COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

SELECT COMMITTEE ON SUPERANNUATION

Reference: Superannuation and standards of living in retirement

Roundtable

TUESDAY, 8 OCTOBER 2002

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SENATE

SELECT COMMITTEE ON SUPERANNUATION

Tuesday, 8 October 2002

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

Senators in attendance: Senators Buckland, Cherry, Sherry and Watson

Terms of reference for the inquiry:

To inquire into and report on:

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

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Committee met at 9.05 a.m.

ANDERSON, Dr Michaela, Director, Policy and Research, Association of Superannuation Funds of Australia

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

WOLTHUIZEN, Ms Catherine, Senior Policy Officer, Financial Services, Australian Consumers Association

CHAIR—I declare this meeting open. Firstly, I would like to thank everybody who has come along and contributed so much to this very important exercise. We do appreciate the quantum and quality of the work that has gone into today's hearing. Under its terms of reference, the committee has been inquiring 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. At today's roundtable hearing we will be taking additional evidence from a wide range of bodies either associated with the superannuation industry or interested in its outcomes, as well as from the Commonwealth government departments with responsibilities in this area.

All of the witnesses who appear before the committee are protected by parliamentary privilege with respect to the evidence that they shall give. This means that witnesses are given broad protection from action arising from what they say. The Senate has power to protect them from any action which disadvantages them on account of evidence given before the committee. The committee prefers to conduct its hearings in public; however, if there are any matters which you wish to discuss with the committee in private, we will consider your request. I welcome all witnesses and thank you for your attendance today. As you are aware, we have a very heavy agenda with lots of issues to cover, including the adequacy of superannuation, the equity of the taxation arrangements applying to superannuation, the integration of superannuation with other social security measures, and ways to simplify the operation of the superannuation system. I will ask each witness group in turn its views on each issue. I would ask that you try to keep your remarks brief and to the point, and during the discussion I would appreciate it if all comments to questions were directed to me as the chair.

You will note, as per the papers that we sent out to you, that we have not included a discussion on the modelling and the modelling assumptions. As you know, we had two very strong views: one put forward by ASFA, the other by Treasury. The committee asked the Institute of Actuaries to prepare a paper. The institute found that both figures in terms of replacement rates were reasonably close. That was believed to be a better way of looking at it rather than how they came to their respective quantum, whether it be 19 or 28. Dr Knox, perhaps you might like to make a brief comment on that, as an actuary?

Dr Knox—I should clarify that I am not here representing—

CHAIR—I know that; that is why I have asked you for your independent assessment.

Dr Knox—I agree with the finding that, in terms of the net replacement rates, the ASFA and Treasury models are very similar. I also agree that looking at net replacement rates is a very valid way of going forward in the adequacy debate.

CHAIR—I now propose to move forward to the adequacy; so we are looking at what that amount really should be. Are there any volunteers to start off? Would someone from Sunsuper like to start?

Mr Luke—I have not come with a specific view on adequacy. I have come with a rather different angle and picking up some points that Treasury made—that is, the efficiency of the

system to deliver the adequacy, the leakages that could come from the system and how that is related to such things as insurance fees and, in particular, the assets under management style of fees, which are of particular concern in that they are poorly understood by consumers. In a whole disclosure regime they can totally undermine the adequacy debate. So our emphasis is from that angle, which we think is an absolutely essential angle from which to look at things.

CHAIR—What about sustainability of returns on investment income?

Mr Luke—In respect of what sorts of returns are sustainable?

CHAIR—Yes.

Mr Luke—I think it is hard to estimate the types of returns but clearly there is a huge difference between a conservative portfolio and an aggressive portfolio. The variation in those is probably of the order of three per cent, so the sustainability of returns in the model did not seem an unreasonable approach.

CHAIR—That has been past practice, though, hasn't it? Looking into the future, can we rely on historical growth figures?

Senator SHERRY—Chair, before we go on, I would really like to hear people's views about what is an adequate retirement income. I appreciate your views and I am interested in going to fees, charges, tax and all the other things, but what we are missing in this debate is a consensus about what is adequate. Is there a consensus about what is an adequate percentage of pre-retirement income? We have talked about all the other issues till, frankly, the cows come home, but there is no consensus on adequacy in retirement. They are the views I would like to hear first and then we can talk about the inputs to that, if you like.

CHAIR—Yes. But, at the end of the day, we have to be very careful that we do not rely on a figure and just expect that from the existing types of arrangements, because there may have to be some structural changes along the way recognising the sorts of leakages which Sunsuper just raised. Mr Kelly, would you like to pick up Senator Sherry's comments?

Mr Kelly—I believe that, as a figure, $30,000 sounds adequate to me. From a marketing point of view, it needs to be that sort of figure. Whether that is adequate depends a lot on the circumstances of the person, which has not been taken into consideration, basically. We are just saying $30,000 for one person.

CHAIR—So, for a married couple, that is $60,000?

Mr Kelly—That is the sort of complication that you have straight off. The way it is presented, it is talking about an individual. Sixty thousand dollars for a couple would be greater than the income of a considerable number of people. You have a credibility problem. Sixty thousand dollars as a household or family income would be higher than what a lot of people are living on in nonretirement. If we say that $30,000 is adequate for one person, are we by default saying that $60,000 is adequate for a couple? Most people in retirement are couples, at least in the initial stages. Do they need $60,000? That seems to me to be far too high a figure. Perhaps it needs to be a different income for different family types.

Senator BUCKLAND—You seem to be arguing for adequacy in retirement. What you are saying makes a lot of sense. In the debate, I have always taken it that adequacy in retirement is for a couple to live to a standard that they are accustomed to, while taking into account that retirement has additional pressures on it and while maintaining some generosity towards their family, like their children who are no longer with them. Sixty thousand dollars may be too high, but $30,000, which I always hear mentioned in the debate, is far too low in my view. I am not sure that adequacy is just a matter of doubling one and one. It is a matter of what is adequate for a family to live in a manner that they are accustomed to, while providing for those additional things that come with a retirement, such as health care, care for new grandchildren and things like that.

Mr Kelly—In other cases you sometimes use 1.7 for a couple rather than doubling. You get some complications there. It is getting too complex if you do that. I am not sure that adequacy in retirement should include having money left over that you can give to your grandchildren and so on, because there are savings from not having to go to work. What you do with the money is obviously up to you, but I do not know that that is an essential part of living.

Senator BUCKLAND—It is not essential, but providing for our children is something that we aspire to do and is something that we do as part of our normal life on our way through to retirement. It is natural to want to continue to do that, but the health care and additional services that you require in retirement and as you are ageing are essential.

Dr FitzGerald—There is almost a consensus of what is a First World replacement rate. Almost all of the major OECD countries seem to have systems which, although they differ in some important structural respects, produce replacement rates on the most meaningful way to talk about those—that is, net or disposable income or expenditure, or fairly similar concepts—of 70 to 80 per cent of late working career income as an income produced in at least the early stages of retirement. That essentially amounts to evidence that around the OECD world people are looking for retirement income systems that protect their standard of living; in other words, systems that avoid any large drop in standard of living in retirement. Seventy to 80 per cent of net income or disposable income replacement—that is, after taxes and pensions and the like—would typically produce something like that when you also think about the changes in the expenditure patterns of people.

You would imagine that over the last five or 10 years of working life a typical household unit—and I think it is best to look at household units rather than at individuals—would probably still have a mortgage, say, of $200,000 and the outgoings to service that mortgage would be something in the order of roughly 10 per cent of income. Some other expenses you would expect to be a little bit less in retirement and you would expect people—although in many of these countries financial savings are fairly small outside pension funds or similar arrangements—to have a few other resources. That is where you get from that 70 to 80 per cent to a fairly similar standard of living—by considering these other factors: the reduced expenditure on things like a mortgage and travel to and from work or whatever and the existence of at least modest other savings to supplement the official retirement incomes of the system in those different countries.

The name of that study is *Ageing and Income: Financial Resources and Retirement in 9 OECD Countries*. It is a major study that was published last year by the OECD. I note that the

institute's paper that was provided commenting on these replacement rate issues has the same view—that a 70 to 80 per cent net replacement rate would be regarded as something like an appropriate target as a reading on the aspirations of this community and indeed any of the OECD country communities. That does not mean that this is written in stone but there is a fair body of opinion that is looking at that area as about what a First World country can realistically set out to achieve, because nine of them are already doing it, although some of those nine have systems which do not look terribly sustainable in the long run because they are not adequately funded, whereas ours looks okay on that score.

Senator CHERRY—Does home ownership significantly affect those replacement rates in that research?

Dr FitzGerald—Home ownership is the reason why having 70 to 80 per cent of disposable income replacement gives you a similar standard of living after retirement. In other words, if you have ceased paying the mortgage but still have the home to live in then that is one of the expenses that in some senses you have prefunded by paying the house off before or at retirement—or in some combination. You have housing in retirement and it is extremely important for those numbers to add up to maintenance of standard of living. In most of these countries there are either high rates of home ownership—and our 70 per cent rate is not terribly remarkable; it is similar to that in the UK, Canada, US and so on—or, as in European countries, some sort of secure long-term tenancy if you do not own a house or apartment, which would alter the picture slightly in some of the countries where home ownership is lower. Generally across these countries home ownership is an important reason why you can aim for less than full income replacement.

Ms Smith—I would agree with much of what Vince has just said. I would like to make some brief comments about the replacement rate and targets and then the dollar amount that was used by ASFA. I would agree that if we are using net replacement rates the target should probably be in the order of 70 to 80 per cent. If we were using gross rates, the target is probably 60 to 70 per cent.

CHAIR—What do you mean by net? Net of what?

Ms Smith—Net of taxes.

CHAIR—Nothing else?

Ms Smith—And transfers, including the pension arrangement. For lower income people the target may need to be higher than that 70 to 80 per cent. For people below or just above average weekly earnings, we may need to go for a higher target than 70 to 80 per cent just for the commonsense reason that there is a flat level below which it becomes very difficult for people to operate.

It is important to understand the parameters that we are saying that within. We are saying that the tax rates are the same—the status quo—as of now. Part of the complications with the Treasury projections were some of the assumptions around the tax rates going up in later years so that people on average weekly earnings were on the highest marginal tax rate. Also in our

comparisons, we compare to the first year of retirement expenditure, not an average over retirement.

CHAIR—We are looking at replacement rate. Can we focus on that?

Ms Smith—It goes to the replacement rate because we are looking at the replacement rate in the first year of expenditure, not a replacement rate compared to an average over retirement. I think it is important also, in looking at those replacement rates and the sensitivity assumptions in terms of growth and those other scenarios, that we assume a relatively conservative assumption of those other parameters so that we are not being overly optimistic about what people might be able to reach. With that, I think it is fair to say, and both Treasury and ASFA figures in terms of those replacement rates show, that nine per cent SG generates retirement income that is 10 to 20 percentage points below the replacement targets so, whichever way we cut it, that is the bottom line.

I want to clarify a couple of points in terms of the actual figures. While in public policy terms I think it makes sense to look at replacement rates—as I said, our target is 70 to 80 per cent on average and higher for lower income people—but percentages have very little meaning in the public arena. So in terms of getting public debate and understanding about people's need to save to do something more than the SG, it is important that we are able to convert that in a way that people can understand. That is why we took a single person on average weekly earnings and tried to translate that into a dollar amount. That is why we had the figure of $30,000 and that is where the differences—if we want to use those dollar amounts for illustration purposes—between the ASFA and the Treasury models become important and where which is the deflator becomes important. ASFA and the Institute of Actuaries both point to the importance of using real wages as the deflator, not CPI. I point out that it was for a single person on average weekly earnings that we were saying an immediate target of $25,000 moving to $30,000 in the long term in today's wages is the important target. For a couple, we acknowledge that there are some economies of scale that are probably operating so it would not be as simple as saying $60,000. The stories that we were presenting in both the replacement rate and the absolute figures present much the same bottom line—in that, at the moment, as our policies are set, we are not going to meet an adequate retirement figure.

The other point I want to make is in terms of those scenarios—the 70 to 80 per cent. I think Vince is right: we must get a consensus on the target. It is a target assuming home ownership for most people. I think the only changing parameter is that people are now retiring expecting to be more active in retirement and they will have a longer period in retirement than previous generations. That will be pushing up people's needs and expectations during retirement rather than the more passive arrangement that we had.

I have just one other point to clarify. We set the $30,000 figure as the target in terms of absolute dollars. In setting that figure we looked at people's expectations. That was one part that we looked at. The other very significant thing we did while looking at that figure—not just expectations, which can often be overoptimistic—was to look at the ABS household expenditure figures and what the different levels of actual income bought in terms of energy costs, health and general lifestyle.

Mr Wells—The Department of Health and Ageing does not have a view on the figure—that is not work that we do. Our involvement is in the relationship between health care needs and aged care needs. Of course, currently they are financed through a different system than the superannuation system. That is an issue that I gather will be up for discussion.

Senator SHERRY—For those who have a view, is there any person who holds a different view about retirement replacement rate—gross or net?

Dr Knox—I would like to expand on Vince's view. The 70 or 80 per cent is a good target, but we should recognise that it will not be a constant over different income levels. This has already been indicated. At lower income levels, where we will have lower home ownership on average, I would say the target should be closer to 90 per cent. At high income levels—shall we say three times the average wage—we could be looking at a 60 per cent to 65 per cent target from the system. Remember that many people at high income levels will have wealth and assets outside the super retirement income and pension system. So I think that rather than saying the target is 70 per cent to 80 per cent across the board, I would see a declining target with income rising. Seventy per cent to 80 per cent is around the middle, but 90 per cent at low incomes, perhaps declining down to 65 per cent from the system at high incomes.

The other point I wish to make is that we need to recognise that even within the system and within the average there are individual circumstances. Whilst 65 per cent to 90 per cent is a good band to look at, there needs to be flexibility within the system to recognise changing circumstances, different family household make-ups et cetera.

CHAIR—Coming back to the Department of Health and Ageing, do you have a percentage of the 70 per cent figure that we are talking about—it could be higher—that will go towards health care needs and ageing costs; that is, those costs particularly associated with the ageing process? Are we talking about 20 per cent or 30 per cent?

Mr Wells—No, Senator, we do not. The current financing of health comprises roughly 70 per cent public and roughly 30 per cent private. The private component is made up largely of funding through private health insurance. In terms of the publicly funded component, there are some services for which people will pay out-of-pocket expenses—medical services or pharmaceutical benefits—but there are in operation safety nets which apply across the board. We have not done any modelling on the proportion of the 70 per cent which would be outgoings for health or aged care services.

Ms Bailey—I support what Mr Wells said about the funding of the aged care sector in particular. I do not have the percentage breakdown, but people who can afford to make a contribution in the Commonwealth funded aged care sector do. For other people, the Commonwealth largely funds that.

CHAIR—In terms of integration, we will be looking at that separately. In terms of adequacy, given the very high proportion of costs associated with the latter years of life, I thought there might be some contribution.

Mr Lewis—The institute has not done any particular modelling in this area yet. We recognise that it is an area that needs work. We do not have any specific conclusions that I can bring forward at this stage.

CHAIR—Mr Maroney, thank you very much for the work that you did on the report.

Mr Maroney—It was my pleasure.

CHAIR—Do you wish to comment on matters that have been raised?

Mr Maroney—On the adequacy questions?

CHAIR—Yes.

Mr Maroney—I support the general range of 70 per cent to 80 per cent, as is included in our report, as the net replacement level. Again, I stress the need for higher percentage replacement for lower income earners, particularly those without owner occupied housing. The variability coming from investment fluctuation, volatility and quite a range of other factors is another key issue. There will be quite a range of dispersion around the averages in this area and that is something that needs to be taken into account in monitoring adequacy at a system level and at an individual level. It is something that the complexity of the system probably works against at the moment, and I note that that is on the agenda for discussion later on. That would be the general view I have on the adequacy issues, Senator.

Mr Dolan—I do not wish to join the debate over the numbers and what the replacement rate should be in numerical terms. I note that the income at retirement will depend on a combination of the time during working life that you spend in employment, the amount of money you earn while working, how much saving you undertake while working and the time you spend in retirement. All those things will govern the capacity to fund retirement income. I note that 50 per cent of people coming on to the aged pension do so from another income support payment so their capacity to earn income for their retirement is reduced.

I would like to make the overarching comment that setting targets may come at a cost for people throughout their working lives. If you set a savings target that produces a retirement income that may be higher than otherwise, that may come at a cost to consumption while in working life and it may affect the capacity to purchase a house, put children through school and all of that. I am just making the general point that retirement income targets need to be set in the context of people's life cycle and that we need to take a reasonably broad approach when looking at retirement incomes.

CHAIR—Do you think people will exercise that degree of discipline in terms of the alternatives? Won't they put priorities on educating their children rather than saving for retirement?

Mr Dolan—Certainly a lot of people come on to the aged pension owning their own homes. So people have, throughout their working lives, put that discipline into purchasing a house, which is one form of saving. People obviously invest in their children in other ways. Not to be too definitive about it, people do make choices about where to put their funding. For a lot of

Australians, saving to purchase a house is the largest form of saving that they make. So people do look at some alternatives.

Senator SHERRY—The system, Mr Dolan, is still underwritten by a compulsion for retirement income isn't it? Taxes pay the aged pension, SG and employees' superannuation. Without that, do you think people would do it?

Mr Dolan—That is hard to say. I was just making the case that when people are making decisions with respect to additional savings over and above those that are prescribed by the superannuation guarantee they are making some decisions to save and that prescribing additional saving on top of the saving they already make may come at a cost in terms of funding other forms of activity. That was the point I was trying to make.

Senator SHERRY—I would like to inject another issue in terms of adequacy. I assume that, when they are talking about adequacy, everyone is talking about at age 65. Some Europeans have state pension access below 65, which has added to pressure. But I assume we are talking about 65 here. It is discretionary whether you wish to work beyond the age of 65, for whatever reason, but the goal should be at 65. There have been some comments in this debate that we should increase the retirement age, which I am personally opposed to. But do people see that as a solution? Sweden and the US are upping the retirement age to 67 over time. Does anyone have any comment about that?

Mr Dolan—Giving people the flexibility, if they wish to do so, to make a transition from full-time work to part-time work at an age that might traditionally have been regarded as retirement provides people with the capacity to supplement their incomes past the age of 65. That provides people with an alternative. Some, but not many, people in the over-65 age group do engage in work activities, so we have, as we called it in the initial submission, a fourth possible pillar to the three-pillar superannuation system, which is working beyond traditional retirement age. If people wish to do that, they can.

Senator SHERRY—If they have not reached whatever the replacement rate is—65 per cent at 65 years—isn't it implicit that they will have to work longer in order to reach their retirement income goal? You talk about choices and flexibility, but is that not the reality for people who do not reach a comfortable retirement income by age 65?

Mr Dolan—Other speakers this morning have indicated that circumstances in retirement need to be determined on a case by case basis. If we set a target of X per cent of income, this being the retirement income goal, that target will not necessarily be for everybody. Some people, even if they are in a variety of circumstances, may wish to supplement their retirement income. So it is hard to say that, if you are below a certain amount, you will have to work. Ideally, people will be deciding whether they wish to supplement their income. They may wish to work for other reasons—for example, personal satisfaction to be gained from work.

Senator SHERRY—I understand that, but the concept that you work until you drop dead seems to be emerging—that is, if you have not got sufficient at 65, the theory is that you will work until you are 75 or 80. We seem to be getting the infusion of this concept that the choice on flexibility is that if you don't get there at 65, you'll work until you're dead. It is a pretty fine balance. It is a pretty harsh alternative that some people are going to face, isn't it? I do not want

to personalise it, but you and I are fine; we will be there at 55. We know the Public Service requirements; we know the politicians' requirements. But it is not a particularly edifying goal or prospect if people have to work until they drop dead, is it?

Mr Dolan—At the end of the day, people will make choices in terms of the income they wish to have in retirement. The government provides the age pension as a safety net for people, to support them in their retirement. The superannuation guarantee provides people with a minimum standard of saving in the form of superannuation. People will look at it as a voluntary retirement saving beyond that. People will make their decisions at 65 as to whether they wish to seek to continue working, based on their personal circumstances.

Senator SHERRY—But should 65—the system having provided through compulsion and incentives, to whatever degree people pick that up—be the age when people, if they wish to retire, are able to retire?

Mr Dolan—That is a very broad question. The system has been designed to provide people with a standard of income in retirement. Whether that is an adequate standard of income is something I do not feel fit to judge. Quite frankly, I will leave that to others. I was just making the point that some people will obviously be facing different circumstances in their retirement, or be responding in ways that suit their own circumstances.

CHAIR—We will move around the table now. Mr Stanhope, do you wish to respond to Senator Sherry's issues?

Senator SHERRY—That was covered in the adequacy topic, because I think that is part and parcel of it.

Mr Stanhope—I would like to make one comment on adequacy. We support the same targets that are generally supported around the table. Our submission indicates 75 to 80 per cent. One of the things we would note in the modelling is that—

CHAIR—Just a moment—I am giving you the call only to answer Senator Sherry's question; otherwise I will go to Ms Rubinstein and then move around the table.

Mr Stanhope—That is fine.

CHAIR—Dr Knox, do you want to address Senator Sherry's issues?

Dr Knox—I think the whole concept of retirement age is a bit outdated. Whilst the system can have a target of 65, which is when the pension cuts in, we have social security before the pension for a variety of reasons and we are seeing people in much more flexible employment conditions both before and after retirement, so the concept that we are all going to retire at 65 is not going to happen and is not happening now. The whole labour market is changing and will continue to change. In my view, more and more people will look for part-time work in their 60s. We need to encourage that. I do not support the work till you drop dead concept but I think we need a system that has a flexible approach to retirement. I would not endorse the idea that 65 is the retirement age. I would endorse a system that encourages people to respond to their individual circumstances and encourages and forces saving so that they have a reasonable level

of retirement savings in their 60s, but some people will continue to work after that. Some people will not work after that, depending on their health, individual circumstances and all sorts of factors, but to say that the retirement age is 65 is outdated and not the way we are going forward.

Ms Wolthuizen—It is certainly desirable to have a level of flexibility that enables people who wish to phase their exit from the work force to do so. But it would be very concerning, having introduced superannuation and encouraged the Australian working population to either make voluntary contributions or support the system, to tell them that they are going to have to keep working beyond an age at which they could reasonably have expected to retire simply because the funds will not be there to enable them to exit the work force at an age when they might wish to do so. I think they would reasonably draw the conclusion that they have been sold a pup and would have preferred to have drawn on the funds that they have put away for retirement to fund other expenses throughout their working life—for example, their mortgage or the education of their children.

