couple of times for people who really needed income and did not want to leave the house to the kids. I can answer your question, Senator: at least one bank does, and that is the ING Bank, offer those reverse mortgages. Take out an amount, put it into a pension and now the person has got an income for the rest of their days. Sure, there is a growing debt, but the house has been left, in one example I can think of, to my golfing mate. His children are far wealthier than him: what does he need to leave an asset to them for? So he is getting the benefit of that by putting that undeducted contribution in. But if he had been one day later than when we saw him—he was coming up to 65—he would not have able to put it into super. What has 65 got to do with it? When I started, all the super legislation was very complex and was all about employment, was all about 10 hours and all of that. It is just meaningless. If we are trying to help people to retire with a decent amount, let them put it into super, let them put it into pensions particularly.

CHAIR—That is a good point.

Senator SHERRY—You seem to take a fairly realistic view about the way superannuation, particularly on retirement, is taxed. You point out on page 8:

In ‘exchange’ our retirement income capital is entirely tax free and considerable income streams can be generated tax free.

I have seen ads, and they are very common, that say a couple can earn up to $53,000 in retirement tax free. Treasury told me in estimates a couple of weeks ago that this was right, that this is what can happen. How do you think we are going to sustain a system where couples in retirement can take income of up to $53,000 tax free when working couples in paid employment taking $53,000 a year in income have to pay $6,000 or $7,000 a year in tax? Don't you think that is going to cause some level of intergenerational concern as it grows?

Mr Kincaid—Not at all. I think the whole reason for putting money into super is not tied, as our friends said here before, to the contribution tax, the deduction you get on your contribution. It is to do with a whole range of factors, but the most important one is the ability to provide themselves with a tax-free income in retirement.

Senator SHERRY—I want to deal with the equity issue. I am not dealing with taxes on super; I am talking about taxation on retirement. This might be great for the financial planning industry, because I see all these ads all the time saying '$53,000 a year for a couple tax free in retirement,' but how do you think a working family is going to feel when they are earning up to $53,000 a year and paying $6,000 or $7,000 in tax? They are paying tax on the same income on which people who are retired are paying no tax. Don't you think that is going to cause a few problems down the track?

Mr Kincaid—No, I do not believe it will cause problems. It is happening every day and it is happening to workers. Let me give you a quick run-down on how you can get $53,000—or $153,000 if you want it. You have to have the capital to do it but, if you have got the capital and you choose to put it into the superannuation system, and we think that is a good thing—

Senator SHERRY—Sorry, you are missing the point. This is what I am saying: there is a working family who are not retired, they are earning wages and salary of $53,000 and they are paying $6,000 or $7,000 tax. That is what happens before they retire: they are paying tax on $53,000 of income. Yet people in retirement are drawing an income stream and are not paying any tax on an income stream up to $53,000. How is this sustainable? Is it equitable?

Mr Kincaid—I do understand your question. It is my inability to get to the point, maybe, that is making it hard for you to follow me.

CHAIR—I might be able to help you. What the retiree gets is really a return of capital expressed as income, but it is not actually income.

Mr Kincaid—That is the point, and very often it comes from undeducted contributions.

CHAIR—That is capital.

Mr Kincaid—The thing that also does not feature in a lot of the submissions is that, when you get to retirement, a very big amount that gets added into your nest egg is typically the family home that has come from the parents. If we encourage people to put that in as an undeducted contribution, back that comes as tax-free income.

Senator SHERRY—Yes, but even on the nine per cent SG over 35 years—or certainly for the next 20 or 30 years—how many people are going to reach $100,000 in capital for retirement through their super fund? It is going to be a minority of the population.

Mr Kincaid—If they do it our way and if their parents have a house—

Senator SHERRY—No, putting aside the house.

Mr Kincaid—But you simply cannot put it aside.

Senator SHERRY—Okay, let us say $200,000 then. What really concerns me about all of this is the equity of it. The higher your income, the higher your capital accumulation, the greater your ability to take advantage of all these tax concessions in retirement.

Mr Kincaid—I sort of agree, but I cannot produce money for people who do not have it.

Senator SHERRY—But my point is that low- and middle-income earners will not have all this capital.

Mr Kincaid—But they still have parents who have houses.

Senator SHERRY—Some of them do.

Mr Kincaid—Simply they do, Senator. We have clients that are worth millions; we have also got lots of clients that simply do not have very much and we probably do our best work in trying to give those people tax-free income.

Senator SHERRY—Okay. How much does all this cost? What are financial planners charging to do all of this? I am not asking you to tell me what you charge, but what, from your knowledge of the industry, which is very extensive, are they charging?

Mr Kincaid—There is a whole range of people in the industry, and some people do not have a good idea of what they are doing and others do—all those sorts of things come into it. For the ones that charge commissions, those commissions have come down over my time from the eight per cent they used to make on retirement products back in the late seventies to probably an average of about two or three per cent. For regular contributions, that will go up to 5 per cent, which I think is far too high.

Senator SHERRY—This is in the post-retirement area?

Mr Kincaid—Pre-retirement and post-retirement; there is not much difference in them. By far the fastest growing area for those who take retirement more seriously is the payment of fees. Unfortunately, people are reluctant to pay fees, and it is a question of their income, but it is growing. They are seeing that that planning is worth so much and are prepared to pay for it rather than have this insidious commission.

CHAIR—It is up front.

Mr Kincaid—Yes, it is up front and ongoing. We charge ongoing fees—or give people the opportunity of paying fees as against commissions.

Senator SHERRY—Can I deal with that issue. You say that two to five per cent pre-retirement and post-retirement is a rough, ballpark figure. Do you think it is right that percentage commissions should be paid both when money is going into super and also when it is being drawn out? Why shouldn't financial planners charge a fee? Why should they be allowed to charge an ongoing commission? What is so special about financial planning that they can do that?

Mr Kincaid—Having seen what some people have to do to help lots of people, on small amounts of money the financial planner deserves a lot more than what he gets.

Senator SHERRY—But what about the principle of an ongoing commission?

Mr Kincaid—Of a trail or whatever.

Senator SHERRY—Yes, a trailing commission of a couple of per cent, which is still very common.

Mr Kincaid—Not two per cent. I have never heard of anything over about one per cent. Generally it is about 0.4 per cent.

Senator SHERRY—Hang on, I see people—this is post-retirement, not pre-retirement so much anymore—come into my office from reputable, major companies where fees and charges of two to five per cent are common. I will not name them, but we will get a copy of their fees and charges. A trailing commission of the income drawn down in retirement of two to five per cent is common across the board.

Mr Kincaid—There is something wrong there. I have never seen a trail commission, or whatever you call it, paid to a financial planner over one per cent. You might be talking about the total.

Senator SHERRY—I am talking about the total cost of the product, including the commission.

Mr Kincaid—I cannot comment on the fund managers' charges, but they typically are between one and two per cent alone.

Senator SHERRY—Yes, plus the commission for the—

Mr Kincaid—Plus the trail commission, yes, which typically is only 0.4 per cent. My point is that the smaller the retiree's amount of money, the more work often a financial planner has got to do.

Senator SHERRY—In the bad old days of super, which we do not see too much of anymore pre-retirement, but I really worry about post-retirement charges where there is a substantial

commission through the life of the product. Why should a commission be allowed to occur in that situation? Why can't the industry charge a fee for a service, like most other service industries?

Mr Kincaid—Very simply, because most people will not pay; they will not pay a fee, whereas they are happy for it to be taken out of the product. One of the surveys—

Senator SHERRY—I understand that, because it is easier to hide a percentage commission.

Mr Kincaid—But it is also the choice of the person.

Senator SHERRY—Come on!

Mr Kincaid—I can honestly tell you that I can sit in front of a person and say, 'Use this fee system, which is ours, as against this commission system for which you will pay more,' but they will not opt for the fee system.

Senator SHERRY—Does the person understand the impact of a three per cent or four per cent commission all up? Do they?

Mr Kincaid—No.

Senator SHERRY—They do not?

Mr Kincaid—No, they can't, but they do not have the ready cash to go the other way—that is the problem.

Senator SHERRY—So it is both: they do not have the ready cash and they do not understand.

Mr Kincaid—And if they fob it off they do not have to worry about it. There is a big element of that, too—even with intelligent people.

Senator SHERRY—That is a fair enough response. I think you are probably right. My final point is: why should it be allowed?

Mr Kincaid—Financial planners do a lot of work in keeping the records and so on. What I could not argue against is a capping of that amount at maybe 0.4 per cent or 0.5 per cent, because there are systems now where you can dial up one per cent or 1½ per cent to the adviser. I do not want to say that that is wrong, but if it is not it is close to it. I cannot justify that for higher amounts. If the person has only got $50,000 in the account, that might be valid, but otherwise no. That is being charged on hundreds of thousands of dollars as well.

Senator SHERRY—Having looked through all the submissions, I think you are the first person who has mentioned compulsion for the self-employed. Why do you advocate that?

Mr Kincaid—We spend a lot of time talking about the employees, but something like 30 per cent or 35 per cent, if I am not wrong, are not employees. Nobody seems to worry about them.

Senator SHERRY—And two-thirds do not contribute.

Mr Kincaid—Two-thirds of them, if they do contribute, are confused with all this mumbo jumbo about $5,000 plus 75 per cent of the balance. I came to Canberra 20-odd years ago to help get that raised from $1,200, but nobody has understood it since then—not even the accountants. They will not put that in. But its genesis is that three-quarters of the contribution is tax deductible because the top marginal rate was 48c in the dollar and the company rate was 36c. So we got back to the 36 per cent for everybody for equality. That is why our submission now says, 'Remove all of that; nobody understands it. Allow them to get exactly the same deductions as an employee or an employer or any combination of that.' There are incredible systems going on—

Senator SHERRY—I understand that, but you are saying that it should be compulsory, which is a pretty major—

Mr Kincaid—I would like to find a way of doing that. We do not say how, but—

Senator SHERRY—It is a pretty substantial step.

Mr Kincaid—Yes, it is, but they are their own worst enemies. But you would go a long way to getting them on the system if you gave them the simple tax deductibility.

Senator BUCKLAND—I will be very brief. The Supermaster's whole submission seems to me to be based on the premise that those getting superannuation have assets outside of their raw superannuation. My experience over a number of years dealing with people and their superannuation is far different from what you are suggesting. How do you relate your submission to those who have nothing but their superannuation at age retirement?

Mr Kincaid—All I can go on is experience. Certainly not all our clients have outside capital, but a very large percentage do. It is because of the deceased parents syndrome, which is experienced by maybe half our clients. With the person who does not have any capital outside—and they are few—we still go about trying to make their tax planning in retirement as good as we can by, for example, splitting the superannuation available with a spouse or by taking out the first $100,000 lump sum and recontributing it as a lump sum. That can eliminate tax not just today but also when they are 60, 70, 80 and so on. To us, that is the biggest single attraction for people putting money into super. We get them to put it into super because they can have it tax free later on. They do not want to be paying tax in retirement.

Senator BUCKLAND—Is age 65 a realistic age for the drawing of superannuation? What are your views on contributions after that age?

Mr Kincaid—We do a lot with the principle of getting people to start paying pensions sooner rather than later. If they retire at 55, start a pension. If they get back into the work force at some later stage, start a second contribution. This retirement notion that we have, where you work to a point and then you cease ever working, went out the window long ago. You work for a while;

you are out of work; you are retrenched; you get back in five years; you consult—you do all sorts of things in different guises. Why do we have to nail something to the wall? I have gone back and done some jobs because I have wanted to do them—and I might in the future. Am I retired? I am for the practical sense, but I would not put any limits on that if you could possibly do it.

Senator BUCKLAND—I do not have any further questions, Chair.

Mr Kincaid—Mr Chairman, I would like to make one last comment. The 15 per cent requests that various submissions have made, including the predecessor—and, I am ashamed to say, my own association—are simply wrong. They have no idea; they have never planned the retirement of anybody. All they are doing is saying, ‘Take the 15 and all the taxes that now bother us and shove them onto somebody else.’ They really have no idea. There is a myriad of problems that I could go into if you are interested.

The other thing is that, if you were to remove both the 15 per cent contribution and the 15 per cent tax on the income and defer that to the end, mathematically the outcome is absolutely identical. There is no gain whatsoever. So now you have the retiree having this millstone around his neck of a growing asset but also a growing liability to be paid out of that at the end. The retiree is trying to plan his retirement on two figures: what he has got and what he is going to lose. I would suggest that no government would like this mounting tax liability bill being thrown up every year on the guy’s notice of all the tax that he is going to have to pay when he gets to retirement. It is a terrible system. I do not think it has been thought out at all.

CHAIR—I have some questions put forward by Senator John Cherry of the Australian Democrats which refer to your submission, Mr Kincaid. The first question is regarding the surcharge: what are your calculation alternatives in respect of page 11? Would you like to take that on notice?

Mr Kincaid—I will take it on notice.

CHAIR—On page 11 in respect of recommendation 4, what would be the cost to revenue at 30 per cent tax deductibility? Perhaps you would like to take that on notice as well. Would this apply to contributions which are currently undeducted?

Mr Kincaid—The answer to the second question is no; we do not seek any tax deduction on undeducted contributions. That is a deliberate mechanism for people to put it in tax free so they can get it out later, but they have the advantage of the growth system while it is invested in there. Regarding the other question, I simply would not be able to answer that as I do not think I have access to the figures to be able to tell you. But my gut feeling is that there would be no difference. It would take a larger mathematical machine than I have access to, but my position is that it would not cost anything as it is only getting rid of all the calculations and mumbo jumbo that goes on.

CHAIR—In your submission, you referred most to self-managed superannuation rather than the work based products at 70 per cent to 80 per cent, which most of the population have. Are your calculations generally referring to the self-managed funds or are they based on the work based products which most of the working population pick up?

Mr Kincaid—Can you refer me to where it says that? Is it on page 8 in the adequacy discussion?

Senator CHERRY—It was a general observation as to whether it was essentially about the self-managed funds and the self-employed as opposed to the employee based funds. It is a general question about your whole submission and what you have been talking about.

CHAIR—Was the thrust of your submission based on self-administration?

Mr Kincaid—No, certainly not. The self-managed super fund suits a large percentage of those who have them; it does not suit most of them, in my book. There are a lot of advantages for those who use it properly and well and so on.

Senator SHERRY—They can be employees or self-employed, can't they?

