



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## **SENATE**

SELECT COMMITTEE ON SUPERANNUATION

**Reference: Superannuation and standards of living in retirement**

FRIDAY, 19 JULY 2002

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BY AUTHORITY OF THE SENATE

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**SENATE  
SELECT COMMITTEE ON SUPERANNUATION**

**Friday, 19 July 2002**

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

**Senators in attendance:** Senators Hogg 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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**Subcommittee met at 9.05 a.m.**

**CHAIR**—I declare open this hearing of the Senate Select Committee on Superannuation. Hearings will be held in Sydney at a later date, and there may be one or two other follow-ups. 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 broad ranging. It is considering issues such as how much income is enough in retirement and what it needs to cover, what superannuation contribution levels and other sources of income are required to meet retirement needs, overall fairness of taxation of superannuation to ensure that individuals and groups are treated equitably in respect of end benefits, how to streamline the operations of the system to reduce costs and to improve membership understanding, and how to improve coordination of superannuation with 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 Commonwealth departments with responsibilities in this area: Treasury, the Department of Health and Ageing, the Department of Family and Community Services and the Department of Finance and Administration, as well as peak bodies representing the medical profession and the health insurance industry. All of the witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence they shall give. This means that the witnesses are protected from action arising from what they say and that the Senate has the power to protect people from any action which disadvantages them on account of evidence given before the committee. The committee prefers to conduct its hearings in public but if there are any matters which you wish to discuss with the committee in private, we will consider your request. I do not expect that to come from Treasury, but it may.

**BRAKE, Mr Roger, General Manager, Superannuation, Retirement and Savings Division, Commonwealth Treasury**

**GALLAGHER, Mr Phil, Manager Specialist, Retirement and Income Modelling Unit, Commonwealth Treasury**

**CHAIR**—I welcome the representatives from Treasury, Mr Phil Gallagher and Mr Roger Brake. Both are well known and respected by this committee. I invite you to make an opening statement.

**Mr Brake**—We thank the committee for the opportunity to make the submission that we have made to the committee and to appear today. I would like to make a few brief opening remarks which touch on the main points of our submission, and then Mr Gallagher would also like to make a few points. The Treasury submission was framed in the context of our departmental mission, which in short is to improve the wellbeing of the Australian people through our advice to government. In other words, we take a broad perspective in dealing with public policy issues. Our submission discusses the key factors which drive the living standards and wellbeing of Australians in retirement. These factors not only include the main elements of Australia's retirement income system but also extend to encompass a range of broader considerations which bear on general economic and social participation. In particular, while the superannuation guarantee system is a central part of the retirement income system, the age pension and voluntary private savings will continue to play a vital role in securing adequate levels of income in retirement. Superannuation taxation returns, fees and charges also have a significant impact on final retirement incomes available through superannuation. As I said earlier, retirement living standards will also be affected by factors outside the retirement income system. A very important one in that respect is home ownership—the place where a person lives—and the level of public services, government benefits and subsidies, along with less tangible considerations such as family relationships and social contact.

As members of the committee would be aware, the Intergenerational Report which was presented with the 2002-03 budget highlighted the need for sound and sustainable economic policies, including retirement income policies, in the face of the budgetary pressures associated with an ageing population. At a broad level, policies which enhance a sustainable economic growth as well as overall economic and social participation directly benefit living standards of the community, including those of retirees. A key message of our submission is the importance of the broader policy environment for the consideration of policy proposals in the retirement incomes area.

We consider any analysis or proposals in this area that do not have regard to this broader context to be of limited use in contributing to the public policy debate. For example, proposals to increase the adequacy of retirement incomes by significantly reducing or eliminating the taxation of superannuation during the contribution and accumulation stage must be assessed against the fiscal implications of such proposals and the associated trade-offs. For instance, deferring the taxation of superannuation entirely to the benefit stage would involve substituting a significant deterioration in the budgetary position over the medium term, with resultant higher

government debt for increased taxation revenue in future years when the current working generation moves into retirement.

The committee has also heard proposals from organisations that the level of compulsory superannuation contributions should be increased. Such proposals need to take account of the impacts on individuals in both their retirement and pre-retirement or working years. For instance, proposals designed to increase gross savings in pre-retirement years with the aim of increasing retirement incomes involve a trade-off between consumption in retirement for lower consumption while working. This trade-off needs to be kept in mind when assessing the merits of such proposals.

When examining what the current retirement income system will deliver for future retirees, it is important that the system is looked at as far as possible in its entirety. At a minimum, any analysis in this area needs to take account of both income from the age pension and superannuation, given that the age pension is projected to remain an important feature of the retirement income framework into the future. Similarly, voluntary savings and other assets such as home ownership are also important in boosting standards of living in retirement. In this context, many of the recent superannuation budget measures are designed to improve the attractiveness of voluntary saving through superannuation.

Our submission also notes that whether or not a particular expenditure replacement rate is optimal is a matter for judgment. However, it is generally expected that a replacement rate of somewhat less than 100 per cent would be appropriate for most retirees. This is because they typically do not face the major expenses, such as home mortgage costs, the costs of raising children and even the costs of commuting, which are generally faced by people of working age. It is also likely that different replacement rates will be appropriate for different individuals, reflecting their own unique circumstances.

Treasury has also provided the committee with detailed, updated quantitative modelling of the retirement income outcomes that can be expected from current policy settings. This comprises hypothetical cameo analysis of a wide range of possible career experiences. In addition, aggregate modelling of the whole Australian population is detailed. Finally, we update some earlier work we have produced on the concessional tax arrangements applying to superannuation.

The analysis we have done shows that the system will deliver substantially higher replacement rates for senior Australians as a group over the longer term. Indeed, the superannuation guarantee system, in conjunction with the age pension, is projected to provide a spending replacement rate for an individual retiring in 2032 on median earnings of 72 per cent after 30 years of contributions and 77 per cent after 40 years. These rates of course do not take into account superannuation contributions over the SG or additional private savings outside superannuation. A particular focus of our modelling has been to examine the issue of the outcomes which are produced for women with interrupted careers. With that, I will hand over to Mr Gallagher.

**CHAIR**—Before we hear from Mr Gallagher, I welcome your mission statement of improving the wellbeing of all Australians. I think some Australians have other views, so it is good to articulate that.

**Mr Brake**—Thank you.

**Mr Gallagher**—One of the things I want to do is to draw your attention to critical differences in what is actually the content of our submission and what is alleged, in a number of submissions, to be the content of our analysis. In particular I am concerned at pages 22 and 23 of the ASFA submission. If you look at page 19 of our submission—

**Senator HOGG**—If you are referring to pages of another submission, we have not brought those with us.

**CHAIR**—We have to get some material.

**Mr Gallagher**—That is okay. I will now just talk about what is in our submission in relation to that.

**CHAIR**—You are not expecting us to follow another submission?

**Mr Gallagher**—No, I am looking at page 19 of our submission.

**Senator HOGG**—All right, you tell us where you want us to go.

**Mr Gallagher**—On page 19 of our submission, we have scenarios for a single male and they have different career lengths and these various lengths were specified by your committee. In particular, I want to look at the scenario where we have a retirement age of 65, a 30-year career length and the person is on one times average weekly ordinary time earnings over their career.

**Senator HOGG**—Just excuse me, page 19?

**Mr Gallagher**—That is on my copy. It appears to be on page 21 on yours. It is table 2.

**Senator HOGG**—Sometimes there are differences in page numberings with these modern technology systems.

**Mr Gallagher**—Table 2 shows the average retirement expenditure that can be achieved on that career length is \$31,793. We show the components of that retirement expenditure in terms of how it can be made up of drawdowns on terms of a lump sum which equates to a private annuity and the age pension. That number needs to be contrasted with the \$19,000 number used by ASFA in the same situation. The \$19,000 number is because they have deflated by wage growth and not used the consumer price index. If we are looking at real living standards in retirement, deflation of incomes in the future by the consumer price index is appropriate. One of the major features you will see in the ASFA submission is that they use their \$19,000 number, and then they immediately talk about what that can buy. They talk about how much it can buy in terms of food, clothing and other items.

**Senator HOGG**—I remember that table. It has a number of levels.

**Mr Gallagher**—Treasury would contend that whenever you are talking about what people can afford to buy, you should use a number which is deflated by the consumer price index. It is certainly the case that the two numbers are very different because of the long period involved.

**CHAIR**—What sort of difference does it make?

**Mr Gallagher**—We have over \$31,000 and they have \$19,000. That is the sort of difference.

**CHAIR**—That is a very significant figure, isn't it?

**Mr Gallagher**—This \$19,000 number that they have used has assumed currency in the debate. It is very important to stress what is involved and, when looking at the living standards involved, what people are able to buy—a number of around \$31,000 on that example that they tend to use would be more appropriate. In the submission, we have made the case—

**Senator HOGG**—Can I just hold you there? I am starting to get a little lost in this. You have referred us to table 2. Which—

**Mr Gallagher**—Second last column.

**Senator HOGG**—So that is someone retiring at 65 after 30 years in the work force. What assumptions are you making there on that person? Are they full time for 30 years? No breaks in employment?

**Mr Gallagher**—Yes, for 30 years. So they will work from 2002 to 2032.

**Senator HOGG**—So they are full time?

**Mr Gallagher**—Yes.

**Senator HOGG**—What other assumptions are you making?

**Mr Gallagher**—We are assuming that consumer prices rises at 2.5 per cent, wages rise at four per cent a year, and that the fund earning rates are seven per cent nominal which means that it is 4.5 per cent real.

**Senator HOGG**—And what fees and charges are you assuming?

**Mr Gallagher**—We are assuming fees and charges will come in two bites. There will be effectively a \$1 administration fee and a \$1 insurance fee taken off contributions on a weekly basis.

**Senator HOGG**—One dollar per week?

**Mr Gallagher**—Yes. We have reflected the investment expenses of the fund as a drop in earnings rates. The fund earning rate may have been eight or 8.2 before investment expenses were removed to give the return of seven per cent.

**Senator HOGG**—So you are saying that the fund earning rate may well have been 8.2 over the period but, with the investment charges taken out, that is reduced back to seven?

**Mr Gallagher**—Yes, and that will be the crediting rate.

**CHAIR**—So the net investment of nine per cent, the amount put into investment, is effectively what?

**Mr Gallagher**—It would be less the 15 per cent contributions tax and it would be less about \$104 a year. I have not calculated it as a net but, obviously, an amount slightly less than 85 per cent of the nine per cent will go into the fund.

**CHAIR**—A significant number of people such as people in some industry funds like C+BUS—we saw them yesterday—would have insurance costs probably somewhat higher than that, which would reduce their benefit, wouldn't it?

**Mr Gallagher**—That could.

**CHAIR**—Say for every one per cent that comes down, what effect would that make on the pension at age 65 after 30 years?

**Mr Gallagher**—Are you saying that every one per cent that comes down in the earnings rate of the fund?

**CHAIR**—Yes.

**Mr Gallagher**—We have not modelled the changes in the earnings rate in the submission.

**CHAIR**—Or the contributions rate.

**Mr Gallagher**—We have certainly shown the difference in the contribution rate as multiples of average weekly ordinary time earnings. Average weekly ordinary time earnings is currently about \$44,000 a year. Seventy-five per cent of 30 is \$33,000 a year. In terms of retirement incomes over the same career length, that makes a difference in retirement incomes of the order of \$2,200 in real terms. You can see quite a marked difference in terms of incomes, but the same contribution rate can give fairly similar outcomes in retirement incomes because of the nature of the pension means testing.

**CHAIR**—So we are talking about average weekly gross earnings or net?

**Mr Gallagher**—This is gross but we do the calculation for the final year of work to show you what the net earnings would be so that we can show the replacement rate, which we have calculated as the average retirement expenditure compared to the expenditure in the final year of working life. We believe this is the appropriate way to demonstrate the relativities between the standard of living you had during your working life and in retirement. The replacement rate that we calculate, which in the first example I gave you is 67 per cent replacement rate, gives you an idea of the amount people can spend. As Roger has said, because there will be fewer expenses

in retirement for a variety of reasons, in actual fact the replacement rate does not equate exactly with the standard of living because of the reduction in costs.

**Senator HOGG**—Before you proceed, what other underlying assumptions are there in this? I note that the benefit is taken as a lump sum—

**Mr Gallagher**—And we have also given you analysis in the tables at the back for a whole of life pension, and we have given you analysis for a 15-year life expectancy annuity. The results are similar, but because there are so many examples—

**Senator HOGG**—I will come to that in a moment. I have a question to raise there.

**Mr Gallagher**—In this one, the benefit is taken as a lump sum and any ETP tax due is paid and then the lump sum is invested in an account and it is drawn on in the pattern of an annuity. So the person just draws down on their lump sum to exhaust it at retirement. The reason that we have done that is so that we can show the potential income in retirement.

**CHAIR**—When I look at the taxation statistics of Tasmania, I find there are very few areas in the state that produce this average income. So my punters say to me, ‘This is not the real world.’

**Mr Gallagher**—That is why we have given you examples which have incomes during working life equivalent to \$33,000 now. In the submission, we also give you a co-contribution example where the person is earning \$20,000 now.

**Senator HOGG**—I would like to come back to the underlying assumptions.

**Mr Gallagher**—The other important thing is that we are calculating life expectancy at retirement, so this person in this table retires at age 65. For a male, life expectancy in 2032 on our projections at age 65 will be 83. This is very important. When we did this analysis, probably even last year, we were only projecting a life expectancy of 82 in that case. The change in life expectancy has had some impact on the replacement rates in these calculations.

**Senator HOGG**—Is there any assumption in your model of access to a health card, which goes into that 67 per cent?

**Mr Gallagher**—No. This is looking at the private income which can be generated from the lump sum and the amount of money which will come from an indexed social security pension. The consumption equivalent of a health card has not been added into the expenditure analysis.

**Senator HOGG**—And so there is no access to the tax offset for seniors taken into consideration?

**Mr Gallagher**—The senior Australians tax offset is taken into account. But the measure itself is not indexed. What happens in the modelling, because the measure is not indexed, is that in the analysis we allocate either the pension rebate or the senior Australians tax offset, depending on which is the larger. After about 15 or so years, it would be the pension rebate that would be the larger.

**Senator HOGG**—What is that worth? Do you attribute a value? Obviously, it is in your model. You must attribute a value for it.

**Mr Gallagher**—I do not have it isolated in the table.

**Senator HOGG**—That is why I am asking you. I am trying to get the underlying assumptions.

**Mr Brake**—In broad terms, we take forward current policies—

**Senator HOGG**—I understand the broad terms. I want to know specifically what the tax offset that you have worked on in your model is worth.

**Mr Gallagher**—I do not have those numbers with me. I need to take that on notice.

**Senator HOGG**—What does that reduce that 67 per cent by? The reason I am asking is that, at the end of the day, we are getting a number of submissions from a number of people. What we want to be able to do—and I agree with your submission—is to compare apples with apples. The ASFA figure of \$19,000 is convenient for the purpose of the position that ASFA is putting forward; I understand that you have a disagreement with that. You think the figure is more like \$31,000, if I read you correctly. I just want to know where we are going, that is all. So you will come back to the committee with that component. Is there any other component or assumption in that 67 per cent?

**Mr Gallagher**—We said, in the heading that I tabled, that we have indexed the tax scales via the consumer price index and we have indexed the pension according to whichever is the higher—wages or the consumer price index. In this example, wage growth is higher. So the tax indexation assumption has an impact on this. CPI is neutral; it corresponds to a return of bracket creep through indexation of the tax scales.

**Senator HOGG**—In your table, in the second last column, the person's final salary would have been \$67,615—is that correct?

**Mr Gallagher**—Yes, and that is because of four per cent wages growth.

**Senator HOGG**—I accept that. They would upon retirement in 2032 take \$225,000 and invest that, and their investment would return them 67 per cent—

**Mr Gallagher**—No, the investment plus the age pension. Their private retirement income generated by the investment of the \$225,000 is shown as \$15,550, and that includes draw-downs. Obviously the whole objective of the superannuation system is to build up the assets during working life so that they can be drawn down during retirement, so it includes the draw-downs.

**Senator HOGG**—I will come to the build-up of assets and the draw-down of those assets later on. That of itself is a fascinating thing for me. But you are saying that these people would earn \$15,000 in private income. Would they receive whole or part age pension?

**Mr Gallagher**—They are receiving a part age pension. They are receiving 92 per cent of a full rate age pension on average over their retirement. Because they have taken their benefit as a lump sum, their first year pension is lower. In their first year of retirement a full rate pension would be worth \$16,900 real but they receive a pension of \$11,674 real. Over the whole of their retirement, as the assets test ceases to bite and as the pension continues to rise in real terms, their government pension average over their retirement is \$17,794. In terms of the other patterns that are shown in the other scenarios which we have prepared for the committee, you will see that in these lump sum examples it is typical that there will be depression of the first year pension amount because of the impact of the assets test that has been modelled here.

**Senator HOGG**—This person will have spent their working life on nine per cent super and I presume their wage now is in the order of \$44,000 gross. Even then there is still going to be a 92 per cent dependency on the age pension, even when they go into retirement.

**Mr Gallagher**—Yes. That reflects the free area of the age pension and the indexation of the free area and also reflects the CPI indexation of the assets test, as well as the indexation of the pension itself. The major effect of the superannuation guarantee is to convert full rate pensioners into part rate pensioners from about 2015-16. Before then, most people retiring with superannuation guarantee amounts will, in our projections, not have any reduction in their pension because of their accumulation of superannuation guarantee. It will be below the effective free area imposed by the income test and the deeming arrangements for the income test.

**Senator HOGG**—I will try to clear this up but I think we will end up having to come back and talk to you people again. I take you to table A1 that you provided. It is on page 39.

**Mr Gallagher**—I am sure we have got the same table A1.

**Senator HOGG**—You seem to have run, at the request of the committee, I believe, a number of cases. This you have done as a life pension.

**Mr Gallagher**—Yes, this is a whole of life pension which will include an insurance element. So there is longevity insurance included in this calculation.

**Senator HOGG**—Looking at that case—if I read the table correctly—according to your model, a person will be on 97 per cent of the pension. Is that correct?

**Mr Gallagher**—Yes. This is someone who starts off earning three-quarters of AWOTE, so they are earning about \$33,000.

**Senator HOGG**—Can we try and compare it?

**Mr Gallagher**—If we want to get the equivalent case, we go to table A2 in the second last column. That gives you the AWOTE case.

**Senator HOGG**—And there the person will be in receipt at 95 per cent?

**Mr Gallagher**—Yes.

**Senator HOGG**—Would it be incorrect, on the basis of looking at the tables that you have provided, to say that the better option is for government policy to look at people taking lump sums? Is the inference that can be made from this that it lessens the dependency on the age pension?

**Mr Gallagher**—No, because there are number of issues associated with taking it as a lump sum which have been abstracted in this analysis. This analysis assumes that people taking lump sums will draw down on them, effectively, in an annuity pattern. In reality, that is not likely to occur. People taking a lump sum are far more likely to have an initial spending of a proportion of the lump sum, because they will fix up their car, their fridge or their house in setting up for retirement, and that would reduce their annual income after initial dissipation. What we have found when we have done—

**Senator HOGG**—Sorry for interrupting, but you have got to where I need to get to. That really means that, under table A2 that we looked at, there is probably a higher dependency on the age pension.

**Mr Gallagher**—With that change, with a dissipation pattern, that would be the case.

**Senator HOGG**—So you have not factored that into your model? That is why I am asking about the assumptions.

**Mr Gallagher**—In terms of these runs, no. These runs have been designed to show a potential average retirement income in particular rather than to look at the dissipation issue. In 1995 we prepared a paper on early retirement in which we looked at the use of lump sums. What we found from the Australian Bureau of Statistics data is that people who have a lump sum large enough to affect their pension entitlement—that is a fairly large lump sum, in excess of \$100,000—predominantly invest it, but the ABS data does not go into exactly how that information assists. With lump sums, there is always an issue with dissipation. There is also an issue in terms of drawing down on the assets over retirement. It would appear that many existing retirees do not draw down on their assets substantially over the period of retirement. There is a tendency to keep assets and try and live off income, I believe. That may be changing, but that is what I have seen in the past. So there are issues, generally, in terms of lump sums.

**Senator HOGG**—We could get bogged down in this all day. I do not want to do that, but it seems to me that we need to have some longer discussions about some of the implications of some of these tables. A lot of people are taking part lump sum and part pension, and I do not know if that is factored into any of your models. You have either lump sum or pension.

**Mr Gallagher**—That was at the request of the committee.

**Senator HOGG**—I accept that, but I think it will be necessary to pursue some of these issues with you.

**CHAIR**—Coming back to table 2, is that 82 per cent of the age pension? Referring to the final column, am I correct in saying that a person retiring, after 40 years work, earning 100 per cent of average weekly earnings gets 82 per cent of the age pension?

**Mr Gallagher**—Yes.

**CHAIR**—What does that say about the Intergenerational Report, the integration of super and social security?

**Mr Gallagher**—It says that we have a three-pillar system and most people in retirement will receive a contribution from at least two pillars. The nature of this interaction has been fully factored into the projections for the Intergenerational Report. The projections for the Intergenerational Report show that age and service pension combined would increase from about 2.9 per cent of GDP now to 4.6 per cent of GDP by 2041-42. Previous analysis which the Retirement Income Modelling Unit published in the past has shown that the savings on age pension which come from the superannuation guarantee become visible from about 2015 onwards, and the main effect on the pension is to convert full rate pensioners into part rate pensioners. You will notice again in this table that the first-year pension, received in this particular case at \$6,625, is substantially below the government pension average over the whole of retirement of \$15,761 as assets are drawn down and the asset test ceases to apply and the income test ceases to apply. So in these cases there is a very strong profile of the pension increasing as people get older in this particular analysis.