CHAIR—Dr FitzGerald, in responding to the age issue would you also respond in terms of the implications for the age pension if a retirement age of 65 is deemed to be outdated, as somebody has said today.

Dr FitzGerald—Responding first to Senator Sherry's points, I agree with David that the notions of a hard and fast retirement age and working till you drop are not where the concerns are. We have seen over the last four or five decades—since World War II or perhaps a little later—an enormous drop in the total number of mature age people in the work force, particularly older males, to the point where the retirement age is nowhere near 65. It is down to an average of about 58, although an optimist could see in the very latest data some signs of the trend having stopped and possibly turning around.

Senator SHERRY—Are you an optimist?

Dr FitzGerald—I am, actually. The issue at the moment is not that people are being made to work till they drop. In the most recent survey of retirement and retirement intentions that I have seen, which was done several years ago, two-thirds of males who retired before the standard retirement age of 65 did so involuntarily. They were not all sacked—some were no longer able, because of medical problems, to work in the area in which they would have liked to work had they not had those problems—but they left involuntarily for one reason or another.

If you bring into it anecdote rather than the slightly hard fact of surveys, there is a good deal of evidence that, before very long, people who retire early miss the milieu in which they spent most of their lives. Many of their friends, relationships and so on were at work. There is, in other words, considerable interest in the community in being allowed to work longer and not being penalised for it. It does not mean that people should be forced to continue involvement in work until a very late age but the issue at the moment is really the other—being allowed to and not being penalised for it.

In my view there is a huge amount at stake for meeting the future needs of the community in facilitating that movement of people remaining in the work force on a part-time basis. That does not mean part-week every week; it might mean part-year or something flexible. If you, one way

or the other, got the retirement age back up to around 65, instead of a bit short of 60 on average—if you imagine that coming about in dribs and drabs over a quarter of a century from now—the GDP, on a lot of reasonable assumptions about other things being equal, would be about one-eighth higher. That is an enormous amount of resources that would be available to meet expenses in old age of all sorts. To the extent that it would be voluntary and people wanted to continue to work part time in such a movement, it would be unambiguously positive. Things that you cannot value, like still having contact with your mates at work and all that, would be wrapped up with it.

In my opinion, when thinking about adequacy one should think about making it possible for people, at least for a long stage of early retirement, if they want to, to supplement their income from the system from involvement in work without undue penalty. It does not mean that they do not pay anything on income they earn, of course, but certainly harsh penalties in terms of the social security system or the tax system should not apply. There are many rigidities in legislation including superannuation that define retirement as a one-way trapdoor—you are either in work or you are retired—and if you are in one category you cannot touch it, and if you are in the other category, some equally rigid things apply to you. Getting that set of issues into the adequacy debate generally is quite important.

Ms Smith—We agree that there needs to be increased flexibility and encouragement of people working post that official retirement age, and that is important. In terms of setting public policy arrangements for adequacy, it is important that the age of 65 is the general working age that we are working to. In terms of the current work pattern arrangements that we have in the work force—that is, the interrupted work patterns that people have—we assume that on average people have no more than 30 years in the work force for that accumulation to happen. If you look at average work patterns you will see not only an interrupted arrangement but also that, increasingly, the average number of years in the work force is 32 years for men and about 28 years for women. For public policy purposes, having, on average, 65 as the retirement age and 30 years in the work force are probably not bad parameters to work to. I note that many people, as has been indicated, involuntarily or voluntarily retire prior to age 65, so these are obviously issues that we need to deal with.

Ms Rubinstein—First of all, on Senator Sherry's issues: the idea of compulsory retirement at 65 has probably gone, partly because of changed behaviour—people do retire earlier—partly because of antidiscrimination principles which mean that the idea that you can force someone to retire at 65 purely on those grounds is no longer acceptable, and probably partly because of the preservation age of superannuation being less than 65 and the preponderance of early retirement arrangements under public sector and other defined benefit funds. The reality is that, although a lot of people want to—and do—continue working, particularly part time or on some sort of consultancy basis after 60 or 65, those opportunities are probably more available to those who need them less. The people who have done primarily physical work or relatively unskilled work are going to find it much harder to find work, not over the age of 65 but probably over the age of 50, 55 or even younger. That is why we see the large proportion of unemployment which occurs amongst men of that age, particularly those in physical and blue-collar occupations, although it also affects others. So although the idea of working part time, especially in retirement or after the age of 60 or 65 is a good one, it cannot be built into a model of retirement. If anything, it has to be possible for people to access those benefits, certainly from age 60 if that is necessary.

On the question of adequacy, like everyone here, we would have no disagreement with both the dollar targets and the replacement level targets. The issue for us has always been: 'Well, what do you need to get there?' I suppose it is analogous to saying that we talk less about the living standards that workers need and more about the actual amounts of money that people are seeking. In that sense, we have supported an objective for superannuation of 15 per cent as the minimum mandatory contribution level, leaving aside from where that comes. We have supported that for some time, and most certainly since the co-contribution scheme which the previous Labor government adopted but which has not been continued as a policy by this government. That is the particular interest that we have: is 15 per cent the right amount?

Certainly, at much higher levels of income, that may be less of an issue. But as far as lower income workers are concerned, there are two issues that we think need to be taken into account. One is the point that has already been made—that the needs of low income workers are going to met by a higher replacement level in retirement, simply because there is a floor to that. There is a basic level of financial support that all people will require in retirement. But the second issue is that, for low income workers, for relatively unskilled and blue-collar workers, the availability of full-time work and permanent work is declining all the time. Workers are increasingly finding themselves in casual employment, in intermittent employment and in part-time employment—sometimes voluntarily, but this is increasingly not the case. Increasingly, casual work is becoming the norm in traditional male blue-collar occupations. By its nature, casual work is going to be somewhat more intermittent than full-time work. For that reason, for those lower income workers, the need for higher provision for retirement is going to be even more critical. It is why we think that 15 per cent by and large is going to hit the target, although that is something that we would be keen to see further work done on. It is not a fixed position; if some better position was put then we would of course be more than happy to look at it.

Just an interesting and final point of information: the United Kingdom, as people may know, has introduced a system of private pensions but there is no mandatory level of employer contribution to these funds. The British Trades Union Congress has adopted a policy of phasing in 15 per cent contributions—10 per cent from employers and five per cent from employees—over a period of time, specifically based, they say, on the Australian model.

Senator BUCKLAND—Has the ACTU expanded, or could it expand, its mind a little further on that? Has there been any thought given to progressive retirement? I introduce that as another element. In 1998, I attempted to get a company to offer progressive retirement. We were caught up because of superannuation and, as it came about, a company restructure. The company is still doing well. Has any thought been given to the situation where a person at, say, age 60 starts to phase down towards retirement—maybe working three days a week—and bringing a newer or younger worker into the work force for training purposes? Can panel members answer that question?

Ms Rubinstein—We have not given detailed thought to that. If it works in the way you have described, obviously it is a good idea. When I first became involved in the trade union movement, our policy was that everyone should retire at 55 and that would create jobs. We have moved on since that time, particularly because people not only do not need to retire but also do not want to, for all the reasons that have already been described. What we are concerned about, however, would be if at a particular age there was forced transfer of people from full time to part time when that was not what they wanted. Generally, that would be accompanied by work

intensification—you can work three days a week but do the same amount of work. If it is voluntary, if it is what people want and it is associated with training and other things, well and good. Obviously that is going to depend on the nature of the employer's business, the kind of job the worker is doing and a lot of other factors, including the financial position of the worker.

Senator BUCKLAND—It throws another spanner in the works, doesn't it? What is adequate if you start going there? I guess that is an inquiry in itself for this committee. If you start going down that path—and there are some companies attracted to that—the question of adequacy broadens out.

Ms Rubinstein—The other thing you cannot assume is that if somebody goes to three days a week—60 per cent of their full-time wage—that is going to be enough for their retirement. Often people's work will become more intermittent for a short period before they retire, for all sorts of reasons, including health reasons. But it does not mean that that can be their final income for what is required for 20 or 25 years of retirement.

Mr Stanhope—This is a classic example of one of the rigidities in the system. If you were to take progressive employment from one employer—that is, to go part-time, intermittent, casual, project or however you did it—you could not draw on your superannuation because of the way the release of benefit rules are written.

Senator BUCKLAND—Yes, but that would factor into your superannuation, wouldn't it?

Mr Stanhope—But if you went to another employer after age 60, you could. The problem is that you cannot draw down the benefits that relate to an employment that is continuing, and the SIS rules make no provision for the nature of that employment changing. It is a classic example of the presumption that we are all males who work for 40 years and who retire once, on a day we know in advance.

CHAIR—Ms Wolthuizen, do you have any comments on adequacy generally?

Ms Wolthuizen—They would be the comments I made earlier about the expectations of consumers.

Mr Brake—As we noted in our submission and as you would be aware, the government has not set an explicit benchmark target—which has been the focus of a lot of discussion today. Also in our submission, we made the point that individual circumstances matter and that what might be considered an optimal replacement rate is likely to vary from individual to individual. We have talked about a couple of significant issues there. One is housing and whether or not people own their own home. A substantial number of people who do reach retirement do own their own home. Another issue of course is the cost of raising children. That can be quite significant right across, from low income to high income people.

On the outcome of the superannuation guarantee system, a comment was made that nine per cent SG would fall 10 to 20 percentage points below an ideal target, which I think was in the range of 70 to 80 per cent but varying. There was discussion that it might vary upwards for low income people. The Treasury modelling finds that for a person on median earnings—that is, the 50th percentile: half the people below, half the people above—after 40 years SG in conjunction

with the age pension will give a replacement rate of 82 per cent. The other factors which have been briefly spoken about today—

Senator SHERRY—Mr Brake, is that assuming everyone makes a total conversion of their lump sum to an income stream?

Mr Gallagher—On that particular assumption, we have done a large variety of runs for the committee. I suspect that example was a lump sum drawn down in an annuity pattern.

Senator SHERRY—A total lump sum draw down as an annuity rather than someone taking part of it or the whole of it and spending it?

Mr Gallagher—That is correct—no dissipation.

Senator SHERRY—That is not the case at the moment, though, in law and in terms of outcome, is it?

Mr Gallagher—Many people will choose to make an initial set of expenditure when they take a lump sum. They will fix up their car, they will fix up their house, they will get a new fridge and they will set themselves up for retirement.

Mr Brake—Many people, of course, will have savings outside of the superannuation system. For low-income earners, those might be generally relatively modest, but some of them will have some savings outside the system. So this is a hypothetical; it is illustrative. We have spoken about housing, and housing would be separate from that. We have not spoken that much about voluntary savings and the considerable concessions which are afforded to people who do wish to derive higher replacement rates than they can earn from the SG system alone. There are quite significant concessions available to those people. A point that has been briefly touched upon is the trade-off between present consumption and retirement incomes. When you are talking about higher SG arrangements and so on, if you think that the incidence of that falls on employees then you are providing higher incomes in retirement by trading off lower income in the pre-retirement phase. Those are some comments that I thought I would make at this stage on the outcome of the SG system.

On the subject of replacement rates, Treasury considers that a percentage replacement rate based on pre-retirement expenditure is preferable to a dollar amount. In this type of analysis, we noted that a $30,000 figure gave a replacement rate of 114 per cent for someone on median earnings. Clearly that would be considered suboptimal for a number of people. In terms of the retirement age, Senator, you talked about the age of 65. The government has introduced a number of initiatives which have increased the flexibility in the system. The SG age has been increased and in this year’s budget the age at which personal contributions can be made has been lifted to 75. These initiatives also provide capacity for those people who wish to do so to continue to contribute to superannuation and to build up their retirement incomes.

Mr Gallagher—I would like to make a couple of comments in regard to the measurement of adequacy and how we should go about that. As our supplementary submission and as our original submission to the committee noted, we favour a replacement rate calculation based on expenditure and we are pleased to see the Institute of Actuaries also using that measure. It is

very important, however, in doing the calculations that we work out for whom we are doing the calculation. Age 65, I think, is an appropriate age because it is age pension age. There is a divergence between age pension age and retirement age. It would seem that, with 50 per cent of people accessing an age pension coming over from other social security payments, we do not have upward pressure in terms of work force behaviour on age 65.

It would seem to me that the replacement rate calculation should be for a person on median earnings if we are looking at the replacement rate of the superannuation guarantee. Seventy per cent of employees earn less than average weekly ordinary time earnings or male total average weekly earnings. The median wage, which is in the order of $33,000, is a more appropriate place to calculate a replacement rate for a superannuation guarantee case. I will take you back to the situation that we had in 1986 when we had just under 40 per cent of the population already covered by occupational superannuation. Those higher income people that already had occupational superannuation continue to have, by and large, superannuation arrangements which are more generous than the superannuation guarantee. In doing examinations, I think we should look at something slightly less than the average weekly earnings.

Senator SHERRY—Should that apply to tax cuts which boost final retirement savings that concentrate on those earning less than the median wage—the 70 per cent?

Mr Gallagher—I am talking about where we should look in terms of who is being impacted by the superannuation guarantee in order to look at the replacement rates given by the superannuation guarantee.

Senator SHERRY—I thought you would say that! But I thought I would ask anyway.

Mr Gallagher—Our submission notes that the superannuation guarantee, for someone on median earnings, can give a replacement rate of 72 per cent after 30 years of contributions and 77 per cent after 40 years. In this case I suspect that the difference between that and Roger's 82 per cent is that both of these numbers are for someone with a woman's life expectancy and therefore a longer life expectancy. The 77 per cent is also for someone retiring in 2032.

In terms of how it is calculated, we generally have a preference for looking at the average over all of retirement rather than the first year of retirement. The reason is that in RIM we can look at situations other than someone who has taken an income stream which is asset test exempt. Whenever you are looking at someone who has been affected by the asset test, the effect of the asset test will be stronger in the first year and then, as their assets are drawn down, their retirement income will improve over the course of their retirement. Therefore I think it is useful certainly to look at both the average over all of retirement and the first year of retirement. The other reason I think it is important to look at the average is because we have a policy under which the age pension is indexed to the higher wages or the consumer price index. In actual fact, the age pension in real terms tends to go up each year. It is useful to reflect that in any retirement income calculations.

As far as the dollar target is concerned, although the government has not set a particular dollar target, to me there are some that would appear to be inappropriate. Thirty thousand dollars represents a replacement rate of 88 per cent for someone on AWOTE, as the actuaries have noted, and represents a replacement rate of 114 per cent by someone on median weekly

earnings. As such, it is well outside of even the replacement rates that many in the industry would support. We have general issues with the use of the expectations of people, before they retire, about retirement incomes in terms of setting the replacement rates. RIM has found, in looking at retirement intentions data, that people who have not retired and are well away from retirement do not have realistic expectations about retirement incomes. Therefore, we have some concerns about setting any target based on the somewhat unrealistic expectations of those well away from retirement. You may get somewhat more realistic expectations if you looked at the retired themselves.

On another issue, which is the way of presenting the dollar amounts, we would say that in looking at the issue of adequacy we should have measures which allow us to see that the real incomes of the retired do get better each year, as well as the replacement rates. Therefore, in looking at replacement rates in retirement incomes, if we are looking at an expenditure measure of the replacement rates—which I think most people have supported—we would say that the appropriate way to deflate an expenditure measure is the consumer price index, because all we are looking at is consumer expenditure. Therefore there is value in looking at an absolute measure of retirement income as well as the relative. There are certain problems with looking at only a relative measure of retirement income. For example, if you take the framework which ASFA has proposed—which is wage deflation and which has support from the Institute of Actuaries—it would give the result that if the real wages of workers went down, their standard of living would not be affected. I think many people in this room would be rather surprised by the conclusion that if, in general, real wages went down the standard of living of the community would not be affected, but that is the consequence of using a measure which uses wage deflation.

Senator SHERRY—But how real is it that real wages will go down? Are you suggesting the age pension should go down if real wages go down?

Mr Gallagher—No, I am not, because, as I have said before, the government policy is that the age pension is indexed at higher wages. What I am saying is that wage deflation—

Senator SHERRY—When have real wages declined? I accept that it is a legitimate criticism but how often does that happen?

Mr Gallagher—It can happen in periods of very high inflation.

Senator SHERRY—But should we base policy projection on real wages going down?

Mr Gallagher—We have not based policy projection on real wages going down. I am just pointing out the problems in not recognising the improvement in real living standards which occur as real wages rise.

Senator SHERRY—But surely the underlying policy parameter should be that real wages will go up?

Mr Gallagher—Yes, and that reflects an improved standard of living. We think that the measure that is chosen should reflect the improved standard of living of both workers and the retired. That is the approach we have taken in the presentation of Treasury modelling.

Senator SHERRY—Mr Gallagher, notwithstanding the differences that have been argued about, even on the figures that you and Mr Brake have used—40 years median income—is there not a very substantial group of people who have been in compulsory superannuation only since the late 1980s and who are now at nine per cent for whom the average will be far lower than nine per cent? I am specifically talking about people who are generally over the age of 40—the baby boomers. They comprise 27 per cent of the population—not an insignificant figure. They are going to fall short even of your projections, aren't they, because the reality is that they have not been in the system long enough?

Mr Gallagher—The Treasury submission shows the replacement rates of workers gradually rising over a period of time, so it does show that effect. As I said earlier, back in 1986 some 60 per cent of employees were not covered by superannuation, so 40 per cent were covered by superannuation. When superannuation was introduced it came in at three per cent, so we had three per cent for that body of workers up until—

Senator SHERRY—I am not disputing that; I think we are all aware of that history. But is it not true that, if we assume 40 years median income, those people currently over the age of 40—the baby boomers—are not going to make it? How can they? If they are on nine per cent now—

Mr Gallagher—The policy is aimed and was always aimed at better incomes in retirement. If you look at the Brian Howe and Paul Keating policy statement from 1989, which set the framework for the superannuation guarantee, you will see that that has always been the objective. I have no doubt that we will be achieving better incomes in retirement over the intervening period.

Senator SHERRY—That is not what I asked. What I asked you to confirm for me is that a substantial proportion of the Australian work force currently over the age 40 will not meet the figures that you have outlined. That is the median 70 per cent earning less than median income. They are not going to be in the system for 40 years, are they? It is impossible, because they have not been in the system for that long.

Mr Gallagher—No, and you would expect in that situation that replacement rates will be lower than in the 30-year case that we have analysed.

Senator SHERRY—Thank you. That is what I am interested in analysing. What about the people who are not going to make it, even based on what some would say is a conservative estimate from Treasury? What about the self-employed?

Mr Gallagher—Self-employed coverage appears to be perhaps higher than I originally expected, if you look at the survey of employment arrangements and superannuation. In any one year the tax data suggests that about 25 to 30 per cent of the self-employed are making contributions.

Senator SHERRY—At what level?

Mr Gallagher—The levels vary.

Senator SHERRY—Obviously they will vary, but do we have an average?

Mr Gallagher—I do not think the average is useful because we get many people with very low taxable incomes making sizeable contributions.

Senator SHERRY—That is not what I asked. Do we have an average?

Mr Gallagher—No, I do not have one readily available.

Senator SHERRY—I would appreciate it if you could get that and give it to us, because I cannot find it and we have searched high and low.

Mr Gallagher—On the basis of the survey of employment arrangements and superannuation we would expect that in excess of 50 per cent of the self-employed have superannuation assets. Obviously, there may well be a pattern where people make superannuation contributions in years that are good and maybe not in years that are not so good.

Senator SHERRY—So we can identify some groups that are not going to make the figures that you referred to earlier—a proportion of those who are employed over 40, whatever that is, and some self-employed. What does your research show about women making this figure that you have outlined to us?

Mr Gallagher—Many women are working casually and part time. There is an issue, therefore, about how you should calculate the replacement rate for someone who is working part time. In our aggregate work we have looked at this issue. In fact the replacement rates for women are higher than for the general population. The replacement rate of disposable income from working is higher than for the general population but it is a replacement rate at a lower level of income because the earnings have been part time.

Senator SHERRY—Going back to the issue of income streams that I referred to earlier, why would anyone take an income stream when the first $100,000-odd is tax free?

Mr Gallagher—From a lump sum? Anyone has the option of taking out their post-1983 component and then taking an income stream with the remainder.

Senator SHERRY—We will get on to that later.

CHAIR—I am concerned about some of the other witnesses.

Senator SHERRY—I just wanted to broaden the conversation out at this point.

CHAIR—We will have that opportunity once we have been right around the table.

Senator SHERRY—I am interested in what people perceive as the way to deal with the problem of the over-40s, the self-employed and, I think, some women who are not going to make the Treasury benchmark.

Mr Gallagher—I do not think the Treasury has set a benchmark.

Senator SHERRY—You have not?

Mr Gallagher—We have done a wide range of hypothetical cases. In order to present consistency with some of those modelled by the industry we have done it along similar lines.

Senator SHERRY—Well, take what I call a benchmark. I have taken your assumption of nine per cent SG, and 40 years median earnings. That is what you have outlined to us and that is what you have emphasised.

CHAIR—Senator Sherry, we are being quite unfair to people like ACOSS who have not yet made a general comment on adequacy. I think we have to give everybody an equal opportunity before we come back to—

Senator SHERRY—But Mr Gallagher is particularly important in this debate, as he well knows.

CHAIR—We always welcome Mr Gallagher's contributions. Ms Doyle, do you have comments on adequacy generally?

Ms Doyle—Most people have already touched on a lot of the issues. AMP certainly has similar opinions about the targets that have been established. The concentration on baby boomers is appropriate because it seems from most of the modelling that the younger cohorts are better accommodated in this system. You have to make the assumption that this is a very young, immature system—it has only been around 10 or 12 years, depending on when you start this—so if you have not been in the public service or you have not been lucky enough to be in a corporate defined benefit plan then the superannuation guarantee is what you are going to be relying on. How that pans out for you is important, particularly if you are a baby boomer who has already reached the age when you can access your superannuation. Some focus on baby boomers is definitely appropriate.

In relation to the payout phase, we are of the opinion that a lot of attention has been put on accumulating the money. You now need to start focusing on how the money is drawn out and how it is taken. You also need to look at the benchmarks in terms of whether we are looking at a first year payout or at the target over life expectancy—or even further than that, taking into account life improvements and those sorts of things. So we certainly need to look at the form of income stream.

I would also like to point out that, from our rough figures, of the money that came out of superannuation last year—money that was paid out—only 30 per cent ended up back in income streams. Ninety per cent of that ended up in allocated pensions, not the life expectancy pensions that are usually used as modelling. That is quite reflective of what people are doing at the moment. Depending on your assumption about how people are taking the money, you need to look at the figure people need to take. If you are looking at a first year payout, you can do that on much lower money as a lump sum. If you are looking at life expectancy or further then you obviously need to accumulate a little bit more. I think that is an important focus when discussing adequacy.