Mr Kincaid—They can be anybody of any size.

Senator SHERRY—You were slightly critical of them there. What is the basis of your concern?

Mr Kincaid—I do not recall being critical, but if I am it is because a lot of people, such as stockbrokers, set them up so that they can market equities. Accountants set them up so that they can charge annual fees rather than somebody wanting and needing the self-control of their super. If that is what it is about, I have no argument. We wind up far more than we set up, and we have been setting them up since 1978.

Senator SHERRY—What is a typical accountant charging for these products?

Mr Kincaid—It depends on where you are. If you are talking about the middle of Sydney, it may be $2,000; if you are talking about suburban Melbourne, it may be $1,200. But what he is offering is maybe the worst thing because it is a matter of getting value. If he is simply doing the history, the books and the tax return some 12 months or, at minimum, 9 months after the event, it is not worth two bob in my book.

Senator SHERRY—On top of those accounting fees you mentioned, there are also the fees and charges for the investment products that have come with it as well.

Mr Kincaid—Sure. But what he should be doing is strategising it and running it the right way, splitting it up and maximising the benefits of getting other moneys into the system, and investing it properly and things like that, which most people do not do.

Senator SHERRY—The tax office are doing a crackdown and it will be interesting to see what they find in this area.

Mr Kincaid—Yes.

CHAIR—Thank you very much, Mr Kincaid. It is a very useful submission.

Proceedings suspended from 10.40 a.m. to 11.04 a.m.

CARMODY, Mr Geoff, Director, Access Economics

CHAIR—Thank you for coming before the committee this morning, Mr Carmody. We realise that you have to put in a submission so that will give us a lot more time for questions and your responses, which we look forward to. I believe you have a short opening statement to make.

Mr Carmody—I do. I really want to focus on the issue of adequacy from a budget and policy perspective. Adequacy is one side of the coin. It has to do with living standards defined in some way—living standards being measured by consumption spending and the bundle of goods and services to which that spending gives access. But adequacy cannot be considered in isolation. The flip side of the coin is affordability. Affordability puts the focus on the income stream financing the consumption expenditure, whether that is sourced from own savings, such as superannuation benefits, or from transfer payments, such as the age pension.

For self-funded retirees, adequacy, however quantified, puts a spotlight on the income stream that can be purchased from accumulated retirement savings. For those fully dependent on the age pension, adequacy, however quantified, puts a spotlight on what the Commonwealth budget can afford having regard for policy on the level of the age pension, the relevant means tests and the number of retirees expected to be eligible. These two interact via the extent to which accumulated savings and own provided retirement income disqualify retirees from all or part of the age pension.

This adequacy and affordability nexus suggests some trade-offs which, in policy terms, might be viewed also as dilemmas. The more adequate retirement income levels are in terms of the standards of living they will finance, the more costly they are in terms of forgoing living standards today and/or higher tax burdens now or in the future. Other things being equal, they will retire more pre-retirement savings by retirees or more taxes to finance. The more adequate the age pension, the more costly it becomes and the higher the burden on future tax payers if it continues to be financed on a pay-as-you-go basis. The more adequate the age pension, the less the incentive to own provide for retirement on a voluntary basis. In short, the more adequate the age pension, the less affordable it becomes for the additional reason that it reduces the need for individuals to save for their own retirement.

I am leading up to a couple of questions that I want to ask, but if I could I just briefly take you through what I see as the current policy on adequacy and affordability. Current policy answers these adequacy/affordability questions as follows. Retirement income minimum standards are set by the level of the age pension, which for individuals is benchmarked at 26.5 per cent of male total average weekly earnings. All employees are forced to save for retirement as from today via a nine per cent guarantee on earnings levied on their employer. Access to the age pension is phased out when retirees exceed specified income and assets tests with access reduced at specified rates such as the 40 per cent withdrawal rate in relation to the income test. The preservation age for access to super is being raised from 55 to 60 years. That, incidentally, still leaves a gap of five years because the age pension age for women is being raised from 60 to 65, which is the age pension age for men.

While all this is happening, other things are happening too. As we all know the population is ageing, health costs are rising, people are living longer in retirement and people are spending longer in education and training before joining the work force. All these things are putting long-term pressure on government budgets and on the adequacy of any given level of super savings. Current policy settings for the pension and compulsory super seem to suggest that the adequacy safety net—that is the minimum—is set by the relationship between the age pension and the MTAWE. It appears that compulsory super's main task is to reduce the proportion of retirees fully dependent on the age pension. But even with the superannuation guarantee set at nine per cent, something like three-quarters of those in retirement will continue to be pension eligible but with an increase in the proportion of pensioners eligible for a part pension.

This brings me to what I think are key questions that, in my opinion, need to be answered before a lot of the other questions are dealt with. The first question is this: if the superannuation guarantee results in little or no reduction in the proportion of retirees receiving at least a part pension, has compulsory superannuation been a successful policy initiative? If the answer to this question is no, what lower pension-dependent proportion of the retired population should the appropriate policy target be? If you know the answer to that question, what are the affordability implications for the Commonwealth budget and for current living standards for those providing for their own retirement income? I do not pretend to know the answers to these questions, but I wonder whether there may be support for the answer 'no' to the first question I have asked.

Here is a little bit of history. The issue of retirement income targets was considered almost exactly 10 years ago, in 1992, by the then Labor government. The super guarantee was then expected ultimately to involve 12 per cent of earnings by 2002 and, based on a 40-year contribution life and retirement at age 65, this was expected to generate retirement income equal to 40 per cent of pre-retirement income. At that time, the government noted that about 75 per cent of people of age pension or service pension age were either full or part rate pensioners, with about two-thirds receiving the full pension. The government stated at that time:

... the current levels of self-provision in retirement are far too low.

But it seems that the role of the super guarantee has been to reduce reliance solely on the full pension in retirement but not necessarily total reliance on the pension. That still seems to be set at around three-quarters of the retired population. Is that an adequate target? If the answer is no, what lower target is appropriate?

I will come back to affordability. Reducing the proportion of retirees dependent on a full or part pension by itself obviously has longer term Commonwealth budget benefits, and these will be particularly desirable if we see an outcome, say, 40 years from now along the lines presented in the 2002-03 Intergenerational Report. But getting to that outcome one way or another requires sacrifices now. For example, if we increase the superannuation guarantee, that will boost retirement income savings, but it will reduce, directly or indirectly, current living standards relative to what they would otherwise be and it will involve to some extent a reduction in current taxation revenue relative to what it would otherwise be. If we reduce taxation on super contributions and earnings, that will boost retirement income as savings, because you are interfering less with the investment accumulation process and you are allowing

the magic of compound interest to work, but it will reduce current taxation revenue. It may not have any effect on national saving—I will come back to that.

Increasing the preservation age to align it with the pension age forces people to work for longer or at least to defer their access to super. Increasing the pension age beyond 65 has the same effect, although there may be some substitution into other social welfare transfer payments. One way or the other, if you think the answer to the question I asked earlier about the proportion dependent on the pension is that we need it to be lower, then costs are inevitable in delivering a policy outcome more in line with what expectations are. I guess the other point is that maybe we cannot answer that question—maybe it is not a sensible question to answer. But, if that is the case, how do we ever make a judgment about the effectiveness of current policy in relation to superannuation? If you do not have these sorts of targets, how can you ever make a judgment about whether forcing people to save is doing the job that we want it to do?

I might briefly make a couple of comments on the taxation of super. I think the shifting of the taxation of super, especially compulsory super, away from contributions and earnings and towards benefits has a lot going for it. It maximises the superannuation savings nest egg that finances retirement incomes, reducing dependence on the pension. It increases the efficiency of the superannuation guarantee. It improves the equity of taxation of super, because only at the end benefit stage can we really know what retirees gain from super saving. Moreover, a progressive rate structure applied at the benefit stage is an automatic incentive to take annuities rather than lump sums. Finally, it is a lot simpler than the current arrangements, not least because of the superannuation surcharge.

Some will argue that such a taxation shift is a cost to the Commonwealth budget. That is true today, but taxing private savings to boost budget bottom lines does little or nothing for national saving; it is just relabelling the saving effort from one bucket to another. Governments, by dint of democratic failure, are constitutionally incapable of running budget surpluses for sustained periods anyway. So it is better to lock the savings away out of the budget limelight, where the temptation to spend them will become irresistible every three years or so, and let them accumulate in peace. If that is done, future governments themselves will enjoy a revenue dividend from higher private savings as the proceeds are converted into annuities and spent on retirement.

To conclude, let me make three points. Adequacy ultimately cannot be considered in isolation from affordability. Improving affordability in a retirement incomes context is all about long-term saving and leaving that saving alone to accumulate as rapidly as possible. Governments have poor track records as long-term savers but, by leaving more saving untaxed until benefits are drawn down, even governments will garner a revenue dividend—and probably just when they need it the most.

CHAIR—Thank you very much, Mr Carmody. Do you think, in relation to what compulsory superannuation will provide, there is a gap between worker expectation and retirement reality?

Mr Carmody—I am not really in a position to answer that question but, from evidence I have seen prepared by others, there does seem to be an expectation on the part of workers that they will enjoy a higher living standard in retirement than their accumulated saving will allow them to enjoy.

CHAIR—You asked a number of questions about the effectiveness of the current superannuation policy, and they are very good questions. Can we afford the present system or a system where there is almost complete or extremely high dependence on the age pension and the associated benefits?

Mr Carmody—Looking at affordability from a Commonwealth budget point of view, given that the age pension is funded out of the Commonwealth budget, the Intergenerational Report suggests that we will have a substantial fiscal pressure build-up likely over the next 40 years. The causes of that partly relate to an ageing population, and it is claimed that they relate a lot more to the rising cost of health but, in the context of the budget, all of the pressures are working to produce a substantial gap between spending and revenue. In that sense, there is fiscal pressure on the budget and on outlays in all their forms which will force governments either to look at all the elements of outlays and decide whether they are affordable, and that includes the age pension, or—and this has not been unknown in the past—to allow, in particular, income tax burdens inexorably to rise as real economic growth occurs. The stark choices we face are either to look very closely at the outlay side across all elements, not just the age pension, and keep tax burdens where they are now relative to GDP, or, if we are to close off that fiscal pressure, to allow tax burdens to rise rather than holding them constant. For governments that is not a hard thing to do. You just have to leave the income tax rates scale where it is. You can even pay back all the proceeds of fiscal drag tax bracket creep attributable to inflation. You can just allow tax burdens to grow with real incomes. It is a longwinded answer to your question, but I am trying to put the age pension affordability issue in the wider context of the budget.

CHAIR—I am glad you raised the issue of health in addition to that of superannuation because, as people live longer, a greater proportion of their disposable income is going to be inevitably spent on health related issues. Do you think that health should be treated as a separate item, or built-in as an additional factor into superannuation savings?

Mr Carmody—We now have a compulsory superannuation system in Australia as part of the retirement incomes policy framework. My response to that would be to answer the adequacy and affordability questions that I asked at the start and to try to make sure that, having answered those questions, we are comfortable that the compulsory superannuation system is doing an adequate job in terms of providing a retirement income with which the economy feels comfortable. Getting that job done in the first instance seems to me to be the priority task for compulsory super. My own view is, as I hinted at during the start of my comments, that we still are not doing enough in that area. I guess I would rather see that sorted out before I thought about loading anything else onto the compulsory superannuation system.

CHAIR—Do you think that Australians will make the necessary drop in their current consumption in favour of higher retirement savings contributions during their working lives?

Mr Carmody—Let me answer that in two parts. The first point is that we now have a pension—which on a number of measures might still be regarded as pretty low—that is now locked in to rising real living standards in this country because it is benchmarked at 26.5 per cent of MTAWE. That may itself be a disincentive for many people to provide for their own retirement.

The other point I would make is that, whatever the arguments about compulsion versus voluntary superannuation savings in the past, we now have a compulsory system. I could argue in support of that system on the grounds that there are many in the community who, because of their living standards or because of short-sightedness or because of a combination of both, probably were not prepared to provide enough for the future by sacrificing spending today. In fact, I think the strongest piece of evidence about the effectiveness of the superannuation guarantee, to the extent that it is effective, is that it forces people who would not otherwise save to do so. Compulsion does not really have much effect on people who are substantial savers anyway, because they can just substitute out of one form of saving into another. The real effectiveness of compulsory super is on the so-called liquidity constrained person. In that sense I think compulsion has overcome what might be regarded as a market failure on the part of those who—at least in that vaguely defined transition range between the very low-income person and the middle-income person—could have provided something for their own retirement but did not.

CHAIR—I note that you have largely addressed the issues of adequacy and affordability but perhaps you can use your wider experience in Access Economics to answer these questions. Given the tremendous growth that is going to occur in superannuation in the next few years—building on top of what we have already seen with over $500 billion in super—can you give the committee some idea of where that money is gong to be invested? Are we going to see lower returns because of the emphasis on equities, or are we going to see more of that money going overseas? To sustain that investment and to provide adequate returns, where do you foresee all this increase essentially going or being invested?

Mr Carmody—I do not think I am in a position to answer that question, apart from noting that, relevant to the adequacy issue, I would not expect in the next decade, or over the next two or three decades, to see superannuation contributions, wherever they are invested, generating the sorts of returns that were seen in the latter part of the 1980s and the 1990s. I think expectations about the adequacy of a superannuation nest egg that are predicated on double digit rates of return are unrealistic. In fact, we should be expecting rates of return in the single digit range. In my view, that does raise a question about whether more could be done to increase the effective adequacy of superannuation contributions by looking at the taxation treatment of superannuation. But that also comes back to the budget implications obviously.

CHAIR—Would there be anyone within Access Economics who would be able to give us some insight into this issue? We are looking at a very big issue and all sides of the retirement incomes question. It has often been said that the Australian market is not sufficiently large. What are the implications of having so much money possibly going overseas? Would there be somebody in your firm who could give us a paper on that?

Mr Carmody—I will get back to you on that.

CHAIR—It would be very handy, because there are very few people who have the ability to look forward, and I believe Access Economics might be one such organisation. We have asked the same question of the bankers this morning.

Mr Carmody—That is a forecasting matter, too, I guess.

CHAIR—Yes.

Mr Carmody—As a person, my most honest answer to that question would be: if I really knew the answer to that question, do you think I would be sitting here?

CHAIR—We hope you would be sitting here giving us the answers.