**CHAIR**—The age pension.

**Mr Gallagher**—Yes. That profile is less obvious where we have given you examples in the tables at the back where people have taken a whole of life pension or a life expectancy annuity, because in those cases those payments are asset test exempt.

**CHAIR**—But at the same time 2032 is a full 40 years, with a little bit of phasing—

**Mr Gallagher**—There is still a bit of phasing in it. It goes from 1992.

**CHAIR**—Despite that, people are going to be still significantly dependent on the age pension.

**Mr Gallagher**—Yes. I think we give some numbers in the submission which refer to our expectation that we would move from a situation in which about 54 per cent of the population of age pension age is a full rate pensioner to about 33 per cent—I think that is the number in the submission.

**CHAIR**—So in effect we are putting in a lot of superannuation effort to get to 82 per cent of the age pension. Is that the wrong interpretation?

**Mr Gallagher**—The objective of the superannuation guarantee was always better incomes in retirement. The submission clearly demonstrates that the two systems combined do give substantially better incomes in retirement. In the detailed tables at the back we have actually shown you what the improvement over a full rate age pension is for each of the cases modelled.

**CHAIR**—Except that there is a notion, obviously an incorrect one, in the general community that this will replace the need for the age pension. What you have demonstrated is that it is now, in partnership with the age pension, going to enhance your income in retirement.

**Mr Gallagher**—That is clearly the nature. We have deliberately modelled—

**CHAIR**—That is quite a significant shift in our perceptions, I think.

**Mr Gallagher**—Yes, but it is something we have been saying since 1993, when we first started modelling this: the impact of the superannuation guarantee is not to reduce the number of age pensioners. The measure that we have found that actually reduces the number of age pensioners is preservation, because preservation prevents dissipation of superannuation on job change; and that is the case for high income earners as well. Preservation in the long term will in fact mean there will be fewer pensioners, because people who might otherwise be able to spend their money on job change will not be able to do so.

**CHAIR**—Yes. Can I return to the problem that you gave us with a reconciliation between your \$29,000 figure and the ASFA figure of \$19,000. There is a big difference: \$10,000. Throughout our inquiry, people from academia and the private sector are trying very hard to look at the differences in the underlying assumptions. You have given us one today, and that was very helpful. Can you assure the committee that that one reason you gave can explain the whole of the \$10,000 difference, or what are some of the other factors? We have got to try and reconcile the two.

**Mr Gallagher**—There are some potential differences in annuity factors.

**CHAIR**—Would you like to take it on notice?

**Mr Gallagher**—I will take it on notice.

**Senator HOGG**—I think it is quite obvious, with the way the clock is ticking away now, that we are going to see you people back here again; you are going to enjoy our company and we are going to enjoy your company. That is the reality of life.

**CHAIR**—So rather than having us press you at the moment, if you are happy to take that on notice, because it is a very significant issue, it would help the whole modelling exercise at a pretty important time in our history.

**Senator HOGG**—When you come back to us, will you be able to tell us the level of drawdown on savings that underpins your models? I do not know if that is obvious from what you have given us here.

**Mr Gallagher**—If you look at table 2—

**Senator HOGG**—Not the drawdown; what level of savings you would anticipate that people would have such that they can draw down?

**Mr Gallagher**—We do show the size of the lump sum, but we have not given you the lump sum less ETP tax, which in some of these examples, as the lump sum grows, could become important because these will all be post-83 contributions.

**Senator HOGG**—If you could give us some idea that would be very helpful.

**Mr Gallagher**—Okay: you want more details on the lump sum.

**Senator HOGG**—Can I go to the broader issue. This committee has to make recommendations in its report and, as you know, reports of committees are either accepted in whole or part or rejected by government—that is the fate of committee reports. But we have had a number of issues put to us which I think need to be addressed, such as: what should be the aim of the superannuation component? Should it be a reduction in the dependency by the population on the age pension and, if so, what sorts of recommendations could this committee make? In other words, rather than attacking it on by saying that nine per cent is insufficient for a proper retirement policy and we really need 12 or 15 per cent—and I am not going to get into a debate on what the level should be, but that argument has been put to us—I am wondering if it should be looked at the other way: how should government, regardless of its political persuasion, set its objective? You have said to us today that under one of these models you are going to reduce the dependency of people on the full-time pension from 54 per cent to 33 per cent. Is that correct? That is broadly what you are saying.

**Mr Gallagher**—That is an outcome. We also show it in aggregate. We show the rise in the replacement rates across all workers in the population, using a model that takes into account all labour force variations in the total population. On average at the moment we would estimate replacement rates probably just below 45 per cent, with the potential to rise over 50 years—given all types of superannuation in the Australian superannuation system, not only SG—to a number closer to 70 per cent. So we have given you not only examples of individual hypothetical cases but a whole of population projection of the replacement rate of retirement income for the Australian population.

We have previously presented that analysis separately for males and females. In fact, women, because their working life incomes may be lower, show quite good replacement rates when you look at it on a whole of population basis as well. So that is an important finding, because it abstracts from selecting one case or another case to looking at the average for the entire Australian population.

**Senator HOGG**—One of the difficulties that, I think I can say, the committee have had is that we have had a number of different people telling us different outcomes, different scenarios, but we have never been able to compare apples with apples, as I said earlier. In your submission, for example, on page 16 you talk about the modelling done by your RIM Unit. You take a look there at account balances and you say that, currently, the average superannuation balance per person is \$62,000. You then go on to say that by 2005 this average balance is going to be \$70,000, by 2010 it will be \$84,000 and it will go to \$113,000 by 2020.

We had C+BUS appear before us yesterday in Melbourne and they were able to tell us that 38 per cent of their members—and they are not a small fund, as you know—have balances between \$1,000 and \$5,000. They were also able to tell us that only 0.3 per cent of their members have

balances greater than \$100,000 after 18 years. They were also able to tell us that the average retirement benefit after 18 years was \$19,600. I am not having a shot at you people, but there is a difficulty when people see figures like yours and then figures like those we got from C+BUS—and, undoubtedly, there is the other end of the financial range as well, which makes the figure average out to \$62,000. Your document talks about payouts at age retirement currently at \$72,000. There is no equating what C+BUS put to us yesterday with what you have put.

**Mr Gallagher**—Our modelling covers the differences between superannuation guarantee schemes, defined benefit schemes and private sector, more generous, defined contributions schemes. The full diversity of that has not been reflected in the submission. Superannuation guarantee is only 10 years old; it has just got to its nine per cent rate. Award superannuation started in 1986 and its coverage spread. The accumulations in accounts which merely have a superannuation guarantee design are appreciably lower than the average overall. It is still the case—and will remain the case—that the bulk of the assets in the Australian superannuation system are not in SG style accounts, even though the majority of people in the system are in SG style accounts, and there is a very wide divergence in asset balances.

In the C+BUS example, because it is the building and construction industry there are a number of factors which might make them special amongst superannuation guarantee style account holders. They have a highly mobile work force which may have intermittent employment. It may be that members have several accounts in different places because of their different employment, some of it outside the industry, and the single C+BUS account may not reflect their total superannuation accumulation.

One of the things that the survey of employment arrangements and superannuation showed was that there were a significant number of people with very small account balances. There are a significant number of people who are currently outside the work force who, because of preservation—and all superannuation guarantee amounts are preserved—have a very small amount in those accounts. That is an issue that we hope to look at further over the remainder of this year, as we get greater access to the data of that survey. But it is certainly an issue that there are small accounts out there and that the average account balance for superannuation guarantee accounts is probably going to be less than \$20,000 now.

**Senator HOGG**—Are you able to give us a list of objectives that the committee might consider?

**Mr Brake**—The current government and former governments have made statements which go to issues like the objectives of retirement income policy. We could certainly give you copies of those. As our submission points out, the government has not set, for example, an explicit benchmark rate. We can certainly provide the information which has been published before on those sorts of issues.

**Senator HOGG**—What sorts of solutions are there? Do you offer any solutions in your submission? If one looks at the Intergenerational Report, it identifies a problem. That is about it, isn't it? It does not offer any solutions. We are looking for solutions. Do your scenarios in any way offer solutions or are they just factual statements of the position that might unfold, as you see it?

**Mr Brake**—We do not offer policy prescriptions.

**Senator HOGG**—No; I am not asking for policy. ‘Solutions’ might not be the right word.

**CHAIR**—The Intergenerational Report touched on one or two aspects, particularly the pharmaceutical benefits scheme, where it indicated that, given the blow-out and the aged population with reference to the numbers that that presented, it was better to take action now than later. That was one possible solution. Do you have others that you could help the committee with?

**Mr Brake**—As you say, the government did introduce some budget measures which were designed to constrain the growth of some outlays. Our focus obviously is on the retirement income system. The Intergenerational Report noted that there was, as Mr Gallagher said, an expected increase in the outlays attributable to the age pension system. By OECD standards, that is a relatively modest increase. But the Intergenerational Report also talked quite a bit about the whole of government issue—that is, when you look at outlays as a whole and what they are projected to be relative to when you look at revenues as a whole and what they are projected to be. But we do not go into that in this submission.

**CHAIR**—Is it possible to help the committee with that extra information? Is it possible to go into some of those other issues to help the debate?

**Mr Brake**—As we said in our submission, one of the committee’s terms of reference is really on the health side and the age pension side of the issue. We have a department of health and a Department of Family and Community Services, so they would have more direct relevance to those issues than the Treasury would.

**Senator HOGG**—But it must have an impact on the model that you finally arrive at. I know you are probably trying to distance yourself from them, and I understand that, but, at the end of the day, you are presenting a model to us that we are asked to interpret, which has other underlying assumptions in it. That was why I was pressing the issue of what the underlying assumptions are. It is not trying to get you to comment on policy; it is trying to find out—

**CHAIR**—Options.

**Senator HOGG**—I call them the solutions; the chair calls them options. I do not care what we call them.

**Mr Brake**—We tried to do two things with the submission. One was to present the committee with what we think is an objective set of results that the system will produce. A number of submissions to you have stated that various people think that what the system is expected to produce is not what they would like it to produce. That is obviously a question for the committee. What we have tried to do in our submission is say, ‘This is what the system will produce.’ We have also tried to say that it is quite a complex system; there are many interactions between the age pension and retirement incomes, the amount people are expected to save now to fund their future retirement, the level of transfers between taxpayers and individuals—all of those issues. We have tried to tease out some of those for the committee so that you have a

picture of what the system produces and what some of the interactions are and that, in looking at these issues, you have a framework which we hope will be useful.

**Senator HOGG**—One of the things that I have not had a chance to pursue today is the issue of different levels of fees and charges. The model at table 2 that we discussed briefly shows, I think, \$1 per week plus one per cent.

**Mr Gallagher**—One dollar for administration and \$1 for insurance, so that is \$2 off a week. Essentially it is \$104. It might be slightly higher than that—it was probably the amounts we had in there—

**Senator HOGG**—But, anyway, the fact of life is that there are many and various levels of fees out there. We have heard evidence before the committee that, for example, if the fee is as low as half a per cent, there is a certain impact; if it is one per cent, I think that takes \$10,000 off at the other end; two per cent, \$20,000; and three per cent, up to \$30,000. A lot of people do not realise this. Part of the problem is the expectation of people: they hear about this nine per cent going into the credit of their account and they do not quite understand what nine per cent means. We have had evidence that, by the time you take off just minimal fees and charges—nothing more—that the nine per cent really is about 4½ to five per cent at best. I am not asking you to confirm that; I am just saying that is the evidence that we have had, and I am not saying that is correct. But the reduction can be as substantial as that, so the real crediting that is going to a person's account is nowhere in the order of nine per cent—it is a substantially lower figure. My question is: have you done models which have different levels of fees and charges?

**Mr Gallagher**—Not in this set, but it can be done.

**Senator HOGG**—Maybe this is something we will have to get back to you on, but it seems to me we need something that shows a range of fees and charges in the order of, say, half a per cent, one per cent, two per cent and three per cent.

**Mr Gallagher**—We would probably do that as a variation in the fund earning rate, and there is no doubt that the private income results in retirement and the size of the eventual final benefit are very sensitive to the fund earning rate assumptions over the periods of 25 and 40 years which we have modelled in the submission. That is a very important parameter.

**Senator HOGG**—If you could do that. The other thing that I wanted to ask you about has escaped me for the moment; we will get it to you through the secretariat.

**Mr Brake**—Can I make one brief point to the committee. We were talking quite a bit about these hypothetical cameo analyses, table 2 and so on, and there is a focus on the extent to which people were using or had the age pension available to them. The caveat here, of course, is that these are just cameos which are based on SG only, and for a number of these people you would think that they would have at least some other financial assets in their retirement. So to the extent to which they have any other financial assets, you would expect these figures to be lower.

**Senator HOGG**—I am glad you jogged my memory, because that was the other issue that I wanted to raise. On page 5, you say:

... expenditure replacement measures are also able to capture the effects of income tax concessions ...

You also talk about the ‘drawdown of capital during retirement’, the level of capital that you expect people will have—I think we have raised that—and the rate of drawdown. One of the issues that has been raised by the committee in broad terms is that people should be able to, in effect, mortgage back their house if that is their asset. If that is the sort of drawdown that you are thinking of, would you let us know?

**Mr Gallagher**—There are no home equity conversions included in this modelling. I have been involved in various schemes since 1985 that looked at home equity conversions. Going back to the original sell-stay schemes in Melbourne from 1985, they have never been a popular thing. When Neal Blewett was Minister for Social Security, he set up a subsidised home equity conversion scheme with the Advance Bank. I think Ms Flanagan from social security might be able to give you some evidence on just how popular that particular scheme was!

**Senator HOGG**—We understand that. That is why I am trying to find out what your assumptions are on the drawdown from capital and what the capital sources are.

**Mr Brake**—Very quickly: our assumption would be that you draw down your retirement income nest egg, if you like, but you do not have to do it or there is no assumption that in fact you have any other assets, so you assume no drawdown of those other assets.

**CHAIR**—Can I interpose at this stage. In the last couple of days, we have received quite alarming evidence that, increasingly, people are entering retirement with alarmingly large amounts of debt. You said that people need to make a little discretionary expenditure on carpets, house repairs, a new car or a fridge—those sorts of items. Do we need to factor in the large amounts of credit debt out there and the fact that the lifestyle and debt structure of families have significantly changed in the last 10 years?

**Mr Gallagher**—It is something that we are trying to get a better handle on with the Australian Bureau of Statistics. We are hoping that they will change their statistical collection so that we can get a better handle on consumer debt. We are not sure of the extent to which it is true. One of the indicators is the home ownership rate. It is still the case that in excess of 80 per cent of people at retirement age own their own home, and there have been fears over the years that that would decrease substantially. The available evidence we have does not run to actually giving us the distribution of consumer debt.

**Senator HOGG**—But that could severely impact on your models, if it holds up to be true.

**Mr Gallagher**—It is certainly an issue, and something we need to be vigilant about and to try and get the best data we can to monitor the extent to which this is an actual problem.

**CHAIR**—So in interpreting your figures, the 82 per cent of age pension after 40 years: that figure will significantly drop if people carry the sorts of credit debt that are around at the moment into retirement years.

**Mr Gallagher**—The amount of the benefits such as age pension could possibly rise if there is substantial debt that leads to dissipation of assets. There is no dissipation in the hypothetical

examples. In the analysis for the entire population, there is a dissipation assumption that people entering retirement will on average spend in the range of \$30,000 to \$40,000, although we do key it off the actual amount of salary. So the whole of population analysis has, underlying it, assumptions about dissipation.

**Senator HOGG**—At what level of wage does 100 per cent therefore kick in in the 2032 model that you gave us at table 2? Do you have a salary level for then and now?

**Mr Gallagher**—On these tables, it is an amount less than 75 per cent of AWOTE, so it is a salary of less than \$33,000 that would give you a full rate age pension for the various cases. Certainly with shorter accumulation we get very close. With a 25-year accumulation at \$33,000, three-quarters of average weekly ordinary time earnings, we have got 99 per cent of pension, so we are getting close in those examples to a full rate age pension.

**Senator HOGG**—Yes. But that assumes that it is full-time earnings, doesn't it? And the reality is that there are very few people out there—

**Mr Gallagher**—It is 0.75. Again, it is a full-time example. We have done scenarios for females with interrupted careers, who have been out of the work force for five years and have worked 10 years part time.

**Senator HOGG**—Where is that?

**Mr Gallagher**—Table 3. If you look at the two columns labelled scenario 2, they show cases where a woman is working full time from 25 to 29 and also at the end of her career, from 45 to 64, but not working at ages 30 to 34 and working 17 hours a week from ages 35 to 44. We have shown you what lump sum benefit, at 75 per cent and 100 per cent of AWOTE, would be generated in those cases and what the age pension consequences of that accumulation would be.

**Senator HOGG**—That is good, but it does not really reflect what is happening out there in the real world.

**Mr Gallagher**—The most comprehensive analysis for the real world is the whole of population analysis. The cameo analysis is easier to explain and to understand the assumptions. The RIM group modelling covers the whole of the population and what happens in the real world.

**Senator HOGG**—I accept that. Can you give us some examples, though, on substantially lower incomes that reflect more the likes of people who will be in industries where full-time work is not really available.

**Mr Gallagher**—In table 5 of the submission we show you examples for someone whose earnings—

**Senator HOGG**—What page is that?

**Mr Gallagher**—Page 26. I must find out what extra two pages Roger has got that I do not have.

**Senator HOGG**—These are the two secret pages of Treasury, are they?

**Mr Gallagher**—You have got the same page numbers as Roger; I must have printed off an earlier version. What we have got there is a case in which someone starts off on \$20,000 and over the 30-year length of their career their real salary rises to the point where it is \$30,000. We are looking at what happens if they have got SG only, then at the case where they have got SG only and member contributions which are designed to maximise their receipt of the government's newly announced co-contribution, and then we look at the superannuation guarantee plus the member contribution which is only sufficient to get the co-contribution and the co-contribution. These tables take into account the fact that the co-contribution income limits are not indexed, so that after about 11 years with average wage rises this person ceases to be eligible for the co-contribution. Nevertheless, it shows the significant impact that the co-contribution can have on final benefits. If you look at the SG only case, the final lump sum benefit would have been \$97,000, but with the SG targeted member contributions and the co-contributions this person can achieve a lump sum of \$131,000. In this case the replacement rates are quite high because for these low income—

**Senator HOGG**—Can I stop you there for a moment. The assumption there is that there is a certain degree of discretionary spending that these people have. Is that correct? It has to be.

**Mr Gallagher**—Yes, there is. During their working life their income net of tax is their spending, but it does not make any particular assumption about mortgages or anything like that. It does not have a full analysis of any consumption basket attached to it.

**Senator HOGG**—Have you ever met one of these people? I would like to meet them. If you know one, please take me out—

**Mr Gallagher**—I think that in many cases people working part-time are often wives in married couples. We have also given you married couples scenarios in which there is a substantial period of part-time work by one partner in the relationship and have shown you what the effects of those are. Do I meet low income people?

**Senator HOGG**—No, I mean I would like to meet one of these people. They would be a rare species.

**CHAIR**—Some witnesses before the committee have indicated the need to set aside funds separately for aged care costs, given the fact that people are going to be living longer and costs of health care are going to be quite high, particularly in their later years. Other witnesses have said to give them an adequate retirement income and that will be enough. My personal experience in the office when people come to me with certain eye problems and need an operation is that they can go to the private sector and have it done almost immediately or wait 12 months if they have not got the \$2,000 that may be required. Does the Treasury have a view about the need for setting aside funds for aged care costs independent of other living expenses, just to be able to access a lump sum in time of need?

**Mr Gallagher**—It is not something we have specifically addressed in our submission. The main point I would like to make about health costs is that, although everyone who survives needs a retirement income, there is huge variability in potential health costs in retirement. Because of that huge variability, if we were to rely on a savings mechanism alone many people might oversave and many people might undersave. You would need some sort of insurance arrangement to cope with the huge variability in health expenditure in retirement. Other than noting that, and that is a relevant factor, I do not think I have anything more to say.

**CHAIR**—In the current environment, with average super funds returns being approximately 4.5 per cent negative, there is an increasing pressure to look at fees, charges and the impact of tax on final pension. It has been put to us that as the amount under investment increases so does the government's tax take, as a result of the 15 per cent less imputation taxes on earnings. Therefore, they say there is a case over time to reduce the couple of contributions taxes that we have. There should be an availability to reduce a contributions tax over time as a result of the growth of taxation of the income from investments. Would you like to comment?

**Mr Brake**—The key point there is that the government, in the forward estimates, projects forward what is projected to be expected revenue over coming years with current policy settings. Where revenue is expected to increase over time, that is projected into the overall fiscal balance. Whether it is increasing or not increasing, if you were to reduce it from what it would be then obviously that has an impact on the fiscal balance.

**CHAIR**—Yes. But, in terms of concern about an increasing tax take of superannuation, if you keep all your other constants the same in terms of rates but allow the income flow to increase, the government's take from superannuation will continue to rise. The view is that, given the importance of maintaining adequate income in retirement with less draw-down ultimately, there is a case for it now beginning to shift back to where we were in 1988 over time to a tax at the back end—that is, when people retire—and to soon start taking off the taxes at the front end in the form of the contributions taxes.