CHAIR—Could you repeat those payout figures from AMP's experience, to make sure everybody got the significance of them?

Dr Knox—You mentioned 30 per cent. Is that 30 per cent of the AMP money paid out?

Ms Doyle—No; that is looking at the industry.

Dr Knox—So it is not just AMP—it is across the industry.

Ms Doyle—It is across the industry. There is no doubt that ability to work part-time, particularly for baby boomers—and Simon Kelly can probably add to this, because he has just done some research on it—is not only a labour force issue of trying to get employers to engage older part-time workers but also an issue of the interaction of social security, annuity tax and income tax, because they interact in lots of strange ways to be quite a disincentive to being a part-time worker. That gets quite technical and is certainly not for debate here but, if you want to encourage people to work part-time, there needs to be a real focus on trying to harmonise those things. Anecdotally, financial planners tell us that self-employed people are quite happy to contribute up to the tax-deductible limit, which is now $5,000. That seems to be the general theme amongst self-employed people.

Senator SHERRY—Do you have any idea what that is as a percentage? Some people love talking in percentages and money terms, hence my question to Mr Gallagher about the average level of percentage contribution from the self-employed.

Ms Doyle—I do not know what their income would be, so any percentage—

Senator SHERRY—It would be useful if you could get some material on that.

CHAIR—Mr Stanhope, would you like to respond on adequacy generally?

Mr Stanhope—Our adequacy target is much the same as everyone else's: 75 to 80 per cent of late working life consumption expenditure. One comment I would make—and Phil Gallagher alluded to this—is that, when we look at what we are replacing, taking a retirement life average tends to overstate the income early in retirement. I grant his point about people who are subject to the asset test but, for the vast majority of people who are not, the indexation of the age pension effectively pushes up their lifetime income, and so taking an average means overstating their early retirement income. That is quite a critical point, because what we are really talking about when we talk about adequacy is aspirations—how people expect to live. Many people around this table have made that point in this debate. It is one that the emphasis on dollar figures tends to walk away from, and I think it is important. People expect a standard of living in retirement and that is the critical point in the argument about which deflator you use. If you use an earnings deflator rather than a price deflator, you bring in increasing standards of living—unless of course they fall, but I do not think they are going to. We do not believe that nine per cent will deliver adequate retirement incomes, because we do not believe that they will meet people's reasonable expectations—and we are not talking about ridiculous expectations.

Leaving that debate aside, we think it is important to start looking at people who do not make 30 or 40 years in the work force at average weekly earnings and at what we can do in that

environment. In some ways we are talking a little about the second pillar of compulsion here but a lot about the third pillar of voluntary savings and incentives for that. There are four things we need to look at there. The first is a little more flexibility. We are talking about a lifetime savings arrangement, yet the system—partly because things are based on income tax, which is annual—is riddled with annual arrangements. So in our submission, for example, we suggest doing away with the age based contribution limits in favour of possibly a better worked but certainly a lifetime contribution limit, which is what we favour.

Also in that flexibility area, we believe very strongly that we should do away with the employment nexus on voluntary contributions altogether. I think we made the point in a recent *Super Review* article that that would leave us with only three contribution categories, which would be mind-numbing simplicity for superannuation—something I suspect that none of us expect to see in our lifetimes. Thirdly in the area of flexibility, we need to look at what is going on in the work-to-retirement transition and the stupid rigidities in the rules. They are not stupid in a sense; they are historical. They came from the Occupational Superannuation Standards Act. They have transferred into SIS, and nobody has sat down and said, 'How do these work with the actual work-to-retirement transition of real people?' We have listed a raft of those in our submission, and so I will not take up much time here, except to say that, in terms of drawing into part-time work, intermittent work—any of those things—as people's expectations of how their later life working experiences are going to be get interrupted by the hard reality of it, there is not much they can do under the current rules. You can be forced to cash out over 65 when you do not wish to. Some of our members have Superannuation Complaints Tribunal cases about that and the way that APRA interprets those rules, for example. So there is plenty to do there.

In terms of the third pillar proper, we have released some research and spoken to the committee about the possibility of expanding the co-contributions measure. In the attitudinal research that we commissioned through Eureka and that Dr FitzGerald released at our conference, we found there was quite an opportunity to get a serious bang for your buck, if you like, in co-contribution rates that were less than dollar for dollar—which was in some ways surprising. But certainly there are plenty of places to go there, and we have provided our research to the committee.

On the tax side, we are particularly energised by the impact of the surcharge on older workers with low balances. Senator Sherry, this gets very close to your concern about baby boomers. We have presented evidence to you that shows that, although obviously no-one knows how much super each person has got, because that information is not aggregated until you—

Senator SHERRY—Except that my concern goes to the general tax burden for over 40s, not just the surcharge tax burden.

Mr Stanhope—I understand. We have produced evidence that shows that it was hitting in some very inappropriate places, if you are talking about a lifetime accumulation. We showed workers who were paying a significant surcharge on accumulations of $40,000 and less. That goes to a general solution that looks a little more at the lifetime side of things—which means you may need to start looking at how much superannuation people have, before you start talking about taxation and other measures.

Lastly, we need to improve retirement income streams. Last year, we did some groundbreaking research which looked at what people were trying to achieve through retirement income streams and what was driving them in terms of their decision making. We were particularly interested in that because there are heavy distortions in the social security rules towards particular sectors of the retirement income stream market. Those distortions are reflected in the modelling that Treasury does. As Suzanne Doyle pointed out, when you look at what people actually want to buy, they do not particularly want to buy those products. Certainly, if we get, on the long term, away from interest based income streams and into income streams with a broader investment backing, we can immediately improve retirement income outcomes for older workers. That is one of the few things we can do quickly that will have an impact. Those are the four comments I wanted to make about the people who perhaps have not made the full 30 or 40 years.

I just want to make a quick comment in relation to Senator Cherry's comment about home ownership. When we did our research last year—and I will provide you with the numbers, Senator—we found that a significant proportion of people who were taking lump sums were using a fair slab of it to pay off mortgages. This is the interesting question that arises in terms of the coincidence of the start of super guarantee and the deregulation of personal finance and what that has done to mortgages. How mortgages used to work was that you had to pay them off, and so they were in a sense a form of forced retirement saving. They are no longer that. They can easily be a revolving door, and certainly it is very easy in a situation in which people find they have got consumption needs or desires late in working life to use home equity as a bit of a buffer for those sorts of things. We need to understand how that is going to impact on people's retirement incomes, because if the first call for, say, $40,000, $50,000 or $100,000 is to get rid of the mortgage, that is going to have a hell of an impact on how much is left over to purchase an income stream or to draw down in retirement.

CHAIR—ACOSS, you have been listening. Would you like to make a contribution?

Mr Davidson—I will make some comments on adequacy generally and then turn briefly to the retirement age issue. To start with the basics in regard to adequacy, the purpose of saving is to defer expenditure. We should therefore aim to achieve living standards close to those we enjoyed previously—that is the purpose of saving. For that reason, we do not find it particularly helpful to set arbitrary flat dollar benchmarks or to survey people about what level of income they would like in retirement, unless we complete the picture by also asking people about their income and living standards prior to retirement and how much of their income they think they should forgo in order to achieve a certain level of income in retirement. A retirement income benchmark should be based on a proportion of living standards over the course of working life—that is, the average living standard attained over the course of retirement compared with the average living standard attained by an individual or household prior to retirement or at least during working life.

If we go to living standards rather than income, we take into account a set of factors that are not often taken into account when retirement income benchmarks are discussed in Australia. These go to the different expenditure needs of retirees—that is, they have smaller households, they generally have lower housing costs and they have lower costs relating to employment. In regard to compulsory saving for retirement, we believe that the basic principle should be to set a living standards target somewhat below, but not substantially below, the average living

standards enjoyed throughout the course of working life. The reason for that, of course, is that people can voluntarily top up their compulsory savings and there is no point in overshooting and securing for people, through the compulsory system, a higher living standard post retirement than that which they enjoyed previously. That would be the wrong way to go in the compulsory system. If people want to do that, they can do it voluntarily.

The only research we are aware of that compares living standards, as distinct from income or expenditure, pre and post retirement is that recently conducted by NATSEM. Single people saving nine per cent of earnings over 40 years and couples with children saving nine per cent of earnings over 40 years in the case of one partner and, I think, roughly 30 years full-time equivalent in the case of the other partner—to take account of child rearing and withdrawal from the labour force—were achieving around 100 per cent of previous living standards in the case of middle-income earners and around 110 to 120 per cent in the case of low-income earners. Here I am referring to singles and couples with children. It was lower in the case of couples without children, because their living standards were relatively high during the course of working life as they did not have the extra expense of children.

We would not like to draw too many conclusions from a single piece of research. We think that more research that looks at actual living standards pre and post retirement is essential before we can progress this debate in any sensible direction. But there are some results from the study—and I am referring to the core scenario; there are a number of alternative scenarios as well—that are quite striking. One is that nine per cent looks to be about right for most in the middle, and looks to be too high for those around the bottom end. There was also previous research by RIM using an expenditure benchmark that tended to suggest that nine per cent was overshooting the mark for those at the bottom end.

In relation to retirement age, the most important comment to make is that in the coming years both men and women will retire later. Indeed, they are already retiring later than they were in the late seventies and early eighties. Male labour force participation amongst mature age workers is no longer declining in a long-term way, as it was in the seventies and early eighties. Research both here and overseas is suggesting that there was a turning point around the mid-eighties. Of course, retirement ages are affected by the business cycle but, abstracting from that, there does seem to have been a turning point in Australia, the US and a number of other countries around the mid-eighties away from earlier retirement amongst males. I would not say that it has turned towards later retirement yet, but there was certainly a flattening out. In relation to women, there is an ongoing trend towards a later retirement age and higher labour force participation amongst mature age women workers.

We have every reason to expect that labour force participation amongst mature age men and women will continue to rise in the coming years for two reasons. Looking at the supply side, most workers will be healthier than previous cohorts and they will also find that, compared to their retirement income expectations, they will not have saved enough. On the demand side, we may well face the prospect of labour shortages in the coming years, at least amongst skilled workers, which is not a prospect that we have faced for quite some time. Employers will be encouraging people to retire later, and I believe they will be offering—at least for skilled workers—more flexible working arrangements, including the option to progress to part-time employment before retirement and the option to leave employment and then return some years later.

I will stand corrected if I am wrong, but my understanding is that the current cohort of retirees—those who have retired in the last few years—were employed on average for roughly 40 years in the case of males and roughly 30 years in the case of women. I am surprised at the figures of 32 years and 28 years that were mentioned earlier, but perhaps that can be clarified. Regardless of that, it is important to encourage this trend towards later retirement and more flexible retirement, given the ageing of the population. Superannuation preservation ages are very important for that purpose. They have a significant impact both here and overseas on people's retirement decision making. Before we get too carried away with retirement ages above 65, we have to take a close look at the existing system, where the preservation age is 55. It is supposed to rise to 60, but I do not think that there are too many people in this room who will be affected by that. An acceleration of the retirement age to 60 would be a good first step. Beyond that, it seems to me ludicrous that we have separate retirement age targets or benchmarks for the superannuation and age pension systems.

Senator SHERRY—Are you suggesting that the pension age access should increase?

Mr Davidson—No, I am not. I am suggesting that the superannuation—

Senator SHERRY—When I was here earlier, I was talking about this concept that some people have been floating—not here; not that I have heard today, anyway—that you work until you drop if you do not have sufficient retirement savings, and this is a solution to the ageing population.

Mr Davidson—It is too early to judge what a benchmark should be for 20 to 30 years time, but I would be happy to see an increase in the preservation age to 60, and then progressing it further to meet the pensionable age. Those are reasonable targets for the medium term. The fact that we are so far away from that at the present time suggests to me that it is best to concentrate on that for the time being.

Senator SHERRY—Anyone born after 1960 has a preservation age of 55, and it goes up to 56 for those born in 1961 and so on. Are you suggesting that that should change?

Mr Davidson—Yes.

Senator SHERRY—Retrospectivity, in other words? People have been told that their access age is 55 or 60, depending on when they were born. Should we tighten that up? Do those people not have an expectation that that was the date at which they would have access and that is enshrined in the law and should remain?

Mr Davidson—Over what period of time is it reasonable for people to expect that nothing will change? Ten years? Twenty years? How many things do not change within that kind of time frame? I do not think that is reasonable.

Senator SHERRY—The law says that people who are currently their late 40s or early 50s have access at 55. Are you suggesting that we should change that?

Mr Davidson—Yes.

Senator SHERRY—Good luck with your suggestion, but I do not think that too many people will be thrilled about it.

Senator CHERRY—I wanted to pick up another point that Mr Stanhope made about the issue of housing and equity. I would be interested in comments from either Mr Stanhope or other witnesses on the relevance of the rising level of household debt and the rising level of house equity on adequacy. You would have to look at the experience over the last 10 years, in terms of the SG being introduced and the national savings rate falling because of the huge increase in debt, and you would have to say that it probably has been a dismal failure. I am wondering about the interaction between retirement savings, debt and housing equity and whether we should be looking at those issues in this inquiry.

Mr Stanhope—Perhaps I could start. There are others in the room perhaps better qualified to comment on the macro figures. The number that we got was part of looking at how people were planning to deal with their lump sums on retirement. There is the ABS retirement intentions survey and so forth, but we were really looking at how people were planning to set themselves up for retirement and how that was going to affect things like RIM modelling, which does not have an offset for owner occupied housing. Partly that is a conservative measure in the sense that there are significant tax concessions to owner occupied housing. A Real Estate Institute survey was done—the original survey was done by Howard Pender and the additional numbers were done by Chris Murphy of Econtech. All he did was overlay the curve of household gearing with the curve of accumulating superannuation assets. If you got the scales right, as he did, you could whack those two curves on top of each other. Nobody was arguing at that stage, given the size of average superannuation balances in, say, industry funds, that there was a causal connection. But, once you get to balances of $30,000 or $40,000 for somebody aged 45 to 50, for example, who has a decision to make about educating children or something, I think it is a little naive not to expect that person to look at their statement and look at their mortgage and go, ‘Ta dah!’ So we asked people what they were going to do. My recollection is that, of the people who were going to take lump sums, 44 per cent were going to use 29 per cent to pay off their mortgages, but I may have those figures arse about. I will provide you with the real numbers.

Mr Gallagher—I would like to comment on that issue. I think the relationship between financial deregulation, award superannuation and the SG is largely coincidental. It would be incorrect to blame the rise in household borrowing on the superannuation guarantee. If you look at the national balance sheets—which I think are the best way to look at this issue, and I also have in mind remodelling—the superannuation guarantee assets are about $75 billion. The rise in borrowing by households has been $365 billion—that is, there is a very large order of magnitude difference between what we have seen in terms of superannuation guarantee savings and the rise in household borrowings. Therefore, I think it is useful to look at the issue of financial deregulation. There are a number of factors that you think might have influenced the rise in borrowing in households. Perhaps one is that—and Bill talked about this earlier—loan devaluation ratios have changed, the need for deposits has changed and, very importantly, people have been able to borrow against their own housing equity in taking a loan. If you look at the national balance sheets, the line of housing equity and the line of rising household borrowing, they have a very similar gradient. I think it would be useful in this issue to look at the access to lending in terms of a person’s own housing equity. I will leave it at that.

CHAIR—We will stop there. After morning tea we will move to the next consideration of equity. If people want to raise questions of adequacy in terms of the headings, I will still permit that.

Proceedings suspended from 10.59 a.m. to 11.22 a.m.

CHAIR—It might be useful if I mention that the committee has received a request from the president of the Commonwealth Bank and RBA retired officers association asking us to send our report to the Commonwealth Bank's managing director. That was brought about as a result of the RBA altering the indexation of its pensions. That followed our report on public sector superannuation funds. You will recall that at the last election the government moved to twice-yearly indexation. The next significant move was the RBA's move to AWOTE and twice-yearly indexation. Now we have had this request from the CBA people to look at our report, and that is good news. The message I am trying to convey is that we hope that quite a lot of good will come out of our deliberations. We are looking at the question of equity.

Ms Wolthuizen—There are a number of issues which have been raised under this topic but I will go to the alternative savings vehicles and pick up on the topic we left off just before the morning break—that is, household debt. Certainly the impact of growing household debt on retirement income planning is of particular concern to the Consumers Association. When we look at issues around alternative savings vehicles and current consumer and investor behaviour we find the continued prominence of property in their planning, current government policy underscoring both the symbolic and actual importance of the family home, and the potential drawing of money from voluntary contributions to superannuation or from other savings to superannuation.

The debt burden is something we are seeing and certainly having reported to us, particularly where consumers are using their home equity to fund their lifestyle either through accessing a line of revolving credit attached to their mortgage or using their home as security for other credit to fund things such as school fees, health costs or lifestyle costs and thereby gradually increasing their debt burden. This is really a mentality that puts off the day of reckoning. Our theory is that that day of reckoning is retirement—that is, when the impact on the end benefit that people will receive from their superannuation if a large or substantial proportion of it is used to pay off debts incurred over the course of their working life is determined.

We think that is something that needs to be taken into account when looking at issues of adequacy. Not only that, we need to look at the kind of information that is given to investors and consumers when considering their retirement planning. Reports we receive indicate that the family home and property are still very much at the forefront of investment advice often given to consumers seeking information about what retirement planning they should undertake and how they should leverage their home equity to provide for other investments rather than looking at something that might be a bit more pedestrian but useful to them in terms of it being an attractive savings vehicle, such as superannuation. There are a whole range of issues around the nature of advice and our concerns with the advice that is given to consumers. But certainly increasing debt burden is one of them.

We are also already receiving a lot of interest in products such as reverse equity mortgages. People have heard of them operating overseas. We would expect interest in those sorts of products to continue. I think that highlights the extent to which consumers view the family

home and property as central to their retirement income planning. I wanted to put those issues very much on the table for consideration. Debt we see as an ongoing concern. When it comes to broader equity issues, I do not think I will be the only one to raise the issue of women. I make the brief point that the maternity leave debate highlights a number of the difficulties in addressing the inequities that women face both during and after their working life. We also need to look at lower income earners, particularly those who upon retirement see their end benefit hovering just above the age pension levels and what have they gained from a lifetime of SG and participation in superannuation.

Dr Knox—I would like to make a couple of comments about equity. One is a concern that we seem to tackle equity on a series of micro issues. We worry about it in the surcharge area, we worry about it in the maximum deductible contribution limit area, we worry about it in the tax area, we worry about here and we worry about it there. In doing that conglomeration of micro we actually get it wrong because we look at it on an annual basis on each little tax measure and we miss the big picture. I would encourage the committee to look at equity—and I am talking here of intragenerational equity between individuals—and recognise that individuals are in the system for a lifetime. So let us not look at it on a piecemeal basis. Let us not look at it on a year by year basis or a tax rate by tax rate basis. Let us recognise it in terms of equity within the retirement incomes system, age pension and super. We are looking at it for people who are in the system for 60 or 70 years potentially—40 years before retirement and 20 or 30 years after retirement.

In that sense, I believe the best way of looking at equity is to look at the total system and recognise, as best we can, revenue constraints, look at the total benefit accrued within the system and tax the total benefit in a fair and equitable manner. Picking up the issue that Catherine raised about women and others who are in and out of the work force, there are major impediments to people contributing significant amounts to catch up. I think we could do better on a fairness and equity basis by providing some catch up provision for those who have been out of the work force for perhaps two, three, five years and giving them an incentive to catch up voluntarily.

CHAIR—Such as?

Dr Knox—The suggestion I made to the committee in my presentation was a personal rebate system that was aged based, declining with age but if you did not use it in a particular year half of it rolled forward. It is a rolling forward mechanism whereby those who could not use it or chose not to use it in a particular year could use it in a later year. I think that would help people who have spent periods out of the work force to catch up. In terms of equity, I think one issue is access and opportunity to top up and the other is the whole range of complexities, particularly in the tax area and other regulations where we have tried to be fair in every little measure rather than be fair in the total picture.

Dr FitzGerald—I was wanting to add a footnote to where we finished before the break in relation to adequacy and particularly Peter Davidson's contribution. I think that if you compare the standard of living, the consumption basket you could afford at the middle of your working life or averaged over the whole of your working life with what you can afford on average about 30 years later, in the middle of retirement, or an average over retirement, you really cannot simply use CPI affordability. The consumption basket that any one of us enjoyed 30 years ago

was missing a whole lot of things that everyone around us now enjoys, including ourselves. That is my way of saying that, if you only kept up with CPI while everyone around you more or less was using AWE, you would have fallen behind 35 or 40 per cent in your standard of living compared to everyone else. Even though you were, in some sense, just as well off as you were, you will not feel anything but having gone backwards.

In short, I suppose I am not really arguing that you have to have a strictly lock step relative view of adequacy compared to those around you, especially when you are looking at the minimum decent standard. But surely when comparing over long periods of time it cannot be just CPI affordability, because that gives you a far too optimistic view of what has happened to individuals when their aspirations have moved forward progressively as to what is a decent standard, and certainly the aspirations of everyone else have moved forward. There really have to be some reference points that more or less keep up with what is normal in the community over time and not try to compare over 30 years quite different baskets.

CHAIR—On the question of equity?

Dr FitzGerald—I might reserve my position and come back on that.

Mr Davidson—Vince raised this point with me during the break and I have given it some thought. I think it is fair to say that retirement income benchmarks should also take account of community living standards at the time as well as an individual's or household's previous living standards. However, we should be careful about the extent to which we do that, because to a large extent people's perceptions of their current living standards are governed by those of their generation rather than by those of the next generation coming through. To a large extent, the baby boomer generation will determine what the community as a whole regards as a decent living standard because there will be so many of them, they will have so much weight in the future population. I think we have to be a little bit careful about setting benchmarks on that basis.

The other reason we need to be careful about it is that if we set retirement income benchmarks and compulsory saving requirements on that basis then the dog begins to chase its own tail. Expectations will rise as retirement income benchmarks and compulsory saving benchmarks increase. To a significant extent, the benchmark we set now—whether it is nine, 12 or 15 per cent—will determine what a future generation of retirees considers to be a decent living standard. My final comment is that we have to bear in mind people's needs to spend their income during their working life. That suggests a strong emphasis on comparisons with living standards at that stage. People might want to achieve much higher living standards later on, but the capacity of most to forgo income is quite limited.