Mr Carmody—I am really quite serious about that. Investment returns in different segments of the market involve a forecasting exercise of some considerable magnitude.

CHAIR—Absolutely. Nevertheless, I think as a committee we have to appreciate the ramifications of this amount of money on Australian markets.

Senator SHERRY—Mr Carmody, if I had recognised you sleeping next to me on the plane this morning, we could have talked some more before we got here. I found the economic overview really useful. I want to take up a couple of issues that you have mentioned. You mentioned the contributions tax issue, and you said that shifting the tax, especially the contributions tax on the SG compulsory contributions, has a lot going for it. My understanding is that the SG reaches its plateau on an income of about $100,000. There would obviously be a cost to revenue in having reduction in a contributions tax on SG contributions only. Do you see that as a first priority?

Mr Carmody—Reducing the tax on SG?

Senator SHERRY—Yes.

Mr Carmody—If one accepts the proposition that the main area where the superannuation guarantee is effective is on those middle-income and lower income earners who would not otherwise save—that is, the so-called liquidity constrained individuals. They are the ones for whom the superannuation guarantee is actually generating a net increase in their saving. To make that net increase in their saving most effective in terms of the investment accumulation process, building up the nest egg in retirement, I think it makes most sense to target SG. The other reason why I would suggest that that is a sensible approach is that it seems passing strange to me that governments of both stripes would legislate and mandate that a percentage related to earnings be withdrawn from the employee and locked away in a super fund when it is then already saving and then come along and sneak a bit back and call it tax revenue. It is already in a sense withdrawn from the availability for the investor; why not leave it alone to accumulate as fast as possible and then tax it on retirement?

Senator SHERRY—I understand your economic argument. If we had priorities about reducing tax on superannuation, it seems to me that what you are suggesting—reducing the tax on SG compulsory contributions—would be a greater economic priority than reducing the tax through the surcharge, for example, which applies only to high-income earners.

Mr Carmody—My preferred position would be to take the tax off all superannuation contributions and earnings.

Senator SHERRY—I understand that, but we have to prioritise.

Mr Carmody—If you are prioritising, frankly, I would get rid of the surcharge straightaway just because it adds complexity and compliance costs which affect every superannuation investor, including those not caught by the surcharge.

Senator SHERRY—But what about from a fairness and equity point of view, and prioritising? How does a reduction in surcharge tax, which cuts in now at $90,500, help? I understand the administration cost issue. That is very minor for low- and middle-income earners. They do not get any benefit from the tax reduction anyway. They are still caught by the administration because there is still going to be a surcharge even with the proposed reduction. From a fairness and equity point of view it seems to me that the logical thing to do is, given priorities, to reduce the contributions tax on SG as you suggest.

Mr Carmody—If we are really worried about equity then we are presumably worried about the benefit aspect of taxation. We are trying to levy taxation as a rising proportion of the benefit enjoyed by the people being taxed. The only sensible way to do that is to tax at the benefit stage. You cannot know before the benefit stage is reached what a retired person will benefit from accumulated superannuation. If you want priorities, mine would be to shift the taxation burden to the benefit stage and then apply an appropriate progression in the rate structure. As I said in my opening comments, I would move the tax away from the contribution and earning stage because that will improve the accumulation investment process—it will boost the nest eggs faster. When those benefits are being drawn down in retirement, then is the appropriate time to consider, in terms of vertical equity—which is what you are addressing—how people on different income levels should be taxed.

Senator SHERRY—Could I get to the generational equity issue? You were not here but we had some discussion about the baby boomers, 40 to 55, the majority of whom have only had compulsory superannuation since the late 1980s, so there is a very significant time lag issue for them. What about a priority of, whatever the tax reduction is—contribution surcharge or whatever—targeting that group, of having a tax reduction to boost retirement incomes for people who have not received the full benefit of the superannuation guarantee, for example?

Mr Carmody—That is getting into more complexity. I would like to think about that. On the face of it, it does not appeal to me, but I have not really thought about it in detail.

Senator SHERRY—The current baby boomer generation, for those who rely on compulsory super, which is about 60 per cent, have had it only since the late 1980s. Generation X, and I think the generation prior to that, the Net generation as they are called, will have super close to nine per cent for most of their working lives. I am really worried about it from a policy point of view. I worry about the politics of it and what is going to happen with the baby boomers on the edge of retirement. The surveys are interesting. The expectation versus reality is going to cause very significant political pressures. That is why I raise the issue as a priority at least for this baby boomer generation.

Mr Carmody—One of the reasons I would like to think about that a bit more is that in other respects one can argue that the baby boomers have done pretty well relative to some of the generations that are coming after them. I accept that they are most affected by the transition, and for some of them they will be still contributing to pay-as-you-go pension payments and ramping up their own contribution for their own retirement. I can see that story. But from a wider

perspective I wonder whether the baby boomers are necessarily as badly done by as just looking at compulsory super alone would suggest.

Senator SHERRY—Let us move to the other end of the scale, to those who are already retired. There are a range of tax concessions and incentives for retirees. One substantial one is a 15 per cent rebate if you take an annuity product. Another, that was introduced in the budget last year, is a 15 per cent rebate on your income tax. The outcome of that—and we see it advertised all the time—is that a couple in retirement can earn up to $53,000 a year tax free. Do you think that approach is sustainable long term, having people receiving that level of income in retirement and not paying any tax?

Mr Carmody—Again, I do not think I can answer that in detail now. But to the extent that the retirement income they are receiving is attributable to savings that had been taxed on the way in—

Senator SHERRY—Could I just say in regard to ‘taxed on the way in’ that the superannuation of a significant proportion of this group was accumulated when the tax rate on super was less than five per cent, pre-1983.

Mr Carmody—There are two issues. One is that if we are talking about the pre-1988 superannuation taxation regime—which was close to where I think it should have been and it is regrettable that it has changed—then I guess there would be a question about allowing substantial concessions at the benefit end. To the extent that we are talking about retirement income that has been accumulated under a regime where it is taxed on the way in, while it is accumulating, and on the way out, I have a lot of sympathy for that. Basically, you have interfered with the investment accumulation process big time anyway, so why should you also interfere with it in some sort of full-blooded way at the benefit stage?

Senator SHERRY—What about where, up until 1988, people—I thought it was earlier—paid virtually no tax or very low tax on superannuation? They paid almost no tax on the way in and, now that that group have retired, they are receiving very significant tax concessions on the way out, when they are taking it as income.

Mr Carmody—I would like to see the numbers, but one of the features that adds to the complexity of the super system is grandfathering. Grandfathering makes a lot of sense in terms of avoiding retrospective application of what are adverse tax decisions for individuals. I doubt that it makes a lot of sense to pursue an argument that, because of decisions they have made on the basis of the rules of the game as they were decades ago, they should be taxed more now—whatever you might think about the sensibility of it in terms of a clean slate approach.

Senator SHERRY—I am not suggesting that you tax them more. The interest I have is that the budget last year, for example, gave an additional tax concession to this group of people. I would like to see the numbers on that, but it was not modelled in the Intergenerational Report. Do you think things like that should be modelled in the Intergenerational Report?

Mr Carmody—A lot of things could be modelled in the Intergenerational Report. An awful lot of assumptions need to be made to produce the numbers that we have seen in the Intergenerational Report.

Senator SHERRY—I understand that and I have my criticism of that. What concerns me is that—and you have obviously read the IG report—there is an assumption in the IG report that revenues as a percentage of gross domestic product will remain absolutely static. But there are a range of impacts through tax expenditures, individual policies that have been introduced in recent times, where there is no projection or attempt to model what the cost of those will be 40 years out—at least to have a debate about it. Do you think those sorts of tax expenditures should be modelled in the same way that other expenditures were modelled in the IG report?

Mr Carmody—As I said, I think there are a lot of assumptions made in the IG report which could be looked at more closely. I would not just single out the ones you have looked at.

Senator SHERRY—I am not disagreeing with you. My point is this: some of these were not even modelled. You can argue about the assumptions made in any economic modelling and projections 40 years out. I have made my point about some of the assumptions that were made, but these things were not modelled. These policy decisions in relation to tax expenditures were not modelled. Why shouldn't they be modelled? Whatever the assumptions are, we should at least have it out there as part of the public debate.

Mr Carmody—As I said before, there are a lot of things that could be modelled. I do not know what was and what was not modelled. I do not know what lies behind the assumption about a constant tax to GDP ratio. Certainly, from a personal point of view, I could point out to you a very powerful mechanism that, if left alone, will increase the tax to GDP ratio substantially over that 40-year period—I have already referred to it—and that is because governments of either persuasion are not prepared to index tax brackets to growth in GDP and inflation.

Senator SHERRY—My understanding of the compulsory superannuation guarantee—and I did play a role in this—was that it had a twin policy objective: it was not only to reduce the number of people who were totally dependent on the age pension but also to provide an additional retirement income. Is that your understanding?

Mr Carmody—I think that is quite clear in *Security in retirement: planning for tomorrow today*, section 5, under 'Retirement income targets' on pages 19 to 23. I think that comes through pretty clearly. I found it interesting that there seemed to be concern that 75 per cent of people in retirement still had access to a part pension, and a statement was made immediately after that observation that own provision is too low. But if you read further down in that section of the report, it does appear that the main role of the SG was to add to the retirement income of those dependent on a part pension and reduce those dependent on a full pension.

Senator SHERRY—Yes. If we had taken the further steps of the three per cent employee contribution and the three per cent government contribution, then that would have been an additional six per cent. There is no need to traverse through the history, but it did not go ahead. That would have had a much more significant impact on the real cost of the basic pension, wouldn't it?

Mr Carmody—Any increase in the SG, other things being equal, will improve adequacy at a cost in terms of forgone living standards today and tax revenue today.

Senator SHERRY—On that issue of forgone living standards: let us say you had higher compulsory contributions from the employee direct, say three per cent. It does not have to lead to a drop in consumption, does it? If it is paid out of improved productivity over time, that is not going to lead to a drop in consumption. It means that the level of increase in consumption will be less if it is phased in over a sufficient period of time, doesn't it?

Mr Carmody—It involves a cost, as I said earlier, relative to what otherwise would occur. Obviously, if you have growth otherwise, then it may pare back that growth rather than lead to an absolute drop.

Senator SHERRY—Finally, the issue of transaction costs—effectively, having compulsory private superannuation, a level of voluntary contribution and the cost efficiency of having that administered in the private sector. There are significant fees and charges both in the accumulation stage and in the retirement stage. In the retirement stage, two to five per cent is quite a common average cost. Do you have any comment to make about the transaction costs and their efficiency and impact?

Mr Carmody—Your question was about these costs that are incurred in the private sector. I want to come back to—

Senator SHERRY—Administration, funds management, advice—all those sorts of things. It is a huge industry.

Mr Carmody—My only comment would be that, as we move into a period where average returns on funds invested move from double-digit to single-digit rates of return, the question of costs, presumably, will become something that is more top of mind. I suspect also that competition between the funds managers plus that greater top-of-mind awareness of costs will have some influence in bringing those costs down. I am vaguely aware of the complexities in actually measuring those costs, and there are arguments about how that is done, but they would be my two observations. If implicit in your question is whether it would be better for this to be managed somehow in the public sector—and I am not saying that was but it might have been an implication of your question—I would come back to my earlier comment, which was that I would much rather see superannuation savings accumulating out of the glare of the budget spotlight in the private sector and in that way contribute to adequacy in future.

Senator SHERRY—I agree with you because I think there is merit in your argument but, effectively, there are transaction costs in a privatised system or those with a large element of private provision. If you look at some of the international experience—the United Kingdom and Chile are two interesting examples—the cost of the structure, particularly the retail distribution, is quite substantial.

Mr Carmody—Whatever happens in the United Kingdom and Chile does not particularly bother me, as long as it is not replicated here if it is really bad. Frankly, I do not care about Chile.

Senator SHERRY—I agree with you in saying 'as long as it is not replicated here'. The retail distribution cost of private pensions or superannuation, or whatever terminology is used, is a significant issue. Should it be an issue?

Mr Carmody—I do not have any comments on that. Obviously, it costs to deliver annuities and pensions, and I do not know whether that cost is as low as it can be. My focus in appearing this morning has been on getting to a stage where we can worry more about that and less about whether people are going to have enough to live on in retirement, because of their ability to accumulate savings during their working years.

Senator SHERRY—But one of the issues that impacts on the final retirement saving is that one per cent commission charged through the lifetime of a product reduces the final saving by 10 per cent, so it can have a big impact.

Mr Carmody—Imagine what a 15 per cent earnings tax does then!

Senator SHERRY—That is a perfectly valid comment. The two major direct issues that the government can have a significant say on, in terms of cost, are fees and charges, and tax. Investment earnings are something it cannot influence, can it?

Mr Carmody—I would agree with you. The thing the government can have most influence on is tax.

CHAIR—I worry about the sustainability of paying pensions in the private sector. If we are going to try and move away from the lump sum mentality, we have to do everything to encourage the paying of pensions. The emphasis in the private sector, especially in an environment where people are living longer, is to provide a greater degree of certainty in setting actuarial rates. Do you think we should be looking at a universal pension payable particularly to people aged over, say, 85 or 80, or some designated figure like that, where people's other expectations of consumption are dramatically changing?

Mr Carmody—A universal pension for people aged 80 would involve abolishing the relevant means tests. Again, it comes back to a question of that nexus between adequacy and affordability.

CHAIR—But can't you see the life companies having great difficulty, or putting up their effective costs or reducing their benefits, if they are facing the option of paying people some very high pensions up to the age of, say, 100? If they had a cut-off figure of 85, the setting of a whole lot of pensions actuarially would be a lot less difficult and more user friendly. If I am going to take out a pension and my family history shows that I am going to only live to about 70, I am going to be really discriminated against, if the settings by the actuary are working on someone living until the age of 85. Can you see the difficulty?

In terms of getting a fairness into the complying pension to all age groups, set it to age 80, 85 or some figure in that area and then have a universal pension after that. The whole purpose is to try and keep encouraging the concept of a complying type pension arrangement, which I do not want to reduce the effectiveness of because some people are living so much longer. Or is that a question for the actuaries?

Mr Carmody—It is probably fairer for the actuaries, but the one point I have been trying to make all morning is that adequacy and affordability, whether we are talking about the public sector or the private sector, are inextricably linked. To the extent that one removes the relevant

means tests on the age pension that exist now, a significant part of the cost will be a cost borne by the budget and so it will immediately become something that needs to be examined in the context of the overall budget situation.