**Mr Gallagher**—There are two points. In terms of the revenue from superannuation, if you look at it in a very long-term sense, the proportion which rises will be earnings tax, but earnings tax itself is highly variable. It is not so much contributions tax rising as a percentage of GDP; the thing that will give the impact in the longer term will be earnings taxes because of the growth in superannuation assets. The earnings tax itself is highly variable. It is very strongly affected by economic cycles and it is very strongly affected by the realisation of capital gains by funds. Superannuation funds, because they are long-term investors, tend to realise capital gains when market conditions are right, so you can get very strong swings in the realisation of capital gains.

In terms of that being an argument for a change in contributions and earnings taxes and moving taxes to end benefit, the real issue there is that, if we were to substantially move away from contributions and earnings taxes to end benefit taxes at this point, there would be a substantial fall in revenue. There would be a substantial fall in revenue for which no-one has identified a replacement revenue in the submissions that you have been given, because it changes the timing of revenue substantially.

**CHAIR**—Yes. There is a big timing difference; I acknowledge that. But it is starting to emerge now, with the growth in the earnings taxes, that there does seem to be certainly an academic case to start levelling off the contributions taxes to neutralise overall the government's tax take from superannuation. That is the point that has been made quite strongly to the committee. Of course, you have to then start factoring in that, as people retire and take their benefits, the earnings component will increase quite substantially.

**Senator HOGG**—Can I just follow on from what Senator Watson is saying. I will take a slightly different tack which was raised at the committee inquiry in Melbourne yesterday. Removal of the contributions tax will cause greater acceleration in terms of the end benefit for the retiree and, whilst you rightly point out what is going to replace that, there was at least a suggestion by one witness yesterday that the people most at risk currently are the baby boomers, who have had a limited period of time accessing superannuation, SG. Whilst the total removal of the contributions tax might not be a possibility—

**CHAIR**—Straightaway.

**Senator HOGG**—for that group there would be a removal which would improve their retirement benefit substantially by the time they reach retirement age. Have you thought of that? Have you modelled that in any way? As I say, it is a proposition that has been put to us. It is not looking at the total removal, but looking at that partial removal.

**Mr Gallagher**—We have done a preliminary order of magnitude costing of a proposal to reduce contributions tax on an age basis for people over the age of 45. When we did that, we found that people over the age of 45, in our estimate, were making about 61 per cent of contributions. So it is a substantial amount of contributions and therefore there was a significant revenue effect. The other thing to say about that is that there is a very wide distribution of superannuation contributions amongst the baby boomers. The proposals that affect contributions tax would, by their nature, give more significant benefits to higher income people making higher contributions.

**Senator HOGG**—So you have not looked at it specifically in terms of—was it 40 plus or 45 plus that was mentioned?

**CHAIR**—It was in that area.

**Senator HOGG**—It was about that. You have probably looked at it in terms of the loss to revenue, but have you looked at it in terms of the benefit to the superannuants?

**Mr Gallagher**—I think we have run a couple of cameos, looking at the benefit from an age based reduction in contributions taxes, but only two cameos—just having a look at what the impact would be.

**Senator HOGG**—Could you make those available to us?

**Mr Gallagher**—I will take that on notice.

**Senator HOGG**—It would be interesting to see. The second thing is: have you run a model where, for those people who will never receive the full impact of the SG because they have a limited working life, you have looked at the progressive reduction of the contributions tax just for that group? Have you limited it to those people who are going to be the heaviest burden upon the age pension system—in other words, not those high-income earners and high wealth owners, but those people who are most at risk? That leads me to the question: which people do you think are most at risk?

**Mr Brake**—Just as a broad point, which is fairly obvious, we do have a maturing system. When you look at the age pension, which increases in real terms over time, people who are retiring now generally will be better off than, for example, those who retired before SG. Those people who only had 10 years in the system obviously have had fewer opportunities than those who follow them. So it is a maturing system, and one thing about reducing contributions tax is that, yes, if somebody is going to be retiring tomorrow, reducing the contributions tax is not going to help them.

**Senator HOGG**—No; we accept that.

**Mr Brake**—In terms of the second thing that you have asked us to look at, we would probably need to have a fair bit more detail to be able to do that, to have a specific—

**Senator HOGG**—What sort of detail? We are curious about is whether, by progressively removing the contributions tax, which is a front end tax, on that group of people at 45 plus, you will limit their dependency on the age pension at the other end. If so, what impact will you make upon that? That is what we are basically asking. I think you have the capability of doing that. Obviously, you would have some constraints in mind in terms of high-income and high-wealth people, so you may like to put some sort of notional ceiling in there as to what group it would apply to. That is why I asked the question: who are the people most at risk?

**Mr Gallagher**—I can answer that question. I can tell you who the people are in my view, which comes more from my previous experience as director of modelling at the then Department of Social Security and as a poverty researcher, and also comes out of our own submission to you. The people who are most at risk in terms of retirement incomes are people who have become disabled well in advance of age pension age. Those people, because they can be existing on a disability support pension for a very long period, do not have substantial assets when they enter retirement. Their household assets and their cars tend to be in poor situations. In the work on living standards by Peter Travers and Sue Richardson, there is certainly a case that when people who have been disabled for a long time get to ordinary retirement age, because of that very low asset accumulation over a long period—

**Senator HOGG**—I accept that group.

**Mr Gallagher**—and no superannuation, they tend to have standards of living in retirement well below the Australian average. In the submission—and this is quite clear because of the nature of the cameos that the committee requested—we show that people who retire early, at age 55 or 60, have appreciably lower retirement incomes because of that early retirement. Early retirement is bad for your accumulation. If you are going on to Newstart allowance, this has a far more stringent assets test. Given that the preservation age is 60, if you retire early at 55, you

cannot get your superannuation assets until you are 60 in the sorts of cameos that we have examined here. When you do, your Newstart allowance is substantially affected by the asset level, or can be if you choose to take your lump sum at age 60.

**Senator HOGG**—I accept that group, but what about those people who are waged or partly waged, who might be in and out of the work force? Does your model make you concerned that people on a certain income level are going to be a burden on the system? ‘Burden’ is not the right word; are you concerned that they are going to access the age pension in its entirety? Do you have a view as to a level of income so that, when you are doing the modelling we have just asked about, you will not include someone on \$150,000 a year? I would think that you are not going to worry about those people, for example.

**Mr Gallagher**—We deliberately kept the cameos in this submission to a maximum level of 1½ times average weekly ordinary time earnings. We presented numbers in the submission that showed that the majority—in excess of 60 per cent—of people with incomes over \$50,000 have either superannuation contributions which are in excess of the superannuation guarantee or substantial financial assets. We estimate that the majority of people with incomes just over \$50,000—given that AWOTE is now \$44,000, that is not a lot above it—have assets in addition to the superannuation guarantee for their retirement. Therefore, for the purposes of this submission, we are looking at incomes that are closer to 75 per cent of AWOTE—more in the \$30,000 to \$35,000 range—in terms of the major interaction for the superannuation guarantee. In Roger’s introductory remarks, he quoted results at median earnings, which are 75 per cent of AWOTE. Half the population are earning above that and half the population are earning below it; the issues are below that.

**Senator HOGG**—You were talking about specifics before. Can you look only at those people who are most vulnerable—if we can call it that—in working out that model? I do not want you to say that what you were talking about was absolute pie in the sky; you have included people at the other end of the marketplace in your model. We are looking at a transitional arrangement for those people who are baby boomers, who have not had access to long-term superannuation, who invariably have low balances. It may well be that a reduction in the contributions tax will be a significant benefit for them when they retire, such that it will decrease dependency on the age pension. I do not know what the outcome will be; that is why we are asking you to do the modelling for us.

**Mr Gallagher**—I will take that on notice. One issue that I would like to pick up out of that is the discussion that has come to the committee on targeting people with low balances. At the moment, we do not have an administrative system which identifies balances and the balances people have across multiple accounts. There is a very large and complex administrative system attempting to identify all taxable contributions across multiple accounts for a person, but we do not have a system which runs to the issue of balances. The RBL system, which looks at ETPs drawn over the life, also does not look at the issue of balances. I imagine it would be very difficult to develop a system which would look across the balances of individuals as a targeting measure.

**Mr Brake**—Another point—which was raised by a witness to your committee—is that, even if somebody were to have a low superannuation balance, they might have high assets elsewhere. That is where the targeting of this would become quite difficult.

**CHAIR**—Just before we proceed, I have to make one correction. Speaking to you earlier, I said ‘income distributions provided by the tax office’. They were from the 2001 census, produced by the Australian Bureau of Statistics. I seek the committee’s approval to incorporate certain statistical data in relation to median income levels in Tasmania, which I contend were significantly below average weekly earnings, together with some statistical subdivisions produced by Treasury and weekly individual income by age and sex. It would be appreciated if that material in relation to those earlier comments could be incorporated in *Hansard*.

*The documents read as follows—*

**CHAIR**—It has been suggested that we should look at removing the age based contribution levels, because they discriminate against certain types of individuals: young sportspeople and those in the entertainment area, such as film stars, whose highest incomes are often earned in their earliest years; and women re-entering the work force. If the adjustment is made using the reasonable benefits limit, isn't that enough? Why do we need a check on the way through as well as at the end? We are trying to encourage people to put money into retirement when they have money there.

**Mr Brake**—I could probably seek some more information on that.

**CHAIR**—I would be very happy for you to take it on notice, because we are a bit short of time. There is another issue. Although a number of witnesses put forward equity issues connected with aged based contributions, we are urged strongly not to go down that path by the administrators. In recent years they have found that all these little things are adding very considerably to their costs, and the surcharge was a most significant one.

**Senator HOGG**—The surcharge is very significant.

**CHAIR**—How would Treasury view the concept of getting people off this lump sum and more into a pension by having a higher rate of tax on a lump sum component?

**Mr Brake**—I know that some submissions have suggested there be sort of mandating of income streams above various levels and so on. But, rather than do that, government policy clearly is to provide tax and social security incentives for people to take benefits in the form of an income stream. That is government policy there. Certainly things such as allocated pensions have been very popular as a means for people to do that. As pointed out earlier by Senator Hogg, average retirement payouts at the moment are relatively low as well.

**CHAIR**—Special thanks for those cameos. They are very helpful. Thank you for agreeing to take a number of issues on notice, which I think will tend to bridge the gap of understanding that some of our colleagues in the private sector have. Also, thank you for your contributions; they have been very helpful.

**Senator HOGG**—Perhaps before the witnesses leave, I might say that we anticipate seeking to recall the officers.

**CHAIR**—Thank you very much for your cooperation.

[10.46 a.m.]

**CORVER, Ms Leonie Anne, Director, Retirement Policy, Seniors and Means Test Branch, Department of Family and Community Services**

**FLANAGAN, Ms Kerry, Executive Director, Strategic Cluster, Department of Family and Community Services**

**KEMP, Ms Hilarie, Acting Director, Seniors and Means Test Branch, Department of Family and Community Services**

**ROJAHN, Mr Eric John, Director, Financial Markets, Seniors and Means Test Branch, Department of Family and Community Services**

**CHAIR**—Welcome. We apologise for being just a little late; Treasury is always a big department and has a lot of influence. We look forward equally to your comments today and now invite you to make an opening statement.

**Ms Flanagan**—Thank you. Firstly, I thank the committee for giving us the opportunity to present the submission of the Commonwealth Department of Family and Community Services. I understand that this morning you were given copies of that submission, which contains coloured graphs.

**CHAIR**—Yes.

**Senator HOGG**—Yes.

**Ms Flanagan**—The submission puts the view that fundamental determinants of the adequacy of retirement incomes are the capacity of people to earn income and save and the lengths of time they spend in the work force and also in retirement. As Treasury stated to you this morning, discussion of retirement incomes needs to take into account broader social and economic trends and pressures, rather than focusing on superannuation and age pension approaches in isolation. Social policies in recent years have been directed towards early intervention and preventative approaches to address social problems emerging and to build economic and social participation. Against these broader social and economic issues, adequate retirement income outcomes are facilitated by a system—and I am sure you would all know of it—consisting of the three components, or pillars, as they are normally called. The first of these is compulsory employer superannuation contributions through the superannuation guarantee. The second is voluntary superannuation and other private savings. The third and, I think, most important, as demonstrated by the work done by the RIM group and presented to you this morning, is social security payments—the age pension in the case of those over age pension age, funded from general revenue and targeted to those in need through the income and assets test, as well as veterans pensions.

I would like to reiterate the results that were given to you this morning: that is, you can see that even for people retiring at 65 after 40 years of working life at least 80 per cent of the age

pension is paid. For people who have interrupted working lives and/or shorter working lives, over 90 per cent of the age pension can be paid. So I think it is critical for this committee to also focus on the contribution of age pension to retirement incomes.

Something we are very interested in focusing on is the fact that the three pillars can be supplemented by earnings for people who can and wish to work—and we have evidence showing that people after retirement age are interested in continuing to work, perhaps on a part-time or casual basis. We now refer to this as the fourth pillar of retirement income. We believe that it is very important, in a policy design sense, to break away from the concept that people have a full working life and then they retire. The reality today is very different, and we need to have public policy responses to recognise this. For example, the government has already introduced measures to allow superannuation contributions to be made after the age pension age—I think up to 70 years old. We think there are other measures that need to span across the de facto retirement age of 65, perhaps in terms of labour market assistance, encouraging people to continue in education et cetera.

Modelling work has shown that as the SG matures there will be substantial and increasing superannuation coverage. As I said earlier, the majority of older Australians will still rely on the age pension as their major source of income. However, the proportion of pensioners receiving a reduced rate of pension is expected to increase—and again Treasury gave you figures this morning of the increase in part-rate pensioners. Even with the projected increase in age pension spending as a proportion of GDP, we believe that Australia's retirement income system is expected to remain one of the most affordable systems in the world. While the ageing of Australia's population is expected to lead to increases in the proportion of the budget spent on the age pension—up from the current 2.9 per cent of GDP to 4.6 per cent of GDP by 2042—Austria, Japan and other European countries are already paying much higher proportions of GDP to cope with their pension and social insurance systems. They are able to manage that at the moment and, as I say, on many comparative measures Australia has a very affordable system, as it is currently designed.

There have been calls over time to remove means tests. However, the means test plays a critical role in maintaining the affordability and sustainability of the age pension system. Without the means test, we estimate that current age and service pension outlays would increase by between \$6 billion and \$7 billion a year. As the population ages, outlays would also increase. We believe it will be important to maintain the integrity of the means test, in order to strike a balance between targeting and providing incentives for self-provision. As well, in a comparative sense, the generosity of means testing and taxation arrangements for older Australians needs to be considered against the needs of other groups that the government may wish to support, such as families with children.

The capacity of people to fund their retirement will depend on work force patterns and income support dependence during their working lives. Also, people are increasingly spending more years out of the work force than in it or spending longer periods in part-time or casual employment. Increasing numbers of people are prematurely retiring from the work force, whether voluntarily or involuntarily. More than 50 per cent of people coming onto age pension do so from another income support payment. Structural ageing will mean that there will be a greater proportion of older people, at a time when the work force participation of this group is declining. The length of time people spend in retirement will also determine the adequacy of

their retirement incomes. People are living longer and longer periods in retirement will see some people starting retirement as self-funded retirees and coming onto age pension later in life.

Changing work force patterns and societal changes, such as the incidence of family breakdown and community fragmentation, will impact on people's capacity to save for retirement; on formal and informal support arrangements for the retired; and on living standards in retirement. While it is not the purview of this committee, we as a portfolio are also interested in the impact of structural ageing on family relationships, in terms of how care arrangements may change in families—from parents to children and those with increased needs as they get older. We are also interested in community impacts: for example, what will happen in the retirement belts that we see developing on the north coast of New South Wales and in southern Queensland? We are interested in the geographical separation of generations in families and what will happen to community infrastructure. A wide range of policies are aimed at meeting these challenges, including policies in the areas of welfare reform and support for families, community and youth. Building workforce participation for mature age people is a priority, we believe.

Some of the submissions have talked about housing and the fact that many of the baby boomers continue to hold most of their wealth in housing rather than in other assets. I think Mr Gallagher alluded to the fact that we have tried for many years to look at sale and lease-back schemes, reverse equity mortgages, home equity conversions et cetera, but we have found that there has been a very low take-up of those. One of the reasons people give us is that they do not wish to re-encumber assets that they have finally paid off; another is that they see it as an important way of passing assets through to their children.

In conclusion, we would like to reiterate that the adequacy of retirement incomes for many Australians would be improved by encouraging work force participation. Consideration of the adequacy of retirement incomes needs to be taken in the broader context of the economic and social environment and other policy developments. Thank you.

**CHAIR**—Is it reasonable to expect the community to pay a benefit to a person, just to enable them to pass on their house or other assets to their children?

**Ms Flanagan**—That is a question you need to ask the community rather than me, a public servant. Certainly, the family house has been exempt from the assets test since 1909. It was possibly included in the assets test for a very few years in the early 1900s. Apart from that, the family house has always been exempt from the assets test, and that has been a policy decision taken by both sides of government.

**CHAIR**—You do not think that this may have to be looked at in subsequent years, given the increasing amount of GDP that is going to be taken up by pension and aged care costs?

**Ms Flanagan**—I do not know the answer to that. Certainly, it has been examined on a number of occasions in the past and, as I say, has remained exempt. One of the things we do find is that home ownership makes people better off in retirement. We have seen this with people in public housing and, in particular, those in the private rental market who will never be able to acquire housing, and we have found this mainly with high levels of poverty among older

single women who do not own houses. Having a house does actually contribute to a better retirement outcome.

**CHAIR**—It was suggested to us that one of the factors that has led to a lot of earlier retirements is the increasing number of younger managers—general managers, CEOs. They have a ‘discomfort zone’ with senior, experienced people around them, and they tend to get rid of them. As a result, we have a lot of fairly experienced people being forced into retirement earlier than they probably should be. Therefore, I was very interested in your fourth-pillar approach, looking at measures to bring these people back into the work force. Certain studies that have been presented to this committee have shown a trend emerging in America where increasing numbers are coming back into some sectors of the work force. What sort of people are they here—for example, are they construction workers? What is the pattern that is emerging? You mentioned it. Do we have identifiable groups that are starting to come back into the work force to form this fourth pillar? How can we encourage that?

**Ms Flanagan**—Again, I am talking about most OECD countries: overall, the statistics show that the employment of males over 45 has decreased but the employment of women over that age is increasing, mainly in part-time and casual employment. One of the issues is around full-time employment and whether men in those age groups are prepared to accept much more casual or part-time intermittent work.

**Senator HOGG**—Do you know what industries that would be in, because that is significant? It is one thing to say that fewer men over 45 are staying in the work force and more women are coming back into part-time and casual jobs, but they may be not coming into the part-time and casual jobs that were otherwise occupied by the men; they may well be going into less well-paid jobs, in some instances, in the service industries. If you can enlighten us, we would be pleased to hear that—if you can be specific.

**Ms Flanagan**—The Department of Employment and Workplace Relations know more of these figures, but more generally it is a very mixed picture. For example, we do know that there has been a lot of change in the labour market, and certainly we believe that people coming onto the disability support pension around the age of 55 come on because they have been in low skilled manual jobs. That is one group. We could possibly take the question on notice to look at it in a little more detail.

**Senator HOGG**—If you could, I would appreciate it because that is quite a significant issue.

**Ms Flanagan**—We will see if we can get some more detailed analysis of what we are seeing in those older age groups. First of all, we will see whether we can pick them up from Centrelink data about what sorts of industries and/or employment categories they have come out of. If not, we can possibly refer it on to DEWR.

**Senator HOGG**—Yesterday we heard evidence from the ACTU in Melbourne that 87 per cent of the net jobs created in the 1990s were in the under \$26,000 per annum income bracket and 48 per cent were in the under \$15,600 bracket—and all of them were in the part-time and casual area. They were in the areas of hospitality and service and those types of sectors. When you are talking about people coming back from retirement and working, do you have a feel for where they are going to in their work?

**Ms Flanagan**—We have similar data to the ACTU in terms of the growth in full-time versus part-time jobs and where they might be.

**Senator HOGG**—Just following on from the chair's question about people coming out of retirement, I do not know about anyone else but if ever I reach the day that I can retire I reckon it will be a marvellous day; I am certainly not looking forward to getting back into the work force. Why are people changing their notions about what retirement is—or their ideals about it? For many people, retirement has always conjured up a time which is free from the need to go to work. There are some people who work for other reasons and can never be retired; no matter what you do, they will keep working until they are 80 or 90. They are workaholics, whether they work in an honorary capacity or whether they are in the work force in a paid capacity. Can you identify whether those people coming back into the work force from retirement are people who need to do that or people who choose to do it—not to survive or to supplement their income but as a means of establishing a lifestyle for themselves?

**Ms Flanagan**—We will take that on notice. We do have some breakdown about retirement intentions and whether there is voluntary or involuntary retirement.

**CHAIR**—Have you got any measures in mind to encourage people of both sexes to re-enter the work force? I know we have the deferment of the age pension bonus. What else is there?

**Ms Flanagan**—We need to think about what we mean by re-entering the work force and when that occurs. You gave an example of somebody at 45 re-entering the work force. We have never regarded somebody at 45 as being retired. To me, there is a real issue around what we mean by retirement age—when people think that is. Many people regard 55 as the defacto retirement age, even though access to the age pension is not available until 65. We are talking perhaps about a 20- or 30-year span. To me, somebody who leaves the work force at 45 and re-enters it is, in effect, unemployed and not retired. The responses used in trying to get them back into employment might be different to those used with somebody who has had a full working life and is being encouraged to think about doing something when they are, for example, 70. You might expect 70-year-olds to do a completely different sort of work to the work you would expect of 45-year-olds, who are perhaps still bringing up a family and needing quite a high income.