CHAIR—Mr Kelly.

Mr Kelly—I am not the author of the report that talks about living standards but, as I understand it, the living standard that they were talking to was a modest but adequate income. To put some reference to that, they were talking about an income of perhaps $13,000 for a single person and $19,500 for a couple. It is just that: it is only a little bit more than the pension. We are talking of a quite modest living standard, and that is after 40 years of employment. Both

of those are quite out of kilter with the adequacy of 70 to 80 per cent of income that has been talked about this morning.

CHAIR—We need to keep that in mind. Ms Smith.

Ms Smith—Perhaps I could clarify the figures I raised before about the average period in the work force because they go to the issues of adequacy and equity in a sense. The OECD projection suggests that men at the moment are working 38 years in the year 2000, but that is expected to fall to 35 years by the year 2030. For women the figure is 21 years on average in the work force now, and it is expected to increase slightly to 22 years by the decade 2030. When we are looking at both equity and adequacy they are important. To come back to the ACOSS figures, bearing in mind the very low targets that were set—I think just a little bit over the pension level of $13,000 for a single person—you would certainly hope that you would be overshooting those targets well and truly after 40 years in the work force, bearing in mind that most people can anticipate nowhere near that. So we need to do obviously better than that in setting our targets.

In terms of our looking at that and at the equity, I think it is important, bearing in mind that we are looking at people's ability to save over a period, that our target—particularly for those people of up to about 1½ average weekly earnings, or $60,000—is the group that we need to focus most on in this inquiry to assist them to get to a more adequate retirement income.

The strategies that we see include both individual effort and effort by government, whether by extra incentives, co-contributions or reducing tax rates. In terms of equity we see the current tax arrangements—the tax on contributions, the tax on earnings and the tax on end—as bringing in a particular set of anomalies and inequities for people with fluctuating incomes or interrupted work patterns. If I had to name one area—and I take note of what David was saying about not picking on particular bits of the system; we have to look at equity as a whole—it would be the tax arrangements taking income on a year by year basis rather than on the lifetime savings of that person. We think it would be much fairer to look at the lifetime savings of the person and then look at the equity implications of that in terms of the tax arrangements and benefits.

Ms Rubinstein—I think our position on equity issues is pretty well known. We believe that, to the extent that there is government support for superannuation, whether through tax concessions, rebates, co-contributions or whatever it might be, it ought to target the section of the community that is going to have the most difficulty in saving for retirement. By and large that is going to be low and middle income earners, not high-income earners. To pick up a point which Senator Sherry was trying to make in the earlier session about the surcharge, the government's policy of, for example, reducing the surcharge is not consistent with that kind of view. Obviously the taxation system as we have it provides rich grounds for contributing to adequacy. There is obviously a connection between them. The government could increase minimum contribution levels by reducing tax. That would be one method by which the government could do that, and we would certainly support reductions, for example, in the contribution tax.

There are obviously advantaged and disadvantaged groups as far as superannuation is concerned. On the one hand you have higher income earners and people who have been in public sector and defined benefit funds for a long time. On the other hand you have low-income

earners, particularly people who have long periods of casual, part-time or very low income work, who will not be able to accumulate the amount that is required for a decent retirement. In that sense, a common increased contribution rate—whether it is 12 per cent, 15 per cent or whatever it is—will help those people and they will not overshoot the target simply because of the intermittent nature of their employment. Casual workers and part-timers are much more likely to be on bare award rates or have lower rates of pay and therefore have less going into their superannuation.

CHAIR—What particular policies should the government adopt to pick up these vulnerable people, the low-income earners? What is a simple mechanism?

Ms Rubinstein—I do not know about simple. The problem with superannuation is that every time you change it you make it more complex. Obviously that is the case with tax changes. But, for example, the taxation of superannuation could target low income people or people with small accumulations. There is something in that as well. You can put together a range of different factors, including age, income and accumulation. I do not know that that is simple, but certainly some tax changes of that nature could be looked at.

One idea which the Labor Party has floated is to reduce the contributions tax for people aged 40 and over. Those people, because of the relatively short time that most of them have been in superannuation—at best, 15 or 20 years—will not be able to accumulate anything like the targets that we have been talking about here. Contribution levels for most of that time will have been at considerably less than nine per cent. That would be one way of doing it. Other ways of doing it would be to increase mandatory contributions, whether from employers, from employees or some combination, but with tax rebates for or assistance with that, again to target low-income earners.

Mr Dolan—I endorse what previous speakers have said about having to look at the equity of the system as a whole. I note that in the retirement income system we have two main components. One component is that people save for their retirement to the extent that they are capable of doing so in their working life. The second element is the provision of an age pension which provides a safety net to support those more in need in their retirement. So there is overall equity in having a system that is based both on the incomes earned by people in working life and a safety net to support those that need support. Those two features give the system some principles of equity.

On reflection, some of the answers to those issues concerning some of the interest groups who may be disadvantaged in retirement may be trying to make them less disadvantaged while they are in working life and helping them improve their own circumstances so that they can support themselves better while of working age and into retirement as well. Not all solutions rest with the superannuation options; some solutions rest earlier in the process. So we need to look a bit more broadly than that.

Mr Maroney—The Institute of Actuaries has been looking at the taxation of superannuation for quite a while, mainly with the objective of trying to come up with a simplification of the system—I will leave the pension issues under the integration heading. But equity is a fundamental aspect of how you can develop options there. I have been closely involved in that for most of the time and my personal conclusion—because it is a continuing discussion within

the profession—is that there are probably two main options that the community and the committee can look at. One of those I would describe as some ‘big bang’ change—terminology that has been applied to the institute’s proposals. I suppose, like major tax reform, it is looking at a very different system and seeing how you try to make the transition to quite a different system. The main issues tend to be that any major change has lots more winners than losers and that it is much more difficult to come up with a transition path that means that the potential losers can be compensated in a manner that is fiscally viable as well as not losing the benefits from the simplification itself.

The other approach is, in a sense, trying to get away from individuals having to deal with all the complexity. That means trying to minimise the future change by saying, ‘We have an imperfect system but we are never going to get a perfect system; let’s just settle on trying to keep it as stable as possible over time because most people can eventually deal with complex systems if they know how they work.’ It does not mean you have to understand the complexity but it is like driving a car or watching a TV: if you know what you have to do to achieve the desired outcome then you can cope with that, provided that each time you use the system it does not change considerably. If the system stayed relatively stable over time, people would become more confident in working it out and would say, ‘I don’t quite understand the details of how the tax works but, if I put more money into the system, I am pretty confident that I will be better off and, yes, I will be able to take an income in retirement. I don’t know exactly how allocated pensions work but, yes, I am confident if I go down that route I will get some advice at the time and things will work out okay.’

Rapid and constant change, which is the most harmful part of our system at the moment, leads to a lot of inequitable outcomes whereby only some people can afford to pay for high levels of advice on retirement. If people have any substantial amounts, they get a better outcome if they pay for advice, otherwise they could end up with an inequitable outcome. Lower-income earners generally find the advice option is much more inefficient for them cost wise and it might be less relevant in terms of the amount of money that is at stake for making their choices.

So there is a whole range of issues. If we want to reduce the number of taxing points, shift the tax towards the end. It will be better to try to do that with some major structural change in the short term and then let the system stay stable. Alternatively, we should accept the fact that we have a very complex system and that the best way to deal with it, if it is going to stay complex, is not to let it continue to change too much—change will always be there to some degree—and to focus on how we communicate the way it works, without necessarily people needing to be expert or needing to rely extensively on expert and expensive advice.

On the quantum change side, some years ago I was involved in a review of social security issues that led to the extension of deeming across the whole range of managed investments; originally that had just been applied to bank accounts. The major driver that spurred the interest of the review committee was the efficiency savings that were feasible. In the past a lot pensioners left money in zero interest cheque accounts and, essentially, that was not an attractive way to maximise the pension. Once pensioners saw there was a way where they could get a higher after-tax and after-pension reduction by investing in an interest earnings arrangement—and that was extended to other managed investments—it became clear that, once they were properly educated, they could be better off. The system was actually paying out less in total from the government’s point of view and there was a real efficiency gain.

I do not think it is as obvious where the real efficiency gain would be within reforming superannuation tax at a macro level, but I believe worthy of serious investigation is the question of whether there is a chance to make some major changes and then try to settle the system down and have a transitional path for the winners and losers. Or we could just continue with a process of dealing with micro change, for either greater equity or greater efficiency, at each of 10 or 20 points, but that is going to be a difficult ask. I believe there are two different options available to take the equity and simplification issues together on the taxing of super. It will require quite a deal of focus to firm up on one or the other or to present both as requiring continuing discussion.

Mr Lewis—I will build on from the comments that John just made, but first of all I would like to support the comments that David Knox made about taking a big picture perspective on this if we can. Also, the institute believes it is preferable to shift tax towards the end benefits within the context of the issues that John has just raised. We recognise there are some funding issues there, but we believe it would be a more equitable system if you could shift tax towards the end benefits. At the same time, partly out of equity and for other reasons, our preference would be to try to steer more people into income stream products. Another issue is partly equity, partly adequacy. In earlier discussions we focused quite a bit on adequacy. I do not think that anyone has really pointed out that in nearly all the cases the individual was still receiving virtually the full age pension. Part of the purpose of giving a tax concession to superannuation was to encourage self-provision. We have a situation where people get tax concessions which lead to self-provision and they still get the full age pension. They even at times go to great lengths to maximise or utilise the assets test or income test in order to draw down as much age pension as possible.

At times we can see some inequities resulting from the way in which the various rules work. I raise that as an issue. It comes later on under immigration. We need to stand back at the moment. People are still going to be drawing the age pension. A nine per cent target includes, effectively, almost a full age pension. If we could focus more on getting to income streams, taxing on the end benefits and better integration with the social security system, we may end up with a more equitable arrangement. It is not that easy, of course.

Ms Bailey—I think these issues fall outside our portfolio’s area of responsibility.

Mr Wells—We would endorse Family and Community Services and Treasury on these matters.

Mr Kelly—My modelling has recently looked at the position of women as well as males in regard to superannuation. The discussion we have had this morning has been about the male working for 30 years or so, so we have really missed two groups. The large group of baby boomers who are going to retire before they get to the point we have been talking about, where they have had 30-odd years of contributions at nine per cent, are going to arrive at retirement without the required amounts. I am finding that the position of the females is basically half that of the males. They are getting a very small amount above what they would get on the pension, which is making almost no difference to their living standards. Initiatives need to be looked at for that group. David Knox mentioned one whereby they would be able to put aside money that they can draw on in other periods.

I have also looked at increasing the superannuation guarantee to 15 per cent and I have found that it does not make a substantial difference because people are still taking early retirement, which almost negates it. So the priority is to encourage people to stay in employment and to look at ways for them to do so. The superannuation accumulation phase is more important than whether it should be nine or 15 per cent.

Senator SHERRY—On that point, though, isn't the reality that a lot of baby boomers, particularly those in their 50s, just will not work for a longer time? There are limited job opportunities for many of them. I find in the real world back in Tassie that a lot of them are blokes who are pretty upset with the world—I was going to use a harder word—and job opportunities in those sorts of communities for those sorts of blokes are very limited.

Mr Kelly—I agree. Certainly a lot of it is involuntary. The ones we perhaps do not even care about are professionals who are voluntarily taking early retirement, because they are not going to be drawing on the age pension or will do so at later stages, but there are certainly large groups of male workers retiring involuntarily. I am finding that 50 per cent of males have retired before the age of 65. I think the ACTU mentioned that in the eighties they had a policy of encouraging people to take retirement at that age. That is certainly not appropriate, but it may have levelled out. As I think Dr FitzGerald mentioned before, we are finding that participation was decreasing but it may have levelled out and—if you are optimistic—may actually be starting to climb again.

Senator SHERRY—Assuming there is a levelling out, I would be interested to know whether we are seeing that because increasing numbers moving into that age cohort are levelling it out and whether the participation rate of people who are over 55 is actually increasing. I suspect it is not; I suspect that, once they are out, they are out.

Mr Kelly—The groups of men you are talking about certainly find it very hard. Even if they do get work it is going to be casual part-time type work whereby they will not make many inroads into adding to their superannuation. I have not seen any data showing whether it is actually increasing, but the situation for that group is certainly not good.

CHAIR—Mr Luke, on behalf of the committee I thank you for providing those graphs, which were very instructive in regard to the impact of trail commissions vis-a-vis up-front fees. Thank you very much for that work. I invite you to comment.

Mr Luke—In relation to equity, there are some interesting things facing a lot of people in superannuation funds. I think John mentioned before the question of how you assist a lot of people—low-income earners—who are in and out of the work force to get reasonable financial advice on tax impacts et cetera. One of the huge challenges facing the whole system is finding a way to do that. There are ways to do it and we have to meet that challenge.

I mentioned before that a lot of people in broader superannuation funds have all their financial needs met by that fund. For instance, all their insurances are met by the fund, and as they move in and out of the work force they are often left without enough money in the fund to even fund their insurance into the future. That eats into their accumulated amount as they try to provide that insurance. There are lots of equity problems for people in the low- to middle-

income areas in the whole of the superannuation debate, and that is particularly true for women; so there are some broader issues of equity there that need addressing.

Another issue in insurance, where people have that covered through superannuation, is the idea that some occupations are almost impossible to cover. As you get into the blue-collar end of life and how one meets that when those people go in and out of employment is also particularly difficult. It is not specifically related to the tax situation, but there is a linkage there.

CHAIR—Or else they are in and out of jobs with different insurance cover.

Mr Luke—Yes.

Mr Davidson—I will focus my comments on the equity or inequity of the tax treatment of contributions, partly because it is very important, since there is $5 billion worth of annual tax concessions for contributions, and partly because it is relatively easy to change things at that end—you do not require complex grandfathering arrangements, for example—and partly because I do not believe it is politically feasible in Australia, even if we wanted to do it, to achieve a large, revenue neutral shift towards taxing end benefits, because the prospect of higher tax rates on retirement savings will not be accepted. We saw that back in 1983, at a time when the tax treatment of contributions and earnings was far more generous than it is now. I am sure we will see it again in the event of any government attempting to substantially raise tax rates on retirement benefits, especially with a high proportion of voters being retired.

We support tax concessions for superannuation saving, including compulsory saving, both to compensate people for compulsory saving—and that is important for reasons of both equity and political sustainability—and to encourage voluntary saving. However, we do not support the present skewing of tax concessions for superannuation contributions towards people on higher incomes. On our calculations, roughly half of those concessions go to people on $50,000 and above, which is roughly the top one-sixth of employees. We agree with the ACTU—at least, in principle—that tax concessions for compulsory and voluntary saving should be skewed the other way, towards low- and middle-income earners. That does not mean they will get a greater amount of tax subsidy—because the contributions are lower—but per dollar contributed they should get more. Under the present system, they get much less, mainly because employer contributions are taxed out of before-tax earnings.

As a result of that a part-time worker on, say, $15,000 a year gets a tax subsidy of 3c in the dollar for employer contributions, which will always be the bulk of his or her contributions. They are not going to save voluntarily to a large extent. For someone on average earnings, it is roughly 17c in the dollar and I am including the Medicare levy and rounding off. For someone on twice average earnings, just under the surcharge threshold, it is 34c in the dollar. For someone on three times average earnings it is roughly 19c in the dollar—and, of course, that is a very small proportion of wage and salary earners.

The current system of tax support for retirement savings is upside-down. It is an upside-down subsidy, and low-income earners in particular get a very raw deal, having been forced to save for their retirement, having a large part of those savings clawed back through the pension means test, and receiving very little taxation support on the way through. They get a very raw deal. However, we are not arguing that reform in this area is simply a matter of increasing taxation

support for those at the bottom end. It should also involve reduction of the excessive and wasteful tax support for the top end, because there is no reason for it. At the top end, fewer people will rely on the pension and more people are likely to save in the absence of the concession—so why do it?

The solution to the problem, as we see it, is to tax all contributions out of after-tax earnings. That is, peoples' marginal tax rates are applied in the normal way and then that taxation is offset in full or in part by some form of targeted rebate. That could be targeted in a range of ways. We would target it more towards the bottom and middle, of course. Others might target it differently, but at least with that kind of system it is possible to target tax concessions for voluntary and compulsory saving in an appropriate way. Under the present system it is not possible to do it without extraordinary complexity. We see that with the surcharge, for example.

Doing it this way would also greatly simplify the system. A dollar contributed will be taxed in the same way, regardless of where it comes from. You would not have five or six different tax treatments for contributions from different sources and you would not need the surcharge either. A revenue neutral reform along those lines—and we believe it should be revenue neutral, because tax concessions for superannuation are, in our view, quite large enough in the context of other calls on public revenue—would leave the vast majority better off. Indeed, we can show how it would leave the vast majority better off and that is a measure of the extent to which the current concessions are skewed towards the top end—the top 10 per cent or so. There would also be much greater scope to reward voluntary saving by low- and middle-income earners—an objective which, I am sure, is shared by most people in this room. It would be possible to achieve such a reform without the need for very complex grandfathering or other arrangements, and that is the reason we are focusing on the contributions end.

Mr Stanhope—IFSA's position is that superannuation as a lifetime savings vehicle is not consistent with taxation treatment on an annualised basis. So we have made a number of points in our submission along those lines. In passing, I guess it is worth noting that, if we are expecting that superannuation would ameliorate or remedy working life disadvantage then I think we are trying to do things that the system was never designed to achieve. That said, it clearly should not compound working life disadvantage, and we think some of the rigidities we have drawn attention to in the system do that.

In terms of measures that we think would aid equity, there is removal of most of the annualised treatment and treatment of superannuation on a lifetime savings basis, whether as total benefit at the end of saving or total accumulation at various periods on the way through. After all, if you are trying to make some form of remedy for retirement savings, you do not want to be doing that after the person has ceased working and you can no longer target anything towards them. We have made a number of points about shifting rigidities out of the system. One point about the employment nexus is that, whilst there are very small groups who cannot contribute, one small but significant group that was mentioned at the 'Ms...ing Out?' conference on women and super held at UNSW was women who have no current work force connection but who have a substantial asset—perhaps realised through a divorce or matrimonial asset split or something of that nature—and cannot move it without a spouse or some connection with a labour market into superannuation and are thus denied some of the taxation benefits, say, in allocated pensions. They are a small group, but there is no reason for keeping them out. That treatment is clearly inequitable, and those rules really do not seem to serve any useful purpose.

More as an aside, I say that we need to be careful about what systems implications we draw with any equity provisions. Superannuation arrangements are pretty cumbersome administratively as it is, but there are—and, with co-contributions, there will be more—data flows between fund managers and government. Those data flows, particularly in the surcharges case, have cost in the order of $100 million to build. They are not cheap, but they exist. Forcing this system—which means those people saving in this system—to spend that kind of money again, and sometimes again, in order to achieve equity outcomes that are sometimes not of that size is clearly counterproductive. So, in terms of anything that the committee might be considering in this line, I think that one of the first principles ought to be administrative simplicity and low cost.

Lastly, in terms of issues about taxation and changing taxation arrangements to achieve equity, we need to remember that the current taxation system is in effect a bring-forward system. That is what happened in 1988—future taxation on superannuation was brought forward into the current fiscal period. In a sense, all that we would be doing in moving that out towards the end of the benefit period is moving that taxation back to where it would otherwise have occurred. One of the powerful arguments for that is that, from the Intergenerational Report, we currently have the means to do it. The problem is occurring out in the years beyond 2020, and returning that taxation revenue out to those years would do something to ameliorate the sort of problem that is identified in the Intergenerational Report. So, apart from being an opportunity to get equity, because we allow people to accumulate in the system and then we deal with it when we know how much they have achieved on a lifetime basis, we might also do ourselves some good in the long-term fiscal perspective.

Ms Doyle—We reiterate what a lot of people have said here which is, from an equity point of view, to move towards an end benefit tax and to do that at progressive income tax levels rather than flat tax levels, which we currently have in the system. We also see that it would be a positive move for income streams. If we are going to maintain the system, where it is voluntary to take an income stream, then incentives are going to be important. If you have income taxes on the end benefit, then that is a huge incentive for taking the income stream option rather than taking the lump sum. That is a bit different from what Peter raised, which was having the income tax rate applied at the front instead. This would then leave the member with an end benefit which is more likely—unless you have other sticks there—to make them take the income stream. It would seem like more of an incentive to take the lump sum under your option, rather than taxing with the income tax scale at the end.

Mr Davidson—We have other sticks!

Ms Doyle—You would need something! We have also been looking at taxing at the end, and also understanding the pressures that would apply to government budgets. AMP proposed the idea of the withholding tax which was instead to take a portion of what you would receive at the end up front. Even though that is unlikely to be revenue neutral, it would be some amelioration of the funding issue that the government would face in that way—which was trying to partially patch up some of the revenue that would be lost in doing that big bang approach as has been suggested. Also, from a simplicity point of view, the idea of doing a benefit tax with income tax schedules does not hit only at equity but also at efficiency and simplicity. Looking at the golden rules of why you do such big moves, it is not just for equity; it is also for those other criteria that are important to keep in mind when doing such a big policy change.

Looking at other options that are on table, reducing the contributions tax does not hit at equity, because you still have a flat tax that applies to everyone. While it might not hit the adequacy button, it certainly does not change the equity outcome very much, because you are still applying the flat tax. If you remove the contributions tax totally, I am wondering if we would get into the issue of microfixes again, to patch up at the end. If you are saying no contributions tax on the front, then what? That means high-income earners are allowed to contribute with no tax. Surely, at the end we have to start patching up again. That is why everyone ends up going back to, 'What is a one-stop shop solution?' as you might say, that stops us having to put these patches on all over the place and ending up with quite a basket case of a system. Even though it might seem as though a benefit tax at income tax rates or whatever at the end is way too big and too messy to go into, if you look at the benefits of it all the time, you keep coming back to, 'Yes, that is probably the best way to go.' Otherwise, we are just going to keep going around in circles for a little while, still patching things up.

CHAIR—There are some challenges for you, Mr Gallagher.

Mr Gallagher—It is important to support David Knox's comments that we should look at the whole of life issue as far as equity is concerned. Although the superannuation system is concessional during the accumulation phase and is more concessional for those on higher incomes, it is less concessional for those on higher incomes in the retirement phase—because of the interaction with social security pensions. Looking at the whole of life cycle thing, it is important to balance not only the tax measures but also the social security measures, in considering the impact of the policy issues. At the margin, it would appear to me that a tax cut on contributions would have the capacity to give higher returns to those with higher incomes and is, of itself, not an equitable measure. It is not a measure as general as having an across-the-board tax cut, which targets people with smaller accumulations. It is perhaps even more the case that a cut in the earnings tax rate would be more beneficial to those with higher asset levels than would the contributions tax.