Senator BUCKLAND—You mentioned earlier the expectation of workers—

Mr Carmody—I did not mention it, I responded to a question, Senator.

Senator BUCKLAND—I beg your pardon. You might respond to another question. There is an expectation or perception among workers that they will retire and that they will come into this great wealth they have accumulated over the years they have been in superannuation, this lump sum amount of money. It appears to me that there is no education program to explain properly to workers what this money is going to do for them. They think they will have a pot of money to pay off a house or even buy a house, as many have done in their older years. Then they give some to the kids to help them along, and then they are stuck, they have got nothing left. What education programs are about at the moment to help people preplan their retirement with their superannuation? I have got plenty of personal experiences that I have dealt with over time and I know that my advice has generally been to go and see someone else because I do not know, but I am quite fearful of the expectations of people as to what their superannuation will do for them in comparison with what in fact it does do for them.

Mr Carmody—Frankly, my advice would be to go and see somebody else too. There has been increasing publicity, at least in the financial press, that tries to convey the point that purchasing an annuity or a complying pension of a reasonably modest amount in the private sector requires a fairly large nest egg. There are rules of thumb that have been put out in articles in the media about the sorts of savings you will need and the rates of saving you will need if you start at various points in your working life to get to those sorts of targets. If there is in fact this gap between what people expect to earn as a fraction of their pre-retirement income in retirement and the amount they have accumulated, there is arguably a case for more widespread education. Part of the problem, I suspect, is the very reason we have got compulsory super in the first place: that for a lot of people retirement is so far away that they probably do not devote as much attention to it as they should.

Senator BUCKLAND—It sneaks up on us quicker than we think, doesn't it? One of the difficulties with that is that a lot of workers do not read the financial press and it worries me. I think that is something we need to address, but there is not enough obligation on the funds to provide education for people becoming members of superannuation funds. I think there is a real void there because of this artificial expectation of 'I'm going to be rich'. It is the most money most people will ever see, probably myself included. That worries me somewhat in terms of people's understanding of superannuation. It worries me also from the other side, that those working towards using superannuation as an alternative to the pension are not providing an education program and getting the understanding out there. There is something missing in the whole process.

Mr Carmody—I do not think I want to add any more comments. I have certainly seen some evidence of attempts to inform people about how much is required to live on income X in retirement. Whether enough education in that area has been undertaken, I do not know. The fact is that compulsory superannuation is most effective for liquidity-constrained people—by

definition, they are people with lower incomes. They are the ones where the accumulation of nine per cent is probably the best they can achieve, because they are forced to do it. If they were not forced to do it, they would not do it. It tends to be the case that the amount they can accumulate from a nine per cent superannuation contribution over their working life may not give them the income they expect in retirement.

Senator BUCKLAND—How could you reasonably and adequately manage as superannuation fund members people who are not in employment—a worker’s spouse, single women or men who have lost their partner in older age, and children? Where would their income be derived from? They would be putting in their own contribution, but what else could they expect to have contributed to their fund other than the earnings of the fund itself? What are the limiting factors to having these people join?

Mr Carmody—Obviously, the need for retirement income is not a function of whether or not you have a job. It is a function of whether or not you are retired. That said, any sort of widening of access to superannuation, which in principle I would support in isolation, will involve the old affordability question in terms of the budget. In terms of employees’ contributions versus employers’ contributions, that is actually a little misleading anyway. Although the superannuation guarantee is imposed on the employer, if you have half-way competitive markets over time, ultimately the employee as consumer and/or as employee will be paying it, not the employer. I think the formal incidence of the superannuation guarantee need bear no relationship with the actual incidence over time, so it does come back to the individual contributions.

Senator BUCKLAND—If a person were to join a superannuation fund but they did not draw an income as an employee—I will use my wife as an example; she does not have an income but has often talked about joining a fund and has asked around about doing that—it would be up to her to put in funds, with no supplementary payments from an employer, and hope that the fund itself is always earning rather than having poor years, as occasionally they do. That is little different from just sticking the money in the bank and hoping for the best.

Mr Carmody—I think we have moved more and more to accumulation based superannuation funds, and that is the fact for all of those funds. The nest egg will depend on the contributions put in, the earnings performance of the fund and the taxation treatment of contributions and earnings.

Senator SHERRY—One issue you have touched on is that effectively it is compulsory saving, particularly for low- and middle-income earners who have a less propensity to save. Have we seen that reflected in national savings figures to date? If we have not, why not?

Mr Carmody—We have seen—and it is the sort of answer that I gave this morning—some of the modelling work that has been done, for example, by the RIM task force. Have we seen it in national saving? Well, national saving performance is a function of a whole lot of things over and above superannuation performance. I would not want to be pinning—

Senator SHERRY—Private saving.

Mr Carmody—With private saving you can get into arguments about whether we look at just the household sector or the household sector combined with the corporate sector. If you combine the two, our private saving performance is better than if you just look at the household sector. From a national saving point of view, you have got to look at the government's performance as well. There are a whole lot of things to disentangle there.

CHAIR—I have a question from Senator John Cherry of the Australian Democrats, who is an observer here today. He asks: is there any public benefit—for example a budget benefit—in increasing the tax concessions on super for high-income earners?

Mr Carmody—That depends on the extent to which high-income earners respond to that concession. It depends on whether you are looking at the budget next year or over a longer period of time. The extent to which the concession induces a higher rate of saving is a debatable proposition for high-income earners because they have got the ability to substitute saving. There is also the question of: if you give just a tax concession, effectively they enjoy an income tax cut as well as a reduction in the distortion against saving. If they respond positively to that concession, then one would expect to see a budget cost in the short term, but that might lead to a budget benefit in the longer term. I would be less confident about that situation than I would be about people who are liquidity constrained and facing a concession.

CHAIR—The retirement modelling done by the RIM section of Treasury was undertaken quite some years ago. Have any of the underlying conditions changed significantly?

Mr Carmody—I cannot remember all the assumptions that were made then. I cannot comment on that; I do not know.

CHAIR—Would you be able to take it on notice or not?

Mr Carmody—I think that is a question for them, not me.

CHAIR—Okay, then. Good.

Senator SHERRY—They are not easy to get answers out of, unfortunately.

CHAIR—Private health insurance—how can wider coverage be encouraged, and are we targeting it properly at the moment?

Mr Carmody—I have no comment on that.

CHAIR—Thank you very much for your contribution today; it has been very enjoyable.

[12.04 p.m.]

DEANS, Mr David Randall, Chief Executive, National Seniors Association

CHAIR—Welcome. I invite you to make an opening statement.

Mr Deans—First of all, I would like to say that my comments are mainly drawn from our 230,000 members around Australia who have had input into the paper that we have provided for the committee. Most people in Australia do not think of it this way but, really, Australia has one of the best, world respected retirement income policies with the three pillars—superannuation, the age pension and personal savings. This was evident to me recently when I attended the United Nations assembly on ageing in Madrid. It was certainly interesting to talk to other countries, and you come back thankful for what we have got. So, when we are debating it today, we are talking about one of the world's best packages. However, there is a lot that can be done to improve the situation for people when they retire and their income in retirement. We would encourage more personal savings into superannuation by simplifying the superannuation system itself, reducing the tax on superannuation and, particularly for people aged 50 years and over—that just happens to be our membership age group, but it is for other reasons as well—

Senator SHERRY—I did notice the correlation in the age!

Mr Deans—Thank you, Senator—moving towards taxing the end benefits, rather than in the early stages of the savings, and a very strong one in our mind is undertaking public education on superannuation itself. We believe that there is really little known about superannuation and, to some degree, savings generally in the community. There should be every incentive to encourage investment in superannuation and, therefore, that leads to self-provision in retirement. Obviously—or maybe not so obviously, but certainly hopefully—it would lead to a smaller budget item on the age pension.

At this stage, there is an ever-reducing number of self-funded retirees, due to the ability to obtain $1 or part pension and, therefore, the concessions that come with the age pension. There is a great move out there in advertising it, and it is in the mindset of people to get at least a part pension so that they can get the concessions that come with the age pension. Again, incentives should be directed to keep people out of social security, rather than that mindset of getting that small pension to be able to get the benefits in the form of concessions. One incentive would be to remove the 15 per cent surcharge on superannuation for those earning approximately $90,000. In our submission we have highlighted that as being probably a bigger benefit for those people aged over 50, because that is when they are reaching their peak in income and when they can contribute a significant amount of money to their superannuation savings.

There is also the issue of no superannuation contribution for people earning $450 a month. These days, when we find a lot of people unemployed, particularly the people in our membership age group, they may have two, three or four jobs and receive less than $450 for each of those jobs, but they do not receive any contribution into superannuation—yet, if you treated their income as one amount, they should. Also, that is more serious for women than for men because women have broken work force participation. It has been reported on quite well

that they will have great difficulty in being self-funded retirees because of that broken work force participation during those years.

As I mentioned, education on retirement incomes and also on retirement generally should be undertaken, and I believe that the best people to undertake this are government, with assistance from the private sector. I think one of the simple things that we need to do as part of this education is to speak and write in simple English when we talk to the normal people out there who have no idea about superannuation until we educate them—and that is the case in most situations, not only with superannuation but with any kind of saving.

Retirement is really an unknown factor. I think most of us can put ourselves in the position where we think we know what we are going to do in retirement, but I am yet to see the book that anyone has written about what you can expect as you approach retirement—even if it gets down to advising people that it is in the last two years of your life that the health costs are very expensive to the system; it is not the time when you retire at 65, or at whatever age you retire, through to the time that you pass away.

The adequacy of the single age pension is questionable. The latest OECD scale assumes it takes 50 per cent more for a couple to reach the same living standard as a single person and, in Australia, it is almost 70 per cent more than the single pension that is paid to a couple. We recommend strongly that consideration be given to adopting the new OECD scale and to raising the single age pension accordingly.

The concessions that come with the age pension are most sought after, as I mentioned before, even though the value is only about $2,000. But it is seen that that is something that people really adjust all their assets to get. Of course, the House of Representatives committee that investigated the issue of concessions put that sort of price on it. Our recommendation, though, is that these concessions be made available to low-income self-funded retirees who would be earning, say, $23,000 or $35,000 for a couple. There is the issue of retirees aged between 55 and pensionable age. For a woman, that is 62, and, for a man, 65. I would suggest that Canberra is full of people like this. The incentive is there for them to get out just under the age of 55—the day before turning 55, in fact. There is no benefit and certainly no work opportunities around for them, so they have a most difficult time until they may reach the stage when they can receive a part pension.

The superannuation contribution by those people in the work force aged 70 years and over is another issue. As an employer, I experienced this recently. One of our staff turned 70—and, yes, some people do work until they are that age—and, all of a sudden, we did not have to pay the eight per cent because that person turned 70. It was only a few months ago. That is discrimination and something should be done about that because, from our point of view, there should be every encouragement for people to stay in the work force as long as they choose. Finally, every incentive should be available for people to be self-sufficient in retirement and out of the social security system. This should be the aim of all parties' retirement income policy.

CHAIR—In your written submission, you look at a number of interesting issues: increasing convalescent care facilities so that older Australians are able to recover properly from in-hospital treatment, reducing the waiting lists for public health services, continuing efforts to remove the gap payments so that people on limited resources are not faced with unexpected

bills et cetera. These are very interesting matters, aside from the revenue implications, but I was wondering if you would like to comment on how we can encourage more people to move into the private hospital system.

Mr Deans—Over the years National Seniors has in fact encouraged the government to make the decision to provide incentives, which of course you could argue were there now. Why don't people take up that opportunity to go to private hospitals rather than public hospitals? It usually comes back to the gap that they have to pay. Until we can achieve a situation where the gap is not there on the cost of health care it is going to be most difficult to see more people take up private health insurance.

CHAIR—Do you think the gap is more important than the straight out annual or monthly premium?

Mr Deans—If people are in private health insurance my feeling is, particularly with our membership age group, that they will stay in it. Before the incentives were put in place we always wondered how people who were on a full age pension—and a great percentage of those people in fact had private health insurance—could afford it. You wondered whether they were not going without food almost to be able to afford their private health insurance. They were scared because they were coming up to the age where they might need a hip replacement and they knew there was a waiting list in the public hospital so they would stay in private health insurance. The gap for those people who can choose whether to be in or out of it is a critical issue.

Senator SHERRY—I notice you have recommended the principle of a tax reduction on superannuation for people over 50. How does a tax reduction for people who are on a surcharge income, which is more than $90,500 now, benefit the considerable majority of people who are over 50 and still working?

Mr Deans—What we argue is that is at a time when their income is at a peak.

Senator SHERRY—I think three per cent of the working population is on an income greater than $90,500. I accept there would be a greater proportion of people who earn more than $90,500 who are over 50: I am sure that is the case. But how do people benefit from that proposal who are not earning $90,500?

CHAIR—Just before you answer that, for the *Hansard* record I think we should clarify it. We are not talking about taxable income; we are talking about taxable income plus a number of other matters added back, including fringe benefits. We are really looking at a lower tax surchargeable income, which is higher than a taxable income.

Senator SHERRY—You say reduce the tax on superannuation either across the board or for people over 50 drawing closer to retirement, and then you talk about confining that to the surcharge tax. How does that benefit low and middle-income people who are over 50?

Mr Deans—I do not think I could sit here and argue that it would because they are not paying the 15 per cent or even part of it.

Senator SHERRY—That is right.

Mr Deans—Why we have brought that policy forward is as an incentive for people to provide for themselves. In the long term that would reduce the budget as far as the age pension is concerned.

Senator SHERRY—Let us go one step back. Why do you argue there should be a tax reduction on superannuation for people who are 50 years of age and older?

Mr Deans—It is not the norm these days but it could have been argued many years ago that it was the norm. Many people have paid off the mortgage on their house, the children have been educated and hopefully left home, but, if not, they are still at home—

Senator SHERRY—That is not always the case.

Mr Deans—but they have got more disposable income. If we could encourage them by lower taxes where they can see a definite increase in the value of those funds rather than doing something else with it, they will invest it in superannuation.

Senator SHERRY—But if they make undeducted contributions they are not paying contributions tax. The issue here surely is the 50 and older who are receiving SG, compulsory contributions, on which there is tax. That is correct, isn't it?