**CHAIR**—We would like to think there is an overlap in terms of common policy for people who are just outside of your particular rule, by virtue of the age selection and also the other department. I would not like to think that the attitude toward a person who is 63 or 64 is that it is not our problem; it is an unemployment problem. We need to have a transitional approach or a whole of life approach to working. Maybe, if we follow your four-pillar approach, we should just regard this as an age which crystallises the commencement of certain types of payments, and those payments may not have an age related name. We have to bridge this problem somehow and have policies that will bring people back into the work force. That is an economic necessity, because of the low fertility rates.

**Ms Flanagan**—Senator, I completely agree with you. I said in my opening remarks that this is a transition phase; it is not black and white.

**CHAIR**—I must compliment you on your opening remarks. They were very succinct and very much to the point.

**Ms Flanagan**—Thank you. We see it as a transition, and we need to come up with policy responses that recognise that. I am saying that it is quite complex to do that but it is important that we give messages to the Australian community that they can continue to work after age pension age—or whatever it might be called—and that remaining engaged with work and the community is a very important thing to do.

I think the Intergenerational Report touched on the other point I would like to raise. There has certainly been a bit of public debate about it. It relates to whether, in fact, with structural ageing—which also takes into account what is happening with lower fertility rates—the market will not adjust itself in some ways. As there will be fewer younger workers, we might see a mature age labour market developing almost by necessity, if we want to keep up economic growth. One of the things we are interested in doing some more analysis of is whether we believe that there will be a market re-created for older workers and whether this is a phase we are going through.

**Senator HOGG**—Have you got a study going on this now? That is how I am interpreting your comments.

**Ms Flanagan**—A lot of academics have been doing work on this: some say the problem will solve itself; others say something completely different.

**Senator HOGG**—Has the department got a study?

**Ms Flanagan**—At the moment, we are looking at analysis that other people are doing and trying to formulate our own view about what we think.

**Senator HOGG**—But you are not doing an independent study yourselves?

**Ms Flanagan**—We are not conducting an independent study as such.

**Senator HOGG**—Is there a need for such a study or is enough being done to allow you to draw the appropriate conclusions from the research that is being done? Or is it too early?

**Ms Flanagan**—I am not quite sure of everything that is around at the moment; certainly a lot of work has been done on it. Rather than commissioning an independent study, perhaps we should try to draw together the work that has already been done.

**Senator HOGG**—What would be readily available to this committee to assist it in making its recommendations or writing its report? Obviously, what you are saying could have an impact on the sorts of recommendations and decisions the committee makes. What do you have available?

**Ms Flanagan**—We can take that on notice and give you a list of some of the studies that are around.

**Senator HOGG**—I can assure you that we are not looking for something voluminous or something that will take you six months to put together. Something that is as succinct as your opening statement—maybe just one page—will do. If you can give us a considered view, that may well assist us in preparing the sort of report that we need to write. On the issue of housing, what surveys or evidence do you have? I understand that people do not wish to re-encumber their assets, as you said. Do you have any factual evidence for that?

**Ms Flanagan**—We do.

**Senator HOGG**—How recent would it be?

**Mr Rojahn**—We could refer to the experience of the Advance Bank Home Equity Conversion Scheme, which ran from 1993 to 1996 as a pilot. That was subsidised by government and the take-up rate under that scheme was quite low. Over a three-year period, only 6,000 pensioners took out a loan under that scheme, out of a total of around 1.2 million pensioners at that time. Building on some of Ms Flanagan's earlier comments, it does seem that there are some barriers to the success of these types of schemes. One of them is the desire of pensioners not to re-encumber themselves. The arrangements are also quite complex; I think that is another thing that is somewhat of a barrier to pensioner acceptance of these types of schemes.

**Senator HOGG**—While we are talking about the sale of the home and assets and the draw down on the house as an asset, do you have any attitudinal survey results which show how people feel when they need to sell their home or unit to go into a retirement village?

**Ms Flanagan**—That is not something we would collect. Health and Ageing are on after us, and I suspect that you might be able to address that question to them.

**Senator HOGG**—I am just asking because I thought you might have come across something. We had a view expressed to us that that causes a deal of angst out there, in that people are required to sell not necessarily at the best time. But you have had no views expressed to your people?

**Ms Flanagan**—No.

**CHAIR**—I refer you to the disability support area. We note that your department is particularly concerned that many people see the disability support pension as an early retirement option. We also note that qualification rates have been increasing by something like four per cent a year over the last four years. On the other hand, when we go back to, say, the 1990s, Australia had the highest rate of growth in disability related payments in the OECD. Almost half those granted disability support were over 50 years old. Therefore, I ask a question about health tests which would perhaps be more in keeping for super TPD insurance needs for disability support payments: can you comment or is that a policy issue?

**Ms Flanagan**—I will comment on it and see whether or not I have answered your question. In the past, we have based access to disability support pension on health based tests. The government announced in the last budget that it was also going to want to test for employability—there was certainly a health need but the consulting doctor was not very often in

a position to offer advice on whether that particular health issue meant that the patient could work 15 hours a week or 30 hours a week. The idea is to have an assessment of employability as another test, in terms of getting access to the disability support pension.

**CHAIR**—What are the factors that are putting Australia out of sync with the OECD in terms of people over 50 accessing disability support?

**Ms Flanagan**—One of the reasons is that, because we have a social assistance system, we have a system which is in some ways unique. That is one of the reasons. Certainly the OECD countries are seeing much higher unemployment rates or underemployment rates in those older age groups, but in Australia it has been increasing at a much faster rate. Australia's participation rate for older males is one of the lowest among the OECD countries. We are not quite sure why that is.

**CHAIR**—I gave you a reason earlier, didn't I, about young executives being too young at the top?

**Ms Flanagan**—Very often young executives at the top do not come onto disability support pension—

**CHAIR**—I know that, but they force other people out because they do not like older people around them; it makes them uncomfortable.

**Ms Flanagan**—Yes.

**CHAIR**—Don't you agree with that theory? It was put to us quite strongly by a retired person the other day.

**Senator HOGG**—Yes, very strongly.

**Ms Flanagan**—I have a number of friends who have had that happen to them. Yes, I have anecdotal and personal evidence that it does happen.

**CHAIR**—So we have to change the culture of corporate Australia.

**Ms Flanagan**—That would be a good place to start.

**CHAIR**—Young is not necessarily beautiful in terms of corporate success.

**Ms Flanagan**—Yes. As I mentioned earlier, it may be that some of the studies we are seeing suggest that that might change anyway. In terms of having a particular pool of people employed, the market might change anyway. Just as the government is interested in working on a strategy for employing people with disabilities, it is also interested in working with business on a mature age strategy, trying to break down some of those views of what older workers can do and trying to show how valuable they are. We need to do more in that area.

**CHAIR**—I am not saying that it is a generalised situation, but I think it is probably occurring with a frequency that is causing some people some alarm—let us put it that way.

**Ms Flanagan**—It is interesting that there are some companies—we have heard of them particularly in England and also in the US—who are employing older people. McDonald's, for example, is not only employing young people; in cities where there is a higher proportion of older people, they actually do quite well by employing an older work force. Another example we have been given relates to a company in Britain—I cannot quite remember its name—where they have big warehouses. They have a policy of employing mature age workers because it appears that, certainly for building companies and things like that, mature age workers know a heck of a lot more about bolts and all those sorts of things than a younger work force does. So it can be very successful.

**CHAIR**—You mention that the means test saves us between \$7 million and \$8 million a year, which is very significant. Coming back to this question of housing and the special cocooned nature of housing, for tax and social security, is it possible to re-examine a tightening of home ownership, especially as superannuation assets grow?

**Ms Flanagan**—Anything is possible to examine. We do not have any data on the value of home assets, because they are not taken into account in our means testing arrangements, so work would need to be done. Presumably we would need to get data from the ABS or some other source on the level of home assets.

**CHAIR**—The committee is in a very delicate position. On the one hand, some of us have to work very much in accordance with government policy but, on the other hand, in terms of the challenges that are out there for the future—and the Intergenerational Report has certainly given us a broader vision of the magnitude of the issues that the community and governments have to face—as a committee we are inclined to test as many options as possible. Some of those may not necessarily be current government policy but, in looking at the future and providing a broad perspective to try to get some of the answers right—because we will never get all the answers right for everybody—we may have to. We apologise if we are testing you on areas where you might say government policy is not to pursue moving in this direction. As a committee, I think we owe it to the parliament to look at wider options. Otherwise, we are reducing the benefit that we might give to the community and relegating our responsibilities to some outside independent body whose terms of reference may not necessarily be as wide as ours.

As you say and as the task force told us this morning, most people rely on the age pension, even after years of compulsory super. Should we really be looking at ways to change this now, by increasing contribution rates, for example—voluntary contributions, government co-contributions, rebates, tax concessions et cetera—to reduce this dependency on the age pension?

**Ms Flanagan**—I would make two points there. Firstly, even with the projections that we do, we find that the age pension is surprisingly affordable, even after 40 or 50 years. Secondly, where you might want to assure adequacy or replacement, do you want to continue to do it with the age pension system or do you want to do it through the superannuation system? If you want to buy the same outcome with the same amount of money, do you want to change internally the pieces that you have to operate with: that is, do you want to increase contributions, which might then mean that you more tightly target or means test the age pension to come up with the same

result, or are you interested as a committee in perhaps recommending changes that will increase the expense of our retirement income system more generally, by increasing contributions, for example, and therefore giving concessional taxation treatment to higher contribution rates?

**Senator HOGG**—Are we really going down a blind alley? Are we chasing something that at the end of the day is not worth chasing? It has been said that 2.9 per cent of GDP goes on pensions now, and that is rising to 4.6 per cent. I have heard that RIM have modelled that even without the SG it would only rise to 4.8 per cent in 2042. For that extra 0.2 per cent of GDP, how much time, effort, energy, wrangling and disagreement will there be? If you want to find an area where there is a plethora of views, superannuation is it. Take the argument about whether the contributions tax should be removed or should stay: you will get the honourable people from the Treasury arguing stridently that the up-front contributions tax should stay and you will get those on the other side of the argument saying that it has got to be removed so that we can increase people's ability to access retirement incomes. You will get people saying that nine per cent is too little and you need 12 per cent; you will get people saying that that is too little and you need 15 per cent. There will be people who will come to us and say, 'It is a product of the employment practices.' There are a whole host of factors. Are we really involved in an exercise in futility that keeps everyone occupied, keeps you appearing before committees, keeps Senator Watson and me in jobs hearing evidence from people, whereas at the end of the day, if the RIM study is correct and there is only 0.2 per cent extra of GDP without the SG, we are better off saying, 'Let's make life easy'?

**Ms Flanagan**—As Treasury has stated—and I think there is a misconception in the community—the superannuation guarantee was not introduced to reduce age pensions; it was introduced to give people a better retirement income. To answer your question: the issue you need to focus on is whether we have the right retirement income for people now. Most of that is comprised of the age pension, but does adding superannuation and the age pension give us the right retirement income for people? What we would say as a portfolio is that giving them the right retirement income might mean that they get the wrong current income, if you increase contribution rates too much.

**Senator HOGG**—And that would put pressure on your resources?

**Ms Flanagan**—That would put pressure on our current income support arrangements as well. To me the real question the committee needs to answer is what the appropriate income across a life cycle is and, therefore, what the appropriate retirement income in that equation is.

**Senator HOGG**—That brings me to the four pillars—or three pillars or, as I call them, 2¼ pillars, because I believe one of those pillars has got the severe wobbles. That is the pillar of voluntary superannuation contributions, voluntary savings and so on. It seems to me that, without that third pillar—or fourth pillar, in your view—there is a severe dent in the retirement policy area. Is that reasonable? Has your department made any sort of assessment about what contributions people make voluntarily and how those affect the budget of your department—claims and other things?

**Ms Flanagan**—We certainly have data, again gained from industry sources et cetera, about the level of voluntary contributions people are making to superannuation. Treasury alluded to the fact that we have people coming onto the age pension system with assets that are not just

accumulated through superannuation. The self-employed have different arrangements; there are many people who come onto our system who have sold up a small business, for example, and that is their asset in retirement. There are a range of other ways that people accumulate and save during their working lives.

**Senator HOGG**—Do you actually have a table that profiles this for us?

**Mr Rojahn**—We can take that on notice. We can provide you with categorical information on the types of assets pensioners hold. That does not necessarily disclose the origins of those assets. For example, some assets are passed on through inheritance and other assets are accumulated through voluntary savings. Some are accumulated through the compulsory superannuation system. We do not have data on that break-up. We do have data on the end product—what the pensioners report to Centrelink when they claim age pension.

**Senator HOGG**—If this committee were to recommend that there be a three per cent compulsory contribution by individuals, would you have any idea of the impact of that on your budget and financial services? Obviously, it would impact on a significant number of people who are at risk out there in the community. They do not have the ability to afford to do it.

**CHAIR**—I might have to qualify that because people who have advocated that have also added the rider, ‘with certain taxation relief’.

**Ms Flanagan**—I am sorry: are you talking about a situation where you would recommend a three per cent compulsory contribution?

**Senator HOGG**—Yes. These are propositions that have been put to us, and you are the obvious people to test them. If I understood you correctly, you indicated that, if compulsory contributions were recommended by this committee, it would impact upon the services and the financing of your portfolio.

**Ms Flanagan**—It might not. It would depend on how people made the three per cent contribution. You alluded earlier to the fact that the voluntary contributions are going down as the SG increases. Whether people are going to replace one form of saving with another, it still might mean that you end up with them coming into the system with the same level of savings; they might just have derived it in a different way. They might stick \$20 in a bank account each week, for example; if they have to make a compulsory contribution, they might no longer put their \$20 in the bank each week.

**Senator HOGG**—Do you have any surveys that show what people do with their discretionary spending in terms of savings and how, if that is removed from them, that would impact upon the services that your department operates?

**Ms Flanagan**—The only things we have access to are independent studies from other organisations about what has happened to savings behaviour with the introduction of the superannuation guarantee. This also gets back to Senator Watson’s remarks earlier on about the level of debt. You need to take into account not only what people are saving but also what debt they are accruing. People’s behaviours, on both sides of the ledger, have changed over time, and there are studies around to show that.

**Senator HOGG**—But you have no real studies?

**Ms Flanagan**—We have not commissioned any studies as an organisation, but we certainly have access to studies that have been conducted by Treasury, for example, on savings behaviour and what has been happening to savings over the last 20-odd years.

**CHAIR**—Over the years the committee has adopted a very progressive approach to income streams. We would like your advice about what is the best approach to encourage income streams over lump sums? Do you believe new products are needed to make income streams more attractive? For example, we have had strong representations about growth pensions in addition to complying annuities.

**Ms Flanagan**—We have too, Senator. In terms of income streams over lump sums, there are a range of factors. Firstly, there is a whole range of ways that people save. Why would you look just within the superannuation system when trying to agree to concessionally treat one over the other? In the past, the government has shied away from making any distinctions on the tax side anyway.

**CHAIR**—And given it to your department.

**Ms Flanagan**—In part, we have created incentives to encourage people to invest in complying income streams in our system. Certainly, the government has also committed to look at growth pensions, because there has been significant lobbying by the industry, and we will be doing that in conjunction with Treasury.

**CHAIR**—What advantages do you see in the introduction of a growth pension over a complying pension? Is it more than just the underlying asset base of the framework?

**Ms Flanagan**—I was around when we actually made the last changes to income streams, back in 1997. Some of the principles the government was interested in at that time in terms of giving a complying pension were that complying pensions were for life and the risk was borne by the individual and/or the company providing the product rather than by the government. My understanding at the time was that the government was interested in providing a safety net for those who might fall on hard times. That safety net is called the age pension. However, why would you necessarily use a growth pension to protect people against the volatility of their assets—compared to somebody who might invest in the share market? I might hand over to Ms Kemp, who knows more about income streams than I do.

**Ms Kemp**—It would help me if you could clarify whether, when you talk about advantages, you mean advantages for individual investors? Are you asking questions about that or more about the advantages for our portfolio?

**CHAIR**—I was asking about the advantages from the point of view of an individual in retirement. You might like to give additional consideration to whether we might make the complying pension more attractive by limiting its payment to some time in a person's 80s—the age of 85 or something. That might make it a more attractive product. At the moment, unfortunately, it is discriminating very much against women, because they are living longer. Should we be saying, 'Yes, we will provide these sorts of factors: that a complying pension can

be paid up to, say, the age of 80—I know there will be howls of protest because that figure is too low, but I am using it just for the sake of argument—and after that the age pension will kick in.’ Wouldn’t that make a complying pension much more attractive, because it would remove some of the risk elements?

**Ms Kemp**—One of the things we do know is that the most popular products are the allocated products, and that could very well be because people can still have access; they can commute the asset and have access to money if they have unexpected expenditures. My understanding of the growth pensions—they are a proposal; there are none in the market at the moment—is that they would not be able to be commuted. I understand that industry are saying that they would be very popular, but that is something that we do not know at this stage. Looking at the attractiveness of the allocated ones, we are surmising that quite a bit of that might have to do with access to capital if you require it.

**CHAIR**—When they are talking about a growth pension, I do not think that they are talking about having a commutation built into it; it is just a straight pension, as I understand it—is that right?

**Ms Flanagan**—Yes, that is my understanding.

**CHAIR**—So, if we diversify the asset base and provide greater equity involvement, it should mean that in a normal year you would have a higher rate of return than under a fixed interest base, which underpins a complying pension.

**Ms Flanagan**—My question is: if they are such a good product, why aren’t they in the market at the moment?

**CHAIR**—Because they are not allowed, under your social security rules.

**Ms Flanagan**—What they are doing is seeking favourable treatment, and they think that that will make the products much more attractive. If they are so attractive, why do they also need concessions provided through either the tax system or the social security system?

**CHAIR**—That is a good question. Can you help us answer it? What are your views?

**Ms Flanagan**—As I say, the government’s policy is that we will be looking at growth pensions.

**CHAIR**—I see. Thank you very much. The question is: would a movement from taxes at the contributions end to taxes at the benefit end control lump sum access?

**Ms Flanagan**—That is a curly one.

**CHAIR**—Would you like to take it on notice?

**Ms Flanagan**—We can take it on notice, but I suspect Treasury is much better able to answer that.

**CHAIR**—Sometimes you have different perspectives, don't you?

**Ms Flanagan**—We do.

**CHAIR**—Your experience is different from Treasury's.

**Ms Flanagan**—The fact is that we do not currently have end benefit taxation.

**CHAIR**—There is very strong pressure, if you look at our submissions, to progressively move to that. People say the decision taken in 1988, in hindsight, was not right and that we should progressively move back to that. It is going to be difficult and it is going to take time, if that policy is pursued, but that is one of the options that this committee has been asked to look at. With social security, people always say the rules are too complex. Can we simplify them without doing injustices to certain groups of people?

**Ms Flanagan**—One of the things that we reply is that we want them to be simple as well. We try to make them as simple as possible, because it can be very difficult if people cannot understand how they operate. We are always looking to try to get simplicity. On the other hand, we have a targeted system, and when you have a targeted system a level of complexity is inevitably introduced. Trying to find the balance between continuing to have a targeted system and retaining simplicity is very difficult. One of the things we certainly get favourable comments on is the introduction of extended deeming, which occurred back in 1996. Pensioners all say how easy it is to understand; there are very clear messages that, if you can get a high rate of return from your assets, you can keep that money. So we do look for things like that. The other comment I would make though is that this inevitably is a highly complex area, just as tax is, because we find that products that try to skirt around our rules are coming onto the market all the time. That is one of the tensions in trying to minimise, I suppose, inappropriate access to the age pension.

**Senator HOGG**—You might be able to comment on this issue: a person is treated for tax and income support as single before retirement but as part of a couple post-retirement. Does the dichotomy cause anomalies at retirement?

**Ms Flanagan**—It can cause anomalies, not just at retirement but also before retirement, if you have somebody who is retired and somebody who is still in the work force. There are certainly anomalies there, and we recognise them. But, again going back to the important change introduced by the previous government to encourage the work force participation of women, the objective of getting increased participation in work force aged seems to be more important than the anomalies created by doing so.

**CHAIR**—Thank you very much for your submission and for the frankness of your comments. They are very much appreciated by the committee. Because of the scope of our inquiry, there is a possibility that we may have to ask you to come back.

**Ms Flanagan**—Okay. Thank you.

[11:45 a.m.]

**GRAHAM, Dr David Trevor, First Assistant Secretary, Ageing and Aged Care Division, Department of Health and Ageing**

**THOMANN, Mr Mark, Assistant Secretary, Office for an Ageing Australia, Department of Health and Ageing**

**WELLS, Mr Robert William, First Assistant Secretary, Health, Industry and Investment Division, Department of Health and Ageing**

**CHAIR**—Welcome. I invite you to speak to your submission, and I would also like to give you the opportunity to comment on matters that may have been raised by other contributors yesterday. If you have had yesterday's submission from the aged community, we invite your comments on it.

**Dr Graham**—Thank you. I will make a short opening statement, and we will then be happy to answer questions. The Department of Health and Ageing's interest in superannuation and standards of living in retirement is related to two major aspects. Firstly, the Minister for Ageing and the department have the responsibility to coordinate responses across government to the range of issues involving an ageing society—and that is what Australian society is, of course. As part of this responsibility, the minister has launched the National Strategy for an Ageing Australia, which provides a framework of issues and possible responses relating to the ageing of the Australian population. As part of the development of this strategy, the government released a number of background papers. One of those papers, *Independence and self-provision*, is the result of a cooperative process across a range of departments, and its purpose was to stimulate awareness and discussion of these issues in the community.