The proposed cuts in the contributions and earnings tax, if they were absolute, would give us a revenue shortfall in excess of $5 billion. It appears to me that we need to look at more revenue neutral and more equitable ways of developing superannuation policy than those particular methods. A number of people have talked about the possibility of looking at assets, in deciding how people should be treated within the accumulation part of the system. This would be very difficult. At the moment, we have no information, in terms of the taxation system, on the assets. As we know, those assets are held across many accounts and there are still a number of accounts in the system for which we do not have tax file numbers. It would take a whole new information regime, of the sort that Bill Stanhope does not want to see, to bring in some sort of equity measures based on superannuation assets. So I think that is difficult.

One advantage that Alex Dolan has spoken of, in terms of looking at equity measures, is that perhaps the social security system best addresses equity issues. It looks at all of the assets after a person has retired and it looks on a household basis; therefore, it provides a far more suitable basis for targeting any measures than does the accumulation part of the retirement income system.

Mr Brake—I have a couple of comments, firstly one on an issue that is related to equity: tax expenditures and how they should be measured. At present, we measure tax expenditure on the

counterfactual basis that superannuation is part of someone's remuneration—that is, if you were to receive that superannuation from your employer, as an employee you would be taxed at your marginal tax rate, and therefore the different tax treatment of contributions from those marginal tax rates gives rise to the tax expenditure. So there are a number of ways in which the committee can look at this equity issue. A number of people have been speaking about the attractions of looking at it over a whole-of-life basis compared to having that superannuation formed as wages. Of course, we have an individual income tax system; we do not have a system of income tax where we wait until you reach retirement wage and then work out all of your income over your working life and give you a bill for that. There are a number of different ways this can be looked at but, in terms of tax expenditure statements that Treasury puts together, it is done on that annual basis with that counterfactual.

I note also that some government measures, such as the co-contribution, rely on an annual basis; and so, if you are looking at providing incentives for people to do something in a particular year, having that depend on their overall accumulation of assets over a lifetime means there are some obvious issues in that respect. We have spoken about the retirement income system as a whole, including superannuation and the age pension, which I think is quite important because there is an important integration between the two, particularly with the means testing of the age pension so that higher income earners are means tested out of the age pension arrangements. We also need to look at, as Phil said, the superannuation system in its entirety, which includes the taxation of benefits and such measures as reasonable benefits limits and the age based deduction limits. So there are a few factors that the committee should consider when it is looking at equity.

CHAIR—Does anybody have any ideas about moving progressively? How do you move progressively from a front-end to a back-end tax? We have $5 billion to move.

Dr FitzGerald—There are a number of roll-up proposals, as they are called. I think that labels like 'big bang' are not very helpful. In my opinion, the only way that you can neatly address the equity issues that you ought to deal with in the superannuation system is to go back towards taxing at the benefit stage. The superannuation system cannot be looked at in isolation from the social security and tax systems, anyway. The changes that we had in 1983 and 1988 were at least as large as or larger than those that would be involved in going back to benefit taxation now. Certainly, there are complexities in it.

The proposal that I think holds most promise is a combination of one that Susan and her colleagues at the University of New South Wales published a few years ago, plus an added little idea—which I think was originally mine—of having the assessed tax or part of the assessed tax that would be payable to consolidated revenue as of a certain date, if you were notionally to take all of your benefits out under the old rules at that date, paid in instalments to the budget over the transition period or over a reasonable period of time. This would if not entirely then at least substantially ameliorate the effect on the budget deficit as currently viewed—this is rather a narrow view anyway, since it does not really take a long enough view of the consequences of tax changes of this sort.

To describe it in simple terms, as of a certain date and given enough notice, everyone's position would be calculated by their fund. Presumably they would get a little note in the mail—and there would be no other bang louder than the mailman putting it in the slot—which would

advise them as to what their position was. That liability for tax under the old system would be then payable to the budget over a period of time. Then, going forward, everything they put into the system from that point on would be taxed under the new system on a benefits only basis.

That is only one of a number of ideas. The Institute of Actuaries has put an enormous amount of work into proposals of this sort as well. The one that I am most familiar with is of about the same vintage as that of the University of New South Wales group. They are big changes, but then so was the move in 1988 which got us into all of this trouble. If you did get tax back to the benefit stage, it would address all of the considerations that everybody has reinforced—that you need to take a whole of lifetime view of equity in taxing superannuation and that you have to take it in the context of what the social security and tax systems are doing, particularly when you are looking at low to middle income people, because to get the superannuation system to do the job of those systems is really going down the wrong track. What you really need to do is to have superannuation neatly mesh into the framework that those systems have set up.

It may be that you cannot contemplate politically or otherwise some transition back to benefits taxation, at least to benefits being the point where you are assessed. It may not be the only place where you collect tax, but if you could move back to it being the place where you made the assessment for equity purposes of whether you had got your right share of concessions than it would greatly simplify a lot of the perplexing aspects of the system now. You would not need maximum deductible contribution limits and others of those belt, braces and safety pin aspects of the system, as they would now become redundant.

However, if you cannot go that way and you are stuck with doing something that improves equity in the accumulation phase, then the surcharge isn't it. It is really something more like what Peter Davidson suggested: treating all contributions as if made from after-tax income and giving the concession in the form of a rebate. I would not try to target that rebate. I think if you simply made it a flat rebate, it would be considerably more progressive than the current arrangement, and the work of targeting can be left to the other systems—the social security and tax systems. While that basis of taxing contributions would be a bit harder for the industry to manage, it is not out of the question—in fact, I do not think it is at all out of the question these days. What that would mean is that the series of numbers that Peter Davidson read out—going from three up to 34 and back to 19—would be a uniform 10 or 15, or whatever you wanted to make it, for everyone. I also like the idea that David Knox mentioned of recognising that there are people with broken work histories and that sort of problem, and that if you were to limit access to that you should allow some sort of catch-up mechanism to deal with that issue. Talking about solutions that start with the assumption that we are stuck with taxing it in one of the three places and trying to find solutions in that framework always brings you back to how much better it would be if we could move tax back to the benefits stage.

CHAIR—It would appear to me that it was far easier to go from back-end to front-end taxes compared with the reverse position which has been advocated here today. Am I correct in that perception?

Dr FitzGerald—I was never elected to anything—give or take a couple of sporting club things. Sure, it is obviously politically difficult to move tax back the other way, but I think it could be done in a way which was pretty painless, as I described it. Nothing would happen to you if you were in mid-working life. You would get an advice that your stake in your fund if

taken out today as a benefit would be due for a liability of thus, and that it would be paid in stages instead of at your retirement but from now on everything you put in will not be subject to that old tax system and you will only pay ordinary tax at the end. For many people that would not be a bad deal, if properly explained.

Senator SHERRY—Not on top of a negative return—which a lot of people find hard to understand no matter how well you explain it.

Dr FitzGerald—Indeed. Change of this kind, as in industry policy and other areas of policy, is always easier in a favourable environment—and a negative return environment is not a very good environment in which to sell change of this sort.

Ms Smith—The contributions tax and the tax on earnings are really intergenerational issues that we need to tackle now—sooner rather than later—because, by bringing that revenue stream forward and spending it, we are deflating the purpose that was intended. Our focus would be on the contributions tax and, if we have to stage it, looking at that in the first instance as being the most detrimental in terms of people's incentive to save. In terms of starting to move taxes to the back end, we have already talked about the importance of that from a simplicity point of view and a lifetime earnings point of view. Also, in terms of adequacy and equity issues, by removing that contributions tax you can in fact help lower income people most. The scenarios which were in the ASFA submission looked at the end impact for people on average weekly earnings of $20,000 and a bit beyond. These scenarios showed that it is the lower income people who are being most helped by the removal of that contributions tax. Indeed, you are starting to address some of those gap issues that have been there without people having to have extra discretionary income to put aside, which can be a difficulty for those lower income people.

In terms of the transition from one system to the other and where we get the revenue from, somewhere in there you have to have a model which crystallises what the taxes and benefits have been at a certain point and then moves forward. I think there is another option, which we put on the table.

CHAIR—The accounting is simple but where does the tax come from? This is the issue.

Ms Smith—Are you asking where the revenue comes from?

CHAIR—Yes. Dr FitzGerald told us how we do it in our accounts, but nobody has told us where we are getting the extra revenue from.

Ms Smith—One model that we have put on the table—and, dealing first with the contributions tax, the revenue that we are talking about is about $2.5 billion a year from that component of the superannuation tax revenue—was to put a cap on revenue being taken out of the system.

Senator SHERRY—Is that just on the contributions tax or on the total for all stages?

Ms Smith—That is on the total. Treasury estimates indicate that, at the moment, $4.6 billion revenue is being taken out from all stages of the superannuation system. They estimate that that will increase to $6.2 billion by the year 2005-06. If you put a line in the sand and say, 'Enough

is enough. That $4.6 billion is enough revenue being taken out,' by the year 2005-06, just on simple arithmetic, you have $1.6 billion.

If you have taken the tax off the contributions then automatically you have more coming out of the earnings stream and more coming out of the end benefits scheme. So our calculation is that, after about five years, there is at least another $400 million there. So we are close to the $2 billion level. If you just take a notion of enough is enough and put a cap on this, we can start moving to a situation where, I believe, we are getting to both a fairer and more adequate retirement income strategy.

CHAIR—Wouldn't Treasury argue that taxes from super are just another means of collecting revenue to meet health, social security and education needs? Maybe Mr Gallagher might articulate that better for me.

Mr Gallagher—The total figure for revenue from contributions taxes alone is about $3.6 billion. If we were to cap superannuation revenue in nominal terms what would happen is that that particular source of revenue would become less and less as a proportion of GDP and less as a proportion of the budget. There would still be the issue of how we would make up the shortfall; whether we would need to increase personal income tax or find some other mechanism to address the shortfall. Under that proposal, superannuation revenue as a proportion of assets would also fall considerably.

Senator SHERRY—Didn't we do it with petrol?

Mr Gallagher—Yes, measures have been taken with petrol.

Mr Davidson—I cannot think of circumstances in which revenue has fallen in proportion to GDP where there have not been large reductions in unemployment. You could do it that way. But I cannot see the policies in place that are going to achieve that in the coming years, to be honest, below about five or six per cent. Secondly, there could be a much larger budget deficit, which is not likely to be acceptable these days. Thirdly, the most likely outcome is that programs are cut—social programs especially.

Senator SHERRY—Wouldn't you also have to do something about the tax free amount on retirement? If you are going to transfer the tax—

Dr Knox—What has not been said thus far is what you do at the back end. Clearly, if you are going to reduce the tax on contributions and possibly investment earnings—we will just leave that one there for the moment—you are going to have to—

Senator SHERRY—There isn't too much of that at the moment anyway.

Dr Knox—True; there will be in the future, we hope. You are going to have to revisit the tax on the end benefits and you may well use that as a measure to encourage income streams as well. You could, for instance, stop indexing the $100,000 lump sum limit and let that freeze over time. Any benefit above that is taxed at full personal tax rates unless you take it in an income stream product or variations of that approach.

You clearly have extra tax coming from the benefits, and over a period and intergenerationally, and looking at the IGR report, that tax over time would of course increase exactly when you need it with an ageing population. So, whilst you might have a slight reduction in tax in the next five years from super, you are actually going to start building a tax chest, if you like.

Senator SHERRY—I am just a bit sceptical about your time frame, though. If you kept the current tax-free threshold of just over $100,000, given current balances and given what people are doing, I think it would take a bit longer than five years to catch up.

Dr Knox—I am sorry; I was not using the five years in that context. For instance, you would not index. You may choose to remove the indexation from that $100,000.

Senator SHERRY—Yes, it might take you 20 or 30 years.

Dr Knox—But in terms of the IGR report, that is where you are starting to hurt. To make a couple of other comments in terms of administration issues, which I think is part of the transition issue, one of the equity issues we have not picked up here is the whole issue of inequity within the surcharge. The surcharge is a dog of tax and we all know that. There are lots of inequities within in it, both for individuals who are subject to the surcharge and for individuals who are not subject to the surcharge.

Some of those inequities would, in fact, flow through and be similar to some of Peter Davidson's suggestions on fully taxing contributions. Whether you are in a defined benefits scheme or an unfunded scheme, there are inequities and assumptions that you are going to have to make. So I just put that on the table. If you were going to go down that route, you are actually adding complexity in inequities of a different sort, part of which we see in this surcharge.

The other comment I would make, and whilst I appreciate what Dr FitzGerald was trying to say in terms of taxing benefits at the changeover date, the transition date, we have to be careful at that point, or at least introduce some flexibility, because we actually do not know what benefits are payable. Whilst we are talking retirement benefits, there is a range of benefits that people may be entitled to out of a super benefit whether that be resignation, retirement, retrenchment et cetera. So we do not necessarily know what tax is payable even on today's balances, because we do not know what benefit the individual is going to get out of that. I am not saying that it is not possible. I am just introducing that as a recognition that it may not be as simple as it first seemed.

CHAIR—Are there any further comments?

Senator BUCKLAND—I did miss some comments earlier on; I apologise for that. Should we be looking at incomes or account balances? Which is the more important when you are looking at equity?

Dr Knox—In my earlier comment, I suggested that over the whole period of lifetime membership of a super fund, the account balance at the end is the best measure of equity. One of the problems of doing it on an annual basis is that individuals' incomes fluctuate. Phil Gallagher made the comment that we do not know the total account balance that any individual has in the

system. Many individuals have three, four or even more superannuation accounts. There is no mechanism to draw them all together. The only time they come together is at the end. To my mind, the best way of looking at equity is at the end, when you know how much people have got out of the system.

Senator BUCKLAND—If it was answered earlier, I appreciate that.

CHAIR—We talk about certain problems associated with the surcharge. Would it worry you that if the surcharge were disallowed in the Senate, the government might just pocket the savings and walk away? Therefore, you would not get your surcharge down to 10.5 per cent and you would not get your low income co-contribution. Is that a possibility?

Dr Knox—I am not a politician, Senator.

Dr FitzGerald—It is definitely a possibility, Chair, but you would know more about that than we would. The mention of co-contributions prompts me to comment, having been implicated in the research that IFSA sponsored. The idea of co-contributions as a supplementary mechanism within the system has found favour at different times and in different forms with both sides of politics. If you are stuck with a system where the overall architecture is much like the one we have now—with taxes all over the place and difficulties in targeting—and your concern about equity was really about the situations of people on low to middle incomes, then co-contributions are not a bad thing to look at. In that research, we found that dollar for dollar matching is an extremely generous incentive; in fact, you can induce people to make a bit of an effort themselves. We are not talking about the people right down the poverty end but about the battlers—if that is still an acceptable term—who have to make a bit of an effort to save.

According to the research and modelling we did, a $1 for $2 incentive would allow you to either extend the coverage of the co-contribution well towards average earnings—certainly past median earnings—or to go a certain distance that way on the same or a smaller budget while also inducing a substantial flow of additional private contributions. That mechanism is one of the variants that is available. If you do not believe we can address all these equity issues by a big bang or a roll-up or a transition model, it offers an opportunity to look at some of the middle income adequacy and equity issues and to target these, which would not disturb the rest of the system.

CHAIR—Mr Davidson, are you happy about this co-contribution approach as a means of delivering better equity rather than a general reduction in the contributions tax?

Mr Davidson—We oppose a general reduction in the contributions tax because the people who will benefit the most from it per dollar contributed are by definition those on higher incomes. I think that is very clear. Matching contributions are much more equitable than the present system and would be more equitable still if they applied to compulsory as well as voluntary contributions. One of the problems with restricting them to voluntary contributions is that the most income constrained groups in the population will not benefit: by definition, they still will not save more and, therefore, will not receive the concession. There will be a certain amount of leakage to the partners of high income people. Having said all of that, matched contributions are certainly much fairer than the present tax treatment, but we would prefer

matched contributions to apply to the compulsory as well as the voluntary contributions. In that way, they are an equity measure for the bottom end as well as being an incentives measure.

Ms Rubinstein—Following on from that, that is very much the ACTU's position. It is our view that the benefit of the co-contribution will be taken up to a very great extent by higher income spouses and also parents who will contribute for their low income family members, who might be students working at McDonalds or something like that. All the evidence we see shows that people who are income restrained, as Peter says, or people who are on low incomes which they need to maintain themselves and their families, are not going to make voluntary contributions. They do not do that now. We suspect that a very large proportion of people making voluntary contributions from up to median incomes or almost average weekly earnings are doing it because they are members of defined benefit or other schemes that require compulsory member contributions, which all of the public sector, a lot of corporation funds and the whole of the tertiary education sector require as well. The idea of some additional contribution—whether you call it a matching contribution, a tax rebate or whatever—to the superannuation of low income people is a good thing, but the way that this is being done means that it will disproportionately go to those who are not in the greatest need.

CHAIR—With respect to Peter, he suggested that it was a dual approach for low-income earners: not only their contribution, but the employer contribution?

Mr Davidson—That is the approach that we would favour. We think it is worthwhile investing in better tax concessions for voluntary contributions for the low and the middle income groups. We just do not have high expectations that it will dramatically improve contribution levels. It is not worth relying on that to too great an extent. It is worth doing, but keep it in perspective.

Ms Smith—It is worth pointing out the disparity in the way different people are using the word 'equity' in the target saving. The equity targets that ACOSS is highlighting are premised on a flat tax and a flat distribution of wealth. ASFA is not just going for a flat rate $13,000 target, which is where a lot of the ACOSS line takes us and where the rebate and other notions that have been talked about over that SG level would be taxed at a higher level than taxes that people take out as wages. So there would be, in fact, a disincentive for saving for retirement. The notion of equity that we are looking at is helping to sustain living standards, particularly for people on $60,000 and less. If you look at that, superannuation has been mitigating some of the inequities that have been there but if we look at it as a percentage—and we have been looking at retaining a living standard pre and post retirement—then removing the contributions tax does help the people under $60,000 more than it does other groups, and does not require either to have discretionary income.

We also support the notion of co-contributions if the parameters of this policy were broadened. Some people do have some discretionary income—middle income groups—but the parameters set at the moment are unrealistic because the people it is targeted at would not have discretionary income. The co-contributions policy could be a useful part of our ammunition to help middle and lower income people save, but it does require the assumption that people do have discretionary income. The advantage of reducing the contributions tax is that you are helping low and middle income people who do not have discretionary income.

There has been some talk about certain pockets of people who need a leg up: baby boomers and women—there is quite a strong string of them if you look at it, which would probably be the majority of people trying to save if we think about it. One worry I have is if we create another set of rules to target just those groups; we already have a very cluttered set of rules for the superannuation system. We ideally need to look at incentives or tax arrangements that help the system as a whole rather than at imposing another set of rules for pockets of groups of people. While the 45-plus group seems an obvious group that has missed out on the 30 years plus of savings, it is worthwhile remembering that the Treasury figures show that if, for example, we drop the contributions tax the majority of those benefits would go to those over 45 because over 60 per cent of the contributions going into the superannuation system are for people aged over 45. Our preference would be to keep the rules applying to everyone rather than to say, 'This pocket or that,' because the minute we do that we get into complications with people with fluctuating incomes or differing circumstances.

Senator SHERRY—Isn't the low-income earners co-contribution a pocket?

Ms Smith—Yes it is.

Senator SHERRY—You endorse that.

Ms Smith—Yes.

Senator SHERRY—You want the parameters broadened; that is still a pocket. Kiddies accounts—that is another new set of complexities.

Ms Smith—I think that is cruel trick by grandparents.

Senator SHERRY—I just make that point.

Mr Stanhope—I just thought it would be worth putting some of the results of our research on the table in the face of the comment that low-income earners will not respond to a co-contribution. In fact, by household income, we found quite a significant increase in contribution both at the dollar for dollar level and at the 50c for a dollar level—or $1 from government for $2 from the individual. For example, even in a $20,000 to $30,000 a year household, contributions go from 19 per cent currently to 33 per cent on dollar for dollar and 25 per cent on $1 for $2. Just to put that into a real-life context, if we looked at a 45-year-old woman earning around $35,000 a year coming back into the work force with, say, 15 years to retirement, the co-contribution at 50c in the dollar—that is, $1 for every $2 she contributes—increases her retirement income from about 59 per cent of pre-retirement consumption expenditure to just under 65 per cent. So that is quite a significant increase in her circumstances.

Senator SHERRY—That is an expectation, isn't it?

Mr Stanhope—No, they are the modelled numbers. They go from—

Senator SHERRY—I know that. But we are not going to know the outcome for a couple of years—when we will see what happens—are we?

Mr Stanhope—This is the modelling based on—

Senator SHERRY—I know that.

Mr Stanhope—someone contributing for 15 years. Our research showed that people—once they said they would contribute—said they would basically contribute from the time they started until the time they retired under a co-contributions arrangement. That is the expectation of the 45-year-old woman, but she is taken from a statistically valid sample.

Senator SHERRY—I understand that. I am not disagreeing with that. But it is a survey of what you expect people will do and what you expect their reaction will be having asked them. Whether they do it will be interesting to see. I look back at how many low and middle income earners were contributing when superannuation was highly tax concessional.

Mr Stanhope—I think we now have a vastly different range of mechanisms to save from superannuation.

Senator SHERRY—I know. But I am just being a bit cautious about your survey in the sense that we will only know what will happen when we see what happens, which will be in another 18 months to two years.

Mr Stanhope—That is true. We discounted our data for whether people will do what they say they will do, and, having commenced doing that, whether or not they will be able to continue doing that in the face of the exigencies of real life. When the Allen Consulting Group did the costings, they discounted for both of those factors and we still came out—

Dr FitzGerald—They discounted for awareness as well.

Mr Stanhope—They discounted for awareness. There were three discounts applied and, even at that point, we calculated that $1 for $2 contributed up to $40,000 a year of income would cost $158 million in outlays for a total extra contribution of $371 million a year. So it is a pretty big bang for the buck and that will be hitting exactly that group that you are trying to target.

Senator SHERRY—It certainly is for the $30,000 to $40,000 group. I have been doing my pub test asking unemployed people and low-income earners I know who are on $20,000 or less if they are going to put money into super and I have not struck one person yet. So I am not too hopeful that, at that income level, we are going to see a lot of take-up beyond what we have already got, which I suspect is partly compulsory where you have part-timers in compulsory generally defined benefit funds.

Mr Stanhope—We did ask that question: are you in a scheme where you have to contribute?

CHAIR—Do you have any concluding remarks?