Mr Deans—If you think of someone—

Senator SHERRY—You are talking about a tax reduction—and I am not disagreeing with the principle you are putting forward—but how do you help people who are 50 years and older who are receiving SG and are taxed on it if you confine the tax reduction just to people who are on a taxable surcharge income of more than $90,500? Don't you want to help the people who are 50 and older who are receiving SG and paying 15 per cent tax on it?

Mr Deans—Who are not paying 15 per cent?

Senator SHERRY—No, who are paying contributions tax. Don't you want to help that group of people?

Mr Deans—Of course.

Senator SHERRY—But you are not suggesting that.

Mr Deans—What we are looking to do is encourage people to invest in superannuation. What the 15 per cent surcharge is doing is discouraging people.

Senator SHERRY—It lowers their retirement income. Doesn't the 15 per cent contributions tax on SG reduce their retirement income as well?

Mr Deans—Most certainly, yes.

Senator SHERRY—Yes. If we are looking at an age based reduction in contributions taxes, shouldn't we be looking at a reduction in the contributions tax for all of that age group?

Mr Deans—I would not disagree with that.

Senator SHERRY—That is what I was trying to get to. Do you think the fact that a significant proportion of this group of people who are 50 and over have not had lifetime superannuation coverage is another reason for targeting a tax reduction at this group, given that the majority were not in the super system until the 1980s?

Mr Deans—Personally, I would take that as a very positive move, if you are recommending that.

Senator SHERRY—There are two other quick matters. You talk about casualisation and people earning less than $450 per month. I agree with you, but how would you cover the administration costs? The amounts going in would be quite low, and the cost of administering such low contributions would eat up a significant amount if people were paying less than $450 in taxable income. Have you thought about that issue?

Mr Deans—If you took the aggregate, of course—and that is the way the administration fees would need to work rather than just each being on $449—if they had three or four positions that they filled as part-timers, consultants or portfolio employment, as they are beginning to call it now, there would be a need to treat that as the aggregate rather than the individual sums of salary.

Senator SHERRY—Don't you think there would need to be some sort of protection in cross-subsidisation? We have it in part at the moment with member protection. Your account cannot drop below $1,000. Don't you think there would need to be some way of cross-subsidising the administration costs for this group of people? The contributions would be quite low.

Mr Deans—Without knowing what the costs would be, I would not disagree with you.

Senator SHERRY—You touched on the issue of the over-70s. Last Friday at about one o'clock in the morning, as I vaguely recall, we approved an extension of voluntary superannuation contributions to people to the age of 75. I did ask about this in the chamber but, as you pointed out, the SG was excluded for that group. You can get SG up to 70, and now you can make voluntary contributions up to age 75, but for 70 to 75 there is no SG contribution. Are you saying that they should get SG contribution as well up to age 75 if they are working?

Mr Deans—That is our policy, yes.

Senator SHERRY—Do you have any idea why the government did not include that in the policy in the bill we have just passed?

Mr Deans—No, I am not aware.

Senator SHERRY—It puzzled me, and I did not get an answer really.

Mr Deans—Both issues were certainly in our submission to government.

Senator SHERRY—Thank you.

Senator BUCKLAND—I note your comments regarding how casual workers can contribute and what they can do. What about those workers who are forced to leave employment because of industry restructure or closure and who, quite frankly, even though they are not 50, cannot get back into the work force? What measures are taken to protect these people and their super into the years ahead? They generally get a lump sum payout when they finish but say that has gone and they are then on a pension until their super is available to them. Have you given any consideration to that?

Mr Deans—No. Our membership has not brought that forward to us and, therefore, we have not considered it.

Senator BUCKLAND—In that case, what group of people constitutes your membership?

Mr Deans—Anyone who is 50 years of age and over.

Senator SHERRY—I have one other issue to raise. Anecdotally, I have been hearing from people who are retired or who coming up to retirement about their increasing concern in relation to the general security of their superannuation or their post-retirement product. They are increasingly worried about the combination of theft and fraud and about lower investment returns. But let us deal with theft and fraud. As a matter of principle, if a person whose superannuation in accumulation or post-retirement is stolen as a result of theft and fraud, do you think that they should be fully compensated when that happens?

Mr Deans—First of all, this will be my personal view. I would like to say yes, except that, when any of us make an investment, particularly if we have a choice of where we are going to make that investment, we take a risk. We have seen the situation where people in retirement have invested large sums of money and it has been rorted. It is usually, of course, very high interest rates that they are looking to get, and so the risk is higher.

CHAIR—We are starting to run out of time. We will take one more question from Senator Sherry.

Senator SHERRY—I just want to finish off this issue. What about when superannuation guarantee is compulsory?

Mr Deans—I believe there would be a very good argument to have that guarantee, yes.

Senator SHERRY—Could you have a talk to your members about this issue, because it seems to be an issue that I am increasingly hearing about. I am sure that you are aware of the problems with solicitors mortgage funds, which is another sort of collective vehicle and, anecdotally at least, there seems to be a lot more worry about this.

Mr Deans—I think, though, that solicitors mortgage funds tend to relate more to people in retirement, rather than before retirement.

Senator SHERRY—Yes. I am concerned about both.

Mr Deans—Yes.

Senator SHERRY—Why shouldn’t a person in retirement, if they go through some sort of collective vehicle where risk is absolutely minimal in terms of investment—that is, you spread the risk—be compensated when their money is stolen? I am not talking here about poor investment return and compensation for that; I am talking about the money being literally stolen from the funds.

Mr Deans—I think there is a very good argument for that, yes.

CHAIR—Senator Cherry has a question but, because of time limitations, we will have to ask you to take it on notice. We will give you a copy of the question to take on notice.

Mr Deans—Yes, thank you.

Proceedings suspended from 12.29 p.m. to 1.34 p.m.

ADAMS, Commodore (Rtd) Harold John, National Vice President, Australian Council of Public Sector Retiree Organisations Inc.

JOHNSON, Mr Gordon, National President, Australian Council of Public Sector Retiree Organisations Inc.

MORONY, Mr Frank, Councillor, Australian Council of Public Sector Retiree Organisations Inc. and President, South Australian Superannuants.

PAULE, Air Vice Marshal John Alan, National Secretary, Australian Council of Public Sector Retiree Organisations Inc.

CHAIR—It is a pleasure to welcome the Australian Council of Public Sector Retiree Organisations. I remind the witnesses as well as my colleagues that last time you appeared before us we picked up a number of your recommendations which actually saw some legislative improvements for your members. It was probably not enough, but I suppose everything is an improvement. Let us hope we can have similar success today. We invite you to speak to your submission.

Mr Johnson—I would like to add one point on behalf of Mr Morony. He is also a member-elected representative on the South Australian Superannuation Board, but he is not appearing here as a representative of the South Australian government.

Mr Morony—Or the superannuation board, in fact.

Mr Johnson—Mr Chairman and members of the committee, thank you for providing this peak council with another opportunity to press for changes to public sector superannuation. It is part of our endeavours to have superannuation benefits for retired civilian government and military personnel adjusted to match the standards enjoyed by the rest of the Australian community. ACPSRO asked the former Senate Select Committee on Superannuation and Financial Services to recommend changing indexing of our pensions to twice yearly. As most of the members of this committee were members of the former committee, we would like to record our appreciation for the efforts of the former committee in achieving that change for our members. We of course look forward to achieving further urgently needed improvements as a result of this hearing.

Our submission sets out the matters which are still of great concern. Rather than repeat what has already been submitted to the committee, I would like to set the scene in the broader context in line with some of the issues you have listed as likely to be addressed during this inquiry. First of all, it is essential to convince this committee that public sector pensions, which have been eroding for the last decade in terms of living standards, are quite modest benefits. There were 116,000-plus CSS and PSS pensioners as at 30 June last year and 62 per cent of that total receive $20,000 per annum or less as a pension. The military situation is just as depressing: as at the same date, there were 57,500 pensioners and 80 per cent of this total receive $20,000 per annum or less.

Looking at the midlevel of these pensions, 26 per cent of Commonwealth civilians and 15 per cent of the military receive pensions of between $20,000 and $30,000 per annum. It is only fair that we also address the higher end of the pension scale. At the higher end of pension payments, only three per cent of civilian, Commonwealth CSS and PSS pensioners and 1.4 per cent of military pensioners receive $40,000 or more per annum. If you combine the highest civilian and military numbers in this category, it is a mere 4,500, or 2½ per cent out of a combined total of 174,000-plus pensioners, who receive $40,000 or more, and, to refine it just one step further, only 0.7 per cent of pensioners receive $50,000 or more per annum.

The low levels of these pensions are further highlighted when compared to the income test for receipt of a part or full Centrelink pension. Currently, from 1 July to 19 September this year, married couples receiving less than $51,454 per annum combined could be eligible for a part or full Centrelink pension and singles receiving less than $30,810 could also be eligible for a part or full Centrelink pension. This now means that nearly all public sector civilian and military married superannuants could have an eligibility for a part or full Centrelink pension. Whether they qualify under the assets test we do not know, but they could if they did. The state situation is in many cases less attractive, and therefore it is important once and for all to dispel the opinion held by so many in government, as well as the community, that all public sector superannuants receive generous benefits. The majority are not receiving generous benefits at all and very many find retirement less than rewarding or satisfying after 30 or more years of government service during which time they made personal contributions to their own superannuation. It makes us very angry when we read articles by financial journalists who refer to our public sector superannuation schemes as being ‘Rolls Royce models’. That was in an article published a few days ago.

Reflecting community attitudes, it is also government policy to encourage older citizens to remain in their own homes for as long as possible. The current superannuation preservation age is 55. So, looking at the age profile, for example for CSS pensioners, it shows a steady rise in numbers from 60 years of age and peaking in the 75 to 80 bracket. The last census of the nation, the 2001 census, also reveals that there are now in excess of four million people 55 years or over, with 1.7 million of these who are 70 years or older. Of the 70 years or over group, about 10 per cent are admitted to aged care facilities, and we have been told that this number tends to remain fairly constant. The remaining 90 per cent of 70 years or older continue to live independently or are cared for by their family or other carers. Many public sector superannuants are in the 70 or over bracket and, considering the large number of these at the low-income end of the scale, their ability to continue to live independently is being adversely affected by the erosion in the value of their pensions due to the inadequacy of CPI indexing.

However, the alternative for some of these retirees of seeking admission into aged care facilities would be a much greater cost to government than would be the added cost of improving public sector pension indexing. In dollar terms at present, the average daily amount across all states and territories paid by the government as residential care subsidy to nursing homes for each resident classified at level 1 is $109 per day, or just under $40,000 per year. At level 5, which is hostel care, the subsidy is $13,500 for each resident. Added to this are the personal contributions the resident must make by law. Therefore, increasing admissions to aged care facilities by, say, 1,000 would incur an additional annual cost of $40 million at level 1 care and $13.5 million at level 5 hostel care. At the federal level our whole approach to this inquiry is consistent with the government’s desire for retired people to live in their own homes as long

as possible and is, in our view, affordable in budgetary terms. We look to the government to encourage the states under the terms of the heads of government agreement to adopt any changes made as a result of this inquiry. I would like ask my vice-president, Commodore Adams, to say a few words too.

Cdre Adams—It is against these changes in Australian society, particularly in respect of ageing, that we have invited your committee to address the issues covered in our submission, particularly as they affect Commonwealth and state funded superannuants. In addition, we have indicated where our people are financially disadvantaged vis-a-vis the wider Australian community. For example, the practice of income splitting already exists in that both DSS and DVA pensions are split between husband and wife. Apart from equity, we believe that the recommendations we have made to your committee will go a long way towards providing fairer outcomes for our people and will enable those of mature years to enjoy less stressful and worrying retirement.

Furthermore, we believe that it is the duty of government to ensure that those who have loyally served governments in important fields of public service, including military service, should not be forgotten to become the poor relations in Australian society. It is against this background that we have asked you to consider the issues outlined in our executive summary. The reasoning for our recommendations is developed in the main body of the paper. Finally, we see the correction of anomalies, such as indexation, income splitting, taxation, especially the superannuation contribution surcharge tax and reversionary benefits, as urgent because the disadvantage gap now being experienced by over half a million Australians is widening every day.

While the recommendations in our paper stand on their own, there are two matters in particular that we would wish to draw to your attention. In relation to the notional surcharge contribution factors, one aspect applicable to military personnel in the calculation of tax surcharge liability is of particular concern to us. We believe that it is iniquitous that Australians who volunteer to go in harm's way as members of Australia's armed services should be assessed at a higher rate than those in civilian occupations, simply because military superannuation schemes are deemed to be more beneficial. We believe that this is reverse discrimination of the worst sort.

Finally, we have gone into the question of costs in some detail in the paper. It is particularly drawn to your attention that the increased costs incurred by government are quite manageable in that the long-term cost of all the existing schemes is, according to the Commonwealth Actuary, a reducing one when expressed as a percentage of GDP. I would like to ask our councillor to represent the views from South Australia as they relate to their scheme.

Mr Morony—I represent South Australian state public sector superannuants. I will not revisit things that have already been said by my colleagues during their introduction, other than to reinforce Mr Johnson's observation of the erosion of the value of CPI indexed pensions and to emphasise that the loss of value of a pension is of particular concern to people who are retired for a relatively long time. People are retiring earlier and are living longer. Retirement at age 55 instead of the previous nominal age of 65 is increasingly common. At the same time, life expectancy is increasing quite dramatically. The pattern of people leaving the work force at age 65 and spending, say, five years in retirement before passing on has been replaced by people

living perhaps 30 or more years in retirement. The cumulative loss of pension value over a period of 30 years can be quite significant.

I refer the committee to the two charts that have been tabled. These charts illustrate the point quite clearly, showing as they do that, between 1990 and 2001, the growth in average weekly earnings was 20 per cent more than the growth in CPI. Even the age pension rose 16 per cent more than a CPI indexed public sector pension. Therefore, a system of indexation that links public sector pensions to a wage index as well as the CPI, similar to the methodology adopted for the age pension, would be far more equitable.