Secondly, the quality of retirement is strongly influenced by the ability of people to cover both discretionary and non-discretionary expenditure. Expenditure in health and aged care is often not discretionary. The government has established a range of measures to ensure both affordability and choice in aged and health care services for older persons. Obviously, a primary aim is to assist people to remain active and healthy wherever possible and for as long as possible and also to have timely access to care when this is needed. Studies have shown that there is a link between the levels of wealth and health, although the causal relationships are complex and require further research.

Australia's life expectancy is now amongst the highest in the world. An important question is whether the improvement in life expectancy involves increasing the years of healthy living—and, of course, healthy living is a primary objective of the department and of the state and territory governments' population health strategies to promote healthy ageing. The complexity of this is shown by the following example: while age adjusted death rates for cardiovascular disease are decreasing, the number of people with dementia is increasing. Of course, the incidence of dementia increases with age.

Not unexpectedly, financial security is one of the highest priorities for people in older age. We have come across this in two areas. One is that we participated in the United Nations World Assembly in Madrid earlier this year where they developed an international plan of action for countries to respond to an ageing society. This assembly was attended by over 150 countries, and financial security was one of the priority items in that discussion. Secondly, in consultations that the Minister for Ageing is having, financial security is one of the issues that he is coming across.

Departments giving evidence this morning, Treasury and Family and Community Services, have covered in detail the interrelationships of superannuation and the income support arrangements. The submission by our department, the Department of Health and Ageing, provides more detail on health and aged care programs. As I said earlier, we are very happy to answer your questions in this area.

**Mr Wells**—I understand the committee had a particular interest in some issues relating to private health insurance. That is my area of responsibility within the department, and I would be happy to take any questions on that. The government's approach to private health insurance has been outlined in our submission and in other documents which are available to the committee, so we are happy to take questions around that as well.

**CHAIR**—The good news is the fact that Australians are among the healthiest people in the world. The other good news is that it is achieved at a relatively modest cost. Those responsible deserve the accolades, because it is significantly above the OECD average. What influence, though, do our relative standard of living, environment and climate have on health standards? In other words, with these relative advantages should we be spending a lot less than the OECD average in terms of our final health care costs?

**Mr Wells**—The evidence of surveys of various countries—I do not have these figures with me but I am sure they are available—suggest that the wealthier the country, the greater the proportion of their GDP they spend on health. There are a couple of exceptions, but by and large the proportion of GDP spent on health does have a correlation with the relative wealth of the country. I expect that is not a matter of policy of all those countries, it is just a matter of fact.

**CHAIR**—Does the standard in terms of having the healthiest people in the world run across all age groups in society? Could it be, for example, that we tail off in the 70s and get progressively worse compared with other countries? Is it consistent across all age groups?

**Dr Graham**—I am not sure if we have got information on that. What we have been talking about is life span, and Australia has one of the longest life spans in the world. Also when groups like the World Health Organisation have done health surveys Australia shows up very highly there.

**Mr Wells**—These data are mainly around mortality, as Dr Graham said, around life span. But again international comparisons suggest that in terms of morbidity, the diseases which affect our population are more or less similar across Western countries of similar wealth and industrial development.

**CHAIR**—So this fact that we are the healthiest population of the world gives rise to the concept of a fourth pillar, that it is easier for our population to move back into the work force in some sort of capacity after a nominal retirement date. That must be a contributing factor.

**Dr Graham**—That is certainly a consideration. There is a debate going on at the moment about whether a longer life span in fact means longer life in health. People are doing studies around what is called compression of morbidity and whether it is compression of morbidity or expansion of morbidity and that a longer life span might just expose people to a longer time of ill-health. The evidence is somewhat clouded at the moment, but I think the trend and the general acceptance is that there is a compression of morbidity, so associated with a longer life span is a longer period of health. That would give more capacity in that regard, you would think, to people being able to be active in the work force.

**CHAIR**—On the other hand, we were told yesterday that, generally, people in the construction industry have a high incidence of deafness and problems with knees and those sorts of things. So their ability, given their skills, to re-enter the work force in their 50s or 60s is fairly limited compared with people such as Senator Hogg, or others, who have not been through that experience of hard work—

**Senator HOGG**—I deny that.

**CHAIR**—for the first 25 years—that is, manual work.

**Senator HOGG**—I have worked hard; I just want to correct the record!

**Dr Graham**—It is said in general terms that the current generations are probably the first generations that are going into retirement not burnt out. In 1909 when the pension first came in, most people did not reach pension age in terms of their life span and probably their professions were much harder. There are a number of factors contributing towards a longer life span, including the nature of work, nutrition, environment and exercise—all these factors come into it.

**Senator HOGG**—A longer life span does not necessarily mean a longer working life, does it?

**Dr Graham**—No, it does not. At the moment, and this information was given by Family and Community Services, there is a fairly high retirement rate in this country compared with others. There is the potential to work as well as the incentives and the inclination to work. All these things come in as factors as to whether people want to stay in the work force.

**Senator HOGG**—But there are incentives to retire as well. I just think of people around this building who, having reached the magical age of 55, have left. There is no doubt about their capacity to continue to work and to continue to contribute. I am not going to name them on the record, but they are very senior people. They came to the crisis stage: if they continued to work, they lost out on the benefit. Therefore, they elected to retire early. There is a disincentive as well as an incentive sometimes.

**Dr Graham**—That applies to the Public Service as well. Partly what people are very interested in is not so much going from employment to retirement, but having a staged or phased environment where they can move from one to the other over a period of time.

**Senator HOGG**—Generally, those people who make that choice are people who have an economic capacity to do so. Those who do not have an economic capacity to do so do not obviously willingly make that choice.

**Dr Graham**—Yes.

**Senator HOGG**—Is there any indication of the need for people to work post reaching the retirement age? We pursued this a bit earlier this morning. Do you have any evidence of the need as opposed to the person's individual desire? In other words, there is a compelling financial need: the existing structures that are in place, either through the age pension or through the person's own superannuation arrangements, do not cater for the person to live in a lifestyle and in a way which makes retirement a pleasurable thing.

**Dr Graham**—We do not have that information. If we were seeking that, we would probably go to Family and Community Services, or the employment area, to try to find out what data they had.

**CHAIR**—With the increase in the age at which people can make contributions to superannuation, there are really a number of anomalies. For example, it has been pointed out to us that, once a person passes 70, they are deemed incapable of managing their own do-it-yourself superannuation fund, and yet they can make contributions to a fund. Do you have a department that monitors changes in the laws to protect the interests of older Australians in terms of ensuring equity and reasonableness? That is one aspect. Obviously, there needs to be a coordinating organisation or department to pick up issues such as those. That is almost an insult to some people who still have very astute minds at age 70. They can pick their investments, but they are not allowed to actually administer them.

The other areas of concern that have not really kept pace are the 10 hours of work per week and the reporting requirements of an individual to a super fund. I get distressed when people come to me and say, 'I'm in casual work but I keep getting these letters from the insurance company.' In fact, I got one myself asking if I was still gainfully employed more than 10 hours per week.

**Dr Graham**—I agree.

**CHAIR**—We do need some sort of coordinating authority. Is there such a coordinating authority? Do you think that is a role for your department?

**Dr Graham**—There are two things I could say. One is that the Attorney-General's Department is developing age discrimination legislation. That has been announced by government, so there is the intention to do that.

**CHAIR**—That is very welcome.

**Dr Graham**—That will cover those sorts of issues. I think they are still working out the scope and the nature of it, because it is very complex legislation, as you can imagine, but it is being developed. The other thing is that the government has set up the Ministry for Ageing, and Kevin Andrews is the first Minister for Ageing. Also, the department has the Office for an Ageing Australia, of which Mr Thomann is the branch head. Its role is to coordinate these types of activities where they do cross over various parts of government and out into the community. The office has a coordination role which is reflected in its role in developing the national strategy, where the types of activities and circumstances you are talking about are being taken into account.

**CHAIR**—Thank you very much.

**Senator HOGG**—You mentioned financial security and how important that is. What is meant by financial security? That comes up in your submission, and I will come to that in a moment.

**Dr Graham**—I will give an interpretation and the others might like to add to it. My understanding of financial security would be that a person has the capacity to cover both their discretionary and non-discretionary expenditure and to live to a certain quality of life that meets their expectations or at least is adequate to have a reasonable quality of life.

**Senator HOGG**—Do you have a view as to what level that might be? This is something that we are receiving evidence on, and people are putting to us that to achieve those levels certain things may need to be tinkered with. Some of them are not just at the edges; they are right in the centre of the debate. Do you have a view?

**Dr Graham**—I do not think there is a single figure. I think it does depend on the individual, the circumstances and their environmental requirements. It also is a complex equation between what they are assisted with and what they have to pay out of their own pocket. With health and aged care there are a number of programs to assist in the non-discretionary end of expenditure, which allows them perhaps more freedom at the discretionary end, and that discretionary end is really an individual's choice.

**Senator HOGG**—I accept that.

**Mr Thomann**—To add to that, I suppose there are an objective aspect and a subjective aspect to the issue of financial security. One of the more valued benefits is the concession card, which is now available to 92 per cent of people aged 65 and over. Eighty-two per cent of those people are receiving the pension and another 10 per cent are receiving the Commonwealth seniors health card. I think that card provides a substantial level of security which you cannot measure in dollar terms. It also links in with the concessions that are available through the state and territory governments and links with their seniors cards, and I understand from our state and territory government counterparts that they are very popular and highly valued.

**Senator HOGG**—But, clearly, looking at what is adequate for people in terms of their retirement has a role to play in the sorts of considerations we are undertaking. Adequacy is one of the key issues that we are addressing, as well as what the factors are that contribute to adequacy. What you have said here, for example, about the health card and access to that

indicates that that is clearly a factor. There are also factors like the SG. What other factors do you believe there could be?

**Mr Thomann**—There are most of the factors we mentioned this morning. One is the cost of housing, and the home ownership rate is obviously very important there in terms of the adequacy of retirement income. So there are housing, concessions and then your discretionary income.

**Senator HOGG**—What about the tax offset that seniors have just got? How significant would that be?

**Mr Thomann**—That increases the amount of discretionary income available.

**Senator HOGG**—That would nonetheless be a significant factor, wouldn't it?

**Mr Thomann**—Yes.

**Senator HOGG**—Do we have any idea of just how significant it would be, in percentage or dollar terms, for those people?

**Mr Thomann**—You would have to discuss that with Treasury.

**Senator HOGG**—I know; I raised it with Treasury. I am just wondering if you have an idea.

**Mr Thomann**—No, I don't.

**Senator HOGG**—The evidence seems to indicate that there are still going to be a large number of people dependent upon the age pension in whole or in part, even with the operation of the SG. There was an initiative a couple of years ago, the 30 per cent rebate, to change the behaviour of people joining public health funds, for example. It could be argued that it did not change behaviour very much at all out there in the community. A number of people did sign up, but mainly the people in the funds were the ones who were going to get the benefit of the rebate. The people who really need it are not going to be the people who access that particular benefit. Are we better off directing those sorts of benefits into superannuation rather than into health? We really need to get the adequacy of the basic retirement benefit fixed first rather than that of the health benefit. Or is there a combination that we need to look at?

**Mr Wells**—The private health arrangements have to be looked at in tandem with the Medicare arrangements. Under Medicare, all Australians have access to public hospital treatment based on clinical need. Australians also have access to general practitioner and out-of-hospital specialist services. There is also the Pharmaceutical Benefits Scheme, where Australians have access to drugs, with copayments and safety nets related to that component. The 30 per cent rebate and the other measures in private health insurance, including lifetime health cover, are designed to offer people choice. They can choose to purchase private health insurance for the benefits they would receive from that. In fact, participation in private health insurance has increased significantly, from around 30 per cent in 1996-97 to close to 45 per cent now. The last figure was about 44.7 per cent. It is interesting to note that the participation in private health insurance of people over 65 is 40 per cent—so that is quite high as well. The

Medicare entitlement is the basic entitlement that all Australians have, irrespective of their income or their asset wealth, but they can, if they wish, choose to take out private health insurance for additional coverage or whatever.

**Senator HOGG**—I accept that, but I understand it is about a \$2.5 billion cost per year.

**Mr Wells**—It is of that order, yes.

**Senator HOGG**—It is of that order—the 30 per cent rebate. It seems to me that we have this enormous shortfall in terms of people's retirement, which is not so much a discretionary issue as a mandatory thing—you go into retirement and you are going to rely on the retirement benefit over a long period of time. Would amounts of that order not be better spent on, and targeted towards, the issue of retirement incomes in the first instance and then we could address the issue of private health fund membership and other associated issues in some other way?

**Mr Wells**—That would be a matter for policy consideration by governments, but, as I said, the current operations of the scheme are built around the fundamental policy of universal access under Medicare. There are no other considerations before government at the moment. They are policy commitments governments have made and therefore the system has been designed essentially around universal access under Medicare.

**Mr Thomann**—I think Mr Gallagher from Treasury answered that question previously when he said that there is a huge variability in health and aged costs such that, if you were to roll that \$2.5 billion into the super scheme, you would have oversaving for some people and undersaving for others. In relation to your first question about financial security, I think we forgot the Medicare universal system of insurance which underpins people's sense of security.

**Senator HOGG**—Turning to page 6 of your document, you say:

Development of the *National Strategy* included wide dissemination of a range of discussion papers and extensive stakeholder consultation ...

You also say:

The strategy concluded that the fundamentals of Australia's retirement incomes system are sound.

What are the fundamentals and what is 'sound'?

**Mr Thomann**—I think we were talking about the balance between the two and a quarter, three or four pillars, depending on what you are counting.

**Senator HOGG**—It depends where you are.

**Mr Thomann**—That is right. Certainly, the feedback we have internationally, from the OECD and others who are trying different systems, is that a mix is the way to go. So we are talking in general terms; we are not talking about the detail that you will get when you look at the interplay between those different systems.

**Senator HOGG**—I raise this because a number of people have put it to us that, whilst they would not say that the fundamentals are sound, they would say they are a reasonable base to build on.

**Mr Thomann**—I think that is what that statement is saying.

**Senator HOGG**—That is what it is saying. It goes on to say:

... it would be prudent to consider improvements along the way as the population ages to ensure that the retirement income system does enable an adequate income for all older Australians including supporting and encouraging individual contributions to retirement saving.

When would a need for change be advocated, to meet the needs of the future? Some people are saying that even if we do it today we are too late; we should have made the changes five or 10 years ago, or whatever it might be. They say that, whilst we have a solid base, a sound base, it is really not enough for future retirement income needs. When do we need to act? What do we need to do? Did you have any program in mind when this statement was made?

**Dr Graham**—It would be an area for other parts of government to say when and how. As Mr Thomann said, the point being made is that we do have the pension system, which is very important underpinning to the whole system. There is a superannuation system and a compulsory component to that. Australia is probably somewhat unusual in terms of personal savings and the level of assets that are tied up in housing. So I think there is no simple answer.

**Senator HOGG**—I know there is no simple answer. You have made this statement; I am just trying to find out what improvements you would advocate. Do you have a list of improvements that you would advocate? You say, 'It would be prudent to consider improvements.' What improvements would you advocate, when should they operate from and what difficulties might there be in implementing them? This has come out of a range of discussion papers.

**Mr Thomann**—I think the major difficulty is the complexity of the issue, as you are discovering; the interplay between various players—those with vested interests of one kind or another. At the Commonwealth level we have several portfolios with an interest in the ageing of the population; not just the obvious ones that have been here today but also DIMIA in their population area. There is interest around fertility policy, and much has been made of policies to improve the fertility rate. State and territory governments are interested in this area. So we have a complex interplay with the social security system. I think the problem for the committee is balancing what we have in place at the moment—a high level of home ownership, the fundamentals of a universal health care system, a compulsory contributory system of superannuation, a voluntary system of superannuation and a retirement income policy—with a range of concessions that interact with those. I think it is inevitable that adjustments are going to be made gradually and in response to the policy perspectives and pressures that different jurisdictions and portfolios are considering in their policy deliberations.

The challenge for government of any complexion will be coordinating that and communicating changes to an Australian public that has been accustomed to particular notions of retirement for a long time. A previous notion, for example, supported many decades of saving to own a home. The strategy there was to own your own home and then live on the pension, because you did not have housing costs. After that came the notion that, with the

introduction of superannuation, we were all going to retire at 55, and that has had a certain amount of currency. Now, as we model it through, start to look at the hard data and get to the detail, there will have to be a mind shift. That mind shift will necessarily take place synergistically with a willingness to gradually make policy changes along the way. It will be a mix of those things. From an economic point of view, there will be an opportunity cost for families. As you pointed out this morning, Senator, for low-income families it is almost a no opportunity cost, in a sense—if you want to turn the economic concept on its head. You may be asking people whether they will save for a house, pay for their children's education expenses, put money into superannuation for their retirement or even put another three per cent away for health and aged care costs. Those are the complex issues that policy makers have to confront.

**Senator HOGG**—I accept that. Part of our difficulty is getting around the wide range of issues out there and coming up with a definitive list. I would have expected that, since you seem to have been through some sort of consultative program where you developed a strategy and concluded that a number of things need to be made, you would have a definitive list, but you obviously do not.

**Dr Graham**—We did get submissions to that background paper. If the committee wishes, we could provide details of some of those submissions. Similar to what you are doing now, they provide a comment on the discussion paper.

**Senator HOGG**—If you can give us a summary of them—

**Mr Thomann**—I would be surprised if you were not hearing the same things in this process from the submissions you have received.

**Senator HOGG**—That is something that we do not know. It would be interesting to find out whether the same sorts of submissions that have been made to you have been made to us.

**CHAIR**—Generally they would be.

**Senator HOGG**—The chair is right; generally they would be, but it would be interesting to know because we have picked up a number of different issues that people have raised with us.

**CHAIR**—It is a question of emphasis.

**Senator HOGG**—That is right.

**Dr Graham**—What we did find out from this whole process was that everything is interrelated. Once you start working on one question, you go to another. What is retirement age, for instance? How is mature age employment going to impact on this? That is an integral question in terms of what is required and when is it required for retirement. What is future productivity going to be and what is going to be the affordability of supporting some of the public systems? There are a lot of unknowns as yet but, as I said, we did find out that all these questions interrelate.

**Senator HOGG**—When should changes be operative from, if there are to be changes? I am not asking you to commit yourself to anything, but if the committee recommends, as I said to a

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previous witness, that the SG should go from nine per cent to 12 per cent, one has to look at whether it is phased in, whether it is a compulsory contribution by the employee, whether it is a contribution by the employer or whether there is a government element in that. Obviously, if there is a need to go from nine per cent to 12 per cent—and let us assume that there is no doubt that that can be justified—obviously, the sooner one puts it in place the greater and earlier the impact it is going to have in the longer term. That would benefit everyone. But if we sit around discussing this for the next five years and at the end of 10 years someone finally says that we had better do something—

**Dr Graham**—The problem, Senator, is that without modelling the impact of that, we may be locking ourselves into an unforeseen outcome. For instance, that three per cent might limit wages, which limits people's capacity to carry a mortgage. That may, in 30 or 40 years time, mean that we have a lower ownership rate among people in this particular 65-plus cohort, and that would affect the whole age and community care system in terms of supporting people in their own homes because they do not have their own homes. You would have older homeless and pressure on residential aged care, which is an expensive way of housing people.

**Senator HOGG**—Precisely. That is why we are looking for some sort of direction from people such as you. While we do not expect you to make nor comment on policy, we are asking for some sort of direction as to where this committee might be going in terms of achieving the sorts of motherhood statements that you people make in your submission to us. That is not a criticism of you; that is part of the difficulty we are confronted with.

**CHAIR**—The Council on the Ageing are very strong on the fact that they believe that the lack of a comprehensive national dental health service was the greatest difficulty in our health service. They indicate that poor oral health affects many older Australians, and failure to act to improve services will ensure that older people, far into the future, will continue to suffer the same problems. They went on to emphasise that poor oral health is associated with poor health generally. It also leads to poor dietary problems and poor dietary problems lead to poor health outcomes. There does seem to be a need to tackle this issue, particularly from the point of view of the aged sector.

**Dr Graham**—It is an important area.

**CHAIR**—How can we do it? How can we best approach this?

**Dr Graham**—Oral health is important not just in terms of general health but for other issues such as adequate nutrition, so it does flow on to other areas of general health. At one end are peoples' dental needs and, largely in the public sector, they are supplied by the state and territory governments. The other end, where we are talking about oral hygiene and better oral practices, really comes under the population health partnership activities jointly run by the Commonwealth and the state and territory governments such as better education about appropriate oral hygiene practices. Within residential aged care, oral hygiene is a component of the standards that residential aged care services are accredited against. So there is an assessment process of which that is one component that homes have to meet to gain accreditation and therefore government subsidies.

**Mr Wells**—The Australian Institute of Health and Welfare has an oral health unit which produces an oral health survey every two or three years. Those data are available from the AIHW.

**CHAIR**—Should we be looking for access to a Medicare-type facility, for which older Australians could be eligible, in the same way as you can bulk-bill for doctors?