Senator SHERRY—I had one other issue as we are going until 1.15 p.m. No-one has touched on the equity issue of the outrageous fees and charges that we see in the industry and their impact on retirement incomes. I understand Treasury's long-term projections estimate an

administration charge of about $1.10 a week all up, if my memory serves me correctly. But we have fees and charges well in excess of that. I just want to raise the issue of the significant impact that excessive fees and charges have on final retirement balances. What can we do to stamp out these practices?

Ms Wolthuizen—It is obviously an issue of great concern to the Consumers Association in terms of how a fund and accumulation are affected by the fees and charges that are levied on individuals, their capacity to avoid them or minimise them, and the trends that are apparent within the industry, both in terms of people being consolidated into funds where they are paying higher fees or maintaining more than one account on which they are paying fees or multiple sets of fees.

In terms of how to address that, we have pursued a campaign seeking better disclosure of how fees and charges are presented to consumers based on our own and other comprehension testing which shows that consumers have very poor understanding not only of superannuation in general but particularly of the costs associated with it and the materials that they are faced with. We see improved disclosure as being a first step towards reducing the costs of fees and charges, hopefully by promoting a more efficient market in superannuation where consumers can avoid or minimise fees, but a step beyond that would perhaps be to consider restrictions on the types of charges that can be levied.

Mr Luke—From our point of view, we see absolute confusion every day in the marketplace about fees and charges. People just do not understand asset fees. They have no comprehension that a one per cent fee can reduce their end benefit by 20 to 25 per cent. They just do not understand it. Disclosure, I agree, is the absolute key to this, and it is simple. There is all this talk that disclosure is a difficult thing to do and that it is hard for people to understand the fees of one organisation versus the fees of another, but if we ever wanted to fix it, we could. We could put five people here in a room, they would come out and it would be fixed.

It is not just in relation to asset fees. For investment fees and administration fees there is a whole new era now of retirement planning and financial planning, and an asset based fee that sits on top of that as well. More people need financial planning. As we move into a choice environment, they must have it. You cannot throw people into a choice environment and then say, 'You don't need a financial planner,' or 'You don't need advice; education will do.' Education will not do. So there has to be a way of giving financial advice, and it cannot be under an asset fee forever. There is the classic situation where, if people sit in a balanced fund today, they might do miles better by going to a planner who tells them to go to a growth fund. The increased return they will get from that is about one per cent and the cost of the advice is about one per cent, so they are worse off because they now have increased volatility for the same long-term return. This stuff is absolutely essential to us as a society. It is at the core of the efficiency and adequacy of what we are doing, and it is simple to fix.

CHAIR—Given an environment of negative returns, protected balances under $1,000 are having quite a significant impact on the net returns to all the other members, because they are weighing the fund down considerably in a negative return environment, aren't they?

Mr Luke—Yes.

CHAIR—Do you have any comment to make on that?

Mr Luke—Yes, I do. One of the major problems with member benefit protection is that people can have 50 different accounts and they get member benefit protection on each account. Somehow, there needs to be some roll-up, because we are all bearing an enormous cost in providing member benefit protection for people under that $1,000. Lots of different providers can have it. The cost to us as an organisation was about $8 million in the last year in forgone fees. That is out of a total fee income for us of around $26 million to $27 million, so it is an enormous amount of money and, in a bad year, it can affect you.

CHAIR—People have been inclined to do it in terms of negative returns, but once returns start to become very positive, you would not want to have 50 different accounts, would you? You would want to get the benefit from the income flows rather than to be weighed down by all your fees and charges.

Mr Luke—People do not care. They have superannuation all over the place and they do not put it together.

Ms Doyle—You have touched on a really important point, which comes down to members being able to accumulate their balances. I suggest that at the moment it is quite easy for members to accumulate their balances if they want to. Given that there is a lot of money in RSAs, ERFs and those sorts of things, it really comes down to people not caring enough about wanting to get their balances together, because most of the public offer funds allow members to accumulate their balances. I would be surprised if there was a corporate fund that would not allow rollovers as well.

As for people being able to say, ‘I had employment money here, here and here over my lifetime,’ and being able to touch on those funds and then say, ‘I want to roll up my balances and put them into my current fund,’ there is not really a problem in trustees enabling people to do that. It comes down to issues such as people not caring enough to accumulate those balances, rather than there being restrictive trustee rules or anything like that which prevent people from accumulating those balances. Public policy which says, ‘We need changes to trustee laws or something like that in order to get people to aggregate their money,’ is not a solution. It comes down to doing things like education, promotions and so on, or just advising members on—

Senator SHERRY—On this issue of education, I have seen a lot of literature in the last—

Ms Doyle—I meant in terms of the ATO and those sorts of things. I would have thought that it would be quite easy to send, with a person’s annual income return, a flyer or something like that to say, ‘Do you know where your superannuation is?’

Senator SHERRY—But in every fund statement that I see, there is always a reminder about people consolidating. Put aside the issue of those who do not want to get out because of exit fees—we know that that exists for some products—people just do not do it. It seems to me that we can educate all we like, but people are not doing it. The funds send out transfer forms with the fund statement.

Ms Rubinstein—That is right. There are exit fees and restrictive trustee arrangements, and we can show examples of them, but in the main you are talking about people with a multiplicity of small accounts. I know that from my son and his friends. At one stage my son had four or five different accounts with a total value of $400. I sat down and got all the forms. One had been run down by insurance and all these things had happened, and he and his friends did not care. If you are 22 or 23 years old, it is a few hundred dollars and you are resentful because you would like the money now. In the real world they do not sit down, ring all the funds, get all the forms and fill them all in. They do not look up the numbers. They just do not do it. Some kind of automatic process of matching across accounts is going to have to happen. It is the only way to do it. Using tax file numbers or something is probably going to be the way.

Ms Doyle—I agree. Even though not every superannuation fund has a tax file number, it is a start, when an income tax return comes in, to do any matching that can be done on a tax file number basis to aggregate some accounts. That would be a positive move.

Ms Smith—I agree that effective disclosure is necessary, and that has to be standardised. That is one of the problems that we have. I am not sure that it is quite as simple as Don would have us say.

CHAIR—Even though this is a pretty large fund.

Ms Smith—ASFA has initiated a number of rounds of comprehension testing that have identified the total confusion people had over the proposed OMC. We are now out in the field looking at some other models, such as projected fees or projected fees against projected outcomes and those sorts of things, to see whether people can understand them. I think that the route that we have to go is standardised and effective disclosure, tested through comprehension testing to make sure that people understand what that information is telling them. That is where we found the confusion to date.

Senator SHERRY—When will that be released?

Ms Smith—Out in the field it is now being compiled and analysed. It will be ready in time for our conference.

Proceedings suspended from 1.14 p.m. to 1.53 p.m.

CHAIR—We have one hour to look at this question of integration and to consider how to improve the coordination of superannuation with the policy outcomes of other social security measures that concern the lives of older Australians, including the aged and health care. We will start with Jane Bailey and Robert Wells from the Department of Health and Ageing and move on to ACOSS and round that way for this particular program.

Ms Bailey—We have made a supplementary submission to the committee following some other questions you asked. I would like to summarise the system that we have. Basically our aged care system in this country is structured around two major components—the residential component and the community care component. Our aged care system operates within the broader context of health, the social security network and housing and community assistance. The objective of all that social policy is to achieve a range of options for older Australians so that they can make choices and receive good care as they get older.

The first thing to say is that the majority of older Australians live very healthy, independent lives within their own means and seem to manage that quite well. People seem to make strategic choices about how they will individually age in place or what choices they will make about their housing or lifestyle support to help them as they age, and that appears to be certainly the majority of people. In our residential setting, which is where people can go when they need more care than is available at home, only about eight per cent are over 70 and about 25 per cent of those are what we would classify as the 'old, old'—the over 85s. So you can see that it is a very small cohort who go into the residential setting.

Most people prefer to stay in their own home and have assistance with care as they require it. There is a whole network of services that supports that through the Commonwealth aged care packages and the home and community care grants with the state governments. The aged care sector is about providing options for those people in the residential setting who can no longer stay in their own home but really to help people maximise their staying at home, to assist them to age healthily and with independence.

Mr Wells—In terms of the health system and health financing, the current system includes Medicare with universal access to essentially publicly funded health care through the combination of Commonwealth, state and territory funding. Along with that, there is a complementary system whereby people can, if they choose, take out private health insurance to cover special needs they might have, to get their services more quickly or to get services in a setting which is more convenient or more what they want. The current system is a mixed system, both in terms of funding—it is roughly 70 per cent publicly funded and 30 per cent privately funded through various sources—and service provision, with public and private.

Under the current system, it is possible to have essential health met through the public system. Approximately 44 per cent choose also to take out private health insurance, and that figure has been steady for more than a year. The current system provides health care for people of all ages, so there is no distinction. It is not just for working age people; it provides health care at generally an affordable rate throughout life, from infancy through to older years.

We were asked to provide some specific comments on proposals for health accounts through superannuation and for compulsory health insurance through superannuation funds. We have provided a supplementary paper in response to those questions. I should say at the outset, however, it has not been possible within the time or resources we have available to us to do detailed modelling of various proposals. Indeed, I think it would require a major commitment from government to change the current system to put in the resources required to do the sort of modelling that would be needed to see whether specific proposals improve on or detract from the current arrangements or indeed have unforeseen consequences which would only become apparent through more detailed modelling.

The current system of universal coverage through Medicare with optional private health insurance is, as surveys have shown, supported by the Australian people and also has the support of the major political parties. The department sees on the horizon no pressure from those ends to move away from the current system. I will leave my comments there.

CHAIR—You have mentioned that there is a wide availability of choice of options put to the elderly. To what extent is cost to some or many of those an impediment to access?

Ms Bailey—The way the Commonwealth funded aged care sector operates is that there is a mix of funding. In a residential setting, the Commonwealth contributes a significant amount towards the cost of care based on the relative care needs of the residents—that is, whether they need maximum nursing care or minimal assistance with daily living. The most money from the Commonwealth is paid to those people who need maximum nursing care. There is a composite arrangement in that there is the Commonwealth contribution, there is an income tested component which is based on what people can pay—in some cases that is 85 per cent of the pension and in other cases there may be more income testing—and in low care facilities there are also accommodation bonds and charges. So the cost is a factor, but the Commonwealth funded residential sector provides a minimum standard of care for everybody, regardless of their capacity to pay. It is about a minimum standard for everybody but people contributing towards the cost of their care and the Commonwealth making a major contribution towards their care costs relative to their care needs.

CHAIR—With options such as health insurance, the cost is a real impediment for some, isn't it, in terms of being able to take it up?

Mr Wells—The figures show that approximately 40 per cent of the population over 65 holds private health insurance. In terms of the cost of private health insurance, measures such as the 30 per cent rebate are designed to make it more affordable, and other policies such as Lifetime Health Cover and some of the taxation arrangements are meant to encourage more people to participate, particularly younger people whose drawing on the funds might not be as great as that of others. The premiums for private health insurance are community rated—that is, they are not risk based or age based. Leaving aside Lifetime Health Cover, where there are some penalties for people who choose not to join, by and large the premiums are the same irrespective of one's age.

Senator BUCKLAND—Ms Bailey, in response to your opening statement and, more particularly, your reference to aged care and care at home, have you looked at perhaps integrating the funding for the care that people generally tend to want? For instance, I would certainly want to be cared for at home—and I have seen that happen, but it is costly. Have you seen any links between that funding and superannuation—that is, that people could pay voluntary or additional contributions into superannuation as a means of covering those reasonably horrendous costs at the later part of their lives?

Ms Bailey—Generally, most people make provision for whatever care they need. If that care is extensive nursing at home, many people make that choice themselves and fund it themselves because that is their preference. However, a lot of people seek to move to the residential setting or have support in their home of a higher level of care, and that is certainly possible. In terms of integrating the funding into superannuation, the capacity and choice you have as you get older about care, besides minimum care needs, are discretionary things that will impact on how much income you have from superannuation.

Senator BUCKLAND—I wonder if others would like to address that. Many do take care of that. When you are working, you can take additional insurance for sickness and accident benefits that is not workers' compensation related. Superannuation is there to care for you in your retirement years. That is what most of us believe. But, in those declining years of our lives, there seem to be greater health needs as well. I am thinking of booking bulk time with the

doctor just in case! It worries me that we are not adequately catering for that in the modelling we are doing for superannuation.

Ms Bailey—I would not be able to comment on that, but the continuum of care is available. People can choose community care or residential care, and the amount they pay for that would to some extent depend on their income. There is a safety net there in terms of what the Commonwealth provides. The products offered to the aged cohort may vary as the baby boomers come into the market and more diversification of products may be available to people to choose from. Lots of private organisations, religious and charitable organisations already offer a very disparate range of products to people who wish to stay at home and to have care in their own home.

Senator BUCKLAND—My problem is that, at the lower end of the economic scale, people do struggle to stay in reasonable health care facilities, and quite often that rules out any hope of having home care. It is just an opinion.

Mr Kelly—Senator, I am sure you are aware that wealth builds up from a very young age over time, which appears as a sort of hump shape that peaks just at retirement. Older Australians are actually the wealthiest Australians. Of all Australian families, the older ones are the wealthiest. By the year 2030, almost half of the wealth of families will be in the hands of families with a head aged 65-plus. So, in theory, they are quite wealthy. And yet we have talked today about the fact that they do not have much useable wealth because over half of their wealth is tied up in the family home. The reason their wealth is tied up in their home is Australians great love of owning their own home. We talked about the aged care requirements for people who want to stay in their own home. But there is also the concessional treatment that it receives from social security payments—the age pension—and so on. So I think we need to look at a way of perhaps releasing some of the equity that people have in their home and using that in some way.

Reverse equity loans were mentioned earlier on. They have been tried in Australia and have not been very successful. If a way could be found where it was included as an asset in the assets test—perhaps not all of it, but a portion of it—that would encourage people at least to re-evaluate or think about having too much in their house. I am trying to address the asset rich, income poor people, especially the widows in Sydney in their million dollar houses who basically have no income. So there is considerable scope for looking at the way the means test works there—which assets are included and so on—to improve the integration of those two things to release some of that wealth. We have talked about people retiring for various reasons too early and using their superannuation before they get to pensionable age. From the government's point of view, it is not getting the benefit of that asset. Again, we need to look at initiatives that encourage people to stay in employment or to not use that money—increasing the age at which you have access to superannuation was mentioned earlier on—before they are age 65 or whatever.

CHAIR—Why don't you think the reverse mortgage scenario caught on in Australia like it did in America?

Senator SHERRY—It has not caught on in America either.

Mr Kelly—I do not know that it has been a great success. I think it has been used in England with some success. In America—

Senator SHERRY—Take-up figure of 60,000 in America.

CHAIR—That is not much, is it?

Mr Kelly—With a hundred million families, that is obviously not a very successful program.

CHAIR—But there has been more success in the UK?

Mr Kelly—I believe so, yes. I cannot talk about that system, but other people might be able to. I think Australians do have the great love of owning their own home, which perhaps in the UK has not been there for the generations that it has been here. So that may have something to do with it. The government initiative that is currently being assessed by the Menzies Research Centre involves a deal where you have partial home ownership with the banks. It may work if the details of that system can be worked out so that it is attractive to both banks and people. I question whether it would be a great success, but that sort of idea deserves encouragement.

Senator SHERRY—Mr Wells, you were mentioning private health insurance and the figures for people over the age of 65. What was the percentage you gave?

Mr Wells—It was 40 per cent.

Senator SHERRY—Has that gone up since the rebate was introduced?

Mr Wells—Sorry, I do not have those figures with me. I could come back to you on notice.

Senator SHERRY—I understand that it has not gone up. That is what I am told.

Mr Wells—I would have to check that. I do not have that information with me.

Senator SHERRY—What is the sense of the rebate if it has not gone up for those people?

Mr Wells—There is a combination of policies; it is difficult to say which policy has had which impact. Before the rebate came in, and before Lifetime Health Cover, private health insurance participation across the population was around 30 per cent. It is now, as I said, up around 44 per cent, so there has certainly been a significant shift. Obviously a high proportion of that would have been in the younger groups, because the Lifetime Health Cover incentives cut in for people aged between 30 and 60. I do not have those previous participation rates.

Senator SHERRY—If health insurance for the over-65s has not gone up, then it has not met that objective—but it has decreased the cost, presumably, at least in the short term.

Mr Wells—It has made it more affordable.

Senator SHERRY—Yes, in the short term.

Mr Davidson—I will confine my comments to two questions: the relationship between superannuation and the social security system—aged pensions in particular—and the relationship between superannuation and aged or health care. In relation to the aged pension, there is a disconnect between the superannuation system and the aged pension system, and in a sense there always will be, because they perform different roles. One is about income replacement and is based on the individual to a large extent; the purpose of the other is poverty alleviation and it is based on the income of the family unit.

I would like to put to rest the notion that ACOSS would like to use the superannuation system to equalise wealth distribution in Australia. We are not that ambitious, to be honest. I would be very happy if the present superannuation system did not contribute to making the distribution of income and wealth worse. If the tax treatment overall, for example, were proportional rather than regressive, that would leave the aged pension to do what it does best, alleviate poverty, rather than its having to focus on compensating for a regressive superannuation system. Having said all that, the superannuation and aged pension systems would be better connected if lump sums were more restricted. There is a serious disconnect between the two systems that threatens to undermine both. In our view, the best way to achieve that is to place restrictions on the level of lump sum benefits—a simple cap which is either reinforced through the tax system or reinforced by banning lump sums above a certain level. Other countries do that; why can't we? We do not believe the solution lies in making income streams more attractive through further concessional tax or income and asset test treatment, because we do not believe it is necessary or desirable to forgo further public revenue to that end when a simple cap would, to a large extent, do the job.

In relation to health and aged care, the main issue is whether the superannuation system should be used for health insurance or health saving purposes. We are actually in favour of using superannuation, within certain strict limits, for a range of purposes, such as health care, housing or career breaks for further education or child rearing, but probably not specifically for health purposes. The reason for that is that we are not convinced that that is the best and fairest way to shift the incidence of the costs of health care from government to individuals or whether that is a desirable thing to do. Essentially, that is what you would be doing by using superannuation for health purposes. There would inevitably be a shift in the incidence of the cost of health care from government and general taxation to individuals through their super accounts, whether or not that is the intention of the policy in the first instance.

Having said that, we would not rule out some shift in the incidence of health care costs, including those for retired people, towards individuals. But the debate should start with a discussion of efficient and equitable ways to finance health care, rather than as an add-on to the debate around the design of the superannuation system. I suspect that, if we started there, hypothecating superannuation to health care would not be the answer.

I think it is also worth pointing out, as a number of experts in the field have, that it is no bad thing that over the next 20 to 30 years a higher proportion of GDP will be devoted to health care and aged care. It is no bad thing, in our view, that government expenditure in that area as a proportion of GDP is likely to rise. If you have an ageing population, there is a need to devote a higher proportion of GDP to that purpose, and one of the most equitable ways to do it is through government financed services.

As I said earlier, we would not necessarily rule out some shift towards private financing. But we should agree at the outset that it is not an undesirable thing, in the context of an ageing population, for a higher proportion of GDP to be devoted to health and that government expenditure on health in proportion to GDP will rise. I am sure it will, and that is a good use of resources under those circumstances.

Mr Stanhope—I have a few comments to make about the integration of the social security system and the superannuation system. Firstly, I have a couple of small observations. The rules are getting out of kilter between the two systems—not that they were ever much in sync. One standout, small example is that last year the social security rules allowed for income streams to be commuted up to $10,000 in the case of hardship. Commutation of that would immediately make the fund noncomplying under the tax rules. If the left and right hands of government do not know what they are doing in those circumstances, we are facing a bigger battle than we might think.

Secondly, and much more seriously, the social security means test rules for income streams are distortional. They did not set out to be but they are in practice—and I will talk a little more about that. Thirdly, we have, in effect—although not by intention—a gate on the tax preferred retirement income streams, which still meet all the policy objectives of drawing down capital over the whole of retirement, effectively kept through superannuation. So you cannot put ordinary money into an allocated pension or annuity, which is by far the most popular retirement income stream product. That is a consequence of a number of technical rules which could and should be fixed.

Let me talk a bit about the distortion in the income stream rules. The recent social security rules, which came in in September 1998, attempted to move from what they call a 'product based environment' to a characteristic based environment but, because of some critical misunderstandings about the nature of the market, they wound up being just another raft of provider based legislation. That is, in order to be in the asset test exempt category, you have to do one of two things. The first is that you have to give up access to your capital. In our research last year in a project called *Retirement savings: desires and drivers*, although we were looking for a whole lot of other stuff, two things cropped up as the most disliked component of a retirement income stream and the most liked. The most disliked was losing your money into a risk pool—people simply were not prepared to do that—and the most liked was that, if you died early, any remaining benefit that you had not been able to use in life would pass to an estate. People are clearly very opposed to joining risk pools. That is something that clearly needs to be taken into account in the design of the social security rules. If those things are desirable, there is an opportunity to put an asset test premium on those things, as but one mechanism to make the outcome a little more neutral and probably more revenue positive for government.

In terms of the income stream rules for what are known as 'life expectancy' income streams, the way those things work—with a guarantee required on the level of income—means that, in effect, in the Australian marketplace you have to have a life office to offer that product. There really is no other mechanism by which you can take returns from different sectors of the market, even if you were doing that, and pay them to people across the whole of the retirement drawdown. In fact, what happens is that people simply match assets to the income flow. But, again, to do that, you need the statutory fund of a life office; you cannot really do it through a managed fund. That was not the intention of the social security rules, but that has been out their

outworking. You will not find those kinds of asset test exempt income streams being offered by managed fund providers—because things just do not work that way. It has been a long and hard battle to convince Treasury and Social Security that that is how it is out there in the real world.

As a consequence of those rules, we saw some very interesting numbers produced at the Colloquium of Superannuation Researchers this year. FACS data showed that, compared with the over-70 cohort, the under-70 cohort appeared to have more assets—which you would expect; they have not used them up yet—and more income, which you would also expect. But what you would not have expected—but it was in the data—was that they also had more age pension. So the new rules have run out more outlays, more age pension, to wealthier people than did the old rules, and it seems a slightly perverse outcome. We as an industry are finding it hard to get traction on distortional rules. Numbers such as that show that we have still got quite some way to go.

The third point I would like to make—and we have covered this off this morning—is that that we clearly need more flexibility and integration in the transition into retirement. We need to update all of those rules. I do not need to talk at length about that, because we did that this morning, but those rules are inherited from the old Occupational Superannuation Standards Act. It is time that we started to look at which ones are appropriate and which ones are not, and to see what we can do to allow people to move people from full-time work into full-time retirement over whatever period it actually occurs in.