CHAIR—Is it the wish of the committee that the document be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The document read as follows—

Mr Morony—Turning to the question of the tax status of schemes such as the South Australian defined benefit pension scheme, the analysis we have done indicates that the untaxed status of the scheme places members at a disadvantage compared to members of taxed complying pension schemes. This is on top of a loss of value attributed to CPI indexation. The key issue with respect to Super SA being an untaxed scheme is the 15 per cent tax rebate that members of a taxed scheme are eligible to claim. The calculations that lead us to this conclusion are in annex B to the ACPSRO submission. In essence, the calculations are based on the assumption that a pension from an untaxed scheme is notionally commuted to a lump sum. No cash payment is involved; it is only a book entry. The tax due on the lump sum is paid to the Australian Taxation Office. The notional lump sum is rolled over to a newly created taxed scheme. The pension benefit derived from the new taxed scheme is reduced by an amount that offsets the tax paid. The member is then able to claim the 15 per cent tax rebate.

Our calculations show that the net income after tax is higher if a pension is paid from a taxed source. The reason for the discrepancy between a taxed and an untaxed scheme is the treatment of the pre-1983 component of the pension. A pension from an untaxed source carries no entitlement to the 15 per cent rebate but, more particularly, it carries no entitlement to a rebate for pre-1983 service. This is in stark contrast to the pensions from a taxed source that do carry an entitlement to a rebate for pre-1983 service.

The considerations can be quite complex, and it is difficult to dissect the calculations in a hearing such as this. SA Superannuants make no claim to being experts in the field, so we are looking for someone who is qualified in the area of taxation and Centrelink regulations to examine the proposals outlined in annex B of the ACPSRO written submission. If we are correct in our conclusion that a taxed scheme offers improved net benefits, we would be anxious to see our members given access to those improved benefits. In answer to critics who might suggest that our proposal amounts to a form of double dipping in respect of both tax concessions and the age pension, I would point out, firstly, that the pension scheme members are far from affluent and, secondly, that the proposal involves only extending to our members exactly the same conditions that apply to other members of the community. It is understood that some state public sector schemes, specifically in Victoria and Tasmania, have already put in place arrangements that enable their members to take advantage of the 15 per cent taxed rebate and age pension entitlements. It would be particularly inequitable if taxation regulations preclude SA Superannuants from the benefits already enjoyed by members of other public sector schemes.

Finally, I would like to repeat two points that are made in the written submission. Firstly, annex B, which deals with the tax status of schemes such as Super SA, relates only to the defined benefit pension schemes; and, secondly, the election to transfer to a tax regime must be voluntary rather than across the board—and the reasons for that are outlined in our written submission.

Mr Johnson—That concludes the introductory part, so we are available to field questions or talk about particular issues.

Senator SHERRY—Mr Morony, in the example you just gave us of the 15 per cent rebate and its impact on taxed schemes, did you factor in any figure for the cost of fees, charges and commissions that would be debited against the income stream that resulted?

Mr Morony—No, but I cannot see that there would be any change in that, because those fees are included in the existing level of pension. They are taken into account in the administration of the existing fund. All this really does is transfer that fund into the taxed regime, so I cannot see a great deal of extra administration costs associated with that.

Senator SHERRY—When you compare the outcome of a taxed scheme and an income stream—whatever form that takes—in the private sector, it varies from adviser to adviser. But there is a fee and a charge that they make, which would reduce the benefit paid from that area.

Mr Morony—Administration fees are already incorporated into the existing pension scheme.

Senator SHERRY—I understand that. In a government scheme they are, but they are much higher in the private sector.

Mr Morony—Yes, they are. They are normally about two per cent higher.

Senator SHERRY—They can be higher than that, or so we heard this morning. I am wondering whether, in any comparison with the outcomes from a tax scheme—

Mr Morony—Senator, I hope you are not under the impression that I am suggesting that the rollover be into a private sector pension scheme. That is not what we are proposing.

Senator SHERRY—Okay. I just wanted to clarify that. This advertisement that you have on your submission did intrigue me—the ‘Separated or Divorced?’ advertisement.

Air Vice Marshal Paule—The advertisement that Stephen Bourke was involved with. It was in the *Canberra Times*. That is a direct copy of the advertisement.

Senator SHERRY—It says: ‘Ask the Architect of the New Laws at Supersplitting.’ Do you know on what basis this person claims that they were ‘the architect of the new laws’?

Air Vice Marshal Paule—Yes. When the laws were first being mooted, there was at least a bill—there might have been more than one bill—

Senator SHERRY—We just got another one.

Air Vice Marshal Paule—and we had discussions with the Attorney-General’s Department. The man we had discussions with was Stephen Bourke, this very guy. We presume he is now retired or has left the Public Service and has set himself up.

Senator SHERRY—At that time, he was working in the Public Service?

Air Vice Marshal Paule—He was two or three years ago, yes. He was a senior member of the Attorney-General’s Department.

Senator SHERRY—I think we will have to have a look at that because I am not sure it is ethical to go out touting your services and advising, having taken part in the advice to government.

Air Vice Marshal Paule—We were taken aback when we saw it.

Senator SHERRY—I am taken aback by it too.

Air Vice Marshal Paule—We thought we would bring it to your attention.

Senator SHERRY—I am taken aback by it too; I find it amazing.

Air Vice Marshal Paule—We have not contacted him about it, by the way.

Senator SHERRY—Okay. We will follow that through in another forum.

Cdre Adams—I think the point we are really making, which is referred to in an article there, is that the Family Law Amendment (Superannuation) Act condones income splitting.

Senator SHERRY—Yes, you are right. There is an incentive to income split when you get divorced.

Cdre Adams—This does tell you how to do it to your best advantage. But if you are not divorced, the option for income splitting is not there. In our submission we have actually said that, if you are clever enough, you can probably organise a Clayton's divorce in order to achieve that.

Senator SHERRY—I think that is right. Finally, I have one question on the military superannuation and the way in which the surcharge tax is calculated. You were saying, Commodore, that because of the structure of the military superannuation fund—and I have heard this in respect of police fund as well—the notional surcharge tax outcome is higher; why is that?

Cdre Adams—That is actually at paragraph 26.

Air Vice Marshal Paule—It is because the Actuary is required to calculate these notional surcharge contribution factors based on the value of the cost to set up the scheme. Because the military scheme has some aspects associated with it that other Commonwealth schemes do not have, the Actuary considers that it is a more beneficial scheme and, because of that, it costs more.

Senator SHERRY—I understand that. Do you know what those benefits are? I am not an expert in the military fund.

Cdre Adams—It is a death and disability provision.

Senator SHERRY—Yes, I thought it might be. It is the same problem that the police have talked to me about as well. They have the same problem, in principle.

Cdre Adams—That would be right. There is no way that you could construct a military scheme now that did not have a death and disability provision in it. Because it has that it is deemed to be more beneficial. We get the answer back from the Public Service and the department that the scheme is more beneficial.

Senator SHERRY—The difference is, a bit like the police, that you effectively have a workers compensation type arrangement in the defined benefit fund, whereas workers compensation type disability arrangements, if you like, are separate from most other superannuation funds.

Cdre Adams—The military has a healthy compensation scheme as well, but that is an additional safety net which is built in for people who join the regular Defence Force.

Senator SHERRY—On the basis of disability, you can get an early payout of your pension from the military fund, the same as the police.

Cdre Adams—Yes.

Senator SHERRY—And because of the nature of the work I suspect that the disability provision is more widely used than it would be in other funds, where it exists.

Cdre Adams—It probably is, because of the nature of the work.

Mr Johnson—I think I can add a little bit to that. I have in front of me a letter from February last year written by the Commonwealth Actuary dealing with this particular issue. Because of the questions being asked about why is the military one structured like it is, I will read just one paragraph from his letter:

> Firstly, I must emphasise that for both the CSS and DFRDB we have used the approach prescribed by legislation. In essence, the legislation requires surchargeable contributions to be calculated as the value of benefits accrued in a year and the insurance cover provided. The value of benefits accrued during the year includes not only retirement benefits, but also resignation, death and invalidity benefits.

If you go to the Actuary's triennial report, the last one for 1999, the employer value pension, the MSBS-DFRDB contribution is assessed collectively at about 25 per cent, and that is considerably higher than in the report covering the CSS and PSS. Consequently, they are being loaded. I think the way to look at this is that if we were working in a civilian occupation that was very hazardous and the employer carried insurance cover for us, he would be almost certainly paying a much higher premium because of the risk situation that his employees were involved in. Why then doesn't the government accept the higher cost because of the military occupation and not load it on under this arrangement?

Senator SHERRY—I understand that, and in the private work force a person would not be in a superannuation fund that would have, effectively, a death or disability benefit of that nature.

Mr Johnson—I agree with that, but the principle is important.

Senator SHERRY—Yes, it is an interesting issue. As I said, I have had the police raise it with me and I am concerned about it. Can you give the committee a copy of that letter later on, or send a copy to us?

Mr Johnson—I think my colleagues will agree. I would not see any problem.

Senator SHERRY—Thank you.

Cdre Adams—The issue is really summarised in paragraph 26.

Senator SHERRY—Yes, I have seen it there.

Cdre Adams—We think it is an important one.

CHAIR—Thank you very much for your presentation.

[2.04 p.m.]

COLEMAN, Mr John, National Secretary, Superannuated Commonwealth Officers Association

FAWL, Mr Terry, Federal President, Superannuated Commonwealth Officers Association

HURLEY, Mr Peter, Vice President, Superannuated Commonwealth Officers Association

CHAIR—I welcome the witnesses from the Superannuated Commonwealth Officers Association. Do you have an opening statement?

Mr Coleman—Yes. First of all, on behalf of our association, I would like to thank the committee for the opportunity to provide our association's views on this very important matter of retirement incomes. Our association represents the retirement interests of approximately 360,000 Commonwealth and territory public servants and ex-public servants. I do not propose to restate in my address the actual issues and recommendations that were contained in our submission, but I would at least like to go over some general issues and take about 10 minutes discussing the few matters that I think are particularly relevant to policies on retirement incomes overall. At the end of that, you will perhaps want to ask questions.

CHAIR—Time is a little short. If you spend too much time on your presentation, it limits our ability to ask you questions. You just have to recognise that.

Mr Coleman—I propose about 10 minutes, if that is okay. I would like to start out by saying that it is appropriate to mention that almost 60 per cent of Commonwealth superannuants receive a superannuation of less than $20,000 per annum. That superannuation has to support both members of a retired couple. That level of retirement income is about on par with that for a couple on age pension when you take into account the concessions that age pensioners enjoy. That level of income, I suggest, may be very little different for Defence Force personnel, as it would be for those in state government superannuation schemes. I am sure some of the people that have appeared before me have brought that point out. My point here is to try to dispel the myth that is held by some people that, because some—and I emphasise some—Commonwealth superannuants have been on high salaries, most of them have a very high superannuation. In fact, they do not. In many cases their super, as I said, is quite modest, almost 60 per cent being on $20,000 per annum or less.

Our association appreciates the need for this committee to consider a wide range of issues that affect the standard of living of all Australians in their retirement. We note that your committee will make decisions to take account of the demands on retired Australians' incomes—in particular, critical issues such as health costs. This was brought out in the Intergenerational Report issued in the last budget. We would also like to register our deep appreciation for the recommendations the committee made in its report last year relating to Commonwealth, Defence and state government superannuation schemes. We welcome the government's decision to adopt the committee's recommendation regarding biannual indexation of our pensions. However, despite your committee's report having been with the government for

almost 15 months now, the government is yet to respond to that key recommendation of indexation of our pensions. I am sure the people who appeared before us have brought out that point as well. Our association is therefore obligated, on behalf of the 363,000 people we represent, to express our great disappointment with the government's failure to respond to that most critical recommendation.

I will now turn to our submission and talk about the structure of some of the issues we see as very relevant, not just those relevant to the people we represent. In our submission we talked about the three key elements to retirement incomes: the retirement income quantum; how that income is maintained; and the taxation policies that, obviously, ultimately affect the amount of disposable income people have in their retirement. It is our view that a whole of government approach is becoming increasingly necessary in determining the standard of living of retirees into the future. We are pleased that the terms of reference of this inquiry demonstrate that this broader approach to retiree incomes is being pursued. We hope that the tendency for governments to pursue individual policies affecting retirees will discontinue in favour of policies that are far wider in their scope and that take account of broader issues that will impact on Australia's retirees. There are signs of that happening already, and we are very pleased at that.

The government's National Strategy for an Ageing Australia is clearly the blueprint for planning and developing policies that will determine the standard of living of older Australians into the future. Whilst that document contains some very important issues for consideration in developing policies for ageing Australians, our association is disappointed that it appears, in some respects, to have overlooked the needs of some groups. I refer, for example, to the chapter on retirement incomes that emphasises the need to maintain a suitable level of income for age pensioners by an indexation method that is not CPI based but neglects to express this need for other ageing Australians. We ask that your committee make recommendations that do not overlook any group of ageing Australians—and I am not referring here only to the people we represent, Commonwealth superannuants.

We share the view of some commentators that, whilst the superannuation guarantee levy will reduce the reliance on the age pension as retirement income, for many retirees it will not provide a level of income to match their intended lifestyle. We believe, therefore, that there must be greater public education about the need for Australians to make voluntary contributions to superannuation funds from an early age—not from the age of 40 or 50, as some people seem to think is appropriate—if they are to be to able to afford the lifestyle that they plan. Education by itself, of course, will not achieve this. There needs to be adequate incentives for voluntary savings to be available to all groups in our society. The taxation policies as they are at present do not provide this incentive. There are some that do, but there are a number that do not, and we have outlined those in our submission. We ask that your committee take account of the need for fairness for all retirees when making its recommendations with regard to taxation policies. I do not propose to individually restate the issues, as I said, that support the recommendations contained in our submission. But I will be pleased, along with my colleagues, to answer any questions that committee members may have or to discuss any particular points that you may want to raise.

I will give an outline to demonstrate a fact that is brought up in our submission. It is a fact that is going to face many ageing Australians, not just Commonwealth superannuants. As stated

in the terms of reference of this inquiry, you will be considering the adequacy of retirement incomes and taking account of the future costs that superannuants will have to meet, including health costs. One of the largest costs that some ageing Australians will have to meet will be the cost of securing and maintaining a place in a residential aged care facility. This is of particular concern to Commonwealth superannuants and other retirees whose superannuation is not indexed according to movements in wages. As we have mentioned in our submission, fees for residents of aged care facilities are linked to age pension repayments which, of course, are indexed in accordance with movements in wages.

We know that some superannuants face considerable ongoing financial hardship because their superannuation pension is not tied to the same index as age pensioners. Their capacity to draw on their assets to bridge this gap in income is limited because of the bond that they have already had to pay to secure their place in the residential aged care facility. The number being placed in this difficult position is set to rise, as the Intergenerational Report clearly indicates. This causes many older Australians considerable worry at a time in their life when they are least able to manage it because of their age and the state of their health.