**Mr Wells**—As Dr Graham said, the responsibility for public dental services is a state responsibility.

**CHAIR**—At the same time, it is obviously a big issue for the National Council on the Ageing to have expressed it in the terms that they have expressed it to us. We are looking for some ways to assist, because this is part of the question of adequacy, isn't it? Coming back to nursing homes, we sometimes wonder, given the huge demand for nursing home accommodation, whether perhaps we are moving too quickly in terms of raising standards. Rather than allowing nursing homes to extend their numbers of beds, they are having to close down their older areas and meet these very high new standards. The very high standards appear to me to be a factor responsible for restricting access because the capital required to replace existing nursing home beds with the modern equivalent is quite extensive.

**Dr Graham**—I would be surprised if COTA agreed that it is inappropriate to apply standards—and in fact good standards—to aged care facilities. This has been a very strong concern of consumers for a very long period of time. Now we have a mandatory accreditation system that covers residential aged care. On the building side, we have a certification system that covers the standard of building.

**CHAIR**—I am not saying that in certain cases standards have not been quite appalling, but are we going a little too far too quickly in terms of the demand that is out there?

**Dr Graham**—That is not our experience—

**CHAIR**—Parliamentarians know how relatives and others really put pressure on you to get a mother or father into nursing home accommodation at a certain stage of their life. We cannot enforce it at all.

**Dr Graham**—Aged care is particularly important for the future, but there is a planning ratio where we supply 90 residential aged care places per 1,000 people over 70 years of age. We use the ABS data to work out the distribution of the population, and generally each year beds are allocated against that ratio. We have got an allocation this year. For example, when we advertise those beds the interest from the industry is many times greater than the number of beds that are available. In terms of saying that the standards are suppressing and closing down homes, they may close down a few temporarily because people decide to rebuild because they—

**CHAIR**—Not closing down homes, closing down beds—the older wards, as it were.

**Dr Graham**—That is not happening, because if a part of a building is closed down and rebuilt, those beds might be taken out of line for a little while, while the rebuilding is going on. Then they might go back into the same facility or be sold on to another facility. Because of the

planning ratio, it is in fact 100 per 1,000—90 residential aged care beds and 10 care packages. We are monitoring that all the time so we are taking into account the growth of the 70-plus population and supplying that into the marketplace. Minister Andrews is particularly keen that, once we do supply them, the people who receive those beds get them operational as soon as possible. By international benchmarks, 100 per 1,000 is a very reasonable figure for the supply or need of aged care. In fact, the government has gone over the 100 mark in terms of care packages to support people in their own homes. In the future I suspect that we will be seeing residential aged care targeted more and more towards very frail people and more sophisticated ways of supporting people in their own homes. As Mr Thomann said before, the supply and security of housing for individuals is going to be important in that future direction.

**Senator HOGG**—On that, one issue that I raised with an earlier group was the sale of the family home to get into nursing homes and so on. It has been put to the committee that the process is just too fast. You may need to go into the nursing home today and yet, who wants to sell in today's market? Today's market is flat.

**Mr Thomann**—The market is good at the moment.

**Senator HOGG**—I am using a hypothetical: today's market is flat; you cannot sell. Yet these people are confronted with having to eat into part of their retirement asset by a quick disposal. What is your response to that?

**Dr Graham**—It is a fairly traumatic time for people because they are usually very frail and they probably have other conditions that make them very emotional at that point in time. In many ways, moving into residential aged care is a long-term care option. They are moving from their homes into another long-term option. There is a need for a balance between government subsidies and user payments. Whether or not a person needs to sell their home depends on their assets and on what their arrangements are to move into that alternative accommodation.

**Senator HOGG**—We have had a range of home options put to us in terms of mortgage back and so on. In the case of people going into the type of arrangement that we have just discussed, it may be that they should be given an option of deferral for another day until the market, when it is flat, improves. Is that a reasonable consideration that we should take into account?

**Dr Graham**—There are some products being tried in the market, such as reverse mortgage loans or equity loans. They have not really taken off for one reason or another.

**Senator HOGG**—We accept that.

**Dr Graham**—Partly it is an attitudinal problem or a difference in Australia compared to other—

**Senator HOGG**—We are not talking about that specifically. We are talking about the case where people need to sell up to get into the nursing home rather than have a forced sale, so to speak. There may be some sort of buy back scheme from the government and then the government at the time sells at a profit.

**Dr Graham**—Depending on their assets, they do have a choice now. It is not a mandatory sale of their house. They may want to be regarded as a concessional resident, which will depend on their assets and on whether they have got income support and a home. They might miss out on being regarded as concessional and therefore get a lower subsidy from the government if they retain their home. All residents, independent of their financial arrangements with the home, would get some level of government subsidy. That is really a choice for the individual. I accept the point that entering a nursing home is a stressful occasion for a person and that they probably have to make quite a range of financial and other lifestyle decisions at that point.

**CHAIR**—Thank you very much for your presentation today. It is much appreciated.

**Proceedings suspended from 12.35 p.m. to 1.33 p.m.**

**SAUNDERS, Mr Michael, Senior Policy Adviser, Workplace Policy Department, Australian Medical Association Ltd**

**CHAIR**—Welcome. The *Hansard* record is a public record. You are protected by parliamentary privilege in terms of what you say. If there are issues you want to take in private, discuss it with us and we will consider your request, but I doubt that will be necessary today. We invite you to make a contribution to your submission.

**Mr Saunders**—Thank you. It is, of course, a broad ranging inquiry, but I would like first to talk about the scope of the AMA's submission. It was written from the perspective of our members, who, like everyone else, need to plan and save for retirement. It does not attempt to address broader policy issues like future demand and funding of health care and future workforce participation.

One of the key issues of the government's policy and one measure of its success is the extent to which Australians' standard of living can be maintained in retirement. Medical practitioners as a group are not likely to call on the age pension, fairly obviously, but it is important that they make provision for a retirement income which is a reasonable proportion of their pre-retirement income.

I feel able to say that medical practitioners on the whole are no better than anyone else at long-term financial planning and at picking good investments. The AMA accepts that it is the responsibility of individuals who are able to do so to provide for their own retirement, but they need a reliable and equitable mechanism for doing so, as we believe all Australians do, and superannuation is the most important part of that mechanism, particularly since part of it at least is compulsory for so many people. The AMA believes that the broad policy of encouraging superannuation savings is correct but that current tax arrangements are inequitable and are a disincentive to invest in superannuation funds and thus to provide for retirement income. There is a lack of equity and too much complexity in the taxing of superannuation, which undermines the objective of encouraging superannuation savings.

Previous reports of the Senate Select Committee on Superannuation have highlighted the fact that Australia is the only country which imposes tax on superannuation at three levels: on entry into the fund, on accumulation while in the fund and on exit from the fund. For the reasons set out in its submission, the AMA believes and recommends that the tax on contributions needs to be reviewed, the surcharge should be removed altogether and individuals should incur taxes only at the time they are able to access their superannuation funds, rather than up front. We believe those changes are necessary for the government to achieve its objective of funding a reasonable level of retirement income through superannuation and for individuals to achieve that aim.

The AMA obviously has views on a whole range of issues—in fact, on virtually every facet of health. Our own submission this time is, as I have said, of a fairly narrow scope, but I would be happy to take questions on the general issues and will do my best to answer them.

**CHAIR**—The Council on the Ageing presented evidence yesterday and indicated that one of the most pressing areas for the aged is access to dental services. How best do we meet that need? Do we open up Medicare access to dentists, orthodontists et cetera?

**Mr Saunders**—I have not any material on access to dental care and, frankly, had not given that too much thought. On the broad issue of Medicare and methods of funding all forms of health care in the future, the AMA did convene and host a public hospital financing forum in April of this year. Within that, there was a paper prepared by Roger Kilham of Access Economics for the AMA which addressed the bigger picture in the longer term for public health funding. That paper canvasses and comments on a range of issues about the demand, provision and funding of health care in the future, including for the current generation of baby boomers. It does not specifically address dental care. In fact, I do not think anything specifically within the AMA's ambit does that. I have brought copies of that paper with me because it does give an overview of the AMA's approach, and I would be happy to leave this an indication of the AMA's view on the bigger picture of future health care funding.

**CHAIR**—Thank you. Should we make this a tabled document?

**Senator HOGG**—I have no objection.

**CHAIR**—Deterioration of teeth is associated with a decline in health and also sometimes results in dietary problems, and poor dietary issues can lead to dental problems. I was quite interested in that aspect of the submission.

I can reassure you that you are certainly not alone in terms of recommending the need to review the surcharge and the tax on contributions. A number of people have recommended how that can be achieved over time. Given that this raises a substantial amount of income for the government—\$2.5 billion plus per annum—can you suggest an alternative way of making up that finance to ensure that budgets do not go into deficit?

**Mr Saunders**—We recognise that the 15 per cent contributions tax and to some extent the surcharge, I guess, do produce revenues for government in the current year for immediate spending. We believe that that, in principle, is completely wrong, as we have outlined here. I do not have specifics on how it might be replaced by some other form of revenue. I suppose it immediately raises the question of at what rate change might occur in it. This is not a formal AMA position, but, if there are very large amounts of money being raised now by the contributions tax up front, perhaps that provides some avenue for future health care funding, including perhaps dental health care funding of the kind you were alluding to before.

**Senator HOGG**—Instead of being an up-front tax, it is not suggested that it be eliminated completely. I think it should be said that it has been put to us that the tax should be at the other end. Within the confines of that, do you have a view as to how that might be achieved—not the abolition of the tax but moving it from the front to the back?

**Mr Saunders**—The retiming of it. Yes, that is in fact what we did intend in the recommendations. At present it is a tax that is imposed up front, before any person has access to the funds. In principle we see that as wrong and, yes, we would propose that the tax, whatever it is, be applied at the time that an individual accesses funds from their superannuation—at the

end, as you say. So, no, we were not proposing the total abolition of the taxing of superannuation.

**Senator HOGG**—No, I know you were not—not like the surcharge, though.

**Mr Saunders**—We are advocating the total abolition of the surcharge, for the reasons we have set out in our submission.

**Senator HOGG**—And what would those reasons be, just for the record?

**Mr Saunders**—The 15 per cent contributions tax on entry to the fund is only the first phase of the tax take on superannuation. It is imposed on money which is not income. It is not accessible, as I have said, until many years down the track, at retirement age in most cases. We believe it not only is questionable in principle but it also undermines the concept of long-term retirement provision through the accumulation of relatively small amounts. I have seen papers showing that charges by superannuation funds of 1.5 per cent to two per cent or 2.5 per cent have a very large effect on a fund over a 10- or 15-year period. If you think about that and the loss of 15 per cent of contributions up front over 20 or 30 years, it would certainly significantly reduce fund accumulation. With the surcharge—which obviously does apply to many doctors—it is grossed up to assessable income and increases the up-front tax bite for many people to 30 per cent, so obviously the effect on the accumulation of funds is that much harder. It is also difficult to administer—and I think a number of other bodies have said that—which has a particular impact on administrative costs for smaller funds and therefore affects the returns for all members, not just those subject to the surcharge.

In the case of defined benefit funds, and perhaps only those outside the public sector, the complicated method of administering it means that they have to set up a negative surcharge account within the fund. At present, the practice of the funds is to increase that account at the long-term bond rate. Especially with negative earnings in recent times and perhaps projected a little further ahead as well, that rate can be higher than the fund earning rate. Over a significant period, that is going to lead to a very rapid accumulation of surcharge debt. In fact, on some projections I have seen, if we did have poor investment returns and the long-term bond rate remained significantly above those returns, the effect could be quite dramatic on the fund benefit available to the contributor at the end of the day. Theoretically, it could even go negative. So we believe the surcharge is inequitable. It is a disincentive in itself to superannuation saving and it does have an impact on all contributors, especially those in relatively small funds, because of its very complex administration.

**Senator HOGG**—It is the complex administration which is the real problem, isn't it? We have heard a suggestion that the tax should be moved across and managed through the ATO.

**Mr Saunders**—Again, as we are proposing for contributions tax—and, as you mentioned, this is another phase of it—if surcharges or extra tax were going to be applied to higher income earners, then surely we would be arguing that that too should occur as part of the tax arrangements on exit from the fund.

**Senator HOGG**—One of the other things you mentioned was the issue of fees and charges, yet you have made no submission to us on that issue, from what I can see. Fees and charges can

impact significantly upon the retirement benefit that will be received by a member of a fund. Do you have a view on that?

**Mr Saunders**—There are a couple of points I would like to make about that. We have mentioned in our submission that fund administrative fees do have an effect, as you have said. They range generally from 0.5 per cent to 2.5 per cent. They are not always clear, either, to the contributors. That is a general comment. Again, if fund earnings are very low or even going negative—let us say, as we have suggested in our submission, that the projection is five per cent per annum or less in the future—then obviously administrative charges of that amount do take a fairly large bite out of anybody's accumulating benefit.

I might say, more from a personal perspective than officially from the AMA—because I happen to have involvement as a staff representative in our own superannuation fund—that one of the things which is very difficult for contributors generally to get at is the relative performance of the different superannuation funds. They have a whole range of investment options and so on, but if you asked, 'Show us how you fare in, for example, your default fund, one of your more conservative funds or one of your balanced funds. Take a benchmark fund, if you like, and tell us how that performs over the year compared to, say, industry funds, which are able to report in that way.' It certainly would be an extremely useful exercise, I believe, if the funds were able to report on their performance each year on a standardised basis, perhaps taking a default fund and excluding taxes and administrative charges.

**CHAIR**—Some of that information is obtainable through groups such as Van Eck and Rainmaker. Consistency in the manner in which various funds present their information is a matter that is very much at the forefront of this committee's attention, because there is no standardisation. But some attempt is made in some quarters to try and provide that. You might have to pay a fee for it, but I understand that information can be gleaned. However, its accuracy or reliability may be open to some question because of interpretation.

**Mr Saunders**—Yes. Because it is not standardised, it is very difficult still to know how to compare. I should have mentioned commissions among the charges as well. It would be good to have some standardised measure of performance which excluded all of the things and just gave the net return to the contributor.

**CHAIR**—That issue will continue with a number of members of our committee.

**Senator HOGG**—That raises the issue: should commissions be allowed at all? It has been said that, with trailing commissions, people can be paying \$40,000 for advice, in effect.

**CHAIR**—Over a lifetime.

**Senator HOGG**—Over a lifetime.

**Mr Saunders**—They can be paying a lot. To make that point again, I think commissions, where they are being charged, need to be very visibly charged.

**Senator HOGG**—Should they be capped? We are really talking about a number of products. We are talking about the mandatory SG component of superannuation, we are talking about the

voluntary contribution part of superannuation, and we are probably also talking about employer contributions that exceed the mandatory level. So one of the issues that confronts this committee is: do we have a standard set of principles in terms of all those elements or do we have differing standards? For example, it may be in terms of the mandatory part, the SG, which is compulsory—no-one can get out of it. Then the committee recommends that there be a fixed charge in terms of fees and charges by a fund but leaves it open-ended in terms of any self-contributions and any contributions that might exceed the SG. That is a possibility. You can go through the permutations and combinations yourself and come up with different mixes and matches. Do you have a view as to whether we should have a ‘one model fits all’, or should we allow flexibility, and the so-called market forces, to dictate what the charges might be when it comes to those non-mandatory parts of superannuation?

**Mr Saunders**—The AMA does not have a formal position on such a matter, but I can certainly see the argument for some kind of limit or fixed amount of commission on the compulsory part of superannuation. There are market forces there, obviously. They usually run on percentage—on my understanding—of equity in the fund rather than on earnings made and so on. As to whether that lends itself to regulation by government at any level or should be left open to competition I do not really have a view. The main thing is that the amount of the charges for commission have to be not only shown, but shown in a way which is visible and comprehensible to the contributors.

**Senator HOGG**—We have heard during this inquiry that a one per cent fee and charge over the life of a person’s investment in a fund could mean \$10,000 less when they finally get their benefit; two per cent could mean \$20,000 less; three per cent could mean \$30,000 less and a four per cent fee could mean \$40,000 less. Two or three per cent to someone does not necessarily sound like a great deal in terms of an administration charge or a fee, but it has a significant effect and impact on their long-term benefit. Your organisation has done no modelling to look at the impact of fees and charges on benefits?

**Mr Saunders**—Not in superannuation. It would not be as great an effect, obviously, as the contributions tax and the surcharge, especially when combined, but it is a significant effect. We have read some of that material, but we have not done any specific modelling on the effects of charges. We just make the point, as we have done in the submission, that especially as the projected returns from superannuation investment are not going to be like they have been for the last 10 or 15 years, on most indicators, there must be more pressure on the charges. They will take a larger component of everyone’s earnings if that is not the case. It is not clear at the moment that competition is achieving a reduction, although that might occur over time.

**Senator HOGG**—Did I understand you to say that a number of your members are not very financially literate when it comes to interpreting their superannuation? Is that a fair way to put it?

**Mr Saunders**—I would put it in a slightly different way.

**Senator HOGG**—That is not meant to be disparaging, because I think it is something that besets most of the population.

**Mr Saunders**—That is exactly it, I think, Senator. In terms of long-term financial planning and trying to choose investments which will serve for retirement income and so on, I think doctors are no better than anybody else at doing that. All Australians and all professional groups certainly need some kind of mechanism which gives them an option for superannuation savings. A couple of years ago at the AMA national conference we had Paul Clitheroe presenting on financial planning. This is obviously only anecdotal, but his father was a doctor and he deals with a number of doctors and certainly his experience and impressions were that they are certainly no better than any other person or part of the community in financial planning in the long-term. Like everybody else, there are always other things to do with your money in the short-term, particularly with business pressures and rapidly increasing business costs for doctors.

**Senator HOGG**—One other issue that has been raised are the entry and exit fees attached to getting into superannuation products. What is your view on that?

**Mr Saunders**—Again, we had not formed a formal view on it, but any of the fees which diminish the money going in there, and hence the accumulation, certainly need some attention. We do not have a position on the regulation of it. I am not very aware of the range of entry and exit fees. I understood that most funds had low or zero exit fees if you rolled over to another fund. It is not an area that we have given particular attention to.

**Senator HOGG**—Some master plans out there do have entry and exit fees associated with them. We saw one yesterday—without naming the company—which had a reasonable upfront fee.

**CHAIR**—Very high.

**Senator HOGG**—I raise it because it also affects the issue of portability, particularly in terms of the exit fee. If there is an exit fee there which makes it prohibitive for one to withdraw one's superannuation, then you may well leave it in a product which is substandard. Nonetheless, if you could move it out of there, you would improve your retirement benefit greatly. But rather than pay a hefty charge, you would leave it there.

**Mr Saunders**—An excellent point. The AMA would support portability of superannuation. Hence, anything which works against that is something we would like to see addressed. At the risk of being too simplistic—

**Senator HOGG**—There is no such thing.

**Mr Saunders**—It seems not. Entry and exit fees, like charges and commissions, are all part of the same basket. It is true that they certainly would have an effect on your willingness or ability to shift to a fund that is better for you. Again, it very much comes up—partly, at least—with being very open, transparent and understandable about those kinds of charges up front.

**Senator HOGG**—Do you have any difficulties with respect to the membership where they do not have continuity of work?

**Mr Saunders**—We do. Doctors in training, in particular, tend to be employed on 12-month contracts. They might shift from one health system to another or from one area health service to another—in some cases it may be even from one hospital to another—and be placed into a different superannuation fund. The difficulties mainly arise from continuity of employment conditions, and particularly service for paid maternity leave when you only have 12-month contracts and one hospital or employer will not recognise the previous service with last year's employer for that purpose. It is an issue for superannuation. I had not been made aware by our members of the issue, but that is probably because young people—until at least 30 and beyond—do not give very much thought to superannuation. But it would be an issue for younger doctors at least.

**Senator HOGG**—Why do you say they do not give much thought to it up until age 30? Are they too busy getting on with life?

**Mr Saunders**—Yes, in a word. My own experience has been—and not just with doctors—that probably up until about 35 most people do not give very much thought to it. Perhaps that is changing. I hope it is, because I think people do need to give more thought to it. We are attempting to do that internally with our own superannuation scheme.

**Senator HOGG**—How are you doing that internally?

**Mr Saunders**—Inviting the financial planner attached to our staff superannuation scheme to come in, and promoting little seminars so that he can explain the effects of fund accumulation, which is essentially about the long term. Decisions made early in life can make things an awful lot easier later in life without having to sacrifice greatly. That is one thing. We also try to publicise internally what is available and encourage people to think about it and come along to these small workplace seminars. That is just within the AMA.

**CHAIR**—You may want to open up that arrangement in terms of ensuring that you are getting the best product at the best price.

**Mr Saunders**—The better informed people are, the better their choices. Once they start thinking about it I figure that the next step is to be much better informed about the different options and so on. My general experience has been that people do not give a lot of thought to superannuation until it begins to loom reasonably large in the consciousness. I am not sure what the committee itself has found in that regard.

**Senator HOGG**—In terms of people's attitudes?

**Mr Saunders**—Their awareness and how they engage with the issue, I suppose.

**Senator HOGG**—It is a concern that we have in terms of education. That is why I was interested to hear your comments about education. Very little real education is taking place out there. People are becoming aware of their superannuation as their balance grows, but it has been a long hard road, so to speak.

**Mr Saunders**—It is a long hard road. For most of the younger people, as I understand it, most funds have a default or a handful of defaults into which you fall by virtue of your age.

Everybody says that if you hang in long enough with a balanced fund you will get somewhere, and I think many young people simply drop into that default fund and, hence, do not engage very well at all with the other options and with the whole issue.