I will make a comment, in terms of this integration debate, about preservation ages. We need to be very careful. If we move the preservation ages upwards, we will expose even more people to preservation ages after they get to a point where they cannot work or do not want to work, either because of their health status or because they do not have a job. We will need a whole raft of new release of benefit rules if we start to play around too much with the preservation age. Senator Sherry has made much of the fact that we currently have about $350 million a year coming out in early release, and so those rules would have to be changed.

I will make a comment about reverse equity mortgages, because they are always put on the table in this debate. The question is often asked: 'Why aren't they available?' One of the first points to make is that, in the US experience, they were expected to be so popular that the first run was balloted to 50 institutions. There have been a number of supplier exits from the reverse equity mortgage market in the US, because it simply has not worked the way anyone expected it to. The demand that people keep hypothesising just does not eventuate. Perhaps the most compelling fact is that the US government started the securitisation of those mortgages. They intended they would all be securitised into the secondary market through the Fannie Mae Corporation—their federal national mortgage loans association—which is a US government instrumentality. They have not been able to exit that market—they are still the only securitiser of those mortgages—and so, in effect, the risk in that portfolio is still underwritten by the US government. So these things have a lot in promise but not a lot in actuality. They are very complex beasts to get into place.

The risks and the costs associated with them mean that they probably could not be provided as a pure market product for the same rate as an ordinary housing mortgage, and I think that that would meet with very great resistance on the demand side. The pilot scheme that was started under the Keating Labor government and not continued by the current government had an

interest rate subsidy in it of one per cent. Those kinds of issues are quite critical to acceptance of reverse mortgage schemes. People in Australia keep forgetting that not only are there a whole lot of supply issues in getting the thing to market but also there is a real demand issue—whether people are prepared to pay for the risk in the product and whether a subsidy would be needed to get over that demand hurdle, much less all the other hurdles.

Lastly, I will make a couple of comments on health and aged care. We spoke very little about this in our submission; we do not see it particularly as an area of IFSA's expertise. My first comment is that superannuation is not a magic pudding, as people have said very many times. If we are going to move into any expansion of the provision of superannuation, then let us get adequacy sorted out first. I do not think we are there yet, and so now is not the time in that sense for drawing on current contributions. However, there may be some sorts of roles—and we pointed this out in our submission—for funding bits and pieces of aged care. In particular, we suggested extensive care. There is a high degree of concern in the community about what would happen if you need it, but it actually happens to very few people—depending on which level of care you are talking about, only between three per cent and seven per cent of the retired population ever wind up needing it.

There are obviously opportunities for superannuation-like mechanisms in that market. But, whatever is proposed in that market, it is quite critical—and we made this point in our submission—that the funding should be limited at most to the additional demographic demands on the system or to some proportion of them. If it is seen as the replacement of the current basic funding of the system—not that Health is proposing that—I think it would be viewed as a very cynical exercise by the population, which would tend to erode confidence in superannuation. We would be very concerned about any attempts to overfund health from superannuation, in that sense.

Ms Doyle—I would like to touch on some of the issues of integrating the age pension and income streams. As you are all aware, we have a voluntary income stream market here at the moment. The way that we encourage people into income streams is being provided not only through taxation but also through the assets test and incomes test with the age pension. It is quite interesting how we have combined the safety net with the provision of private income streams as well. We have not exactly got it right there—because of the way that, as Bill mentioned, you have some income streams that have more preferential arrangements than others. Getting away from that, I think you are also talking about the incentives between taking a lump sum and an income stream, let alone the different types of income streams there are. Most people might say, 'The balances aren't big enough and that's why people take lump sums,' but the levels that you have on the tax-free thresholds and the RBLs are indexed. They keep moving and looking bigger and bigger compared with the balances that are there. If you fundamentally want to address people taking income streams, you have to look at that as well.

I want to take up some of the points that Bill mentioned in relation to the income streams. At the moment, we have the most preferential arrangements given to those income streams which last for a lifetime or a life expectancy. But in the market, we are finding that they are not very popular with consumers. Some of the characteristics of those income streams are that they lock the retiree into a fixed rate of return and, therefore, a fixed income—be that nominal or indexed at a certain rate. Coming out of an environment where you have had asset and portfolio choices and then locking yourself for a long time into those sorts of flows has not been very popular.

Likewise, it is only when you hit the really high RBLs that those sorts of income streams make a bit more difference to you as well. So those are features of the products that you might say we really need to address by asking, ‘What do today’s retirees want?’ Those types of products were derived a long time ago, and one would say that they need to be brought into the 21st century for the needs of today.

Another point with the lifetime income stream is that consumers are probably a little concerned that they will lose their capital. At the moment, you can only guarantee 10 years of that capital. We have been trying to raise that to more of a life expectancy rate. We see that that would be an improvement there. If you could guarantee 15 years worth of the payment, that may well be more attractive because at least it is lasting for life expectancy rather than just 10 years of payments. We think that would be an improvement on the lifetime pension. You also have to remember that the lifetime pension is pretty much like an indexed annuity. Actually, the government is one of the better providers of a wage indexed annuity over the lifetime; and so it is very hard to ‘compete’ with that. Looking at the longevity products that are out there, if you are talking about the government being one of the better providers of it as well, it is very hard to compete in that marketplace for a lot of the lower level consumers.

Looking at the way that the incentives all work together, the types of income streams that are out there and the features that people want, there is no doubt about it, they have to be there. You want them to draw down an orderly income stream over a long time and not to have too much flexibility because, if we are going to keep tying the incentives in with the age pension, there are going to have to be some controls over it. Otherwise, you back out of that and say, ‘It’s not tied in with the age pension,’ and you have a different set of incentives. Basically, that is where we think a lot more needs to be done, from that perspective. In relation to health, when we are talking about baby boomers and looking at the amounts of money that they have, I would have thought that funding the next 20 years might be a quite difficult task for them, let alone looking at aged care! Sometimes we might have to focus on the here and now for some groups with health.

Looking at what other assets they have, we have looked at accessing capital in the house. Once again, we talked about the reverse mortgages. In the UK we have what we call an ‘equity release’ product which is offered through one of the UK subsidiaries. It is usually bought by people who are 70 to 75 who are maybe looking for funding from a proportion of their house equity. It is not very often that you find that they would actually release 100 per cent of the capital in the house—it might only be 20 per cent. It can be as a lump sum or as an income stream for the retiree, but usually it is not a great deal that is coming out. Lump sums are very popular, and if they want to they can pay it back; so they can release the mortgage over the house. Usually you will find that we have done it with a mortgage provider underneath, and so it is not the life company that takes the sole risk of that; it is with a partner as well. That way has been seen to be quite popular in the UK.

Senator SHERRY—I want to clarify something. Maybe Mr Gallagher or someone else could answer this. With respect to incentives, I notice, Bill—I do not want to unfairly pick on you—that you used the word ‘subsidy’ when it came to reverse mortgages. Perhaps ‘subsidy’ is a reference to a financial incentive for something that we do not like, and an ‘incentive’ is something we do like. With respect to the current incentives or subsidies that are paid for income stream products, is it the 15 per cent rebate?

Ms Doyle—That is on all superannuation provided annuities.

Senator SHERRY—There is also the 15 per cent senior citizens or offset—I forget the technical name of the program.

Mr Stanhope—The older Australians tax offset.

Senator SHERRY—What is the cost of buying an annuity? What is the ballpark figure?

Mr Stanhope—Those costs are published regularly. I do not have them at my fingertips, but every issue of *Personal Investor* will have a range of annuities that you can purchase. Generally, by the rate you will get for $100,000 is how they are published. They are in the press every week. They do move around with the fixed interest market. One of the risks of purchasing a fixed interest annuity is that interest rates might improve in the next few months.

Senator SHERRY—But what is the ballpark figure at the moment for, say, $100,000?

Mr Lewis—In our submission we quote a current annuity market for a $100,000 payment, producing $5,960 as the first-year income, CPI indexed, for a male aged 65.

Senator SHERRY—For life?

Mr Lewis—For life. And $5,212 if that includes a reversion to a surviving spouse.

Senator SHERRY—Is it a lower outcome for a female if they bought—

Mr Lewis—Yes, it is.

Senator SHERRY—Why is that?

Mr Lewis—Because they are expected to live longer.

Senator SHERRY—Should it be? It seems to me that it is a form of discrimination. The pension system does not pay a lesser pension to women because they live longer.

Mr Lewis—No; the federal government picks up a higher cost for pensions for women. It comes down to a question of whether you are looking at individuals or at a group, as to which way you go on that one. It is a debate all around the world as to whether you have what we might call unisex annuity rates or whether you have rates that reflect the situation for the individual.

Ms Doyle—Here in Australia we have a very small pool. It is a voluntary market here, and so doing a unisex rate would be very expensive. You usually find it is more in—

Mr Lewis—Those annuity rates sound conservative, and part of the reason for that is that the life office is guaranteeing for the next 20, 30, 40 or 50 years that it will be there and will pay a defined amount. Not too many organisations do that, other than perhaps the federal government.

It is going to be around and it is going to actually pay that money. So it has to be reserved and it has to have the right investment strategy. That is why those rates are low. The other thing that was mentioned earlier was the 15 per cent. That 15 per cent rebate on annuity streams is really a refund of the 15 per cent contributions tax. So it is not really an incentive; it is just an equalisation.

Senator SHERRY—I understand that, but it acts as an incentive.

Mr Lewis—Understood.

Senator SHERRY—In terms of costs, what is the average fee and charge on these sorts of products, as a percentage? Can anyone enlighten me?

Mr Stanhope—According to the research that we have provided to you from Michael Rice, it is 1.7 per cent.

Senator SHERRY—Is that the average?

Mr Stanhope—Yes, across all income streams.

Senator SHERRY—Do you know if that is a trail commission through the life of the product generally?

Mr Stanhope—As you know, that is not within my expertise. The number I know—

Senator SHERRY—I wondered whether you knew or not.

Mr Stanhope—No. I can find out for you, but it is in the Michael Rice data that we have already provided to you.

Senator SHERRY—Does anyone else know amongst all the experts?

Mr Lewis—That was a per annum figure, was it?

Mr Stanhope—It is TER.

Senator SHERRY—What is this 1.7 per cent charged against? Is it through the life of the product, or is 1.7 per cent the entry fee that is charged?

Mr Lewis—No. Michael Rice did numbers on TER.

Dr FitzGerald—It is not an annual charge; it is the entry charge.

Dr Knox—I would have thought it would have been the initial fee.

Senator SHERRY—Nothing else is charged through the life of the product?

Mr Lewis—There would be an initial fee, which could vary, depending on whether there were things like commission to the intermediary. When you say 'initial fee', it is all built into the price of an annuity. The 'annuity price' means that, after all fees have been included in the calculation, there would be an initial cost and then an ongoing cost. I do not know if the 1.7 per cent is the average of the two—

Mr Stanhope—That is across all income streams so that is a TER figure for allocated products as well.

Mr Lewis—So there are allocated as well as immediate annuities in there. Sorry, Senator, I do not have the numbers in front of me. It would be built into the annuity calculation. There would be an assumption as to an initial cost and an ongoing cost—including the cost, for instance, of monthly payments into a bank account.

Senator SHERRY—Is that figure that you identified earlier net of fees, charges and commission?

Mr Lewis—Yes, it is.

Mr Brake—I will only make very brief comments here in terms of integration between the superannuation and the social security systems. It is important to note that our system is a three-pillar system. There is talk from time to time about having arrangements whereby people would not be drawing down on the aged pension. The outcome for the current system is that, even into the foreseeable future, most people will have access to at least some part-rate age pension. To back up Mr Gallagher's point earlier that superannuation builds on the aged pension arrangements, that will be the case for most people. As I earlier noted, the government has introduced a number of policies which allow people to continue contributing to superannuation past age 65. Growth pensions in particular was an issue raised by Mr Stanhope. The government is committed to an examination of growth pensions, and we and the Department of Family and Community Services are actively working on that examination at the moment.

Mr Gallagher—One important issue with regard to superannuation and retirement incomes is the nature of the integration. One major issue here has been whether there is a major problem with double dipping—people getting their superannuation money and spending it, before accessing the aged pension. In looking at the overall equity of the scheme, certainly double dipping presents a theoretical problem. However, we did some research in RIM that looked at ABS data on what people did with their lump sums. We found that people with enough money to affect their pensions—that is, they had a reasonable amount of money, given the three tests: the aged pension, income test and asset test—predominantly invested any superannuation amount received. Even if they took it as a lump sum, they still invested it and tried to make use of it rather than spend it on an overseas holiday. So it is not clear that there are major issues with double dipping at the moment. But there certainly is potential there, and it is an issue that probably will be kept under review.

The other issue is the link between superannuation and aged care. As we discussed this morning, superannuation in conjunction with the aged pension should give, ideally, a replacement rate for income during working life. Although people may vary in the targets they set, the range of targets people were suggesting this morning suggests that perhaps people when

they retire need less money than they did during their working lives. Health does not work that way. Whereas everyone needs income in retirement, health costs in retirement are highly variable. You are faced with the difference between the people whom Ms Bailey has described as having a healthy retirement and therefore not needing a lot of health care expenditure in their older age and the people who end up requiring nursing home services and acute care hospital services in the one year. So it can vary from very little up to $100,000. Given the huge variability in health costs, it is very difficult for people to save directly to meet those costs and, irrespective of the saving mechanism, you probably need some sort of insurance mechanism to intermediate.

CHAIR—Yes, we got that evidence from one of our earlier reports.

Ms Wolthuizen—I just wanted to echo some of the comments made earlier by Mr Kelly regarding reverse equity mortgages. We think they are worth considering, particularly as long as eligibility for the aged pension is measured with respect to a means test but the family home is not subject to that same test. It is worth looking at ways of unlocking equity in the family home, particularly in the kinds of situations we have reported to us by people who have elderly parents or relatives who cannot pay their rates because they are living in a house in an area which has experienced rapid property value rises. In those scenarios they do not necessarily want to see the individual having to move and sell up in order to afford to live. By the same token, there is a sense of a growing demand for that sort of product and it is worth looking into, to see if it can be made viable. I also think some of the demand issues which may have prevented it from being popular when last examined in the Australian context possibly do not exist any more, largely because of the focus on rising property values in certain Australian property markets.

CHAIR—Sometimes I have heard that the children are not all that keen on mum and dad doing that.

Ms Wolthuizen—But they are probably not that keen, either, on selling up the family home and using the proceeds to put the parent into expensive aged care facilities, either.

CHAIR—That is right.

Ms Wolthuizen—So I think some of those issues are perhaps changing attitudes, as well.

Dr Knox—In view of the time, I would like to make just three brief comments. My first point is that in terms of integration we have mainly concentrated on superannuation, the aged pension and social security. I will not go through the arguments and the disconnect that we have talked about, but we need to recognise, as we did this morning, that there is another part of that integration, and that is part-time and casual employment. Therefore, the whole system needs to be flexible enough to enable people to move in and out of part-time or casual employment while they are in their sixties and even their seventies.

On top of that we need to have a tax system, together with the means testing system, that actually encourages that sort of behaviour. I do not say that we should force it; I do not want people to work until they drop dead—to use Senator Sherry's comments of this morning—but I think we need to encourage behaviour to maximise what you can call the 'human capital'. We are going to need it with an ageing population, and the current system just does not do that. We

need that integration of superannuation and pensions with employment conditions and the tax system, to encourage the appropriate behaviour in terms of employment and the use of the financial capital that these retirees have.

The second point I make is about one of the questions you raised in terms of the sustainability of our aged pension system. I believe it is sustainable in the longer term, because of the means testing. It will grow a little bit in terms of GDP, but I am quite sanguine about that and I think that is okay.

Senator SHERRY—Just on that point, is it sustainable because of its low rate?

Dr Knox—Its relatively low rate.

Senator SHERRY—Compared to other OECD countries?

Dr Knox—The growth that we are going to see in government expenditure in the next 20 to 30 years will not be in the age pension area but in the health area, as the Intergenerational Report—

Senator SHERRY—On that point, does anyone have the figures on what the current assets test and means test are actually saving us on the age pension?

Mr Dolan—We estimate that the income and assets tests currently save roughly $6 billion to $7 billion a year on the age pension. That is compared to a total expenditure now of $17 billion a year, and so it is quite a big saving. That saving would, of course, rise over time as the population ages.

Dr Knox—My third point concerns health funds and super—whether we should have health funds as an extra account area. My view at the moment is that we should not, for a couple of reasons. Mr Gallagher highlighted the fact that individual health expenditure is incredibly variable. When we retire, most of us expect to live for 10, 20 or 25 years and have a fair idea of what our income needs will be. Some of us will have very significant health costs in retirement, and some of us will have almost nil—we will live a healthy life for 10 years and drop dead on the golf course or something like that. There is incredible individual variety—much more so than in retirement income—and you will therefore need some pooling. So, at the moment, I do not think the super system is the way to go. I would also make the point, which we talked about this morning, that it is important to get the super system for retirement income right before adding health—to get the adequacy and the tax system appropriate before adding another area of complexity. So my view at the moment is that we should not add health to super; we should get the retirement income component right first.

Dr FitzGerald—I will talk about integration on the health front rather than with the age pension, which has probably had enough treatment. Let us step back and ask why this is an issue. In a paper published a couple of weeks ago we included a chart similar to the one in the Intergenerational Report, although we did it in a slightly different way. We built a model explaining demand for each of 12 or 13 categories of health and aged care service, by single age and gender, with a detailed cost function for the provision of each of those categories of service

and a detailed model of who pays for them under current arrangements—or alternative ones, if you want to model those in.

Over the 40 years that the Intergenerational Report looked out, purely for the Commonwealth budget, we get a similar answer when we take out the part of the expense that is borne by the Commonwealth budget—5¼ to 5½ per cent of GDP or so more than now. The composition is a bit different: we have stronger growth in aged care costs to the Commonwealth budget and we have not continued the recent extraordinary—extraordinary in historical terms—very rapid increases in the price of pharmaceuticals out for 40 years as the RIM group did. But overall we get a similar number of something like a five per cent increase in the Commonwealth budget outlay—five per cent of GDP, that is—which is considerably more than the GST raises now.

Before racing ahead to the next part of the story, which is how such a thing can be paid for, it is worth saying that in projecting forward costs under the current system we have to be extremely conscious that we are paying for something with a lot of micro-imperfections that has been sheltered from the microeconomic reform we have seen in many other areas of government provision of services, such as the utilities. It is very hard to think of an area of provision of services where there is more compartmentalisation into rigid occupational categories—nurses not being allowed to do anything that is the traditional work of doctors, and so on. Those sorts of work practices are one set of issues. There is also a great deal of variation—extraordinary variation, in some cases—in the extent to which treatments are provided to similar groups in different parts of the country.

You would think, looking at all of the evidence—as a forum that our firm organised a few weeks ago did—that there is scope to take quite a bit of cost out of the system while getting better outcomes. But there is no doubt in my mind that the costs, both to the society as a whole and to the Commonwealth budget under current arrangements, will rise very considerably. It is not possible to say that there is only a little bit due to ageing and a lot due to other drivers of cost. In fact, the interaction between drivers of cost—such as increasing costs of technology—and the ageing is what produces the big numbers. You could say that, if there were no other drivers of costs, it would only be plus three per cent of GDP, but in fact the two together are what produce the big number, not one or the other. The fact is that it is like superannuation and provision for retirement income, it is certainly something to do with old age. It is a future need. Looking at the baby boom generation, it will be mostly for them, over the period of the Intergenerational Report, that we see this increase.

The issue is not about whether it is a good or a bad thing to provide good health care for that generation. We will do it and we will want to do it. Really the issue is about how it is to be equitably funded. Given that it is a large future foreseeable need of a similar kind to the retirement income we are funding for, one would think that some sort of prefunding has to be part of the solution. Some of that prefunding might be what we already see around us—that is, the money that is going into superannuation or into our houses—and the question then becomes: how do you have the baby boomers, in their old age, with enormous assets, pay a fair share as against the future young taxpayers? I think that Peter was alluding to ACOSS not being against the idea of pretty well-off, asset-rich baby boomers somehow having it arranged that they pay some greater share other than through taxes, which they will pay some of.

That was the set of thoughts that led me, as the one who threw this into the ring a couple of years ago, to think of having something like health accounts in the superannuation system. This would not be a full-service health insurance type operation—because obviously, as a couple of the speakers have said, everybody over 65 can pay regular premiums, but the actual need for health services is highly variable. So there has to be some pooling aspect; but I do not see that as being done in the superannuation system. It may be done as it is now in the public system, by sharing all the imposts on the budget and having them met either by taxpayers or by individual contributions that we make when we go to the chemist and so on. But my view is that the balance does have to shift, otherwise the situation looks inequitable.

There is something to be said for having people see part of their super building up to give them a provision—that they will see in their statement when they retire at age 60 or 59 or whatever—so they can say, ‘I have this provision that will allow me—if only someone would provide it to me, if my choice is private—a fairly predictable basis on which I can be covered for my retirement. I have the provision for it. Will somebody offer me the product?’ Or else they can say, ‘I prefer the public system, thank you very much,’ and there could be another set of rules that say there will be some sort of annual contribution, or whatever it is.

One way or another, you cannot get over the fact that there is a big impost on future budgets that has to be met, at least in part, out of the accumulations that the baby boomers make. If we can work out how to access the wealth in the bricks and mortar that they will own—which is an extraordinarily important thing for many people to turn their minds to—then that will greatly reduce the problematic aspect of this issue. But that is a complex enough issue on its own.

In conclusion, it should be said that there is already quite a lot of relevant behaviour out there, particularly in respect of people who are going into low-care aged care or hostel type accommodation, and there is no great political fuss about many of those people selling their house and deciding that they are no longer going to come back to the family home and moving on. That happens without fuss, and so there is a certain amount of realising of the wealth in the family home going on now without fanfare. One would think, when addressing the issue of the elderly person unable to pay the rates and rattling around in a big house in Mosman, that that is a ridiculous situation and a solution could allow some of the wealth to not only be liberated to pay the rates but also give that person some decent top-up to their income. The issue obviously has many benefits, if it can be resolved.

Ms Smith—In looking at the household expenditure profiles for older people using the ABS data, our target was set assuming the status quo in terms of the provision of Medicare, PBS and the other range of services. To the extent that we are expecting more to be paid to cover those costs, the adequacy target of savings needs to be lifted at the same time. Our preference, though, would be to try to maintain at least the current level of services. What Vince and others have said on the expectation of health costs is true: they will be going up in the future. Part of the saving for superannuation goes to that so-called ‘discretionary health’, and it is a large part of what saving superannuation is about.