The significant erosion of the real benefit of retirement incomes due to inappropriate indexation is clearly demonstrated in our submission. On page 13 you can see a table and a chart that show what the gap has been for the last 10 or 12 years. The table shows the projected difference for the next six to seven years. I emphasise again that this inequity affects not only Commonwealth superannuants but also those from the defence forces and state government superannuants. I have a copy of a letter from one Commonwealth superannuant who wrote to us. The letter highlights this point quite clearly, and I would like to leave that letter with you, if I may.

Some of the recommendations made in our submission refer to inequities that apply solely to those superannuants we represent. We have a duty, of course, to do that, but quite a number of the inequities apply equally to other self-funded retirees. We ask the committee, in considering the issues we have raised, to consider those issues in the broader context because they apply to people other than the people we represent. Once again, I thank you for the opportunity to present our position regarding this inquiry. I would be pleased to take any questions from committee members.

CHAIR—Mr Coleman, have you read the submission from your colleagues the Australian Council of Public Sector Retiree Organisations?

Mr Coleman—Yes, I have.

CHAIR—Are there any differences between the two of you in your approach or emphasis?

Mr Coleman—For the most part, because both of our associations represent pretty much the same groups of people or people with much the same issues, I cannot think of any that are vastly in contrast.

CHAIR—So you are basically lineball with their submission as you see it?

Mr Coleman—Yes.

Senator SHERRY—There are two things that I have picked up from your submission. On page 16 you comment about the proposed closure of the PSS. You state that the proposal appears to be a cost-cutting exercise. Is that because in proposing to shut the current schemes, the PSS and the CSS, it is likely to be only SG contributions from then on for new employees?

Mr Coleman—I suspect that is the case.

Senator SHERRY—And probably higher fees and charges, from what I have been able to identify.

Mr Coleman—That is a considerable concern to us, as I am sure it is to anyone who is making contributions to funds that are subjected to these fees.

Senator SHERRY—You might have a look at the evidence we drew out—and I will get my office to send you a copy—on this issue of the costs, fees and charges in the public sector versus what happens in private industry. It is another issue—I just thought I would touch on it while you were here. The other thing which I did not realise and which I found quite interesting relates to surviving spouses. Under the 1922 act, beneficiaries revert immediately to the lower rate of payment after the death of a partner. There are 12,736 pensions in force under the 1922 act. I had not seen that in previous submissions.

Mr Coleman—If I recall correctly, that point was made in our submission to the earlier inquiry.

Senator SHERRY—Sorry, I did not pick it up then. You learn something every day!

Mr Hurley—I think it is, but it is worth saying that they are the only ones that still seem to be hanging on the rack. In the last budget, some of the anomalies for war widows were corrected. These people are still suffering. Even though they are fewer in number, it would be nice if they could get off that hook.

Senator SHERRY—Finally, I think the previous witnesses touched on some reporting in one of the papers last week that referred to public servants retiring just one day short of 55. Criticisms were made about that practice. I think Mr Max Moore-Wilton, who is the head of PM&C, complained about this leading to an alleged problem, and the government has now embarked on some sort of review. If any changes are proposed, I take it your organisation would not want them to be retrospective to existing members of the funds.

Mr Coleman—Certainly not.

Senator SHERRY—I have had quite a bit of feedback about this issue in the last week from public servants who are currently members and are worried that the current benefit may be changed retrospectively. While you are here, I thought I would seek your view on that.

Mr Coleman—Thank you for that.

Mr Fawl—Of course, that would not be a problem if the superannuation was indexed on wage basis indices. That is fundamentally the reason why people want to retire one day before reaching age 55—the deferred benefits are then increased by the wage cost factor based on their salaries. If they were the same indices that we had had for retired people, there would be no benefit in that.

Senator SHERRY—I will be interested to see whether Mr Moore-Wilton adopts that as a solution.

Mr Fawl—I cannot speak for him.

Senator SHERRY—Nor can I, but I will be interested. I will have a look at it.

CHAIR—Given that employment in the public sector nowadays is not for life, as it used to be for so many people, and given the increased mobility of the work force and the fact that the Commonwealth schemes have been closed, do you think there is a case for having some sort of interest rate added to that from a predetermined date instead of just having cost-of-living increments? We could not make it retrospective—it would have to be some date in the future—but would that restore a sense of equity for you?

Mr Fawl—I would think that any form of equity would be worth considering.

Senator BUCKLAND—I have only a couple of questions in relation to the voluntary contributions. How much scope exists for Commonwealth officers to make these voluntary contributions?

Mr Coleman—Five per cent is compulsory, and they can make a voluntary contribution of any amount between five and 10 per cent. Of course, in addition to that, they can take out private superannuation if they so wish.

Senator BUCKLAND—Yes, of course. And apart from that additional five per cent voluntary contribution, can they put in one-off contributions such as an annual review bonus? I am not sure they even get them.

Mr Coleman—No, not in the CSS or the PSS.

Senator BUCKLAND—Do you know what percentage of members have taken that option up?

Mr Coleman—I do not, no. I could not give you a figure. We could probably find that out from ComSuper.

Senator BUCKLAND—If you could find out, can you let us know?

Mr Coleman—Yes.

Mr Hurley—I think it is fairly small based on some figures that I saw.

Senator BUCKLAND—So there is no campaign to encourage people to make this additional contribution?

Mr Coleman—No. And the additional amount that is made above the five per cent forms part of the lump sum. It does not get added to the employer's contribution.

Senator BUCKLAND—No. I see.

Mr Fawl—For a lot of people at a younger age, there is no way they can afford to pay an extra five per cent. If we are looking at people on a lower wage—and most of our organisation members are in that situation—not too many people can afford to pay an additional five per cent over and above the compulsory contribution. For a lot of people that is not an option.

Senator BUCKLAND—That interests me somewhat, because we must be really underpaying these officers. I am aware of a number of industry funds where the voluntary contribution participation is particularly high. It is more so with people in the 25- to 38-year-old range—and I am not sure why we picked that range—who had really taken this up as a very positive option.

Mr Hurley—I think some people are influenced by their financial advisers. It is no secret that the younger people are advised to invest in a house and pay that off. Then you get the next scale up, if they are married and their children come along, to cover the education. And then, at the end of that, depending on their circumstances, concentrate on superannuation. I know from some personal family experiences that that is fairly widespread. That may be a deterrent in one sense, but it backs up the point that Terry makes that a lot of them are just not in the position to meet all those costs and something has go, and superannuation seems to be it. It is interesting. I am not sure whether you are aware of the study that AMP had done for it lately, but it says that there is only $34,000 on average in superannuation accounts. That is very small.

Senator BUCKLAND—I thought it was somewhat disturbing.

Mr Coleman—It may well be that, if we increased the level of education to the general public about the importance of starting to make savings to superannuation, those people, when they have got past those financial barriers and hurdles of paying off a house, may well put more money into superannuation where they are going to attract taxation concessions than if they put it into general savings. I suspect there might still be scope to have people increase the amount they put in above five per cent. But, as both Terry and Peter have said, I do not think that would apply to many people in their younger married life where they have got mortgages and children to look after.

Senator BUCKLAND—I appreciate that. I have one other question. Today we have heard a couple of comments in relation to addressing the future problem of aged care and providing for that. I am not too sure, and maybe I have fallen asleep when it has been happening, but no-one has actually explained to me exactly how they intend to use their superannuation to address the future aged care difficulties that we might have—that is, people going into aged care facilities.

Mr Hurley—I think there are a number of difficulties. I will point out one, and that is when a self-funded retiree goes into, say, a hostel, for argument's sake. First of all, they have to put up a

bond, then they lose 87 per cent of their total income and then they have costs on top of that. I am aware of a particular situation where one lady is actually putting out the equivalent of 110 per cent of what her previous superannuation was, just to stay in a hostel.

This is a pretty general situation and one that needs to be reviewed. We have referred to the fact that, already, superannuants are disadvantaged each time that there is an increase in the age pension, because the adjustment is at the age pension indexation rate as opposed to the CPI. In the broader situation, I do not think there is any system that broadly caters for a situation where a self-funded retiree, a superannuant, wants to sell up one house and move to another. Immediately they have some money in the bank, everybody wants to get their hands on it. It does not seem to be a clear passage to be able to do a switch, either into a smaller home or into an aged care facility.

I think there is a similar problem in terms of those persons who want to stay in their own home. Oftentimes, they have significant capital cost just to be able to do that. In addition, even though there have been top-ups on HACC and systems like that, particularly taking into account the Intergenerational Report, there is not going to be enough money in the future to even maintain at current levels, so that will need to be looked at as well.

Senator BUCKLAND—I think there is a bigger question than what I can run here. I have heard the problem—I suppose we are always hearing the problem—but there does not seem to be any real addressing of that particular need.

Mr Fawl—I think, when you look at the number of people earning an income each year of $20,000, they do not have very many options to do anything at all.

Senator BUCKLAND—That is right.

Mr Fawl—A lot of people now—say in Sydney, where I come from—are asset rich and income poor. The rates say that, if you are over the limit to get a concession from a part pension, you are living on your Commonwealth superannuation and you are paying full rates—and rates, as you would be aware, are based on the unimproved capital value of your land—and rates are extremely high. Lots of people, as I say, earn $20,000 to $25,000 a year. They are lucky to have an option of what they are going to have for tea the next night, much less providing for their future. It is just a fact that 57 per cent of our members—and I know I am repeating myself—are in this extremely low-income base, and they just have no options at all. They are falling behind that little bit each time their income is indexed to the CPI.

Senator BUCKLAND—Thank you very much.

CHAIR—Thank you very much for your presentation today.

[2.29 p.m.]

DAVIS, Mr Noel, Legal Adviser, Society of Superannuants

SOMERVILLE, Mr Peter, Treasurer, Society of Superannuants

STEEL, Mr Donald, Actuarial Adviser, Society of Superannuants

WOODS, Captain Ian, President, Society of Superannuants

CHAIR—Welcome. I invite you to speak to your submission.

Mr Davis—Mr Chairman, I will hand up to the committee a couple of things that supplement the submission, as they will be relevant for us to discuss.

CHAIR—If you have read comments by the previous witnesses in relation to the surcharge, you might like to comment on them.

Mr Davis—I have not read them.

CHAIR—They refer to the fact that members of defined benefit funds are discriminated against particularly severely relative to the surcharge.

Mr Davis—We are here to support that submission.

CHAIR—We did not ask them questions on that because we thought that that would be your forte.

Mr Davis—We want to highlight a significant problem with the surcharge that will affect retirement living standards in defined benefit funds. I will summarise what is in the submission. As I think you know, a defined benefit surcharge is on the notional contributions made, not on the actual contributions made. In all of the funds which I am familiar with, a surcharge account is created for the members to whom surcharge is applied. When the trustee of the fund pays surcharge tax, it creates this account and adds some rate of interest to it from that time until retirement. Commonly in private sector funds, that rate of interest is the actual earning rate of the fund. The notional employer contribution for defined benefit funds is calculated in accordance with the regulations prescribed under the surcharge legislation. That calculation is premised on the basis that one size fits all. Some people refer to it as averaging—that is, the notional contribution on which people are taxed is calculated in the same way for everybody without regard to the particular circumstances of each of the funds. We submit that not taking into account the individual circumstances and just making a general notional calculation is a totally inappropriate basis on which to levy tax on people. The actuary for the fund is required to calculate that by assuming both long-term earnings of eight per cent and salary growth of 4.5 per cent. That gap between the two of 3½ per cent is vital to the calculation. It is that one-size-

fits-all calculation for all funds that we think gives rise to a particular problem that I will now summarise.

I take it that you all have a copy of the submission. Annexure B contains material prepared for the society by David Knox, an actuary with whom I suspect you are familiar. At the bottom of page 2 of those materials, he uses the assumptions that the legislation requires on an example of the Qantas pilots' superannuation fund. The table shows three different entry ages of 30, 40 and 50 and what the surchargeable amount ends up being as a percentage of the 'employer financed benefit'—the expression that he uses—at age 60. That is around the range of 15 per cent, but for two of the categories we can see that it exceeds 15 per cent. On page 3, he looks at another scenario of different levels of salary increase and different earning rates.

In the materials I have just handed up, the Association of Superannuation Funds published the long-term investment returns that average superannuation funds have achieved—that is the two-page document which is an extract from the November 2001 *Superfunds* journal. In looking at page 2, you will see that at the bottom left-hand side, for the last 25 years up to the year 2001, the average fund earning rate has been 13.6 per cent. If we look at the right-hand column at the bottom, at 30 years and 35 years, for the last 30 years up to 2001 the average fund earning rate has been 12.4 per cent; and for 35 years, 12.3 per cent.

We can see from that that the long-term earning rate in superannuation funds has generally been around 12 per cent, a vastly different figure than the assumed earning rate of eight per cent that the legislation requires to be taken into account. It is the possibility that earning rates will be higher than eight per cent and more towards 12 per cent that gives rise to a particular problem in defined benefit funds. It is that members will end up with a much higher percentage than 15 per cent of the employer financed benefit being deducted from their benefit.

Returning to David Knox's material, which is annexure B, and looking at page 3 of that, he has set out three different salary increase scales that he has adopted, and I would ask you to adjust two of those figures. In paragraph 2 at the top of page 3, he refers to a conservative salary scale averaging 1.8 per cent from age 30 to 60. The figure 60 should in fact read 40, and then 0.5 per cent from 40 through to age 60. In paragraph 3, I would ask you to adjust age 60 to age 40.

He has used some different salary increase scales, and then in the first table at the top of page 3 he has applied those salary increases to earning rates. For example, you will see fund earning rate seven per cent at the nil salary scale, where there has just been a two per cent CPI increase assumed over the years—26 per cent of the employer financed benefit has disappeared in surcharge for that particular member. That is, at retirement, 26 per cent, according to his calculations of what would have been the employer benefit but for surcharge, has disappeared and has deducted from the benefit, and so approximately a quarter of the benefit has been lost. At the bottom of page 3 he summarises the reasons for that. The last dot point on page 3, he says:

In extreme cases, it is even possible for the accumulated surcharge account to exceed the employer financed benefit.

This last result can arise when there are member contributions.