**Senator HOGG**—Do you think people have quite unrealistic expectations about what superannuation in the broad sense will deliver? Do you think that they believe that because they are in superannuation it is going to deliver them a retirement benefit with an adequate income on which to live? I would not have expected this to affect a great many of your members, but we have found that a lot of people have grandiose ideas, in a sense, as to what nine per cent superannuation will deliver. The truth of the matter is that the vast majority of them will end up on a combination of SG and the age pension.

**Mr Saunders**—All the material does tell me that. The medical work force is changing, as you doubtless know: most medical students and most medical graduates are women now. This is quite a change from tradition in the medical work force. Many of them now and projecting into the future will be working if not intermittently then at least not full time and not continuously through their whole careers. But you are right: obviously doctors, on the whole, are well able to earn enough to be able to look after themselves in retirement. I suspect that, going back, the only people who had superannuation were public sector employees, and they tended to be defined benefit funds. That is not going back all that far, and anybody who had superannuation was regarded as being reasonably well looked after. So it may be that people think, 'Hey, I've got superannuation,' and do not give very much thought to how much they have and what they will have when it comes to the end point where they will need it.

**CHAIR**—With the reluctance of some of your younger members—those under 35—to address the issue of superannuation, perhaps you should pass on some advice that was given to the committee from the Department of Finance and Administration. They say:

Compulsory superannuation contributions for a person on average earnings are unlikely to be sufficient to generate a fully funded retirement income. An objective of a self-funded retirement would be more fully achieved if Australians saved more and saved earlier in a voluntary manner.

While you are quite confident that medical practitioners, as a group, are not likely to impose on government and call for income support in retirement through the age pension et cetera, there could well be a number of your members—whom Senator Hogg has referred to—with broken periods in the work force for a number of reasons who, over a lifetime, do not match this magical average weekly earnings. If they are on or below that figure, their contributions to their superannuation are likely to result in an income stream of about 82 per cent of the pension. That will be a bit of a shock to the system.

**Mr Saunders**—It will be a very big shock to the system, Senator, and that could well happen. My role in the AMA—

**CHAIR**—Averages can do terrible things to some people.

**Mr Saunders**—They can do awful things. My role in the AMA in the Workplace Policy Department is in fact to try to keep a brief on superannuation so that we can advise our members and get out there and encourage a greater engagement with the whole issue. That certainly includes making sure they have enough and that they are projecting forward enough.

**CHAIR**—So there might be a few yardsticks that you might be able to include in your bulletins to your members.

**Mr Saunders**—Thank you. There might be.

**CHAIR**—As there are no further questions, I thank you very much for appearing before the committee and speaking on behalf of the AMA. We always respect their contributions. Thank you for appearing this afternoon.

[2.12 p.m.]

**BOWEN, Mr Phil, General Manager, Budget Group, Department of Finance and Administration**

**COOMBS, Mr Gregory, Team Leader, Long Term Budget Policy Branch, Budget Group, Department of Finance and Administration**

**IGNATIUS, Mr John, Acting Manager, Family Services AAV, Budget Group, Department of Finance and Administration**

**WILSON, Ms Sandra, Branch Manager, Superannuation Branch, Business Services Group, Department of Finance and Administration**

**CHAIR**—Welcome. The committee invites you to make a short opening statement, after which we will ask a number of questions.

**Mr Bowen**—I will make a very short opening statement.

**CHAIR**—You may make it a little longer, if you would like to comment on other aspects that other witnesses have raised—not necessarily departmental witnesses. You might like to refute certain suggestions in terms of practicability, cost or other reasons.

**Mr Bowen**—Thank you for that opportunity.

**CHAIR**—We need assistance.

**Senator HOGG**—We also need assistance because we got the submission late and some of us have not had a chance to even read it yet.

**Mr Bowen**—I will give a brief synopsis of the submission. I do apologise that we were unable to get the submission to you earlier, and I appreciate your difficulty in that regard. The focus of our submission is primarily on an area of particular relevance to the Department of Finance and Administration, namely the relationship between superannuation and the age pension in the context of long-term population ageing and the implications that that has, from our perspective, for the future impacts on government expenditures going forward.

The release in May 2002 of the government's Intergenerational Report, which projects the fiscal implications of population ageing over the next 40 years, provides an opportunity to consider superannuation and the standard of living in retirement. Australia's retirement income system has sound foundations. It accords with the World Bank's three-pillar approach—I am sure that you have been told that before.

**CHAIR**—We now have a fourth pillar.

**Senator HOGG**—Yes; someone suggested a fourth pillar. So that you are under no illusion, I said that one of those pillars is a little bit shaky, and so it could be a 2½-pillar or 3½-pillar approach. You take your choice.

**Mr Bowen**—What was the fourth pillar?

**CHAIR**—Returning to work after retirement.

**Mr Bowen**—We do touch on that.

**CHAIR**—Do you? I would be surprised if there was not a certain liaison between the premier departments in terms of submitting to a major committee like this.

**Senator HOGG**—I am surprised that they are talking.

**Mr Bowen**—There is liaison. But the three pillars are: compulsory superannuation saving; voluntary saving; and the age pension safety net. As I am sure you know, the World Bank endorsed this approach in 1994, when it emphasised that a country's retirement income policy should be an instrument of economic growth and a social safety net for the low income aged. In addition, a range of measures have been introduced to raise incomes in retirement. These measures include the introduction of compulsory superannuation, the strengthening of preservation rules and the promotion of voluntary superannuation. It is obvious that sound macro-economic and micro-economic policies have also assisted the strong economic growth that Australia has experienced over the last decade. That has increased the living standards of Australians, including those in retirement. In our view, that continues to be a very important aspect of this issue.

Reflecting these initiatives, Australia's superannuation assets have more than doubled in nominal terms over the past six years—largely because of strong returns, voluntary contributions and the introduction of compulsory superannuation in 1992-93. Also, the share of employees with superannuation has risen rapidly: from 55 per cent in 1998 to 91 per cent in 2000. Nonetheless, we see challenges remaining for the future. As shown by the projections in the government's Intergenerational Report, the ageing of the population has significant implications for Commonwealth finances. Australians aged 65 years and older are projected to increase by about four million and they are living longer in retirement—'Thank God!' we say.

**Senator HOGG**—Particularly when we are amongst them.

**CHAIR**—I am told that this is the healthiest nation in the world.

**Mr Bowen**—A further issue is that declining fertility is projected to diminish the proportion of the population that will earn the income from which taxes will be drawn to fund the projected rise in expenditure on pensions. The fiscal implications of this demographic phenomenon mean that Commonwealth expenditure on the age pension is projected to rise as a proportion of GDP from 2.9 per cent in 2001-02 to 4.6 per cent in 2041-42. Australia's maturing superannuation system has been factored into these projections. However, compulsory superannuation contributions for a person on average earnings are unlikely to be sufficient, alone, to generate a

fully self-funded retirement income when the scheme is mature. I think you would have heard from Treasury on that point earlier today.

To attain the objectives of a self-funded retirement and a higher standard of living in retirement, it is clear Australians need to save more, including through voluntary contractual superannuation contributions. In addition, as most of the retirement benefits payable by superannuation funds reflect earnings, because of compounding effects, rather than contributions, Australians need to start saving earlier for retirement. The rising share of the aged population in the total population diminishes the potential for people of working age to support older Australians to the extent that they have done in the past and brings into sharp focus the importance of, among other things, raising workforce participation rates—there is pillar number four. Delaying retirement and other measures to increase workforce participation would increase the likelihood that retirees will be better able to self-fund their living expenses. Improvements to the design of income stream products—and this is not our area of expertise—to cover longevity risks may also assist in that regard.

Together, compulsory and voluntary superannuation savings have the potential to significantly raise the level of self-funded retirement in Australia. While there is no clear evidence at present that individuals are dissipating superannuation for the purpose of meeting the age pension means test, this could emerge as an issue as superannuation funds grow. To the extent that there is a community preference for early retirement and for utilisation of lump sum superannuation benefits in ways that bypass the means test for the Commonwealth age pension, the benefits of superannuation savings may not be fully reflected in a proportionate reduction in reliance on the Commonwealth age pension. Furthermore, although the gap is narrowing between the superannuation preservation age and the pension eligibility age, a gap still remains. Such a gap may be a contributory factor to encouraging retirees to dissipate lump sums or place them in a form that is sheltered from age pension means testing before reaching the pensionable age. Finally, small superannuation accounts may also encourage similar dissipation of lump sums. That is a brief synopsis of our submission. To the extent we can, we will be happy to try to answer your questions.

**CHAIR**—Mr Coombs, you indicated that you are responsible for long-term budget planning.

**Mr Coombs**—That is right: long-term budget policy.

**CHAIR**—In your submission, I was expecting some sort of assessment of the long-term implications of the issues that were raised in the Intergenerational Report. Could you take on notice and give us some assessment of some of the issues raised in the Intergenerational Report? In other words, we have the skeleton there, but we want some flesh on the bones.

**Mr Bowen**—Before we do that, let us get some clarification. We have touched on it—in particular the issue of the expected growth in age pension costs going out.

**CHAIR**—Yes, but it has to be particularised or focused on, doesn't it, to enable other collegiate action? That is what we are looking for. It is all very well to say age costs are going up. That is what the Intergenerational Report told us.

**Mr Bowen**—Yes, that is right.

**CHAIR**—We were hoping you might have included that. You are under a lot of pressure, so we put the request to you. If possible, the committee really would appreciate your linking the sorts of issues raised in the Intergenerational Report—an assessment of those issues. We are not asking for it tomorrow or next week, but it would be good to have it in the next few weeks.

**Mr Bowen**—It would help if we could get from you, through the secretariat, a more precise statement of what you would like us to look at. We would be happy to do what we can on that.

**CHAIR**—One of the difficulties is that the Intergenerational Report itself was fairly vague, apart from giving us certain ratios that we could expect between now and the next few decades.

**Senator HOGG**—We have been told there is a problem; we want to know a little bit more about the problem. That is what we are getting to.

**CHAIR**—Associated with that comes the next request. We have been told that five per cent of GDP will be budget deficit by approximately the year 2042—that is a very significant figure. Given that we are looking at the very long term, the committee would also like some information about how this will be funded. Again, it is an unfair question to ask you to take on right now, but you might have to answer it in conjunction with your colleagues from Treasury. It is a big issue that we need to have some handle on, in a general way, because it is quite significant. We need to have a clear picture, unless we are just going to continue going into debt. We certainly do not want to move into deficit.

**Mr Bowen**—I accept it is a very important question.

**CHAIR**—As a committee, we have to take a responsible attitude towards this.

**Mr Bowen**—Yes. It will become increasingly pressing over the next 10 to 15 years.

**CHAIR**—The whole purpose of the Intergenerational Report was to help us to take action now to cope better with these emerging trends.

**Mr Bowen**—Yes, so that we can take action as early as possible. I would have to say, though, that there are many options that can be put forward as ways to resolve that issue.

**CHAIR**—That is not a problem.

**Mr Bowen**—But at the end of the day—

**CHAIR**—It is up to government.

**Mr Bowen**—It is up to government.

**Senator HOGG**—We accept that. I think what we are looking for are the options that are available. We are getting them from a whole range of sources. You are the people who probably have a lot of this at your fingertips—we would expect that you should have. I would like to ask

what 'long-term budget policy unit' implies? Does it imply that that unit has a far more pre-eminent role in government than, say, Treasury or one of the other departments?

**Mr Bowen**—I do not think we would ever claim such a role.

**Senator HOGG**—Shyness does not get rewarded here. We are just trying to work out why it is called the Long Term Budget Policy Branch. What you do that is different from what Treasury does?

**Mr Bowen**—The Long Term Budget Policy Branch is a unit within the Budget Group in Finance, and it has a couple of roles. It is a source of advice for the Minister for Finance and Administration on the broader macro-economic issues; it does not in any way cut across Treasury's much broader role, but it is an in-house source of advice to the minister on those issues. It also has a wider role, contributing with Treasury to the IDC that worked on the Intergenerational Report, for example. In particular, it looks at the long-term expenditure policy implications—very much a Finance responsibility—of current government policy, demographic trends et cetera.

**Senator HOGG**—First up in your opening remarks you raised the issue of the relationship between superannuation and the age pension: does the long-term budget policy unit or your department, as such, have a view about how that relationship will change over time? Are we going to become more heavily dependent or less dependent upon the age pension? It is being put to us by members of the public, academics and the like, and others who have made submissions to the committee, that somewhere between 15 to 20 per cent of people currently—in that order, as broadly as that—are basically fully independent of the age pension system. If we look to 2032 or 2042 or whenever it might be, do you see that figure decreasing or increasing and, if you do, for what reasons is it doing that? For example, are we going to find that, instead of 15 to 20 per cent, the figure will go back to 10 to 15 per cent? Or will it go the other way, from 15 to 20 per cent out to 30 per cent perhaps? If so, what are the reasons and the factors that will affect that? If we are going back the other way, why is that happening, and what are the potential remedies—not looking at policy statements as such but telling us what some remedies might be? We have people coming up to us and saying, 'Retirement benefits are not adequate. Our solution to the problem is to go from nine per cent to 12 per cent. That is the magic fix.' We know that it is not the magic fix. Would you comment on that.

**Mr Bowen**—I will attempt to comment first—

**Senator HOGG**—Do not be shy.

**Mr Bowen**—and then I might turn to a colleague or two. To the extent that we have been involved in this work and, as I think you understand, we have not done the primary work.

**Senator HOGG**—Yes, I accept that. But at the end of the day, if I am not wrong, the buck is going to stop with you to a certain extent, isn't it?

**Mr Bowen**—Obviously, we share responsibility, in that we do have a very clear responsibility to advise the government on expenditure programs. I guess where we have got to in what we have said in this submission is that, on the basis of current policy settings and

current savings patterns, we would expect that in the future there will be a lower proportion of people who have a full age pension and perhaps a higher proportion of people who have a part pension, because of their access to superannuation savings. I think that is reflected in the rate at which the age pension is projected to grow in the Intergenerational Report. I think there is quite a lot of evidence around internationally that our growth projections for the pension are much lower than those of many other countries in the OECD world.

However, in looking at this in preparation for our appearance here, it is apparent that, if we want to do better than that, a couple of things need to happen. There needs to be an increased level of voluntary savings to complement the compulsory savings under the guarantee arrangements and an increased or extended participation of people in the work force, so that, to put it bluntly—

**Senator HOGG**—Put it bluntly. I said, ‘Don’t be shy.’

**Mr Bowen**—retirement lives are not as long as they currently are, so that we get people in full- or part-time working situations contributing to the economy and the growth of the economy, which is so essential if we are to have the capacity in the future to be able to provide the age pension safety net and other safety nets that we will need to provide as a community at that time.

**CHAIR**—There is really a sixty-four dollar question here, isn’t there? The information that has now come from three prime government departments today shows that people’s standard of living is really going to be dependent on the interaction between superannuation and the age pension, with the majority falling on some sort of access to the age pension. Given that, what sort of incentive do you think there will be for people to sacrifice present living standards by putting voluntary money—after tax money—into superannuation? The information that has come out of Treasury, the Department of Family and Community Services and yourselves today may well encourage some people to put a lot more in, but there are those who might sit back and say, ‘After 40 years, with investment earnings and contributions taxes, is the little bit that I am able to put in going to make any significant difference?’ I just fear that this may drive people further away from making voluntary contributions—although I did say this is a sixty-four dollar question. It might send some out into the marketplace, thinking that they have to put more either into superannuation or into other investments. What is your assessment? I think the whole mechanics of this thing have changed.

**Mr Coombs**—Perhaps one point that should be made is that there is a trade-off here between the types of investments that an individual might make. For example, in a compulsory superannuation scheme there is, to some extent, a trade-off in terms of the wage negotiations that a person will conduct with their employer. Therefore, even though the SG is added to the remuneration of a person, at the end of the day it is open for negotiation over wages. So, while the SG has some particular advantages in the sense of being able to control some superannuation benefits, there is also a more global trade-off that is given in the workplace. Another trade-off is in terms of national savings and individual savings of a broader kind. To some extent, if you control the level of superannuation savings through compulsory measures, those gross savings may not be matched with net savings—that is, people may choose to invest in other ways; they may choose to spend in other ways. And there are also implications for national savings.

**CHAIR**—Or they may choose to spend on current consumption.

**Mr Coombs**—They may do. Yes, that would be one choice. There is both a choice at a particular point and also between now and some time in the future.

**CHAIR**—Why I raise this point is that, if people sit down and make an analysis of the figures, or if others do it for them, which we have, the GDP cost of pensions is 4.6 per cent. But then, if we look at the cost without the superannuation guarantee, it is 4.8 per cent. So won't a significant number of people say, 'What's the point?' It will be so much harder to convince employers to put additional moneys in, won't it?

**Mr Coombs**—It may be. But could I just put it to you that a key issue here is a community attitude towards saving for retirement. In a sense there needs to be, in my view, a degree of individual responsibility; where they can, individuals need to ensure that they have adequate savings.

**Senator HOGG**—That relies on the element of their having some discretionary amount of money to spend.

**Mr Coombs**—That is right. Therefore an implication of a compulsory superannuation scheme, or any superannuation scheme for that matter, is that it is income dependent. Therefore, you come back to a situation where people who have a problem with insufficient income—or indeed no income—are not able to provide for their future needs. That is, therefore, a bedrock situation, and that is the pension—that is the social safety net which is the pension scheme. Unfortunately, over the next 40 years a demographic change will put a lot more pressure on the total amount of the pensions which are paid, even though into the future people will in general be better able to provide for their future needs, because of the SG and other superannuation arrangements being made.

**Senator HOGG**—Some people will be able to better provide. That is the problem.

**Mr Coombs**—That is right: income earners.

**Senator HOGG**—And this is where we have people appearing before us trying to put solutions to us regarding what may better enable people to provide. We do not have a closed mind about what those solutions might be. At this stage, it is fair to say that the committee is trying to explore as wide a range of possibilities as might be around.

**CHAIR**—I would like to move on to another issue. Mr Bowen, you very appropriately raised the gap between the super preservation age and the age pension qualification. My question is: should that gap be closed or should it be removed? As a supplementary question: do you have any thoughts on how double dipping could be reduced. As an example, something that immediately comes to my mind is a higher tax on lump sums to perhaps push people more into the income stream.

**Mr Bowen**—I can comment—

**CHAIR**—Or would you like to take it on notice? I am quite happy for you to do that, because I have quite a few questions and I have only got a quarter of an hour to go.

**Mr Bowen**—All right. Perhaps we should press on. I cannot comment in detail on those.

**CHAIR**—That is why you might like to take it on notice.

**Mr Bowen**—Yes.

**CHAIR**—Speaking as a parliamentarian, the retired community of Australia is very appreciative of Finance's assessment of the affordability of giving access to the concession card. Now 90 per cent of people living in retirement have access to that card, and the fact that you provided that advice to the government is very much appreciated by the retired community of Australia. Obviously, you have taken the question of sustainability into account in putting forward that recommendation. I can tell you that that is very widely appreciated out there in the community.

The other question is: what are the long-term implications, especially on health costs, if Australia is not able to continue its prodigious productivity growth in the long term, as we have in the past, and it is less than the Intergenerational Report figures? We want the downsides as well as the upsides. Would you like to take that question on notice?

**Mr Bowen**—We can take it on notice. Obviously, as you know, the major factor driving future costs is health.

**CHAIR**—Absolutely.

**Mr Bowen**—I do not have figures today, but the downside risk of lower productivity is pretty serious, I would have thought.

**Senator HOGG**—So can you give us something?

**CHAIR**—We would like you to take it on notice. It is a big issue.

**Mr Bowen**—We can take it on notice.

**Senator HOGG**—I accept that, but are you able to give us something?

**Mr Bowen**—Mr Coombs has a brief comment to make.

**Mr Coombs**—The Intergenerational Report indicates that the productivity level would need to be fairly strong in order to raise the incomes necessary to cover costs on the budget as well as those costs associated with retired persons. Productivity is basically a function of two components: one is to do with the growth of the labour force; the other is to do with multifactor productivity, just doing things better or innovation. As the work force stagnates over time, labour growth will slow—

**CHAIR**—It falls rather than stagnates.

**Mr Coombs**—Yes, so the productivity associated with labour force growth will diminish, and therefore that is a risk to total productivity in the economy.

**CHAIR**—That is behind my question, because that is an implication.

**Mr Coombs**—That is right. But a trend over the last few years shows that productivity growth is now increasingly associated with multifactor productivity.

**CHAIR**—Technological change.

**Mr Coombs**—That is technological change or simply doing the same thing in better ways, and that is a favourable trend which suggests that long-term productivity growth can at least possibly be supported by technological change rather than by labour force growth.

**CHAIR**—We are thrilled you have come along this afternoon, Mr Coombs. You are going to take the rest of that question on notice for me, because so far so good.

**Mr Bowen**—Yes.

**CHAIR**—I have another question for you: in your assessment, what are the implications of growing personal debt and falling non-super savings on retirement incomes and budget sustainability?

**Mr Bowen**—I think we will take that one on notice.

**CHAIR**—This issue has really come up as a new issue for us, but a very important one in the relationship between lump sums and income. Other people have suggested to us, so I think we have an obligation to ask the question, that super health accounts may be a better means of assisting people than, for example, the \$2.5 billion in private health fund membership rebates—in terms of protecting the budget. Is that too much of a policy problem for you? You might like to take it on notice, and we will accept your response.

**Mr Bowen**—We would be happy to take it on notice. It is not something that I—

**CHAIR**—People have raised that issue with us and asked us to explore it, and obviously yours is the logical department. We do have difficulties: this inquiry is so broad that we have to go outside current initiatives, current philosophies and that sort of thing.