Looking to a mature system, I think there are a couple of things that need to be touched on in terms of the integration. I agree with Phil: at the moment I do not think there is any evidence of double dipping occurring in terms of the lump sum—for the most part, people use that money sensibly. On the mature system though, for when those amounts of money become larger, I

think it is sensible to put in place now some cap on what that lump sum might be—whether it is $50,000 or something like that for use and then the rest required as an income stream. We think that going with an income stream model makes sense in terms of retirement strategy, although if we do go down that path we need to think of a broader range of products than are there now. Clearly, the set of allocated pensions versus complying pensions does not give much flexibility for people to meet their needs.

Senator SHERRY—On that point: for overseas, where there is little if any lump sum, do we have any overview of what is available in those markets and the costs?

Ms Smith—I cannot help you with the costs. Certainly, in the UK model—and maybe there would be other people more equipped to talk about this than me—there are a range of products available which allow you to have, for example, lower start-ups in terms of what you draw down and then enable you to take out more in later years. There are those sorts of things, which are akin to an allocated pension arrangement that allows some variation of draw-down.

Senator SHERRY—I did not so much want detail now, but I do not know whether anyone here could provide us with information in that area. It seems logical that there is a greater range of products: there must be a greater range of demand, because they do not have the same lump sum issue.

Mr Lewis—Senator, I am not so sure about the UK, because they have been used to receiving income streams and so they tend to have them more structured, more like a pension or an annuity. In fact, I think the allocated annuity is more an Australian sourced idea.

Ms Smith—Yes. I meant to say, though, that what is happening is that the market is in fact moving from just the pension to a variation, in the UK. We have some papers on that that we received from a conference we had at the IMF, about some of those new arrangements coming into place. I wanted to highlight too that, if you look down a mature system and the amounts that are likely to be saved in the $140,000-$280,000 range, this is where there does need to be some finetuning between the asset test and the income test and the way that that works. The asset test, in comparison to the income test, is more punitive and there is a range of income in which the effective marginal tax rates go over that 100 per cent mark. We need to finetune that so that there is comparability between that arrangement and ensuring that there are some incentives to save there. I do not have the answers to that, because there is always the balance between that terrible trade-off between getting the tapers down but not blowing the costs out. But we do have to make that work better.

I would agree with people raising the issue of home ownership. Clearly, that is an anomaly at the moment. If 50 per cent of wealth is being put into the home and the incentives are there for people to put more and more into the home, yet it is outside the asset test arrangements, that is clearly creating a number of anomalies—as is the senior Australians tax offset. If we are looking at a system which is looking at replacement rates pre- and post-employment, that is another area that is not really working in sync. I am afraid I do not have the answers, but I would pinpoint those as the critical issues.

Mr Dolan—Talking about the age pension and the superannuation interface, I would first of all like to reiterate the point that the age pension is a needs test safety net and interacts with the

superannuation system, although the age pension in a sense looks at people's circumstances well beyond those provided for by superannuation, and so it is a little broader in its scope. The age pension future expenditures are expected to be fairly sustainable and of moderate growth over the coming decades, as noted before, due to the operation of the means test—which, as I said before, reduces current expenditure by about $6 billion to $7 billion a year. So it has quite a significant impact on the age pension and on maintaining its affordability. As I said, the means test is very broad based. It looks at people's circumstances in order to determine how much pension payment they may receive. People acquire their assets and income from a whole range of sources other than just superannuation. People have income and assets from business, rental property, financial assets and inheritance. So, in a sense, the means test recognises the broad range of vehicles through which people build up their means.

I noted that Philippa raised the issue about the interaction between the assets test and the income test. I should note that the assets test is designed for a different purpose. There are high thresholds before the asset test applies. This is designed to ensure that people with sufficiently high wealth do not access the age pension. Even with superannuation kicking in—more so over the coming decades—the means test will likely continue to have a broad impact, given that people will continue to obtain their income and assets in retirement from a range of sources other than superannuation.

I notice that the first dot point of today's agenda mentions consideration of a universal age pension for people aged over 80 years. That would obviously come with some cost, and we estimate it to be over $2.5 billion a year. Given that the total savings from the means test is $6 billion to $7 billion a year, it is not surprising that exempting the over-80s would cost a significant amount of money, which again reflects the wide variety of income and assets that they hold. So there are some issues there.

Mr Maroney—Superannuation has been a political football for nearly all my working life, which dates back to the early eighties. One thing that I have noted with interest is that all the official inquiries into how the system runs et cetera since and before then, probably dating back to 1975 with the Hancock inquiry, picked on the issue of lump sums and pensions and said that we need to force people to take pensions or annuities to make this system work. That was 27 years ago. I am not an Eastern Suburbs rugby league supporter but, if I were, I would still be celebrating today after the big win on the weekend, and I may be hopeful that after 27 years there still is a chance of getting that line of inquiry up. While the political parties have been on different sides of most other issues, I can only think of one occasion, if my recollection is working right, when one of the parties proposed compulsory pensions. I think that that was John Hewson in regard to the Fightback superannuation proposals. David Knox might remind me whether I am right or wrong. Regardless, it has generally been regarded as a very politically difficult thing to force people to take pensions or annuities. That is 27 years down in my counting.

One of the other things that we heard today was that last year 30 per cent of benefits taken were converted into pensions. I think that they said 'only 30 per cent'. I say that 30 per cent is quite good. Ten years ago it would have been close to zero. Despite the lack of enforcement, we have moved from an almost zero pension system to a 30 per cent pension system by the way that the rules have evolved. Maybe the problem is solving itself, because there is a big attraction under the tax and social security rules for people to take a pension. As education continues and

people's benefits grow et cetera, I am not nearly as pessimistic as I would have been a few years ago. As I said, I am not an Eastern Suburbs supporter; I am a North Sydney supporter, and I gave up my hopes of winning a New South Wales NRL premiership about four years ago when they got booted out of the competition. Around that time I decided that perhaps forcing people to take pensions or annuities is not necessary and that if we can keep encouraging them along the way and get that 30 per cent to over 50 per cent maybe the system is working better than we think in that area.

CHAIR—How long will it take to get to 50 per cent?

Mr Maroney—Give it another five years with a lot of education or 10 years without so much, because it is a generational thing and people's attitude to guaranteed income streams will probably be far more positive over the next couple of years, seeing what happened to people in the last year or so. A lot of retirement intentions and desires are affected by what you see your parents go through. A lot of the education of our system is going to take a long time to work its way through, but it is already flowing through quite well in that area. As most people become familiar with helping their parents deal with retirement under the current system, those messages will flow down quite well to the next generation. I do not think that we should ease up on that. Provided that we can push the system by encouraging people to go down the income stream route, I do not think that it is something where you need to come up with a perfect compulsory solution and force it onto people.

CHAIR—We now move on to simplicity, particularly in the context of a mandatory superannuation system. We will consider how to streamline the operation of the system to reduce cost and improve member understanding. Before we do that, I understand that Mr Wells has some information he would like to table in response to some issues raised today.

Ms Bailey—I wish to add a rider to an issue that Dr FitzGerald raised. It was in relation to the selling of houses to move into low-care accommodation. The process is that a certain amount of the bond is retained but the balance is retrieved, so it is not quite the same as a one-way stream of equity going out. The bond is capped at a certain amount and after five years that amount is refunded.

Dr FitzGerald—Nevertheless, people sell their house to liberate the money in the first place to put the bond up.

Ms Bailey—However, the asset is not entirely dissipated in the process.

Dr FitzGerald—That is right.

CHAIR—Do we have any volunteers to talk about how we are going to simplify and streamline the system to reduce costs?

Senator SHERRY—Cap fees and ban exit and entry fees! I am getting a good reaction to this.

Mr Stanhope—On simplifying the system, we started this debate this morning. I do not know whether you want to take it further but I think there is considerable merit in talking about

the possibility of rolling up some of the taxation arrangements and some of the grandfathering. Even if we were not talking about a change in where the tax occurs, if we were to roll up the concessional amounts, fix them and carry them forward in some way, we would simplify the system quite dramatically. Other suggestions made in our submission were to remove the vast number of categories of people who are not in employment who can contribute. That would leave us with deductable contributions from the employer, deductable contributions from the self-employed and voluntary contributions. A world in which there are only three categories of superannuation contribution would be simpler than the one that we have. Those were two of the main suggestions in our proposal.

CHAIR—So draw a line in the sand?

Mr Stanhope—Draw a line in the sand on concessions, even if we do not move tax from front to back. There is still an argument to draw a concessional line in the sand, roll them up, index them however, deal with them however, but get them out of the mind-numbing complexity that people face.

CHAIR—As Dr FitzGerald has already indicated, it sounds simple but what figures do you use—retrenchment benefits, retirement benefits et cetera?

Mr Stanhope—Those issues certainly arise in non-accumulation funds, but in accumulation funds where those benefits have been contributed to an accumulation amount it is not a particularly difficult thing; it would be a number. We are really talking about pre-1983 and post-1983 kinds of numbers.

Dr FitzGerald—It was David who made the valid point that doing the calculations is tricky, but that is essentially only for defined benefit funds. Since they are a threatened species outside the public sector, if not already extinct in many parts of the economy, you would think that with cooperation among the governments—who mainly have the schemes where these sorts of complexities arise—you could find solutions in that area and marginalise the remaining areas of problems to a fairly small margin.

CHAIR—What about from a modeller's point of view, Mr Kelly?

Mr Kelly—I do not have on hand a model of how you would do that.

Mr Maroney—My suggestion is that there is a need for a structural solution to it. It is not just a matter of dealing with current complexity and trying to simplify it—because inevitably the processes, as they work at the moment, tend to add more complexity over time. We need a range of structures that include cross-portfolio coordination, so that you do not have the left hand or the right hand of the government trying to do things to improve it and cutting across one another on the rules affecting tax, social security treatment and a range of other issues. There is a need for greater quantification through benchmarking, both domestically and internationally, of where our cost structures actually lie. We need to work on trying to get down to a range of regular measuring, monitoring and reviewing processes, and putting pressure through market forces—and potentially other forces—to have those cost structures made more efficient over time in a way that is both sustainable and meets the community's needs. We are not spending enough on education and advice at the moment and we probably need, over time,

to spend more on that; but there are probably areas where money is being spent at the moment inefficiently.

You cannot just come out and say that here is a new structure that is going to be cheaper and better, as against having a range of structures at the regulatory end, a regulatory review from the efficiency side of things. Whenever new proposals are being put up, we need to make sure they are done in a way that is most efficient from an administration and implementation point of view—which means more consultation with administrators, funds managers and back office sorts of operations. That happens a lot more in other parts of the economy than in this part. I am not quite sure why that is the case, but there is a whole range of structural issues about the way that any reform processes take place that do not lend themselves to really measuring how well we are doing in the efficiency stakes, as compared to other drivers. That is going to require an ongoing interaction between the parliamentary side, the government side, the regulators, the industry and the range of service providers to improve it in a sustained fashion. I do not think there are any simple solutions but, unless we get some of the structure ones right, even if we make minor incremental improvements there is too much of a risk of slipping backwards.

Mr Stanhope—I want to give an example of that. We are currently in the process, with Minister Coonan, of considering what model she would prefer for split spouse contributions. Industry has just spent an awful lot of money building systems to split benefits on divorce, basically. Yet, having built all of those systems, if worst comes to worst in that scenario—and the industry has pretty widely indicated its preference not to do this, because it means bucket loads of cost at no benefit—we are looking down the barrel—

CHAIR—What about splitting on end benefits?

Mr Stanhope—Our submission to Treasury shows that that would achieve all of the objectives of the proposal and would be based on a system that we have already built. Those kinds of considerations, when new add-ons are imposed on the system, would allow us at least to get leverage from the sorts of money that members have already paid for through their fees—whereas building new systems or major changes to existing systems will come at considerable cost. It seems to us that, particularly in some of those environments, although you can see that the objectives of the measure are laudable, the process by which they are going to be administered—sometimes for reasons of savings, perhaps, in tax office processing or wherever—means that members will ultimately wind up bearing the cost and will damp their retirement savings. It is important, when we talk about the sort of changes to the system that John is talking about, that we do those in a way that sits on the considerable investment we already have in existing systems in all sectors of the industry.

CHAIR—When one considers the growth in tax law, is it not a pipedream to expect tax simplification to apply to superannuation?

Dr Anderson—It may be a pipedream, but I would like to echo John's and Bill's comments. One of the things we suffer from all of the time is having a policy land on us, one that is usually rather piecemeal, and then having to look at how we can implement it. We can all think of several examples where the implementation has not been what the industry would have suggested and where, with more and earlier consultation about what the objective was, we probably could have got to a better outcome. I am worried that, with all the talk about

simplifying, we will just continue to put little patches over the system—and that means patches over our systems—which are very costly. Putting it mildly, I am dismayed at the kinds of figures that funds give for implementation costs. So, yes, we need to get to simplicity, but government have to actually come to the party and tell us about the initiatives that they want to put in so we can suggest lower cost applications.

CHAIR—Just a straw poll: is it the consensus around the room that splitting superannuation should generally occur at the end rather than on the way through?

Ms Smith—Sorry, should the income splitting be at the end?

CHAIR—At the end, yes.

Senator SHERRY—I was a bit confused about the question.

CHAIR—As you go through it, generally.

Ms Smith—The spouse split.

CHAIR—Is anybody against it? What are the arguments against that?

Senator SHERRY—Can I pose a fundamental question. If you split super during working life, you end up with two fees and charges with no additional contributions, so what is the net benefit to the system other than, obviously, a greater empowerment of presumably a female?

Mr Stanhope—We think that is illusory, in the sense that you would expect that this is a voluntary arrangement. If you are trying to ameliorate the inequitable distribution of economic resources between members of a couple, do the policy makers suppose that the same partner who does not share now is going to enter into voluntary superannuation splitting in order to share? It seems counterintuitive to us. But the most important point, aside from that slightly flip one, is that the benefits do not crystallise only on retirement or separation. We will have systems in place from 28 December this year to do splits on separation so that we can take care of any inequities that occur should the marriage break up. But our experience—and several people around the table have mentioned this—is that couples come to retirement planning together, they do all of that kind of planning together, and that is the point at which they are best able to make a decision about where and how they should divide the superannuation between them, if that is what they choose to do.

Senator SHERRY—I accept what you say. Obviously they will do it, won't they, because of the tax advantage? You have got two tax-free thresholds. If you go from a tax-free threshold of over $100,000, you would be mad not to do it. That then begs the question: what is all this going to cost, and who is it going to advantage? We will explore that at another time, I suspect.

Mr Stanhope—I am sure we will get to that again, Senator.

Mr Davidson—We have a problem with it in principle, except on separation and divorce—and for exactly that reason. In a tax system based on individuals, to allow people to split their

incomes and/or savings would be regressive. In any kind of progressive, individually based tax system that will be the case. The people who are in position to take advantage of it are, by and large, the better off.

Mr Brake—I do not really want to get into a great discussion on the merits of the government's policy, because that is not my role.

Senator SHERRY—Yes, it is!

Mr Brake—I am happy to articulate the government's position.

Senator SHERRY—It is expected of him—it is his job and I do not reproach him for that!

Mr Brake—I want to pick up on a couple of points, and one is the process by which we provide advice to government. In Treasury we are very keen to make sure that, to the greatest extent possible, we advise the government on the implementation aspects of superannuation proposals. We do undergo consultative arrangements to that end and we are always happy to hear ideas about how we can do things better in terms of those consultation processes. The government's commitment to allowing spouses to split contributions was designed to assist couples to have access to two ETP tax-free thresholds, where one partner may have relatively low superannuation balances. It can also serve to give the lower account balance holder, who will often be a woman, economic independence with regard to their superannuation during the contribution phase. I just wanted to make those points.

Dr Anderson—In a discussion on splitting, ASFA raised the issue of splitting at retirement. That did not seem to get into the minister's consideration. It did get into the splitting document that later came out, but in a very poor form, in that the whole issue that we had raised about how you would prevent costs from blowing out—by taking into consideration the whole amount rather than only from a particular date, which we had gone to some length to explain—actually did not appear in the options in that document. That was put forward very early in the discussions, and yet we are just now finding some interest in it.

CHAIR—Dr Knox, do you have a solution?

Dr Knox—I think that the sensible way is to split at the end. We now have provisions to split on separation or divorce. I have not been party to the earlier discussions, but the industry is able to split on separation. It therefore seems to me inequitable that a couple that stays together cannot split. You have a situation where a couple that divorces splits, but a couple that stays together does not split.

Senator SHERRY—So you are encouraging divorce?

Dr Knox—You are encouraging divorce and then remarriage.

Senator SHERRY—Outrageous, isn't it!

Dr Knox—I can see some behavioural encouragement for the appropriate outcome! It just makes sense to let the one account go through to retirement and then, as the couple bring their various retirement benefits together, you split at that point. It is a lot simpler: that is where the financial planning comes in and that is where the tax is paid. That would be the sensible point to do it at.

CHAIR—Are there any other contributions on that issue?

Senator SHERRY—I do not have any more on that issue, but Dr FitzGerald was talking earlier about the health accounts—and there are quite a few sceptics about this issue of health accounts. What is the difference, in practice at least, between a health account accruing through working life and a person taking a lump sum at 55 to 60 and spending it on health?

Dr FitzGerald—None, if the accumulation through working life is what led to the lump sum and there was a product that you could buy that gave you cover for your actuarially expected remaining life or you were at least able to get some sort of regular premium product that your lump sum would fund. That is precisely what I was suggesting: that it is really only labelling part of your super as the front end—a system which has a presence in every workplace which marshals small amounts of money and brings them into efficient administration and is perfectly capable of sending them to the appropriate place to purchase that cover.

As I was saying earlier, I do not suggest that this be a means of underwriting the private health insurance option only. I think that, over the coming decades, there will need to be some pooling mechanism that permits baby boomers to make some sort of contribution to their cover in the public system, rather than leave it all on the future young taxpayer. The same accumulation and use of part of the retirement benefit for that could apply on that side. That is where the burden on future public budgets mainly is.

CHAIR—Are there any general comments about simplicity across the system?

Ms Doyle—From the trustee's perspective, if we could remove the work test for voluntary contributions, that would add to simplicity. We were talking today about adequacy, and we touched on the third pillar as being very important, particularly for baby boomers going forward. So we are looking at personal contributions there. At the moment we have a work related test in order to make those voluntary contributions. If we could remove that test and make it such that anyone can make a superannuation contribution voluntarily, that would help not only from the individual's point of view but also from the trustee's point of view in being responsible for asking, 'Are you actually eligible to make these contributions?' We are putting more pressure on trustees, and that adds to the whole complexity from their point of view and it costs.

In relation to the splitting of contributions, if we are doing it at the benefit stage, from an administrative point of view, and if each year we are not having to do notional accounts and having to keep track of portions, allocations or anything like that, even though the split may not be physical—just as long as we are not having to do too much there if it is at the benefit stage—and it is a clear, very transparent process, I think it would be a much better outcome.

Mr Luke—Education is something we talk about a lot. There should be some sort of consistency of education across the board. Lots of people are spending lots of money on it now. I think it is being done far better than it ever has been, but there needs to be consistency. A couple of the little points down the bottom are important for efficiency. The lost member register is a fantastic thing that the ATO is doing in working with funds in that way. We really need to do something about account consolidation, which we talked about before. The fact that people have four or 10 accounts when they are 17 is inefficient and it costs a lot of the money for the system overall. Someone pays for those inefficiencies, so we have to do something to encourage people. For people who have been working in the system for a number of years to have member benefit protection does not make any sense at all. There has to be a time when they do not get it any more or there is some form of forced consolidation. Perhaps that is the way it needs to be done.

Senator SHERRY—You cannot have exit fees in those circumstances.

Mr Luke—No, you cannot have exit fees. Finally, John talked earlier about an efficiency rating. We have to look at how efficient we really are. While some of the AFSA papers have shown that overall most people are paying reasonable fees, there are enormous anomalies around and some people are paying atrocious fees. We need to find some form of efficiency measures in addition to disclosure so that the population knows what to expect.

CHAIR—What do we do about all those old products that have got high exit fees?

Senator SHERRY—It is not just old products though; there are a few of the newer products around with them too.

Mr Luke—I do not know.

CHAIR—Do you cap them all?

Mr Luke—If they exist, the trouble is that you really need to see what the incidence of that fee would be. Some people might do better to stay in them rather than exit and take the fee later on—it depends how it is charged. It is very difficult to know exactly how, without looking at how they are structured.

CHAIR—But some people find that they cannot afford to get out and they cannot afford to get in.

Mr Luke—That is right.

Senator SHERRY—The advice I have had on this is that legally you cannot overrule an existing contract retrospectively. So existing contracts with exit fees are very difficult to do anything about, practically.

Mr Lewis—You would find in many cases that if you removed those exit fees you would place a financial impost upon the institution that is providing the contract. The exit fee is probably to cover some costs or expenses. It is not just profit; it is there for a reason.

CHAIR—So, in other words, you would make it mandatory for new products after a certain date, to purely cover the costs.

Mr Lewis—I am not sure.

CHAIR—Or make it cost related.

Mr Lewis—I am not sure whether mandatory is the way to go. My personal view is that you certainly need an environment which discourages those contracts. Disclosure is probably the best way, rather than mandatory measures—but that is a personal view.

Senator SHERRY—But the irony is that most of the products with higher exit fees were chosen in a choice environment anyway—people picked them.

Mr Lewis—Yes; but I wonder about the level of education and understanding then, as compared with today's.

Senator SHERRY—I wonder about today's, anyway.

CHAIR—Portability will partly be addressed in a choice report—because there are two issues: there is choice and there is portability for existing products.

Mr Lewis—As Mr Luke said earlier, in a choice environment you have the need for advice, which will increase your costs.

Mr Luke—I think is that is the most confusing thing. I talk to a variety of people from all different walks of life in the superannuation environment about how to give advice. It is very easy to give it to very high net worth individuals in lots of ways, and people are very interested. But the question is how you do it throughout the system and how you give it to people that have very little assets and very little income. We almost need to work together to find very efficient ways of doing that.

CHAIR—We might close there, because some people have got to get taxis to get to the airport and sometimes they are not as available as we would like them to be. I take this opportunity to thank everybody for participating today. It has been a very worthwhile exercise from the committee's point of view, and we thank you very much for your contributions. The meeting has been first class.

Committee adjourned at 3.48 p.m.