I will not read the rest of that, but he goes on to say, on the top of page 4, that figures 1 and 2 show the outcome assuming a long-term earning rate of nine per cent, and that a person who becomes a member of the fund at age 30 could lose 46 per cent—approximately half—of the employer financed benefit that is in a surcharge debit account and will not be available to that member in retirement.

On page 5, under the heading ‘The suggested solution’, he offers a solution to this problem. It is that a check be made at the time the benefit is payable to the member, in the same way as applies in the public sector funds under the legislation that applies to them, so that it can be determined whether the surcharge exceeds 15 per cent of the employer financed benefit. If it does, he suggests that it should be capped at the 15 per cent in the same way that your fund is and in the same way as public sector funds generally are, but private sector funds are not. In the last paragraph in his submission, he says that if it does exceed 15 per cent of the employer financed benefit, the tax office should refund to the fund the difference and that can then become part of the benefit payable to the member.

We think that is a very significant problem in relation to the surcharge. We have referred to some other issues in these papers, such as the fact that there is age and sex discrimination in it. If we look at annexure C, which is another paper prepared by David Knox, at page 8 in paragraph 2 in his conclusions, the last sentence says:

Older members in defined benefit schemes are subject to larger benefit reductions due to the surcharge than younger members.

He is pointing to a form of age discrimination—

CHAIR—I am sorry, we do not have page 8 of annexure C.

Senator SHERRY—It is on page 3 of annexure C that we have.

Mr Davis—Sorry, it is paragraph 2 at the bottom of your page 3.

CHAIR—The effect of the surcharge?

Mr Davis—Yes, he says in that paragraph:

The effect of the surcharge in reducing the final benefit increases with the age of the member, even allowing for the reduced benefit that is received on earlier retirement.

So older members are subject to bigger benefit reductions. In the table at the top of that page he has demonstrated how that works. He has assumed there three people who are aged 30, 40 and 50 at the time they become members of the fund. You will see in the right-hand column that if all three leave employment 10 years later, the surcharge reduction for the 50-year-old has been 15 per cent, whereas for the 30-year-old it has only been six per cent. That is clearly an unfair result; the level of tax payable is dependent on what your age is and on no other factors.

CHAIR—Given that the sex discrimination act publicly has not yet passed the parliament—

Mr Davis—The age discrimination act, Senator?

CHAIR—Yes.

Mr Davis—That is proposed, but not yet passed.

CHAIR—That is right. Given that that is assumed to pass later this year, there will be problems with the surcharge, won't there? Is that the very issue you are making?

Mr Davis—We say that the surcharge is completely inconsistent with it.

Senator SHERRY—Now that the government have heard your evidence, I suspect they will put in a clause to make sure it is.

Mr Davis—You have a confidence that others may not have, Senator.

CHAIR—I am just trying to work out the interaction between the two and which would take precedence.

Mr Davis—Normally one piece of legislation does not govern another. The effect will be that the two will be inconsistent, but ordinarily the age discrimination act will not override the surcharge legislation.

CHAIR—It will not override it?

Mr Davis—That is right.

CHAIR—As you say, it will further highlight some of the problems of the surcharge.

Mr Davis—The reason why we say there is sex discrimination in the surcharge is that some women go out of the work force for a period of time while having children and later on they have to make up catch-up contributions in order to end up with the same retirement benefit. Making those catch-up contributions can cause surcharge to occur because it pushes them over the limits that they would not otherwise have been pushed over.

CHAIR—What are some solutions to overcome the problems with defined benefit funds and the created surcharges? Some witnesses have drawn attention to this problem about unfairness. Short of getting rid of it, how do we refine it to restore some equity, say, compared with a defined accumulation fund?

Mr Davis—The society's position is that the only way to overcome the myriad of problems that exist with the surcharge, including the huge expense in administering it, is to remove it altogether. If that is not achievable, private sector defined benefit funds should be treated in the same way as public sector funds, so that the surcharge is capped at 15 per cent.

CHAIR—We have heard that point.

Mr Davis—Mr Steel may have some other points.

Senator SHERRY—Just before Mr Steel does give us his points, I have a question for you, Mr Davis, in relation to something that you perhaps asked Mr Knox. We now have the surcharge revenue collection figures—both past collections and projected collections—published in the budget for first time after five years. In relation to this solution of capping at 15 per cent—I know it would be hard to calculate—what would the impact be on past revenue? What is the windfall gain to government as a result of it not being capped at 15 per cent and what is the cost to revenue if that was done? I know it is not easy to answer. It is something that Treasury should be able to tell us, but I suspect that, if I asked them, they will not tell me, because I have had a lot of trouble getting information from them in this area.

Capt. Woods—The society has had discussions with the tax office in conjunction with the Corporate Superannuation Association, and Minister Coonan has agreed already. We have expected but have not yet received exactly what you ask: what the impact of implementing the David Knox solution would be on government revenue? That was asked of the minister in January this year. We had expected a written reply to that on Friday, 28 June, but it has not yet been forthcoming, but we are promised that it will arrive.

Senator SHERRY—When you say that Minister Coonan had agreed, do you mean that she had agreed to the costing but had not agreed to make the change?

Capt. Woods—She had agreed to do the costing. The ATO have acknowledged that the problem that has been identified has ‘the real potential for significant inequity’.

Senator SHERRY—I understand them saying that, but they were told about this problem years ago.

Capt. Woods—This might have been the first time that they were listening.

Senator SHERRY—Yes, the first time in five years.

CHAIR—Mr Davis, are you going to represent the judges?

Senator SHERRY—That is a bit unfair, Chair!

Mr Davis—The judges have got very good representation.

Senator SHERRY—Yes, I am sure they have—at both ends!

CHAIR—I know you have shared some of the committee’s views over the years.

Mr Davis—Yes. I think Mr Steel has a couple of points that he wants to make.

CHAIR—Go ahead, Mr Steel.

Mr Steel—Thank you for the opportunity to make some comments. I would like to touch briefly on the suggestion of capping the surcharge debt at 15 per cent of the post 20 August 1996 component of employer financed benefits. It may well be that a certain person has

incurred surcharges at low rates. The surcharge is a graduated tax. It would be quite possible for a person to incur surcharges at four, five, six and seven per cent of their adjusted taxable income during their career. As these debts build up to a very considerable amount in a defined benefit fund because of high earning rates, it would be totally inequitable to cap their surcharge debt at 15 per cent. The surcharge debts which they should have incurred are based on only four, five and six per cent. Yet they would still be pushed up to the cap by high earning rates.

Senator SHERRY—So would you want a proportionate cap?

Mr Steel—We are talking about complications.

Senator SHERRY—I understand the complications.

Mr Steel—I feel that it is fair enough to draw the committee's attention to the fact that a 15 per cent cap might put a 15 per cent cap on the surcharge debts of people who have only been surcharged at much lower rates.

Senator SHERRY—You are right. Has that issue been raised with the minister?

Capt. Woods—No, not that I am aware of. We have been struggling for three years to get the issue identified and, having successfully done that, we would like to refine it going forward. But as yet I do not believe it has been raised.

Senator SHERRY—I think Mr Steel raised a very valid point.

Capt. Woods—Very valid.

Senator SHERRY—I do not know whether you in your contacts with Mr Knox could ask him to have a look at the fiscal implications of that. I just want to find a figure so that we can try and debate the issue with Treasury if they do not give us a figure.

Capt. Woods—Certainly if they do not give us a figure and we are able to get reliable information from government then we will get one.

Senator SHERRY—But, from what you were saying earlier and what Mr Steel just said, capping at 15 per cent is only a partial solution to a tax rate that is in practice applying higher than it should in terms of the rate that is struck. If we are looking at solutions to effective overtaxation, we should look at the adverse impact on all of the people who are in that category. I am very keen to see what the revenue implications are of doing that, because that is something we have to take into account.

Capt. Woods—I might have to ask you to ask some questions in parliament, Senator.

Senator SHERRY—I have asked a lot of those over the years. I have been accused of being obsessed with the surcharge.

CHAIR—How do we get rid of the surcharge? Do we get rid of it by gradualism, as has been proposed, to 10.5 per cent or do we get rid of it in one go? How do we replace that income? Is it inequitable to make all the savings reductions off the surcharge vis-a-vis the contributions tax?

Mr Steel—In my opinion, it would be more equitable to review the general tax scale than to persist with a tax which is as flawed as the superannuation surcharge.

CHAIR—Sorry, what do you mean by that?

Mr Steel—To review the general personal tax scale: 17 per cent on $6,000 to $20,000, 30 per cent on the next band and 47 per cent on the highest band. It would be better to raise the required revenue by general taxation than to impose a seriously flawed tax on superannuation.

Capt. Woods—If I could expand a little on that, the question I would like to ask the government, the minister or the Treasury is: if a small increase in the marginal rate was made at the same level where surcharge tax cuts in—let us say for those above $105,000 who are fully surchargeable—what would the increase be in the marginal rate of tax applied to those taxable incomes above $105,000 in order to raise the same amount of money that surcharge currently raises from those people? I think that would refine what Don has said.

Senator SHERRY—I understand the argument. You have two different tax schedules. The surcharge now cuts in at $90,500 at one per cent for every $1,200 or whatever the exact figure is. I understand the argument—it is not that simple.

Capt. Woods—Agreed. That is why he says it is fatally flawed.

Senator SHERRY—But the administrative costs, which reducing the rate does not overcome, are still there. It is Australia’s most costly tax to collect.

Mr Steel—Absolutely. I have seen defined benefits funds where the costs of administering the surcharge are far in excess of the surcharge that is collected. The surcharge that is collected is peanuts.

Mr Somerville—In essence, we need to know the size of the problem as well. That is the first step. Suggesting how we might fill that gap is maybe one step ahead of where we should be at this stage.

Senator SHERRY—I think you are right. If we know the size of the problem and it is $30 million, $40 million or whatever the figure is, I think there is a pretty good equity argument. I do not see anyone advancing an argument that they should be paying anything higher than the effective rate of the surcharge.

Mr Steel—I would like to make a few more comments about various inequity aspects of the surcharge, if I may.

CHAIR—Go ahead.

Mr Steel—My comments are mainly directed towards defined benefits funds, but it is plain, I believe, that to surcharge employer contributions to accumulation funds which are not fully vested will result in the taxation of benefits which some members will never receive. The benefits could be forfeited on resignation, tax has been paid and no provision for it ever to be refunded. Is it absurd?

CHAIR—An excellent point. Some more?

Mr Steel—Yes, I have many.

Senator SHERRY—We have a 3 o'clock cut-off time, I'm afraid.

Mr Steel—Perhaps I could make a written submission, if there is no time.

CHAIR—Yes.

Mr Steel—Defined benefits funds provide a variety of benefits and each of the benefits to a particular member is of considerably different worth. A resignation benefit might be very much less valuable than a retirement pension, particularly if the retirement pension includes a spouse's reversion and so on: it could call on a very small percentage of employer contributions to finance the resignation benefit and a much higher percentage of employer contributions to finance a retirement benefit. So the surcharge is based on an averaging system. It assumes that every member will receive a bit of every benefit. I submit to you that averaging is entirely inappropriate for the calculation of personal taxes. If I were to say to you that taxation of every person who lives in Canberra should be calculated by adding up all the incomes of the people who live in Canberra and dividing by the number of Canberrans and each pays tax on that income, you would say it is ridiculous.

Senator SHERRY—It is a fair enough analogy.

Mr Steel—But that is exactly the same principle that is embedded in the surcharge legislation. May I read to you the government's own words in the explanatory memorandum to the Superannuation Legislation Amendment (Superannuation Contributions Tax) Bill 1997, speaking of application of the surcharge to certain unfunded public sector schemes:

> It is proposed that benefits should not be reduced by more than 15 per cent of the employer financed component of a benefit accrued after 20 August 1996. In general, trustees will have discretion to allow reductions to be applied in a fair and equitable manner, taking various matters into account. This discretion is necessary in cases where actual benefits are considerably more or less than the projected benefit on which the surchargeable contributions and therefore the surcharge tax has been based.

The government's own words damn the superannuation surcharge in its application to defined benefits funds. It says that in these public sector funds when the member's benefit emerges, or more properly when payment has been completed, we will see what the surcharge debt should have been and we will revise it. No such provision applies in private sector schemes.

Let me give you another example of the inequity working to the advantage of the member in a defined benefits scheme. Mr Smith is a very competent employee of his company and it has been assumed for surcharge purposes that his salary will grow at the same rate as every other

member, 4.5 per cent per annum. But Mr Smith when he is 57 years of age graduates to the position of the managing director and his salary is quadrupled. He has then got 30 years of prior service, and in this defined benefits fund the hike in his benefits with his salary being quadrupled is retrospective to all those 30 years of past service. He has got a huge increase in his accrued benefit.

CHAIR—But not a commensurate increase in tax.

Mr Steel—It all escapes a surcharge. Members of the committee, the surcharge tax is seriously flawed. There is only one solution: there is no other solution but to repeal it.

CHAIR—I think you have got a few more ideas, have you? Would you like to give us those in a supplementary paper?

Mr Steel—I would be very pleased to.

CHAIR—We would be pleased to receive it, too.

Mr Steel—Thank you so much.

CHAIR—Thank you very much.

Senator SHERRY—You should have appeared before the committee six years ago, Mr Steel.

CHAIR—Be careful, Mr Steel.

Mr Steel—Senator, I incurred the wrath of my family. I am an apolitical person, let me say that. I probably voted Right more than Left much more in my life.

Senator SHERRY—That does not matter; it does not worry us.

Mr Steel—But I have to qualify that. Mr Davis is aware that, when the surcharge legislation was introduced, at my personal cost I put a significant advertisement in the *Australian* condemning the surcharge. So I have been consistent. I tried to do something six years ago; I could not get anybody to listen.

CHAIR—Some people listened.

Mr Steel—I am glad of that, Senator. Shall I say that no fruit has yet been borne?

Capt. Woods—We are certainly going to give him the opportunity in the future—

CHAIR—You have got to be very patient in this game.

Capt. Woods—to get to many Australians and educate them with all the points that he has saliently put here today. The society and its organised labour base will make available to all of

Australia the information that Don has so generously come down and presented for us this afternoon.

Senator SHERRY—And we would appreciate any information you get on the tax revenue implications, because that would be useful for later on.

CHAIR—On behalf of the committee I thank all witnesses who have given evidence today. We will be taking evidence again next week in Sydney.

Committee adjourned at 3.02 p.m.