**Senator HOGG**—Thinking outside the square.

**CHAIR**—Yes.

**Mr Coombs**—One of the issues with health superannuation accounts is that the health needs of individuals are quite variable over time. It is important to point out that, in terms of health needs, expenditure in the last two years of life is far greater than health expenditure needs at any

other time in a person's life. So there is a timing issue regarding how superannuation might be used to fund an individual's health needs. All I am pointing out is that this area is particularly complex.

**CHAIR**—Absolutely. None of it is easy. But the same argument is being used when we ask whether health accounts should be part of the superannuation package. People say, 'Just give us plenty of income and that will take account for us.' When we put that to another group, they said there is no consistency in patterns between different individuals in society in terms of their health needs as they get older. Maybe for some people it is best to go down one line, but not for others. It is very hard to get an across-the-board picture.

This committee has always been rather reluctant to allow access to super for any reason. It has been suggested, again, to the committee that there should be access to that super to pay for training to meet Treasury's new fourth pillar requirement of returning to work and to make people more relevant for staying in work. Again, it may be a question on notice. Mr Coombs, has there been any analysis of the benefit of providing tax concessions to super, which I think Treasury have estimated to be in the order of \$10 billion, on age pension savings?

**Mr Coombs**—The basic answer to that is that is principally a Treasury issue.

**CHAIR**—Perhaps we will take that up with Treasury.

**Senator HOGG**—We have had a submission from some Commonwealth government superannuants that they would be far happier to see their pensions linked to wage growth rather than CPI. I do not think this is a new concept. Can you comment on how it relates to their adequacy and the implications for the Commonwealth?

**CHAIR**—We know you have a vested interest, but we will accept that. We feel sorry for you, and we have referred to that in our previous reports.

**Mr Bowen**—I think we all have a vested interest. It might be appropriate for Ms Wilson to answer that as it is directly in her area of expertise.

**Ms Wilson**—The committee has had an inquiry into this particular issue and has made recommendations, and the government is considering its response to that. As far as adequacy is concerned, there has not been a full-scale review of adequacy in that context. I think the committee has done a fair bit of work on it and it has reported on it. A number of other parties have as well, but the department has not particularly.

**CHAIR**—The committee appreciates your recommendations to government, and the government's response of at least making indexation twice yearly. But the committee still believes there is a case for looking at closing that gap between the indexation method that applies to retired Commonwealth public servants as opposed to that for those who are on age pensions. So it is going to be an ongoing issue of a similar nature to the way we kept pursuing the quarterly payment of superannuation guarantee, because it is our constituency. They have given long, valued service over many years, which we appreciate.

**Senator HOGG**—There is one other issue. I know we are a little pressed for time and you may well need to take this on notice. Again, it goes to the adequacy issue that we have to deal with. Whilst we will be holding an inquiry on the issue of choice of funds, in relation to the Commonwealth super area will the issue of choice of funds—I am not talking about it from a policy perspective—impact on the issue of adequacy? I am not trying to get into the merit, but if one moves to a different model, will that potentially make a greater liability for the Commonwealth further down the track?

**Ms Wilson**—If I have understood your question correctly, the model that the government currently has in mind for Commonwealth employees is that new employees would be offered a choice of funds which would not include the current Commonwealth schemes. As part of that arrangement, the Commonwealth would fund its contributions immediately. So there would be no increase in the actual superannuation liabilities. There would be an impact on the cash balance, because the government would be funding, into private sector schemes, moneys that currently do not leave the Commonwealth sector. Does that answer your question?

**Senator HOGG**—In terms of the long-term overall benefit, would it leave the government with a gap at the other end, so to speak, that it would have to fund? Has that been looked at?

**Ms Wilson**—This is a fairly complex sort of issue because, even with the current schemes, it depends upon the individual concerned as to whether or not there is a gap. It depends on how long they have been in the scheme; they may have been out of the work force for 20 years and join it at age 45. So there will be a gap with a number of people.

**Senator HOGG**—Could you take that on notice and give us some assessment?

**Ms Wilson**—We will have a look at it and see whether we can give you any assessment. We can certainly explain our understanding of the situation.

**Senator HOGG**—Under the new choice regime, would people end up with just the SG or would they end up with SG and better, given that that is what many of them would be on now?

**Ms Wilson**—If I can explain what the government's policy is: basically, the arrangement was that the level of employer contribution into a super fund would be a matter for the employee and the employer to determine. Obviously, it could not be less than the super guarantee. The government has announced that it is not reducing the level of superannuation funding to Commonwealth employers. They will still have the same pot of money to put towards superannuation, but employers and employees will have the flexibility to decide whether all that pot goes into superannuation or whether some goes into superannuation and some goes into salary.

**Senator HOGG**—So, if I understand correctly what you are saying, adequacy in retirement is not going to be affected?

**Ms Wilson**—It is very hard to say. That depends on individuals' choices.

**Senator HOGG**—We can pursue that later. We are going to have to stop because we are finishing at 3.30 p.m.

**CHAIR**—Thank you very much.

**Mr Bowen**—Our pleasure.

**CHAIR**—It has been a pleasure for us, too, I must say. We have enjoyed the participation today. Thank you also for your willingness to take on notice a number of important questions and come back to the committee.

**Mr Bowen**—We will certainly do our best on those.

**CHAIR**—It would appear that we may want an extension of time from the Senate because of the issues that have just come to hand to do with evaluation and testing. It has been an interesting inquiry, and thank you very much for your input. We appreciate it.

**Mr Bowen**—Thank you.

[3.01 p.m.]

**SCHNEIDER, Mr Russell, Chief Executive Officer, Australian Health Insurance Association Ltd**

**CHAIR**—Welcome. We thank you for your attendance and also thank your association for permitting you to come and make a presentation to this very complex but important inquiry. We invite you to make an opening statement.

**Mr Schneider**—Thank you. I will try to be brief.

**CHAIR**—You might like to comment on some matters that we have raised with the departmental representatives who were here earlier. We touched on the question of the rebate, which I know is very close to your heart.

**Mr Schneider**—Indeed. I did wish to do that because obviously health costs are a very important component of the question of aged savings. It is very important that we ensure that the community and the individual can afford a proper health care system in the future, and ageing is obviously going to impact on that cost. As you probably know, people over 65 consume about 41 per cent of total health care benefits. The problem in policy terms is that some over-65s do not consume any health benefits at all and some may consume enormous amounts of health care. This is one of the reasons why we have a community rated health insurance system today—so that the costs of the individual can be shared through the much larger group or pool. This ensures that those people who are of high risk, who cannot necessarily be identified, can obtain the benefits of private health care, or health care paid for by health insurance, regardless of their risk status. This is one of the things that I think people who propose long-term saving schemes for health care may overlook. It might be possible for some individuals to accumulate savings in their lifetimes that are predicated for health care—

**CHAIR**—What sort of savings would you have to have?

**Mr Schneider**—Personally, I think it would very difficult for an individual to generate sufficient savings in their lifetime to be quite sure that that would pay for the health care costs that they could face in retirement.

**CHAIR**—That is important. Thank you.

**Mr Schneider**—But the paradox is that some may; some may indeed have a very large surplus, because not all people need health care before they die. Some need enormous amounts of it; some are very fortunate and do not.

So that is the result in terms of a savings account, and personally I think it would be a policy error to transfer the funding that is currently provided to the health insurance rebate to a long-term savings scheme. The outcome of that would be that many people would drop their health insurance totally, which would immediately drive premiums up, and that would have to be met by the people who remain insured, who would tend to be older or sicker. So there would be an

immediate negative impact and that would compound over time, which would mean that again the cost of even buying insurance in retirement would become unaffordable. I would prefer the rebate to be retained and emphasis placed on continuing to generate growth within the insurance system from younger people or lower risk people. Younger people are not necessary all lower risk but the majority of them are lower risk than those who are older. For the assistance of the committee, I did have my office prepare a couple of graphs that give you some indication of utilisation rates by age and the growth in numbers of people over 65 who are insured.

**CHAIR**—Thank you.

**Senator HOGG**—For the *Hansard* record, could you read the names of those documents into the *Hansard*, please?

**Mr Schneider**—The first table is the number of members with private health insurance aged more than 65 years of age. The second is the private health insurance average drawing rates by five-year age cohorts, which in effect shows the benefits people draw at different ages. Predictably enough, you will see that that increases with age. The third one shows the numbers of persons insured who currently are paying a loading under the lifetime health cover system. As you know, people who postpone joining after age 30 are subject to a two per cent loading for each year they postpone membership.

**CHAIR**—Perhaps we should incorporate those.

**Senator HOGG**—I have no problem with incorporating. I just think it is handy always to identify a document clearly for anyone reading the *Hansard*.

**CHAIR**—It would make the explanation a lot easier if the table was incorporated as part of the record. There being no objection, it is so ordered.

*The tables read as follows—*



**Mr Schneider**—This one actually illustrates the numbers of people who are now paying a loading. There are about 90,000 people above age 30 who have taken out health insurance in the last two years and are now paying between two per cent and 70 per cent above the premium they would have paid had they joined two years ago. This is a partly reassuring and partly disturbing phenomenon. It is reassuring because it means people are continuing to see health insurance as attractive even at higher rates. That is a paradox which makes it a little disturbing also, because we are seeing people who are paying loading of a minimum 50 per cent; that is those aged over 55 who have taken out health insurance in the last two years. One suspects that they have done that because they have come to the conclusion that probably they are going to need health care in the near future, if they do not already need it, which in health insurance terms represents adverse selection. This is not a problem in the short term. The numbers are only about 8,000 out of an insured population of nine million, so that is capable of being absorbed without any great difficulty. If it were to continue, however, it would represent some problem for lifetime health cover, and I suggest that the two per cent loading may not be adequate if the intention is to encourage earlier entry, particularly by people at higher risk.

I think that is probably all I wish to say in my opening remarks other than to again emphasise this particularly important point. Australia is very fortunate in that it has, unlike most other countries in the world, a system of community rating for health insurance which is non-discriminatory and which does ensure that people at higher risk have their health costs subsidised by people at lower risk. That means that large numbers can be insured and also ensures that more and more people are paying for their own health care or at least contributing towards it. The community rating system depends very heavily on intergenerational support; that is, young people maintaining support for the old. I would suggest that in terms of policy measures the most positive ones to look to are those which continue to encourage younger entry into the system.

**CHAIR**—Can you give us some means by which we can encourage younger entry?

**Mr Schneider**—I do not come here with a view to imposing anything further on the Commonwealth or its taxation resources, but one way of doing that, if that were deemed to be attractive, would be to consider exempting from the fringe benefits tax employers who pay health insurance premiums. That could be dealt with in a variety of ways. One option might be to do it for those employers who subsidise the insurance for under-30 members of their work force.

**CHAIR**—Superannuation is exempt from the fringe benefits tax, isn't it?

**Mr Schneider**—Superannuation is exempt.

**CHAIR**—So you want to put contributions by corporations on behalf of their employees on the same status as superannuation?

**Mr Schneider**—Yes. I think that would be a more positive measure than trying to introduce medical savings accounts, quite frankly.

**CHAIR**—I think you have given us a very good reason for not proceeding with the area of medical accounts.

**Senator HOGG**—I would like to ask a question which follows on from that statement. In effect, are you advocating a system that would be parallel to the SG in terms of health?

**Mr Schneider**—Not quite. I would see the 30 per cent rebate as being an essential component of the system for health insurance to retain health insurance membership. But if it were desired to grow that membership or encourage the community rating component of it by encouraging younger people into the risk pool, one of the deterrents to an employer subsidising the younger member is the fringe benefits tax. We have a situation at the moment where most people under 30 believe they are invincible and they are never going to need health care of any sort and therefore they tend to not be interested in paying for health insurance, even with a 30 per cent rebate. For many of them, even lifetime health cover is still a remote impost or incentive. In many cases, employers would like, for a number of reasons, to subsidise health insurance premiums for their young staff but, if they do so, they have to pay the fringe benefits tax, which means that any sort of subsidy is just not affordable for them. We believe that it would be a useful adjunct if that deterrent were removed. It would provide, under certain circumstances, an incentive for the employer—who is going to take a more long-term view than his or her 22- or 23-year-old employee, who probably cannot afford to be insured anyway—

**Senator HOGG**—My fear with your proposition is that we will end up being a de facto SG program. Superannuation was originally the province of the very few rather than the vast masses of people in the work force. If that were to be the case, I would see it again being something that was being made available to a limited range of people.

**Mr Schneider**—The important thing about it is the impact it has on the insurance pool. People over 65 take about four times the benefits that they pay for. We need the contributions of something like four to 10 young people to cover the costs of people on the higher end of the scale. For that reason, anything that actually encourages younger people to come in—their premiums therefore going into the pool—reduces the overall cost.

**Senator HOGG**—I understand that, but you have the fertility rate operating against you, everything going against you, which, to me, makes it look as though there would be real problems.

**Mr Schneider**—Which leads me to the other point of our submission, which is that the only way we will be able to make health care affordable in future years is not going to be by simply concentrating on rating systems or on savings but by actually controlling the cost of health care and reducing the rate of growth of the cost of health care. That is not an easy thing to do, but it is achievable. One of the problems that the health insurance system has at the moment is that its capacity to control costs is severely inhibited by both regulation—

**CHAIR**—Mayne Nickless went down this route, and it was boycotted by the doctors.

**Mr Schneider**—Yes, we always have those problems. I think there are ways in which we can actually get some cost containment in the system.

**CHAIR**—Can you articulate those?

**Mr Schneider**—I think there are a number of them. First of all, I do not think we have a sufficiently competitive market in health care services and I think we put too much emphasis on hospitalisation, as distinct from preventive care. What we need in the health insurance area—and in the public sector too—is more encouragement of facilities outside hospital that are lower cost and that are probably more appropriate for the patient. At the moment, the health funds are inhibited from offering alternatives to hospitalisation and we have perverse incentives that actually drive people from lower cost treatment into higher cost treatment. There are perverse financial incentives that encourage a patient to be treated in a hospital or a day hospital rather than in doctors' rooms, yet the care may be more appropriate in the doctors' rooms than in the other setting. There may be care that should be provided by providers other than doctors, but there is a lot of inhibition on that too. I could elaborate on this, if you wish. I would be happy to provide you with a submission rather than take up the time today.

**CHAIR**—I think that might be handy.

**Senator HOGG**—Given the time of the day and the time of the week, that may well be helpful indeed. Are you really advocating some sort of age based premium to reflect the cost of cover?

**Mr Schneider**—No, I do not think so. I think we really need to retain community rating. If we base the premium on age, we effectively price people at higher ages out of the system and then you would have to start looking at some form of very significant government subsidisation. Personally, I prefer retaining the system where the low risk person or the person who is not using services today subsidises someone who is. I think that is a much more effective regime than trying to go down the pathway of age rating as such. Lifetime health cover is a different system. It is actually community rated but with an incentive for people to join early or pay a loading if they join later. But that is a different thing from age based rating.

**CHAIR**—Would there be any incentives in the collection being via the taxation mechanism, such as the Medicare levy, and then on-forwarding that to the nominated health funds?

**Mr Schneider**—That is certainly a way of achieving a universal scheme but also applying some of the benefits of competition, provided some of the regulatory constraints are removed from insurers, allowing insurers to achieve cost containment in the sector. It does need some of the regulatory restrictions removed. We should be encouraging good performance and quality care, but we have to do something about the rate of growth of cost.

**CHAIR**—Which costs?

**Mr Schneider**—Of the cost of care. Health care inflation runs at about 2½ times ordinary inflation.

**CHAIR**—What aspects of health care are growing faster than others, for example?

**Mr Schneider**—Technology, particularly, is driving a lot of the cost. We have to come to grips with technology. Without denying people access to the best possible technology, we have to find ways of ensuring it is used appropriately. If I can give you just one very brief example: you may have seen the pill with a camera inside it that you can swallow and that will then take

photographs every half-second of your internal organs. That is much preferable to having an endoscopy, to having a tube stuck down your throat. The problem is that I am told that will cost about \$8,000 to \$9,000. It is non-invasive, it is probably safer than the other treatment, but it is very expensive. Obviously, the attraction to the consumer is going to be to swallow this little pill rather than have a tube applied to them.

I think that the only thing we can do is to try, with clinicians, to construct very detailed appropriateness indicators for the use of that technology. We should not deny people use of the technology, but we should make sure it is used only for those people who will genuinely benefit from it rather than, as can be the case with a lot of technology, using it for its own sake.

**CHAIR**—My late doctor was of the view that the threat of legal action was making doctors so ultra-cautious that they were prescribing a range of tests that in 80 per cent of cases were not necessary.

**Mr Schneider**—I think that is a very big problem.

**CHAIR**—So obviously you could do something in relation to that issue. That would drive costs down very significantly, wouldn't it?

**Mr Schneider**—I am getting into an area which is beyond my competence, but it would seem to me that, as the whole question of compensation is under review at the moment, there needs to be some protection for clinicians who do practise best practice. If it can be argued that a particular treatment is appropriate, that should be a prima facie defence. I think that you could extend that into the area of tests, where some tests may be essential and some tests may be discretionary. I do not believe that a practitioner should necessarily pay a penalty for providing a treatment which is discretionary, as distinct from not providing a treatment which is necessary or appropriate. I think we are straying a little out of my sphere of competence—

**CHAIR**—But we are talking about the containment of costs.

**Mr Schneider**—We do need to address all the areas within the health care system that unnecessarily inflate costs. We have done some research based on our existing utilisation figures, and it shows that ageing alone, without bringing into account new technology or anything else, would add about one per cent per year to costs over the next 10 years. That is probably in both public and private sectors. If we overlay that with unnecessary treatments or unnecessary technology, we will find that the costs will really become out of the reach of anyone—beyond the capacity of the taxpayer to pay, let alone the insured person.

**Senator HOGG**—I would like to ask one question on your submission. You say at point 8:

There are therefore three essential policy steps needed to keep health insurance prices within the reach of the growing elderly population:

(a) retain the 30-percent rebate, as it provides an effective cushion for those on lower incomes against inevitable increases brought about by improved health technology and greater treatment options.

What evidence have you got of that?

**Mr Schneider**—The cushion?

**Senator HOGG**—Particularly for lower income people. My understanding is that lower income people cannot afford private health insurance anyway.

**Mr Schneider**—The most recent figures we have seen from the Commonwealth statistician show that more than two million people on incomes below average weekly earnings are privately insured. I think, from memory, the majority of those are on incomes of less than \$20,000 per year.

**Senator HOGG**—Sorry, what are those numbers?

**Mr Schneider**—Two million people on household incomes of less than \$35,000 per annum are privately insured. I believe a large proportion of those—and I do not have the figure in my head—are on less than \$20,000 per annum. I can research that and provide you with those figures, if you wish.

**Senator HOGG**—If you could I would be interested to see those figures, because I would be surprised. My experience tells me that there are a large number of people on low incomes who have gone into a health scheme to take advantage of the rebate and have pulled out because the premiums went up. Also there are those who, even if they wanted to, do not have the disposable income available to them to take up that health insurance.

**Mr Schneider**—That is quite right, but we should remember that one person in three over 65 today has private health insurance. While many of those are self-funded retirees, many others would probably just be on the age pension and they are making quite a sacrifice to be privately insured, in addition to which there are quite a large number of young people who would also be on low incomes. There are almost a million people over 65 with private health insurance and the majority would be on relative low incomes. Certainly without the rebate, if there are problems of affordability—

**Senator HOGG**—The argument has been put to the committee, and there is not much use putting it to you because you would disagree with it, that the rebate may well be better spent being directed into retirement benefits to let people use it themselves to generate sufficient income. At this stage, the system is not providing an adequate retirement benefit for them anyway, even with the supplement of the pension.

**Mr Schneider**—Again, there are those questions that we talked about earlier. Firstly, if it were directed away from health insurance, it would increase the price of health insurance, which would reduce the numbers privately insured, including older people if they were already in the system. So it would exacerbate the problem of affordability rather than solve it. Then there is the question of the disparate spread of health needs among the elderly. Some people might benefit quite a lot from having that money but others might be severely disadvantaged and the money provided to them would not be sufficient for their care. It is not unusual for people to need something like \$50,000 or \$60,000 worth of health care in a year. We have examples of people who have required \$200,000 and in one recent case, I think \$422,000 was the highest benefit payout. That is a very big benefit payout to an older person—I cannot recall their age; they were over 60. I question whether any individual could afford to accumulate that sort of

saving in their lifetime. These are extreme cases, but extreme cases tend to question whether a policy is right or not. If you wish, we can provide you with some details of some of the higher costs.

**Senator HOGG**—If you could that would be helpful.

**CHAIR**—Are there significant economies of scale in terms of administration and marketing of joint ventures between, say, health funds and superannuation funds?

**Mr Schneider**—I am not aware of any specific ones but there has been discussion between the health insurance industry and people who have proposals to put forward about long-term superannuation and long-term health care savings. As far as we are concerned, the question of long-term savings accounts is one issue which should not be addressed as an either/or question; it should not be an alternative to the existing health insurance arrangements. If the wish is to have it as an addition to it, obviously we would have no objection, but I do not think we would see it as being an appropriate substitute for existing policies.

**CHAIR**—Thank you, Mr Schneider. That concludes the committee's proceedings today. The committee will continue to take evidence on 8 August. On behalf of the committee, I thank you, Mr Schneider, and all the other witnesses who have given evidence to the committee today.

**Subcommittee adjourned at 3.29 p.m.**